

NOTES TO THE INTERIM FINANCIAL INFORMATION

1. Basis of preparation and significant accounting policies

(a) Basis of preparation

The unaudited interim financial information has been prepared in accordance with HKAS 34 “Interim Financial Reporting” issued by the HKICPA.

(b) Significant accounting policies

Except for the initial adoption of the below mentioned standards, amendments and interpretation, the significant accounting policies adopted and methods of computation used in the preparation of the unaudited interim financial information are consistent with those adopted and used in the Group’s annual financial statements for the year ended 31 December 2017 and shall be read in conjunction with the Group’s Annual Report for 2017.

Standards, amendments and interpretation that are relevant to the Group and are initially adopted for the financial year beginning on 1 January 2018

The Group has initially applied HKFRS 9 “Financial instruments”, HKFRS 15 “Revenue from Contracts with Customers” and other amendment and interpretation from 1 January 2018 onward. 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. Except for HKFRS 9, of which the impacts to the Group’s financial statements being significant, the application of HKFRS 15 and other amendment and interpretation do not have material effects on the Group’s financial statements. Details are disclosed as below:

- 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 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: (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 is to be made on transition, and subsequently on initial recognition. The classification depends on the entity’s business model for managing its financial instruments and the contractual cash flow characteristics of the instruments, or the election of fair value option.

A financial instrument is subsequently measured at amortised cost only if it is a debt instrument, and the objective of the entity’s business model is to hold the asset to collect the contractual cash flows, and the asset’s contractual cash flows characteristics represent only unleveraged payments of principal and interest. A debt instrument is subsequently measured at fair value through other comprehensive income if it is held in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and the instrument fulfils the contractual cash flows characteristics. All other debt instruments are to be measured at fair value through profit or loss.

NOTES TO THE INTERIM FINANCIAL INFORMATION

1. Basis of preparation and significant accounting policies (continued)

(b) Significant accounting policies (continued)

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

(i) Classification and measurement (continued)

Equity instruments are generally measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition to recognise unrealised and realised fair value gains or losses in other comprehensive income without subsequent reclassification of fair value gains or losses to the income statement even upon disposal. Dividend income is recognised in the income statement when the right to receive payment is established.

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

The accounting for fair value option of financial liabilities were changed to address own credit risk. The amount of change in fair value attributable to changes in the credit risk of the financial liabilities measured 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 below accompanying notes explaining the original measurement categories under HKAS 39 and the new measurement categories under HKFRS 9.

NOTES TO THE INTERIM FINANCIAL INFORMATION

1. Basis of preparation and significant accounting policies (continued)

(b) Significant accounting policies (continued)

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

(i) Classification and measurement (continued)

Financial assets	Notes	Original	New	Original	Re-	Re-	New gross
		classification	classification	gross			
		under	under	carrying	classification	measurement	carrying
		HKAS 39	HKFRS 9	amount			amount
				under	HK\$'m	HK\$'m	under
				HKAS 39			HKFRS 9
				HK\$'m			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	(a)	FVPL (T)	FVPL (T)	49,710	-	-	49,710
	(b)	FVPL (T)	FVPL (M)	183	-	-	183
	(c)	FVPL (T)	FVOCI	179	(179)	-	-
	(d)	FVPL (T)	AC	712	(712)	-	-
	(e)	AFS	FVPL (M)	-	988	-	988
	(f)	HTM	FVPL (M)	-	1,381	(4)	1,377
	(g)	FVPL (D)	FVPL (M)	19,336	-	-	19,336
	(h)	FVPL (D)	FVOCI	5,079	(5,079)	-	-
	(i)	FVPL (D)	AC	5,249	(5,249)	-	-
	(j)	AFS	FVPL (D)	-	7,818	-	7,818
Financial assets at fair value through profit or loss – equity securities and fund	(g)	FVPL (T)	FVPL (T)	203	-	-	203
	(h)	FVPL (D)	FVPL (M)	12,543	-	-	12,543
	(i)	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

NOTES TO THE INTERIM FINANCIAL INFORMATION

1. Basis of preparation and significant accounting policies (continued)

(b) Significant accounting policies (continued)

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

(i) Classification and measurement (continued)

Financial assets	Notes	Original	New	Original	Re-	Re-	New gross
		classification	classification	gross			
		under	under	carrying	classification	measurement	carrying
		HKAS 39	HKFRS 9	amount			amount
				under			under
				HKAS 39	HK\$'m	HK\$'m	HKFRS 9
				HK\$'m			HK\$'m
Investment in securities – debt instruments	(c)	AFS	FVOCI	531,964	–	–	531,964
	(f)	AFS	FVPL (M)	988	(988)	–	–
	(i)	AFS	FVPL (D)	7,818	(7,818)	–	–
	(a)	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 INTERIM FINANCIAL INFORMATION

1. Basis of preparation and significant accounting policies (continued)

(b) Significant accounting policies (continued)

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

(i) Classification and measurement (continued)

Financial liabilities	Notes	Original	New	Original	Re-	Re-	New gross
		classification	classification	gross			
		under	under	carrying	classification	measurement	carrying
		HKAS 39	HKFRS 9	amount			amount
				under	HK\$'m	HK\$'m	under
				HKAS 39			HKFRS 9
				HK\$'m			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 (D)	FVPL (T) FVPL (D)	16,936 2,784	- -	- -	16,936 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

NOTES TO THE INTERIM FINANCIAL INFORMATION

1. Basis of preparation and significant accounting policies (continued)

(b) Significant accounting policies (continued)

Standards, amendments and interpretation that are relevant to the Group and 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 are 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 shall be 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 are 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.
- (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 that are not managed and evaluated on a fair value basis.
- (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.

NOTES TO THE INTERIM FINANCIAL INFORMATION

1. Basis of preparation and significant accounting policies (continued)

(b) Significant accounting policies (continued)

Standards, amendments and interpretation that are relevant to the Group and 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 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.

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. Following table is the impact of adoption of HKFRS 9’s impairment requirements as at 1 January 2018 to the Group.

Impairment allowances	At 31 December 2017 under HKAS 39 HK\$’m		At 1 January 2018 under HKFRS 9 HK\$’m
		Re-measurement HK\$’m	
Cash and balances and placements with banks and other financial institutions	–	83	83
Advance and other accounts (including loan commitments and financial guarantee contracts)	4,106	1,204	5,310
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
Others	5	9	14
Total	4,156	1,440	5,596

NOTES TO THE INTERIM FINANCIAL INFORMATION

1. Basis of preparation and significant accounting policies (continued)

(b) Significant accounting policies (continued)

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

(iii) *Hedge Accounting*

The requirements 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 risk management and 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.

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

The Group has taken an exemption not to restate comparative information for prior periods with respect to classification and measurement in accordance with the transitional provision of HKFRS 9. The adoption of HKFRS 9 reduced net assets after tax at 1 January 2018 by HK\$2.5 billion in aggregate, and the Group's total capital ratio decreased by around 10 basis point. 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.

NOTES TO THE INTERIM FINANCIAL INFORMATION

1. Basis of preparation and significant accounting policies (continued)

(b) Significant accounting policies (continued)

Standards, amendments and interpretation that are relevant to the Group and 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
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)
	(1,816)
Opening balance as at 1 January 2018	(1,774)
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	9,474

NOTES TO THE INTERIM FINANCIAL INFORMATION

1. Basis of preparation and significant accounting policies (continued)

(b) Significant accounting policies (continued)

Standards, amendments and interpretation that are relevant to the Group and 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 at 1 January 2018	4,499

Note:

- 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 subject to amortisation was reversed to retained earnings directly.

NOTES TO THE INTERIM FINANCIAL INFORMATION

1. Basis of preparation and significant accounting policies (continued)

(b) Significant accounting policies (continued)

Standards, amendments and interpretation that are relevant to the Group and 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 adopted HKFRS 15 using the modified retrospective method of adoption. The application of this standard does not have a material impact on the Group’s financial statements. 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 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.
- HKAS 40 (Amendments), “Transfer 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.
- 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 INTERIM FINANCIAL INFORMATION

1. Basis of preparation and significant accounting policies (continued)

(c) Standards, amendments and interpretation issued that are relevant to the Group but 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
HKAS 19 (2011) (Amendments)	Plan Amendment, Curtailment or Settlement	1 January 2019
HKAS 28 (2011) and HKFRS 10 (Amendments)	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	To be determined
HKAS 28 (2011) (Amendment)	Long-term Interests in Associates and Joint Ventures	1 January 2019
HKFRS 16	Leases	1 January 2019
HKFRS 17	Insurance Contracts	1 January 2021
HK (IFRIC) – Int 23	Uncertainty over Income Tax Treatments	1 January 2019

- HKAS 19 (2011) (Amendments), “Plan Amendment, Curtailment or Settlement”. The amendments require entities to use the updated actuarial assumptions to determine current service cost and net interest for the remainder of the reporting period after a change is made to a plan. The amendments also clarify how the requirements for accounting for a plan amendment, curtailment or settlement affect the asset ceiling requirements. The amendments shall be applied prospectively for annual periods beginning on or after 1 January 2019. The application of these amendments will not have a material impact on the Group’s financial statements.
- HKFRS 16, “Leases”. Please refer to Note 2.1(b) of the Group’s Annual Report for 2017 for brief explanations of the standard. The standard will affect primarily the accounting for the Group’s operating leases. As at the reporting date, the Group has non-cancellable operating lease commitments of approximately HK\$1.8 billion. However, the Group has not yet determined to what extent these commitments will result in the recognition of an asset and a liability for future payments and how this will affect the Group’s profit or loss and cash flows. Some of the commitments may be covered by the exemption for short-term and low-value leases and some commitments may relate to arrangements that will not qualify as leases under HKFRS 16.
- Please refer to Note 2.1(b) of the Group’s Annual Report for 2017 for brief explanations of the rest of the above-mentioned standards, amendments and interpretation.

(d) Improvements to HKFRSs

“Improvements to HKFRSs” contains numerous amendments to HKFRSs which HKICPA considers not urgent but necessary. The amendments comprise of clarification to changes in presentation, recognition or measurement purpose, amendments to the basis for conclusions as well as terminology or editorial amendments related to each HKFRSs. These improvements do not have a material impact on the Group’s financial statements.

NOTES TO THE INTERIM FINANCIAL INFORMATION

2. Critical accounting estimates and judgements in applying accounting policies

The nature and assumptions related to the Group's accounting estimates in this reporting period are consistent with those used in the Group's financial statements for the year ended 31 December 2017, except for those previously related to impairment of financial assets and held-to-maturity securities which are no longer applicable under HKFRS 9. The key assumptions or other estimation of uncertainties under the impairment requirements of HKFRS 9 are presented as below:

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 credit 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 in 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 existing internal rating models and loss estimates, behavioural models and forecasting factors. 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 8 of the Group's Regulatory Disclosures for 2017 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 like Sovereign, Bank, Corporates, Retail Small Medium-sized Enterprise, Residential Mortgage Loan, Credit Card etc.) when their ECL is assessed on a collective basis;
- Development of ECL models, including the determination of macroeconomic factor forecasts (e.g. Gross Domestic Product, Consumer Price Index, Property Price Index etc.) 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 downturn) 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.

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. 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.

3.1 Credit risk

(A) Gross advances and other accounts

(a) Impaired advances

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 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.

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Gross impaired advances to customers	2,667	1,371
Impairment allowances made in respect of such advances		
– Stage 3	1,265	N/A
– Individually assessed	N/A	491
Current market value of collateral held against the covered portion of such advances to customers	3,095	1,523
Covered portion of such advances to customers	1,606	1,083
Uncovered portion of such advances to customers	1,061	288

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

As at 30 June 2018, gross impaired trade bills amounted to HK\$4 million (31 December 2017: Nil), and there was no impaired advances to banks and other financial institutions (31 December 2017: Nil).

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.1 Credit risk (continued)

(A) Gross advances and other accounts (continued)

(a) Impaired advances (continued)

Classified or impaired advances to customers are analysed as follows:

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Gross classified or impaired advances to customers	2,667	2,079
Gross classified or impaired advances to customers as a percentage of gross advances to customers	0.22%	0.18%
Impairment allowances made in respect of such advances		
– Stages 1 to 3	1,265	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.

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.1 Credit risk (continued)

(A) Gross advances and other accounts (continued)

(b) Advances overdue for more than three months

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 exceeded the approved limit that was advised to the borrower.

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

	At 30 June 2018		At 31 December 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	225	0.02%	117	0.01%
– one year or less but over six months	76	0.01%	123	0.01%
– over one year	385	0.03%	313	0.03%
Advances overdue for over three months	686	0.06%	553	0.05%
Impairment allowances made in respect of such advances				
– Stage 3	473		N/A	
– Individually assessed	N/A		309	

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Current market value of collateral held against the covered portion of such advances to customers	607	520
Covered portion of such advances to customers	307	289
Uncovered portion of such advances to customers	379	264

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.1 Credit risk (continued)

(A) Gross advances and other accounts (continued)

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

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 30 June 2018, there were no trade bills and advances to banks and other financial institutions overdue for more than three months (31 December 2017: Nil).

(c) Rescheduled advances

	At 30 June 2018		At 31 December 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"	186	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".

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.1 Credit risk (continued)

(A) Gross 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.

	At 30 June 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	112,874	22.22%	–	–	–	451
– Property investment	50,814	83.55%	26	92	–	41
– Financial concerns	18,559	1.42%	–	–	–	38
– Stockbrokers	7,483	32.45%	–	–	–	1
– Wholesale and retail trade	41,572	33.30%	25	153	18	101
– Manufacturing	48,086	12.93%	5	25	2	80
– Transport and transport equipment	65,110	25.73%	955	14	2	166
– Recreational activities	1,866	1.68%	–	–	–	2
– Information technology	20,624	1.21%	–	7	–	97
– Others	108,195	41.71%	20	565	8	253
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	9,992	99.77%	16	131	–	3
– Loans for purchase of other residential properties	240,914	99.93%	88	1,293	–	51
– Credit card advances	14,081	–	134	504	118	196
– Others	70,083	82.97%	336	808	324	531
Total loans for use in Hong Kong	810,253	56.94%	1,605	3,592	472	2,011
Trade finance	70,492	16.20%	155	85	137	151
Loans for use outside Hong Kong	349,763	8.25%	907	1,157	656	1,723
Gross advances to customers	1,230,508	40.76%	2,667	4,834	1,265	3,885

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.1 Credit risk (continued)

(A) Gross advances and other accounts (continued)

(d) Concentration of advances to customers (continued)

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

	At 31 December 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

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.1 Credit risk (continued)

(A) Gross 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

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Hong Kong	966,567	911,691
Mainland of China	139,302	135,990
Others	124,639	98,745
	1,230,508	1,146,426
Impairment allowances made in respect of the gross advances to customers – Stages 1 and 2		
Hong Kong	2,566	N/A
Mainland of China	374	N/A
Others	945	N/A
	3,885	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

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.1 Credit risk (continued)

(A) Gross advances and other accounts (continued)

(d) Concentration of advances to customers (continued)

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

Overdue advances

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Hong Kong	3,752	3,061
Mainland of China	256	181
Others	826	928
	4,834	4,170
Impairment allowances made in respect of the overdue advances – Stage 3		
Hong Kong	502	N/A
Mainland of China	57	N/A
Others	303	N/A
	862	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 INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.1 Credit risk (continued)

(A) Gross 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

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Hong Kong	1,880	1,379
Mainland of China	177	111
Others	610	589
	2,667	2,079
Impairment allowances made in respect of the classified or impaired advances – Stage 3		
Hong Kong	767	N/A
Mainland of China	65	N/A
Others	433	N/A
	1,265	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

(B) Repossessed assets

The estimated market value of repossessed assets held by the Group as at 30 June 2018 amounted to HK\$48 million (31 December 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.

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.1 Credit risk (continued)

(C) Debt securities and certificates of deposit

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

	At 30 June 2018			
	Financial assets at fair value through profit or loss HK\$'m	Investment in securities at fair value through other comprehensive income HK\$'m	Investment in securities at amortised cost HK\$'m	Total HK\$'m
Aaa	7,890	124,590	43,280	175,760
Aa1 to Aa3	18,228	140,850	4,430	163,508
A1 to A3	17,052	309,331	30,070	356,453
Lower than A3	7,564	31,043	10,640	49,247
Unrated	1,338	14,967	6,199	22,504
	52,072	620,781	94,619	767,472
Impairment allowances				
– Stage 1		139	22	
– Stage 2		–	–	
– Stage 3		–	43	
		139	65	

	At 31 December 2017				
	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	Total 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
	73,589	561,701	50,577	499	686,366
Impairment allowances					
		–	45	–	

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.1 Credit risk (continued)

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

The gross impaired and overdue debt securities and certificates of deposit are analysed as follows:

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Overdue for more than one year		
– Investment in securities at amortised cost	43	N/A
– Held-to-maturity securities	N/A	45
	43	45

3.2 Market risk

(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 subsidiaries over a one-day holding period with a 99% confidence level, and sets up the VAR limit of the Group and subsidiaries.

The following table sets out the VAR for all general market risk exposure¹ of the Group.

	Year	At 30 June HK\$'m	Minimum for the first half of year HK\$'m	Maximum for the first half of year HK\$'m	Average for the first half of year HK\$'m
VAR for all market risk	2018	30.0	24.1	45.7	32.7
	2017	46.1	38.0	80.9	57.3
VAR for foreign exchange risk	2018	18.0	10.7	20.2	15.3
	2017	23.6	23.6	54.1	38.4
VAR for interest rate risk	2018	23.6	18.7	43.0	28.7
	2017	38.2	27.6	82.4	52.9
VAR for equity risk	2018	1.7	1.2	7.0	2.7
	2017	1.4	0.7	5.3	2.6
VAR for commodity risk	2018	3.1	0.8	3.4	1.7
	2017	1.6	1.2	2.0	1.6

Note:

1. Structural FX positions have been excluded.

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.2 Market risk (continued)

(A) VAR (continued)

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

- the use of historical market data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99% confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

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

(B) Currency risk

The Group's assets and liabilities are denominated in major currencies, particularly 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.

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.2 Market risk (continued)

(B) Currency risk (continued)

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.

	At 30 June 2018							
	Equivalent in million of HK\$							
	US Dollars	Pound Sterling	Japanese Yen	Euro	Renminbi	Australian Dollars	Other foreign currencies	Total foreign currencies
Spot assets	853,888	24,939	159,510	37,639	297,452	42,749	59,885	1,476,062
Spot liabilities	(745,084)	(16,542)	(11,049)	(20,072)	(319,164)	(23,697)	(60,867)	(1,196,475)
Forward purchases	982,209	20,154	22,959	54,219	433,691	18,302	93,004	1,624,538
Forward sales	(1,088,121)	(28,594)	(171,267)	(71,566)	(410,445)	(37,309)	(92,362)	(1,899,664)
Net options position	1,521	(3)	(14)	(123)	(111)	(19)	(2)	1,249
Net long/(short) position	4,413	(46)	139	97	1,423	26	(342)	5,710

	At 31 December 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

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.2 Market risk (continued)

(B) Currency risk (continued)

	At 30 June 2018					
	Equivalent in million of HK\$					
	US Dollars	Baht	Malaysian Ringgit	Philippine Peso	Other foreign currencies	Total foreign currencies
Net structural position	4,491	2,304	2,688	1,567	1,552	12,602

	At 31 December 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

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.2 Market risk (continued)

(C) Interest rate risk

The tables below summarise the Group's on-balance sheet exposure to interest rate risk as at 30 June 2018 and 31 December 2017. Included in the tables are the assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing date and maturity date.

	At 30 June 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	288,247	27,373	32,591	-	-	27,197	375,408
Financial assets at fair value through profit or loss	8,100	7,019	11,032	13,972	15,949	11,898	67,970
Derivative financial instruments	-	-	-	-	-	39,843	39,843
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	153,370	153,370
Advances and other accounts	965,592	221,675	36,078	32,286	6,109	7,199	1,268,939
Investment in securities							
– At FVOCI	69,698	172,784	131,887	167,199	79,213	5,182	625,963
– At amortised cost	699	1,009	6,173	49,520	37,218	-	94,619
Interests in associates and joint ventures	-	-	-	-	-	457	457
Investment properties	-	-	-	-	-	20,757	20,757
Properties, plant and equipment	-	-	-	-	-	48,389	48,389
Other assets (including deferred tax assets)	6,238	-	-	-	-	72,492	78,730
Total assets	1,338,574	429,860	217,761	262,977	138,489	386,784	2,774,445
Liabilities							
Hong Kong SAR currency notes in circulation	-	-	-	-	-	153,370	153,370
Deposits and balances from banks and other financial institutions	210,695	2,261	875	460	-	23,472	237,763
Financial liabilities at fair value through profit or loss	5,422	5,875	2,797	1,319	499	-	15,912
Derivative financial instruments	-	-	-	-	-	31,678	31,678
Deposits from customers	1,286,498	229,357	161,507	1,133	-	175,085	1,853,580
Debt securities and certificates of deposit in issue	1,390	13,813	374	-	-	-	15,577
Other accounts and provisions (including current and deferred tax liabilities)	15,832	-	-	-	-	72,820	88,652
Insurance contract liabilities	-	-	-	-	-	104,914	104,914
Subordinated liabilities	-	63	-	20,611	-	-	20,674
Total liabilities	1,519,837	251,369	165,553	23,523	499	561,339	2,522,120
Interest sensitivity gap	(181,263)	178,491	52,208	239,454	137,990	(174,555)	252,325

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.2 Market risk (continued)

(C) Interest rate risk (continued)

	At 31 December 2017						
	Up to 1 month HK\$'m	1 to 3 months HK\$'m	3 to 12 months HK\$'m	1 to 5 years HK\$'m	Over 5 years HK\$'m	Non-interest bearing HK\$'m	Total HK\$'m
Assets							
Cash and balances 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

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.3 Liquidity risk

(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%

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%

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 section “Regulatory Disclosures” on BOCHK’s website at www.bochk.com.

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.3 Liquidity risk (continued)

(B) Maturity analysis

The tables below analyse the Group's assets and liabilities as at 30 June 2018 and 31 December 2017 into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

	At 30 June 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	199,949	115,495	27,373	32,591	-	-	-	375,408
Financial assets at fair value through profit or loss	-	7,227	6,766	11,113	14,447	15,775	12,642	67,970
Derivative financial instruments	11,295	4,348	3,804	6,987	8,221	5,188	-	39,843
Hong Kong SAR Government certificates of indebtedness	153,370	-	-	-	-	-	-	153,370
Advances and other accounts	152,062	43,438	66,112	187,184	563,142	255,192	1,809	1,268,939
Investment in securities								
- At FVOCI	-	59,213	142,612	135,256	203,551	79,956	5,375	625,963
- At amortised cost	-	911	1,142	6,502	49,126	36,938	-	94,619
Interests in associates and joint ventures	-	-	-	-	-	-	457	457
Investment properties	-	-	-	-	-	-	20,757	20,757
Properties, plant and equipment	-	-	-	-	-	-	48,389	48,389
Other assets (including deferred tax assets)	33,060	16,073	200	1,801	12,642	14,924	30	78,730
Total assets	549,736	246,705	248,009	381,434	851,129	407,973	89,459	2,774,445
Liabilities								
Hong Kong SAR currency notes in circulation	153,370	-	-	-	-	-	-	153,370
Deposits and balances from banks and other financial institutions	188,065	46,102	2,261	875	460	-	-	237,763
Financial liabilities at fair value through profit or loss	-	5,422	5,879	2,798	1,318	495	-	15,912
Derivative financial instruments	6,570	3,721	3,591	7,103	6,750	3,943	-	31,678
Deposits from customers	1,065,470	396,113	229,357	161,507	1,133	-	-	1,853,580
Debt securities and certificates of deposit in issue	-	1,390	13,813	374	-	-	-	15,577
Other accounts and provisions (including current and deferred tax liabilities)	45,308	29,988	283	6,079	6,987	7	-	88,652
Insurance contract liabilities	37,320	361	887	2,979	16,997	46,370	-	104,914
Subordinated liabilities	-	-	439	-	20,235	-	-	20,674
Total liabilities	1,496,103	483,097	256,510	181,715	53,880	50,815	-	2,522,120
Net liquidity gap	(946,367)	(236,392)	(8,501)	199,719	797,249	357,158	89,459	252,325

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.3 Liquidity risk (continued)

(B) Maturity analysis (continued)

	At 31 December 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 INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.3 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.

3.4 Insurance risk

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

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

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

For the in-force insurance contracts, most of the underlying insurance liabilities are related to endowment, 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 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 appropriate level of prudential margins.

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.5 Capital management

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 and the internal ratings-based (securitisation) approach to calculate the credit risk capital charge for its securitisation exposures. A small residual credit exposures which includes 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.

(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”.

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.

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.5 Capital management (continued)

(A) Basis of regulatory consolidation (continued)

The particulars of the above-mentioned subsidiaries of BOCHK are as follows:

Name	At 30 June 2018		At 31 December 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	516	444	506	464
China Bridge (Malaysia) Sdn. Bhd.	20	14	37	31
Bank of China (Hong Kong) Nominees Limited	–	–	–	–
Bank of China (Hong Kong) Trustees Limited	11	11	15	15
BOCHK Information Technology (Shenzhen) Co., Ltd.	393	254	355	238
BOCHK Information Technology Services (Shenzhen) Co., Ltd.	384	348	366	312
Che Hsing (Nominees) Limited	1	1	1	1
Po Sang Financial Investment Services Company Limited	361	346	363	346
Po Sang Securities and Futures Limited	843	536	990	511
Sin Chiao Enterprises Corporation, Limited	7	7	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 INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.5 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 30 June 2018 (31 December 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 30 June 2018 (31 December 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:

	At 30 June 2018	At 31 December 2017
CET1 capital ratio	16.62%	16.52%
Tier 1 capital ratio	16.62%	16.52%
Total capital ratio	20.12%	20.39%

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.5 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:

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
CET1 capital: instruments and reserves		
Directly issued qualifying CET1 capital instruments	43,043	43,043
Retained earnings	150,453	142,208
Disclosed reserves	44,667	43,673
Minority interests arising from CET1 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in CET1 capital of the consolidation group)	–	–
CET1 capital before regulatory adjustments	238,163	228,924
CET1 capital: regulatory deductions		
Valuation adjustments	(18)	(12)
Deferred tax assets (net of associated deferred tax liabilities)	(107)	(51)
Gains and losses due to changes in own credit risk on fair valued liabilities	241	(69)
Cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties)	(50,831)	(48,556)
Regulatory reserve for general banking risks	(10,746)	(10,224)
Total regulatory deductions to CET1 capital	(61,461)	(58,912)
CET1 capital	176,702	170,012
AT1 capital: instruments		
AT1 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in AT1 capital of the consolidation group)	–	–
AT1 capital	–	–
Tier 1 capital	176,702	170,012

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.5 Capital management (continued)

(B) Capital ratio (continued)

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Tier 2 capital: instruments and provisions Capital instruments subject to phase out arrangements from Tier 2 capital	7,717	11,576
Tier 2 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in Tier 2 capital of the consolidation group)	–	–
Collective provisions and regulatory reserve for general banking risks eligible for inclusion in Tier 2 capital	6,546	6,390
Tier 2 capital before regulatory deductions	14,263	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	22,874	21,850
Total regulatory adjustments to Tier 2 capital	22,874	21,850
Tier 2 capital	37,137	39,816
Total regulatory capital	213,839	209,828

The capital buffer ratios are analysed as follows:

	At 30 June 2018	At 31 December 2017
Capital conservation buffer ratio	1.875%	1.250%
Higher loss absorbency ratio	1.125%	0.750%
Countercyclical capital buffer ratio	1.403%	0.934%

The additional information of capital ratio disclosures is available under section “Regulatory Disclosures” on BOCHK’s website at www.bochk.com.

NOTES TO THE INTERIM FINANCIAL INFORMATION

3. Financial risk management (continued)

3.5 Capital management (continued)

(C) Leverage ratio

The leverage ratio is analysed as follows:

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Tier 1 capital	176,702	170,012
Leverage ratio exposure	2,558,199	2,461,068
Leverage ratio	6.91%	6.91%

The additional information of leverage ratio disclosures is available under section "Regulatory Disclosures" on BOCHK's website at www.bochk.com.

4. Fair values of financial assets and liabilities

All financial instruments 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 and certain exchange-traded derivative contracts.
- 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 over-the-counter ("OTC") derivative contracts, debt securities and certificates of deposit with quote from pricing services vendors, issued structured deposits and other debt instruments.
- 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.

For financial instruments 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.

NOTES TO THE INTERIM FINANCIAL INFORMATION

4. Fair values of financial assets and liabilities (continued)

4.1 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.

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.

NOTES TO THE INTERIM FINANCIAL INFORMATION

4. Fair values of financial assets and liabilities (continued)

4.1 Financial instruments measured at fair value (continued)

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.

NOTES TO THE INTERIM FINANCIAL INFORMATION

4. Fair values of financial assets and liabilities (continued)

4.1 Financial instruments measured at fair value (continued)

(A) Fair value hierarchy

	At 30 June 2018			
	Level 1 HK\$'m	Level 2 HK\$'m	Level 3 HK\$'m	Total HK\$'m
Financial assets				
Trading assets (Note 21)				
– Debt securities and certificates of deposit	249	31,091	–	31,340
– Equity securities	111	–	–	111
– Other debt instruments	–	4,000	–	4,000
Other financial assets mandatorily classified at fair value through profit or loss (Note 21)				
– Debt securities and certificates of deposit	–	15,593	1,990	17,583
– Equity securities	3,330	–	–	3,330
– Fund	5,677	2,325	455	8,457
Financial assets designated at fair value through profit or loss (Note 21)				
– Debt securities and certificates of deposit	685	2,464	–	3,149
Derivative financial instruments (Note 22)	11,581	28,260	2	39,843
Investment in securities at FVOCI (Note 24)				
– Debt securities and certificates of deposit	184,174	434,990	1,617	620,781
– Equity securities	3,963	317	902	5,182
Financial liabilities				
Financial liabilities at fair value through profit or loss (Note 28)				
– Trading liabilities	–	13,337	–	13,337
– Financial liabilities designated at fair value through profit or loss	–	2,575	–	2,575
Derivative financial instruments (Note 22)	6,632	25,046	–	31,678
Subordinated liabilities (Note 34)				
– Subordinated notes	–	20,611	–	20,611

NOTES TO THE INTERIM FINANCIAL INFORMATION

4. Fair values of financial assets and liabilities (continued)

4.1 Financial instruments measured at fair value (continued)

(A) Fair value hierarchy (continued)

	At 31 December 2017			
	Level 1 HK\$'m	Level 2 HK\$'m	Level 3 HK\$'m	Total HK\$'m
Financial assets				
Trading assets (Note 21)				
– 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 21)				
– 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 22)	10,510	23,033	–	33,543
Available-for-sale securities (Note 24)				
– 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 28)				
– Trading liabilities	–	16,936	–	16,936
– Financial liabilities designated at fair value through profit or loss	–	2,784	–	2,784
Derivative financial instruments (Note 22)	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 period (31 December 2017: Nil).

NOTES TO THE INTERIM FINANCIAL INFORMATION

4. Fair values of financial assets and liabilities (continued)

4.1 Financial instruments measured at fair value (continued)

(B) Reconciliation of level 3 items

	At 30 June 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	-	-	2	-	-
- Net loss on other financial instruments at fair value through profit or loss	(81)	(16)	-	-	-
- Other comprehensive income					
- Change in fair value	-	-	-	(57)	90
Additions	89	82	-	-	-
Disposals, redemptions and maturity	-	(124)	-	-	-
Transfer out of level 3	-	-	-	-	-
Reclassification	-	-	-	-	-
At 30 June 2018	1,990	455	2	1,617	902
Total unrealised gains/(losses) for the period included in income statement for financial assets held as at 30 June 2018					
- Net trading gain	-	-	2	-	-
- Net loss on other financial instruments at fair value through profit or loss	(81)	(16)	-	-	-
	(81)	(16)	2	-	-

NOTES TO THE INTERIM FINANCIAL INFORMATION

4. Fair values of financial assets and liabilities (continued)

4.1 Financial instruments measured at fair value (continued)

(B) Reconciliation of level 3 items (continued)

	At 31 December 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
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	-	-

NOTES TO THE INTERIM FINANCIAL INFORMATION

4. Fair values of financial assets and liabilities (continued)

4.1 Financial instruments measured at fair value (continued)

(B) Reconciliation of level 3 items (continued)

As at 30 June 2018 and 31 December 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\$45 million (31 December 2017: HK\$41 million).

4.2 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 4.1. 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 4.1.

NOTES TO THE INTERIM FINANCIAL INFORMATION

4. Fair values of financial assets and liabilities (continued)

4.2 Financial instruments not measured at fair value (continued)

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 4.1.

Subordinated liabilities

The subordinated loan is on floating rate terms, bears interest at prevailing market interest rates and its carrying value approximates fair value. Fair value for subordinated notes is based on market prices or broker/dealer price quotations.

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.

	At 30 June 2018		At 31 December 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 24)	94,619	93,251	N/A	N/A
Held-to-maturity securities (Note 24)	N/A	N/A	50,577	50,998
Loans and receivables (Note 24)	N/A	N/A	499	498
Financial liabilities				
Debt securities and certificates of deposit in issue (Note 30)	15,577	15,596	21,641	21,578
Subordinated liabilities (Note 34) – Subordinated notes	N/A	N/A	18,917	20,985

NOTES TO THE INTERIM FINANCIAL INFORMATION

5. Net interest income

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
CONTINUING OPERATIONS		
Interest income		
Advances to customers, due from banks and other financial institutions	20,354	17,475
Investment in securities and financial assets at fair value through profit or loss	8,043	6,006
Others	146	105
	28,543	23,586
Interest expense		
Deposits from customers, due to banks and other financial institutions	(8,921)	(5,752)
Debt securities and certificates of deposit in issue	(308)	(41)
Subordinated liabilities	(554)	(434)
Others	(270)	(163)
	(10,053)	(6,390)
Net interest income	18,490	17,196

Included within interest income and interest expense are HK\$27,742 million (first half of 2017: HK\$23,220 million) and HK\$9,392 million (first half of 2017: HK\$6,569 million), before hedging effect, for financial assets and financial liabilities that are not recognised at fair value through profit or loss respectively.

NOTES TO THE INTERIM FINANCIAL INFORMATION

6. Net fee and commission income

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
CONTINUING OPERATIONS		
Fee and commission income		
Credit card business	1,734	1,537
Loan commissions	1,712	2,086
Securities brokerage	1,705	1,054
Insurance	865	628
Funds distribution	552	440
Bills commissions	400	393
Payment services	325	323
Trust and custody services	313	254
Currency exchange	268	195
Safe deposit box	154	147
Others	636	575
	8,664	7,632
Fee and commission expense		
Credit card business	(1,281)	(1,107)
Insurance	(198)	(139)
Securities brokerage	(196)	(128)
Others	(515)	(480)
	(2,190)	(1,854)
Net fee and commission income	6,474	5,778
Of which arise from:		
Financial assets or financial liabilities not at fair value through profit or loss		
– Fee and commission income	1,953	2,254
– Fee and commission expense	(20)	(24)
	1,933	2,230
Trust and other fiduciary activities		
– Fee and commission income	406	345
– Fee and commission expense	(14)	(10)
	392	335

NOTES TO THE INTERIM FINANCIAL INFORMATION

7. Net trading gain

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
CONTINUING OPERATIONS		
Net gain from:		
Foreign exchange and foreign exchange products	1,694	83
Interest rate instruments and items under fair value hedge	175	417
Commodities	61	107
Equity and credit derivative instruments	114	90
	2,044	697

8. Net (loss)/gain on other financial instruments at fair value through profit or loss

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
CONTINUING OPERATIONS		
Net loss on other financial instruments mandatorily classified at fair value through profit or loss	(1,538)	N/A
Net gain on financial instruments designated at fair value through profit or loss	356	1,188
	(1,182)	1,188

9. Net gain on other financial assets

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
CONTINUING OPERATIONS		
Net gain on investment in securities at FVOCI	77	N/A
Net gain on investment in securities at amortised cost	11	N/A
Net gain on available-for-sale securities	N/A	407
Net gain on held-to-maturity securities	N/A	13
Others	(2)	15
	86	435

NOTES TO THE INTERIM FINANCIAL INFORMATION

10. Other operating income

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
CONTINUING OPERATIONS		
Dividend income from investment in securities	127	69
Gross rental income from investment properties	328	293
Less: Outgoings in respect of investment properties	(33)	(41)
Others	76	155
	498	476

Included in the "Outgoings in respect of investment properties" is HK\$1 million (first half of 2017: HK\$6 million) of direct operating expenses related to investment properties that were not let during the period.

11. Net insurance benefits and claims and movement in liabilities

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
CONTINUING OPERATIONS		
Gross insurance benefits and claims and movement in liabilities		
Claims, benefits and surrenders paid	(9,458)	(6,504)
Movement in liabilities	(1,926)	(6,508)
	(11,384)	(13,012)
Reinsurers' share of benefits and claims and movement in liabilities		
Reinsurers' share of claims, benefits and surrenders paid	4,285	3,501
Reinsurers' share of movement in liabilities	865	2,088
	5,150	5,589
Net insurance benefits and claims and movement in liabilities	(6,234)	(7,423)

NOTES TO THE INTERIM FINANCIAL INFORMATION

12. Net charge of impairment allowances

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
CONTINUING OPERATIONS		
Advances and other accounts		
– Stage 1	462	N/A
– Stage 2	(141)	N/A
– Stage 3	(585)	N/A
– Collectively assessed	N/A	(501)
– Individually assessed	N/A	151
	(264)	(350)
Investment in securities		
– At FVOCI	(12)	N/A
– At amortised cost	(5)	N/A
– Held-to-maturity securities	N/A	–
	(17)	–
Others	(61)	(4)
Net charge of impairment allowances	(342)	(354)

13. Operating expenses

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
CONTINUING OPERATIONS		
Staff costs (including directors' emoluments)		
– Salaries and other costs	3,821	3,478
– Pension cost	232	220
	4,053	3,698
Premises and equipment expenses (excluding depreciation)		
– Rental of premises	362	354
– Information technology	286	268
– Others	208	210
	856	832
Depreciation	996	927
Auditor's remuneration		
– Audit services	3	3
– Non-audit services	6	2
Other operating expenses	1,086	776
	7,000	6,238

NOTES TO THE INTERIM FINANCIAL INFORMATION

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

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
CONTINUING OPERATIONS		
Net gain from fair value adjustments on investment properties	918	887

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

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
CONTINUING OPERATIONS		
Net loss from disposal of equipment, fixtures and fittings	(2)	(8)
Net gain from revaluation of premises	12	6
	10	(2)

16. Taxation

Taxation in the income statement represents:

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
CONTINUING OPERATIONS		
Current tax		
Hong Kong profits tax		
– Current period taxation	2,975	2,722
Overseas taxation		
– Current period taxation	380	224
– Over-provision in prior periods	(20)	–
	3,335	2,946
Deferred tax		
Origination and reversal of temporary differences and unused tax credits	(28)	(54)
	3,307	2,892

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 for the first half of 2018. Taxation on overseas profits has been calculated on the estimated assessable profits for the first half of 2018 at the rates of taxation prevailing in the countries/regions in which the Group operates.

NOTES TO THE INTERIM FINANCIAL INFORMATION

16. Taxation (continued)

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

	Half-year ended 30 June 2018 HK\$m	Half-year ended 30 June 2017 HK\$m
CONTINUING OPERATIONS		
Profit before taxation	21,185	18,142
Calculated at a taxation rate of 16.5% (2017: 16.5%)	3,496	2,993
Effect of different taxation rates in other countries/regions	43	56
Income not subject to taxation	(430)	(265)
Expenses not deductible for taxation purposes	118	86
Tax losses not recognised	–	2
Over-provision in prior periods	(20)	–
Foreign withholding tax	100	20
Taxation charge	3,307	2,892
Effective tax rate	15.6%	15.9%

17. Dividends

	Half-year ended 30 June 2018		Half-year ended 30 June 2017	
	Per share HK\$	Total HK\$m	Per share HK\$	Total HK\$m
Interim dividend	0.545	5,762	0.545	5,762
Special dividend	–	–	0.095	1,005
	0.545	5,762	0.640	6,767

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. This declared dividend is not reflected as a dividend payable in this interim financial information, but will be reflected as an appropriation of retained earnings for the year ending 31 December 2018.

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

The calculation of basic earnings per share for the first half of 2018 is based on the consolidated profit for the period and profit from continuing operations attributable to equity holders of the Company of approximately HK\$17,528 million and HK\$17,528 million (first half of 2017: HK\$17,486 million and HK\$14,897 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 first half of 2018 (first half of 2017: Nil).

NOTES TO THE INTERIM FINANCIAL INFORMATION

19. 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 first half of 2018 amounted to approximately HK\$171 million (first half of 2017: approximately HK\$170 million), after a deduction of forfeited contributions of approximately HK\$4 million (first half of 2017: approximately HK\$4 million). For the MPF Scheme, the Group contributed approximately HK\$46 million (first half of 2017: approximately HK\$42 million) for the first half of 2018.

20. Cash and balances and placements with banks and other financial institutions

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Cash	15,103	14,243
Balances with central banks	99,781	88,886
Placements with central banks maturing within one month	13,370	9,691
Placements with central banks maturing between one and twelve months	1,632	1,486
	114,783	100,063
Balances with other banks and other financial institutions	85,136	153,105
Placements with other banks and other financial institutions maturing within one month	102,122	101,452
Placements with other banks and other financial institutions maturing between one and twelve months	58,340	57,741
	245,598	312,298
	375,484	426,604
Impairment allowances		
– Stage 1	(76)	N/A
– Stage 2	–	N/A
– Stage 3	–	N/A
	375,408	426,604

NOTES TO THE INTERIM FINANCIAL INFORMATION

21. Financial assets at fair value through profit or loss

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Securities		
Trading assets		
– Treasury bills	13,577	17,780
– Certificates of deposit	1,731	1,483
– Other debt securities	16,032	24,662
	31,340	43,925
– Equity securities	111	203
	31,451	44,128
Other financial assets mandatorily classified at fair value through profit or loss		
– Certificates of deposit	161	N/A
– Other debt securities	17,422	N/A
	17,583	N/A
– Equity securities	3,330	N/A
– Fund	8,457	N/A
	29,370	N/A
Financial assets designated at fair value through profit or loss		
– Certificates of deposit	–	159
– Other debt securities	3,149	29,505
	3,149	29,664
– Equity securities	–	3,481
– Fund	–	9,062
	3,149	42,207
Total securities	63,970	86,335
Other debt instruments		
Trading assets	4,000	6,859
	67,970	93,194

NOTES TO THE INTERIM FINANCIAL INFORMATION

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

Total securities are analysed by place of listing as follows:

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Debt securities and certificates of deposit		
– Listed in Hong Kong	11,753	18,203
– Listed outside Hong Kong	13,482	17,870
– Unlisted	26,837	37,516
	52,072	73,589
Equity securities		
– Listed in Hong Kong	2,410	2,578
– Listed outside Hong Kong	1,031	1,106
	3,441	3,684
Fund		
– Unlisted	8,457	9,062
Total securities	63,970	86,335

Total securities are analysed by type of issuer as follows:

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Sovereigns	21,785	28,929
Public sector entities	2,389	703
Banks and other financial institutions	31,241	39,844
Corporate entities	8,555	16,859
Total securities	63,970	86,335

NOTES TO THE INTERIM FINANCIAL INFORMATION

22. Derivative financial instruments

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.

NOTES TO THE INTERIM FINANCIAL INFORMATION

22. Derivative financial instruments (continued)

The following tables summarise the contract/notional amounts and fair values of each class of derivative financial instrument as at 30 June 2018 and 31 December 2017:

	At 30 June 2018		
	Contract/ notional amounts HK\$'m	Fair values	
		Assets HK\$'m	Liabilities HK\$'m
Exchange rate contracts			
Spot, forwards and futures	386,259	12,734	(9,296)
Swaps	1,549,180	12,926	(12,332)
Options	46,648	127	(64)
	1,982,087	25,787	(21,692)
Interest rate contracts			
Futures	14,792	2	(11)
Swaps	1,032,117	12,481	(9,503)
Options	1,570	2	(2)
	1,048,479	12,485	(9,516)
Commodity contracts	27,943	1,177	(65)
Equity contracts	8,110	394	(403)
Credit derivative contracts	392	–	(2)
	3,067,011	39,843	(31,678)

	At 31 December 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 INTERIM FINANCIAL INFORMATION

23. Advances and other accounts

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Personal loans and advances	341,007	327,827
Corporate loans and advances	889,501	818,599
Advances to customers	1,230,508	1,146,426
Trade bills	39,232	42,975
Advances to banks and other financial institutions	4,357	6,259
	1,274,097	1,195,660
Impairment allowances		
– Stage 1	(3,492)	N/A
– Stage 2	(397)	N/A
– Stage 3	(1,269)	N/A
– Collectively assessed	N/A	(3,615)
– Individually assessed	N/A	(491)
	1,268,939	1,191,554

As at 30 June 2018, advances to customers included accrued interest of HK\$2,070 million (31 December 2017: HK\$1,729 million).

NOTES TO THE INTERIM FINANCIAL INFORMATION

24. Investment in securities

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Investment in securities at fair value through other comprehensive income		
– Treasury bills	250,158	N/A
– Certificates of deposit	33,682	N/A
– Other debt securities	336,941	N/A
	620,781	N/A
– Equity securities	5,182	N/A
	625,963	N/A
Investment in securities at amortised cost		
– Certificates of deposit	18	N/A
– Other debt securities	94,666	N/A
	94,684	N/A
– Impairment allowances		
Stage 1	(22)	N/A
Stage 2	–	N/A
Stage 3	(43)	N/A
	94,619	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		
– Other debt securities	N/A	499
	720,582	618,191

NOTES TO THE INTERIM FINANCIAL INFORMATION

24. Investment in securities (continued)

Investment in securities is analysed by place of listing as follows:

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Debt securities and certificates of deposit		
– Listed in Hong Kong	85,045	80,808
– Listed outside Hong Kong	246,076	210,804
– Unlisted	384,279	321,165
	715,400	612,777
Equity securities		
– Listed in Hong Kong	3,963	4,468
– Listed outside Hong Kong	317	134
– Unlisted	902	812
	5,182	5,414
	720,582	618,191

	At 30 June 2018		At 31 December 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	17,145	16,975	N/A	N/A
– Listed outside Hong Kong	40,890	40,533	N/A	N/A
	58,035	57,508	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

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

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Sovereigns	312,500	234,032
Public sector entities	44,402	45,374
Banks and other financial institutions	215,876	213,826
Corporate entities	147,804	124,959
	720,582	618,191

NOTES TO THE INTERIM FINANCIAL INFORMATION

25. Investment properties

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
At 1 January	19,669	18,227
Additions	2	13
Disposals	–	(2)
Fair value gains	918	1,197
Reclassification from properties, plant and equipment (Note 26)	168	234
At period/year end	20,757	19,669

26. 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	5	628	633
Disposals	(3)	(4)	(7)
Revaluation	1,659	–	1,659
Depreciation for the period (Note 13)	(532)	(464)	(996)
Reclassification to investment properties (Note 25)	(168)	–	(168)
Net book value at 30 June 2018	45,290	3,099	48,389
At 30 June 2018			
Cost or valuation	45,290	10,135	55,425
Accumulated depreciation and impairment	–	(7,036)	(7,036)
Net book value at 30 June 2018	45,290	3,099	48,389
The analysis of cost or valuation of the above assets is as follows:			
At 30 June 2018			
At cost	–	10,135	10,135
At valuation	45,290	–	45,290
	45,290	10,135	55,425

NOTES TO THE INTERIM FINANCIAL INFORMATION

26. Properties, plant and equipment (continued)

	Premises HK\$'m	Equipment, fixtures and fittings HK\$'m	Total HK\$'m
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	(1,024)	(927)	(1,951)
Reclassification to investment properties (Note 25)	(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 INTERIM FINANCIAL INFORMATION

27. Other assets

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Repossessed assets	21	30
Precious metals	8,025	6,291
Reinsurance assets	46,135	43,717
Accounts receivable and prepayments	24,257	24,350
	78,438	74,388

28. Financial liabilities at fair value through profit or loss

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Trading liabilities		
– Short positions in Exchange Fund Bills and Notes	13,337	16,936
Financial liabilities designated at fair value through profit or loss		
– Structured deposits (Note 29)	2,575	2,784
	15,912	19,720

The carrying amount of financial liabilities designated at fair value through profit or loss as at 30 June 2018 was less than the amount that the Group would be contractually required to pay at maturity to the holders by HK\$4 million (31 December 2017: HK\$3 million).

NOTES TO THE INTERIM FINANCIAL INFORMATION

29. Deposits from customers

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Current, savings and other deposit accounts (per balance sheet)	1,853,580	1,775,090
Structured deposits reported as financial liabilities at fair value through profit or loss (Note 28)	2,575	2,784
	1,856,155	1,777,874
Analysed by:		
Demand deposits and current accounts		
– Corporate	151,462	145,029
– Personal	62,121	58,808
	213,583	203,837
Savings deposits		
– Corporate	320,250	372,909
– Personal	531,441	540,283
	851,691	913,192
Time, call and notice deposits		
– Corporate	484,661	409,151
– Personal	306,220	251,694
	790,881	660,845
	1,856,155	1,777,874

30. Debt securities and certificates of deposit in issue

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Debt securities, at amortised cost	15,577	21,641

31. Other accounts and provisions

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Dividend payable	8,014	–
Other accounts payable	69,080	53,088
Impairment allowances on loan commitments and financial guarantee contracts		
– Stage 1	308	N/A
– Stage 2	11	N/A
– Stage 3	2	N/A
	77,415	53,088

NOTES TO THE INTERIM FINANCIAL INFORMATION

32. 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 this interim financial information 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 first half of 2018 and the year ended 31 December 2017 are as follows:

	At 30 June 2018				
	Accelerated tax depreciation HK\$'m	Property revaluation HK\$'m	Impairment allowances HK\$'m	Others HK\$'m	Total HK\$'m
At 1 January 2018	693	6,649	(549)	(1,147)	5,646
Effect of adoption of HKFRS 9	–	–	(190)	170	(20)
Charged/(credited) to income statement (Note 16)	41	(59)	28	(38)	(28)
Charged/(credited) to other comprehensive income	–	231	–	(522)	(291)
Release upon disposal of equity instruments at fair value through other comprehensive income	–	–	–	(14)	(14)
At 30 June 2018	734	6,821	(711)	(1,551)	5,293

	At 31 December 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	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 INTERIM FINANCIAL INFORMATION

32. 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:

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Deferred tax assets	(292)	(58)
Deferred tax liabilities	5,585	5,704
	5,293	5,646

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Deferred tax assets to be recovered after more than twelve months	(93)	(38)
Deferred tax liabilities to be settled after more than twelve months	6,930	6,794
	6,837	6,756

As at 30 June 2018, the Group has not recognised deferred tax assets in respect of tax losses amounting to HK\$27 million (31 December 2017: HK\$25 million). Of the amount, HK\$9 million (31 December 2017: HK\$9 million) for the Group has no expiry date and HK\$18 million (31 December 2017: HK\$16 million) for the Group is scheduled to expire within six years under the current tax legislation in different countries/regions.

33. Insurance contract liabilities

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
At 1 January	103,229	86,534
Benefits paid	(9,102)	(10,815)
Claims incurred and movement in liabilities	10,787	27,510
At period/year end	104,914	103,229

The insurance contract liabilities that are covered by reinsurance arrangements amounted to HK\$38,636 million (31 December 2017: HK\$38,074 million) and the associated reinsurance assets of HK\$46,135 million (31 December 2017: HK\$43,717 million) are included in "Other assets" (Note 27).

NOTES TO THE INTERIM FINANCIAL INFORMATION

34. Subordinated liabilities

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Subordinated notes		
– designated at fair value through profit or loss	20,611	N/A
– at amortised cost with fair value hedge adjustment	N/A	18,917
Subordinated loan		
– at amortised cost	63	63
	20,674	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. Amounts qualified as Tier 2 capital instruments for regulatory purposes are shown in Note 3.5(B). The carrying amount of subordinated notes designated at fair value through profit or loss as at 30 June 2018 was more than the amount that the Group would be contractually required to pay at maturity to the holders by HK\$605 million (31 December 2017: N/A).

The subordinated loan is from BOC, the intermediate holding company, with interest rate at 12-month LIBOR plus 1.50% per annum payable annually. The subordinated loan is repayable on five equal annual instalments starting September 2017 and matures on September 2021.

35. 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 INTERIM FINANCIAL INFORMATION

35. Discontinued operations (continued)

The results of discontinued operations for the period are as follows:

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
DISCONTINUED OPERATIONS		
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 for profit attributable to equity holders of the Company		
Basic and diluted		
– profit from discontinued operations	–	0.2449

NOTES TO THE INTERIM FINANCIAL INFORMATION

35. Discontinued operations (continued)

The net cash flows incurred by discontinued operations are as follows:

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 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:

	Half-year ended 30 June 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

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

NOTES TO THE INTERIM FINANCIAL INFORMATION

35. Discontinued operations (continued)

The net cash inflow from disposal of discontinued operations is analysed as follows:

	Half-year ended 30 June 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

36. Share capital

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Issued and fully paid: 10,572,780,266 ordinary shares	52,864	52,864

NOTES TO THE INTERIM FINANCIAL INFORMATION

37. Notes to condensed consolidated cash flow statement

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

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
Operating profit		
– from continuing operations	20,215	17,223
– from discontinued operations	–	141
	20,215	17,364
Depreciation	996	927
Net charge of impairment allowances	342	361
Unwind of discount on impairment allowances	–	(1)
Advances written off net of recoveries	(150)	(186)
Change in subordinated liabilities	176	378
Change in balances and placements with banks and other financial institutions with original maturity over three months	(10,277)	2,348
Change in financial assets at fair value through profit or loss	26,391	(8,153)
Change in derivative financial instruments	(5,668)	14,158
Change in advances and other accounts	(78,326)	(139,397)
Change in investment in securities	(90,585)	22,478
Change in other assets	(4,064)	(6,855)
Change in deposits and balances from banks and other financial institutions	14,336	109,575
Change in financial liabilities at fair value through profit or loss	(3,808)	5,958
Change in deposits from customers	78,490	141,974
Change in debt securities and certificates of deposit in issue	(6,064)	8,130
Change in other accounts and provisions	15,963	68,515
Change in insurance contract liabilities	1,685	7,678
Effect of changes in exchange rates	(231)	(10,816)
Operating cash (outflow)/inflow before taxation	(40,579)	234,436
Cash flows from operating activities included		
– interest received	27,591	22,759
– interest paid	8,387	5,734
– dividend received	127	69

NOTES TO THE INTERIM FINANCIAL INFORMATION

37. Notes to condensed consolidated cash flow statement (continued)

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

	At 30 June 2018 HK\$'m	At 30 June 2017 HK\$'m
Cash and balances and placements with banks and other financial institutions with original maturity within three months	305,268	411,936
Treasury bills, certificates of deposit and other debt instruments with original maturity within three months	2,651	82,337
– financial assets at fair value through profit or loss	27,567	698
– investment in securities		
	335,486	494,971

38. 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.

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Direct credit substitutes	5,855	8,414
Transaction-related contingencies	23,871	30,092
Trade-related contingencies	32,121	28,294
Commitments that are unconditionally cancellable without prior notice	427,002	397,100
Other commitments with an original maturity of		
– up to one year	16,206	17,976
– over one year	144,660	154,582
	649,715	636,458
Credit risk-weighted amount	72,870	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.

NOTES TO THE INTERIM FINANCIAL INFORMATION

39. Capital commitments

The Group has the following outstanding capital commitments not provided for in this interim financial information:

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Authorised and contracted for but not provided for	167	146
Authorised but not contracted for	75	3
	242	149

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

40. Operating lease commitments

(a) As lessee

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

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Land and buildings		
– Not later than one year	715	607
– Later than one year but not later than five years	1,073	634
– Later than five years	41	14
	1,829	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:

	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Land and buildings		
– Not later than one year	555	543
– Later than one year but not later than five years	465	502
	1,020	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 INTERIM FINANCIAL INFORMATION

41. 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 and certain interests in associates and joint ventures.

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 period presentation.

NOTES TO THE INTERIM FINANCIAL INFORMATION

41. 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
Half-year ended 30 June 2018								
CONTINUING OPERATIONS								
Net interest income/(expense)								
– External	1,086	7,357	7,315	1,494	1,238	18,490	–	18,490
– Inter-segment	4,554	(831)	(3,209)	(22)	(492)	–	–	–
	5,640	6,526	4,106	1,472	746	18,490	–	18,490
Net fee and commission income/(expense)	3,838	2,071	486	(306)	568	6,657	(183)	6,474
Net insurance premium income	–	–	–	7,390	–	7,390	(9)	7,381
Net trading gain/(loss)	464	843	687	(123)	141	2,012	32	2,044
Net gain/(loss) on other financial instruments at fair value through profit or loss	5	–	311	(1,502)	–	(1,186)	4	(1,182)
Net (loss)/gain on other financial assets	–	(2)	43	45	–	86	–	86
Other operating income	12	1	6	84	1,044	1,147	(649)	498
Total operating income	9,959	9,439	5,639	7,060	2,499	34,596	(805)	33,791
Net insurance benefits and claims and movement in liabilities	–	–	–	(6,234)	–	(6,234)	–	(6,234)
Net operating income before impairment allowances	9,959	9,439	5,639	826	2,499	28,362	(805)	27,557
Net charge of impairment allowances	(30)	(49)	(1)	(4)	(258)	(342)	–	(342)
Net operating income	9,929	9,390	5,638	822	2,241	28,020	(805)	27,215
Operating expenses	(4,068)	(1,408)	(653)	(225)	(1,451)	(7,805)	805	(7,000)
Operating profit	5,861	7,982	4,985	597	790	20,215	–	20,215
Net gain from disposal of/fair value adjustments on investment properties	–	–	–	–	918	918	–	918
Net (loss)/gain from disposal/reevaluation of properties, plant and equipment	(1)	–	–	–	11	10	–	10
Share of profits less losses after tax of associates and joint ventures	45	–	–	–	(3)	42	–	42
Profit before taxation	5,905	7,982	4,985	597	1,716	21,185	–	21,185
At 30 June 2018								
ASSETS								
Segment assets	365,053	895,996	1,266,036	134,809	139,150	2,801,044	(27,056)	2,773,988
Interests in associates and joint ventures	395	–	2	–	60	457	–	457
	365,448	895,996	1,266,038	134,809	139,210	2,801,501	(27,056)	2,774,445
LIABILITIES								
Segment liabilities	1,013,012	844,573	483,166	126,604	81,821	2,549,176	(27,056)	2,522,120
Half-year ended 30 June 2018								
CONTINUING OPERATIONS								
Other information								
Capital expenditure	3	–	–	5	627	635	–	635
Depreciation	259	67	57	8	605	996	–	996
Amortisation of securities	–	–	386	94	(6)	474	–	474

NOTES TO THE INTERIM FINANCIAL INFORMATION

41. 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
Half-year ended 30 June 2017								
CONTINUING OPERATIONS								
Net interest income/(expense)								
– External	1,773	5,795	7,716	1,340	572	17,196	–	17,196
– Inter-segment	2,994	(101)	(2,469)	(12)	(412)	–	–	–
	4,767	5,694	5,247	1,328	160	17,196	–	17,196
Net fee and commission income/(expense)	2,889	2,392	377	(284)	583	5,957	(179)	5,778
Net insurance premium income	–	–	–	5,477	–	5,477	(9)	5,468
Net trading gain/(loss)	393	630	(765)	311	99	668	29	697
Net gain on other financial instruments at fair value through profit or loss	6	–	3	1,176	–	1,185	3	1,188
Net gain on other financial assets	–	15	217	203	–	435	–	435
Other operating income	39	5	15	95	1,013	1,167	(691)	476
Total operating income	8,094	8,736	5,094	8,306	1,855	32,085	(847)	31,238
Net insurance benefits and claims and movement in liabilities	–	–	–	(7,423)	–	(7,423)	–	(7,423)
Net operating income before impairment allowances	8,094	8,736	5,094	883	1,855	24,662	(847)	23,815
Net charge of impairment allowances	(214)	(82)	–	–	(58)	(354)	–	(354)
Net operating income	7,880	8,654	5,094	883	1,797	24,308	(847)	23,461
Operating expenses	(3,686)	(1,353)	(649)	(200)	(1,197)	(7,085)	847	(6,238)
Operating profit	4,194	7,301	4,445	683	600	17,223	–	17,223
Net gain from disposal of/fair value adjustments on investment properties	–	–	–	–	887	887	–	887
Net (loss)/gain from disposal/revaluation of properties, plant and equipment	(5)	–	(1)	–	4	(2)	–	(2)
Share of profits less losses after tax of associates and joint ventures	33	–	–	–	1	34	–	34
Profit before taxation	4,222	7,301	4,444	683	1,492	18,142	–	18,142
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
Half-year ended 30 June 2017								
CONTINUING OPERATIONS								
Other information								
Capital expenditure	3	–	1	13	808	825	–	825
Depreciation	226	73	45	8	575	927	–	927
Amortisation of securities	–	–	16	5	–	21	–	21

NOTES TO THE INTERIM FINANCIAL INFORMATION

42. Assets pledged as security

As at 30 June 2018, the liabilities of the Group amounting to HK\$14,955 million (31 December 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\$4,248 million (31 December 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\$19,414 million (31 December 2017: HK\$26,002 million) mainly included in “Financial assets at fair value through profit or loss” and “Investment in securities”.

43. Significant related party transactions

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

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

General information of the parent companies:

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

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

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

The majority of transactions with BOC arise from money market activities. As at 30 June 2018, the related aggregate amounts due from and to BOC of the Group were HK\$112,367 million (31 December 2017: HK\$186,565 million) and HK\$57,255 million (31 December 2017: HK\$60,385 million) respectively. The aggregate amounts of income and expenses of the Group arising from these transactions with BOC for the first half of 2018 were HK\$1,825 million (first half of 2017: HK\$549 million) and HK\$283 million (first half of 2017: HK\$197 million) respectively.

Transactions with other companies controlled by BOC are not considered material.

NOTES TO THE INTERIM FINANCIAL INFORMATION

43. Significant related party transactions (continued)

(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.

(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:

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
Income statement items		
Associates		
– Fee and commission expenses	6	20
– Other operating expenses	39	37
Other related parties		
– Fee and commission income	5	5
	At 30 June 2018 HK\$'m	At 31 December 2017 HK\$'m
Balance sheet item		
Associates		
– Other accounts and provisions	17	4

NOTES TO THE INTERIM FINANCIAL INFORMATION

43. Significant related party transactions (continued)

(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 periods, 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 is detailed as follows:

	Half-year ended 30 June 2018 HK\$'m	Half-year ended 30 June 2017 HK\$'m
Salaries and other short-term employee benefits	16	17

44. 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:

	At 30 June 2018				
	Non-bank private sector				Total HK\$'m
	Banks HK\$'m	Official sector HK\$'m	Non-bank financial institutions HK\$'m	Non-financial private sector HK\$'m	
Mainland of China	333,161	100,450	29,876	145,482	608,969
Hong Kong	10,508	–	29,156	309,157	348,821
Japan	10,616	143,634	2,796	1,494	158,540

	At 31 December 2017				
	Non-bank private sector				Total HK\$'m
	Banks HK\$'m	Official sector 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
Japan	14,773	79,727	4,452	1,109	100,061

NOTES TO THE INTERIM FINANCIAL INFORMATION

45. 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.

		At 30 June 2018		
	Items in the HKMA return	On-balance sheet exposure HK\$'m	Off-balance sheet exposure HK\$'m	Total exposure HK\$'m
Central government, central government-owned entities and their subsidiaries and joint ventures	1	282,231	33,284	315,515
Local governments, local government-owned entities and their subsidiaries and joint ventures	2	59,004	12,342	71,346
PRC nationals residing in Mainland or other entities incorporated in Mainland and their subsidiaries and joint ventures	3	70,689	10,467	81,156
Other entities of central government not reported in item 1 above	4	29,452	3,423	32,875
Other entities of local governments not reported in item 2 above	5	2	1	3
PRC nationals residing outside Mainland or entities incorporated outside Mainland where the credit is granted for use in Mainland	6	78,125	8,163	86,288
Other counterparties where the exposures are considered to be non-bank Mainland exposures	7	2,775	329	3,104
Total	8	522,278	68,009	590,287
Total assets after provision	9	2,575,524		
On-balance sheet exposures as percentage of total assets	10	20.28%		

NOTES TO THE INTERIM FINANCIAL INFORMATION

45. Non-bank Mainland exposures (continued)

	Items in the HKMA return	At 31 December 2017		
		On-balance sheet exposure HK\$'m	Off-balance sheet exposure HK\$'m	Total 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%		

NOTES TO THE INTERIM FINANCIAL INFORMATION

46. 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 30 June 2018 and 31 December 2017 are as follows:

	At 30 June 2018			
	Entities under			After combination HK\$m
	Before combination HK\$m	common control HK\$m	Adjustment HK\$m	
Share capital	52,864	1,062	(1,062)	52,864
Merger reserve	–	–	(1,106)	(1,106)
Retained earnings and other reserves	196,086	201	–	196,287
	248,950	1,263	(2,168)	248,045
Non-controlling interests	4,280	–	–	4,280
	253,230	1,263	(2,168)	252,325

	At 31 December 2017			
	Entities under			After combination HK\$m
	Before combination HK\$m	common control HK\$m	Adjustment 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

NOTES TO THE INTERIM FINANCIAL INFORMATION

47. Comparative amounts

In respect of the acquisition of the Indonesia Business and the Cambodia Business from BOC on 10 July 2017 and 6 November 2017 respectively, the Group has applied merger accounting method for the business combination under common control. Comparative amounts in the condensed consolidated income statement and relevant notes have been restated as if the Indonesia Business and the Cambodia Business had always been carried out by the Group.

In respect of the transfer of the Philippines Business and the Vietnam Business from BOC on 29 January 2018 as explained in Note 46, the Group has applied merger accounting method for the business combination under common control. Comparative amounts in the interim financial information have been restated as if the Philippines Business and the Vietnam Business had always been carried out by the Group.

48. Compliance with HKAS 34

The unaudited interim financial information for the first half of 2018 complies with HKAS 34 “Interim Financial Reporting” issued by the HKICPA.

49. Statutory accounts

The financial information relating to the year ended 31 December 2017 that is included in this Interim Report as comparative information does not constitute the Company’s statutory annual consolidated financial statements for that year but is derived from those financial statements. Further information relating to these statutory financial statements required to be disclosed in accordance with section 436 of the Hong Kong Companies Ordinance is as follows:

The Company has delivered the financial statements for the year ended 31 December 2017 to the Registrar of Companies as required by section 662(3) of, and Part 3 of Schedule 6 to, the Hong Kong Companies Ordinance.

The Company’s auditor has reported on those financial statements. The auditor’s report was unqualified; did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying its report; and did not contain a statement under sections 406(2), 407(2) or (3) of the Hong Kong Companies Ordinance.