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Confirmation and your Representation: In order to be eligible to view the attached Offering Circular or make an investment decision with respect to the securities, investors must be purchasing the securities outside the United States in an offshore transaction in reliance on Regulation S under the Securities Act. By accepting the e-mail and accessing the attached Offering Circular, you shall be deemed to have represented to The Hongkong and Shanghai Banking Corporation Limited, Barclays Bank PLC, Citigroup Global Markets Limited, CLSA Limited, DBS Bank Ltd., Deutsche Bank AG, Hong Kong Branch, Deutsche Bank AG, Singapore Branch, J.P. Morgan Securities plc, Mizuho Securities Asia Limited, Morgan Stanley & Co. International plc, Standard Chartered Bank, Standard Chartered Bank (Hong Kong) Limited, UBS AG, Hong Kong Branch and United Overseas Bank Limited (the “**Dealers**”) and us (1) that you and any customers you represent are and that the electronic mail address that you gave us and to which this e-mail has been delivered is not located in the United States and (2) that you consent to delivery of the attached Offering Circular and any amendments or supplements thereto by electronic transmission.

You are reminded that the attached Offering Circular has been delivered to you on the basis that you are a person into whose possession the attached Offering Circular may be lawfully delivered in accordance with the laws of the jurisdiction in which you are located and you may not, nor are you authorised to, deliver or disclose the contents of the attached Offering Circular to any other person. You should not reply by e-mail to this notice, and you may not purchase any securities by doing so. Any reply e-mail communications, including those you generate by using the “Reply” function on your e-mail software, will be ignored or rejected.

The attached Offering Circular does not constitute, and may not be used in connection with, an offer or solicitation in any place where offers or solicitations are not permitted by law. If a jurisdiction requires that the offering be made by a licensed broker or dealer and the Dealers or any affiliate of the Dealers are a licensed broker or dealer in that jurisdiction, the offering shall be deemed to be made by the Dealers or such affiliate on behalf of The Bank of East Asia, Limited 東亞銀行有限公司 in such jurisdiction.

The attached Offering Circular has been sent to you in an electronic form. You are reminded that documents transmitted via this medium may be altered or changed during the process of electronic transmission and consequently, none of The Bank of East Asia, Limited 東亞銀行有限公司, the Dealers, the Trustee or any of the Agents (each as defined in the attached Offering Circular) nor any person who controls any of them nor any director, officer, employee nor agent of any of them or affiliate of any such person accepts any liability or responsibility whatsoever in respect of any difference between the attached Offering Circular distributed to you in electronic format and the hard copy version available to you on request from the Dealers.

You are responsible for protecting against viruses and other destructive items. Your use of this e-mail is at your own risk and it is your responsibility to take precautions to ensure that it is free from viruses and other items of a destructive nature.



The Bank of East Asia, Limited 東亞銀行有限公司

(incorporated with limited liability in Hong Kong)

U.S.\$6,000,000,000

Medium Term Note Programme

Under the Medium Term Note Programme described in this Offering Circular (the “**Programme**”), The Bank of East Asia, Limited 東亞銀行有限公司 (“**BEA**” or the “**Issuer**”), subject to compliance with all relevant laws, regulations and directives, may from time to time issue Medium Term Notes (the “**Notes**”). The aggregate nominal amount of Notes outstanding will not at any time exceed U.S.\$6,000,000,000 (or the equivalent in other currencies).

The Notes may be issued on a continuing basis to one or more of the Dealers appointed under the Programme from time to time by the Issuer (each a “**Dealer**” and together the “**Dealers**”), which appointment may be for a specific issue or on an ongoing basis. References in this Offering Circular to the “**relevant Dealer**” shall, in the case of an issue of Notes being (or intended to be) subscribed for by more than one Dealer, be to all Dealers agreeing to subscribe for such Notes.

An investment in Notes issued under the Programme involves certain risks. For a discussion of these risks see “Investment Considerations”.

Application has been made to the Singapore Exchange Securities Trading Limited (the “**SGX-ST**”) for permission to deal in, and for the listing and quotation of, any Notes which are agreed at the time of issue thereof to be so listed on the SGX-ST. Such permission will be granted when such Notes have been admitted to the Official List of the SGX-ST. There can be no assurance that an application to the SGX-ST will be approved. Unlisted Notes may also be issued pursuant to the Programme. The relevant Pricing Supplement (as defined in “*Summary of the Programme*”) in respect of the issue of any Notes will specify whether or not such Notes will be listed on the SGX-ST (or any other stock exchange). Admission to the Official List of the SGX-ST and the listing and quotation of any Notes on the SGX-ST is not to be taken as an indication of the merits of the Issuer, its subsidiary companies (if any), its associated companies (if any) or such Notes. The SGX-ST assumes no responsibility for the correctness of any of the statements made, opinions expressed or reports contained herein.

The Notes of each Series (as defined in “*Summary of the Programme*”) to be issued in bearer form will be sold in an “offshore transaction” within the meaning of Regulation S (“**Regulation S**”) under the United States Securities Act of 1933 (the “**Securities Act**”) and will initially be represented by a temporary global note in bearer form (each a “**temporary Global Note**”). Interests in temporary Global Notes generally will be exchangeable for interests in permanent global notes (each a “**permanent Global Note**” and, together with the temporary Global Notes, the “**Global Notes**”), or if so stated in the relevant Pricing Supplement, definitive Notes (“**Definitive Notes**”), after the date falling 40 days after the later of the commencement of the offering and the relevant issue date of such Tranche (as defined in “*Summary of the Programme*”), upon certification as to non-US beneficial ownership. Interests in permanent Global Notes will be exchangeable for Definitive Notes in whole but not in part as described under “*Summary of Provisions Relating to the Notes while in Global Form*”.

The Notes of each Series to be issued in registered form (“**Registered Notes**”) and which are sold in an “offshore transaction” within the meaning of Regulation S (“**Unrestricted Notes**”) will initially be represented by a permanent registered global certificate (each a “**Global Certificate**”) without interest coupons, which may be deposited on the relevant issue date (a) in the case of a Series intended to be cleared through Euroclear Bank S.A./N.V. (“**Euroclear**”) and Clearstream Banking, société anonyme (“**Clearstream, Luxembourg**”), with a common depository on behalf of Euroclear and Clearstream, Luxembourg or in the case of a Series intended to be cleared through the Central Moneymarkets Unit Service, operated by the Hong Kong Monetary Authority (the “**HKMA**”) (the “**CMU**”), with a sub-custodian for the HKMA and (b) in the case of a Series intended to be cleared through a clearing system other than, or in addition to, Euroclear and/or Clearstream, Luxembourg or the CMU, or delivered outside a clearing system, as agreed between the Issuer and the relevant Dealer. The provisions governing the exchange of interests in Global Notes for other Global Notes and definitive Notes are described in “*Summary of Provisions Relating to the Notes while in Global Form*”.

The Notes have not been and will not be registered under the Securities Act or with any securities regulatory authority of any state or other jurisdiction of the United States, and the Notes may include Bearer Notes that are subject to U.S. tax law requirements. Subject to certain exceptions, the Notes may not be offered, sold, or, in the case of Bearer Notes, delivered within the United States. Registered Notes are subject to certain restrictions on transfer, see “*Subscription and Sale*”.

The Issuer may agree with any Dealer and the Trustee (as defined herein) that Notes may be issued in a form not contemplated by the Terms and Conditions of the Notes herein (the “**Conditions**”), in which event a supplementary Offering Circular, if appropriate, will be made available which will describe the effect of the agreement reached in relation to such Notes.

Moody’s Investors Service, Inc. (“**Moody’s**”) is expected to rate Senior Notes issued under the Programme “A2” and Dated Subordinated Notes issued under the Programme “Ba1”. Standard & Poor’s Rating Services, a division of the McGraw-Hill companies (“**S&P**”) is expected to rate Senior Notes issued under the Programme “A” and Dated Subordinated Notes issued under the Programme “BBB-”. Tranches of Notes (as defined in “*Summary of the Programme*”) to be issued under the Programme will be rated or unrated. Where a Tranche of Notes is to be rated, such rating will not necessarily be the same as the ratings assigned to the Programme. A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction, revision or withdrawal at any time by the assigning rating agency.

Sole Arranger

HSBC

Dealers

HSBC
CLSA (a CITIC Securities Co.)
J.P. Morgan
Standard Chartered Bank
Standard Chartered Bank
(Hong Kong) Limited

Barclays
DBS Bank Ltd.
Mizuho Securities
UBS

Citigroup
Deutsche Bank
Morgan Stanley
United Overseas Bank Limited

The Issuer, having made all reasonable enquiries, confirms that this Offering Circular contains or incorporates all information which is material in the context of the issuance and offering of Notes, that the information contained or incorporated by reference in this Offering Circular is true and accurate in all material respects and is not misleading in any material respect, that the opinions and intentions expressed in this Offering Circular are honestly held and that there are no other facts the omission of which would make this Offering Circular or any of such information or the expression of any such opinions or intentions misleading in any material respect and which, in each case, is material in the context of the issuance and offering of the Notes. The Issuer accepts responsibility accordingly.

This Offering Circular is to be read in conjunction with all documents which are incorporated herein by reference (see “Documents Incorporated by Reference”).

No person has been authorised to give any information or to make any representation other than those contained in this Offering Circular in connection with the issue or sale of the Notes and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer or any of Sole Arranger or the Dealers (as defined in “*Summary of the Programme*”) or the Trustee or the Agents (each as defined in “*Terms and Conditions of the Notes*”). Neither the delivery of this Offering Circular nor any sale made in connection herewith shall, under any circumstances, create any implication that there has been no change in the affairs of the Issuer or the Issuer and its subsidiaries (the “**Group**”) since the date hereof or the date upon which this Offering Circular has been most recently amended or supplemented or that there has been no adverse change in the financial position of the Group since the date hereof or the date upon which this Offering Circular has been most recently amended or supplemented or that any other information supplied in connection with the Programme is correct as of any time subsequent to the date on which it is supplied or, if different, the date indicated in the document containing the same.

The distribution of this Offering Circular and the offering or sale of the Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Issuer, the Sole Arranger and the Dealers to inform themselves about and to observe any such restriction.

The Notes have not been and will not be registered under the Securities Act and include Notes in bearer form that are subject to U.S. tax law requirements. Subject to certain exceptions, Notes may not be offered, sold or delivered within the United States. For a description of certain restrictions on offers and sales of Notes and on distribution of this Offering Circular, see “*Subscription and Sale*”.

The Notes are being offered and sold outside the United States in reliance on Regulation S. For a description of these and certain further restrictions on offers, sales and transfers of Notes and distribution of this Offering Circular, see “*Subscription and Sale*”.

THE NOTES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE U.S. SECURITIES AND EXCHANGE COMMISSION, ANY STATE SECURITIES COMMISSION IN THE UNITED STATES OR ANY OTHER U.S. REGULATORY AUTHORITY, NOR HAS ANY OF THE FOREGOING AUTHORITIES PASSED UPON OR ENDORSED THE MERITS OF THE OFFERING OF NOTES OR THE ACCURACY OR THE ADEQUACY OF THIS OFFERING CIRCULAR. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENCE IN THE UNITED STATES.

This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Issuer, the Sole Arranger, the Dealers, the Trustee or the Agents to subscribe for, or purchase, any Notes.

To the fullest extent permitted by law, none of the Sole Arranger, the Dealers, the Trustee or the Agents accept any responsibility for the contents of this Offering Circular or for any other statement, made or purported to be made by the Sole Arranger or a Dealer or the Trustee or any Agent or on its behalf in connection with the Issuer or the issue and offering of the Notes. The Sole Arranger, each Dealer, the Trustee and each Agent accordingly disclaim all and any liability whether arising in tort or contract

or otherwise (save as referred to above) which it might otherwise have in respect of this Offering Circular or any such statement. Neither this Offering Circular nor any financial statements of the Issuer or the Group are intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by any of the Issuer, the Sole Arranger, the Dealers, the Trustee or the Agents that any recipient of this Offering Circular or any financial statements of the Issuer or the Group should purchase the Notes. Each potential investor of Notes should determine for itself the relevance of the information contained in this Offering Circular and its purchase of Notes should be based upon such investigation as it deems necessary. None of the Sole Arranger, the Dealers, the Trustee or the Agents undertakes to review the financial condition or affairs of the Issuer during the life of the arrangements contemplated by this Offering Circular nor to advise any investor or potential investor in the Notes of any information coming to the attention of any of the Sole Arranger, the Dealers, the Trustee or the Agents.

From time to time, in the ordinary course of business, certain of the Dealers and their affiliates have provided advisory and investment banking services, and entered into other commercial transactions with the Issuer and its affiliates, including commercial banking services, for which customary compensation has been received. It is expected that the Dealers and their affiliates will continue to provide such services to, and enter into such transactions with, the Issuer and its affiliates in the future.

The Dealers or certain of their respective affiliates may purchase the Notes and be allocated Notes for asset management and/or proprietary purposes and not with a view to distribution.

In making an investment decision, each potential investor must rely on its own examination of the Group and the terms of the Notes being offered, including the merits and risks involved. The Issuer does not and the Sole Arranger, the Dealers, the Trustee and the Agents do not make any representation regarding the legality of investment under any applicable laws.

Potential investors should be able to bear the economic risk of an investment in the Notes for an indefinite period of time.

WARNING

The contents of this Offering Circular have not been reviewed by any regulatory authority of any jurisdiction. You are advised to exercise caution in relation to the offering of the Notes. If you are in any doubt about any of the contents of this Offering Circular, you should obtain independent professional advice.

STABILISATION

In connection with any Tranche of Notes, one or more of the Dealers (or persons acting on their behalf) may act as the stabilising manager(s) (the “Stabilising Manager(s)”). The identity of the Stabilising Manager(s) (if any) will be disclosed in the relevant Pricing Supplement.

In connection with the issue of any Tranche of Notes, one or more of the Dealers named as Stabilising Manager (or persons acting on behalf of any Stabilising Manager(s)) in the applicable Pricing Supplement may, subject to applicable laws and regulations, over-allot Notes or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager(s) (or persons acting on behalf of any Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the

terms of the offer of the relevant Tranche of Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the relevant Tranche of Notes and 60 days after the date of the allotment of the relevant Tranche of Notes.

PRESENTATION OF INFORMATION

In this Offering Circular, unless the context otherwise requires, (i) references to “**BEA**” or the “**Issuer**” mean The Bank of East Asia, Limited 東亞銀行有限公司 and, as the context may require, its subsidiaries; (ii) references to “**BEA (China)**” mean The Bank of East Asia (China) Limited; and (iii) references to the “**Group**” mean The Bank of East Asia, Limited 東亞銀行有限公司 and its subsidiaries.

Unless otherwise specified or the context otherwise requires, references to “**U.S.\$**” and to “**U.S. dollars**” are to lawful currency of the United States of America, references to “**HK\$**”, “**Hong Kong dollars**” and “**HK dollars**” are to the lawful currency of Hong Kong Special Administrative Region of the PRC (“**Hong Kong**”), references to “**RMB**” and “**Renminbi**” are to the lawful currency of the People’s Republic of China (“**PRC**”), references to “**sterling**” and “**£**” are to the lawful currency of the United Kingdom, references to “**€**”, “**EUR**” and “**Euro**” are to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended from time to time, references to “**Australian dollars**” are to lawful currency of Commonwealth of Australia, and references to the “**PRC**” and “**Mainland China**” are to the People’s Republic of China and, for the purpose of this Offering Circular, except where the context requires, do not include Hong Kong, Macau Special Administrative Region of the PRC (“**Macau**”), or Taiwan, the Republic of China (“**Taiwan**”).

The Hong Kong dollar has been linked to the U.S. dollar at the rate of HK\$7.80 to U.S.\$1.00 since 17 October 1983 (the “**Linked Exchange Rate System**”). In May 2005, the HKMA broadened the 22-year old trading band from the original rate of HK\$7.80 per U.S. dollar to a rate range of HK\$7.75 to HK\$7.85 per U.S. dollar.

For convenience only, all Hong Kong dollar amounts in this Offering Circular have been translated into U.S. dollar amounts at the rate of U.S.\$1.00 = HK\$7.80. Such translations should not be construed as representations that the Hong Kong dollar amounts referred to could have been, or could be, converted into U.S. dollars at that or any other rate or at all.

FORWARD-LOOKING STATEMENTS

This Offering Circular includes statements that are, or may be deemed to be, “forward-looking statements” within the meaning of Section 27A of the Securities Act and Section 21E of the United States Securities and Exchange Act of 1934, as amended (the “**Exchange Act**”). These forward-looking statements can be identified by the use of forward-looking terminology, including the terms “believes”, “estimates”, “intends”, “may”, “will” or “should” or, in each case, their negative or other variations or comparable terminology. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this Offering Circular and include statements regarding the intentions, beliefs or current expectations of the Issuer concerning, among other things, the results of operations, financial condition, liquidity, prospects, growth, strategies and the industries in which the Group operates.

By their nature, forward-looking statements are subject to numerous assumptions, risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. Forward-looking statements are not guarantees of future performance and that the Group's actual results of operations, financial condition and liquidity, and the development of the industries in which the Group operates, may differ materially from those made in or suggested by the forward-looking statements contained in this Offering Circular. In addition, even if the results of operations, financial condition and liquidity and the development of the industries in which the Group operates are consistent with the forward-looking statements contained in this Offering Circular, those results or developments may not be indicative of results or developments in subsequent periods.

The cautionary statements set forth above should be considered in connection with any subsequent written or oral forward-looking statements that the Issuer or persons acting on its behalf may issue. The Issuer does not undertake any obligation to review or confirm analysts' expectations or estimates or to release publicly any revisions to any forward-looking statements to reflect events or circumstances after the date of this Offering Circular.

The following list includes some, but not necessarily all, of the factors that may cause actual results to differ from those anticipated or predicted:

- changes in the general operating environment of the Hong Kong banking industry;
- changes in general economic, market, business and regulatory conditions in Hong Kong, Mainland China, the United States and other countries;
- changes in the monetary and credit policies of the United States, Hong Kong and Mainland China;
- changes or volatility in interest rates, foreign exchange rates, equity prices or other rates or prices;
- changes in Hong Kong governmental policies, laws or regulations, in particular those affecting the banking industry in Hong Kong;
- the effects of intensifying competition in the banking industry in Hong Kong; and
- the performance of the real property and financial markets in Hong Kong.

Additional factors that could cause actual results, performance or achievements to differ materially include, but are not limited to, those discussed under "*Investment Considerations*".

Any forward-looking statements that the Issuer makes in this Offering Circular speak only as at the date of such statements, and the Issuer undertakes no obligation to update such statements. Comparisons of results for current and any prior periods are not intended to express any future trends or indications of future performance, and should only be viewed as historical data.

DOCUMENTS INCORPORATED BY REFERENCE

The Issuer hereby incorporates by reference (i) each Pricing Supplement, (ii) the most recently published audited consolidated annual financial statements, and any interim consolidated financial information (whether audited or unaudited) of the Issuer and/or the Group published from time to time after the date of this Offering Circular, and (iii) all amendments and supplements from time to time to this Offering Circular, each of which shall be deemed to be incorporated in, and to form part of, this Offering Circular and which shall be deemed to modify or supersede the contents of this Offering Circular to the extent that a statement contained in any such document is inconsistent with the contents of this Offering Circular.

Copies of all such documents which are so deemed to be incorporated in, and to form part of, this Offering Circular will be available free of charge during usual business hours on any weekday (Saturdays and public holidays excepted) from the specified offices of the Issuer and of the Paying Agents set out at the end of this Offering Circular.

SUPPLEMENTAL OFFERING CIRCULAR

The Issuer has given an undertaking to the Sole Arranger and the Dealers that, unless it has notified the Permanent Dealers in writing that it does not intend to issue Notes under the Programme for the time being, if at any time during the duration of the Programme a significant new factor, material mistake or inaccuracy arises or is noted relating to the information included in the Offering Circular which is capable of affecting an assessment by investors of the assets and liabilities, financial position, profits and losses, and prospects of the Issuer and/or of the rights attaching to the Notes, it shall (i) prepare and publish an amendment or supplement to the Offering Circular, (ii) advise the Sole Arranger and the Dealers promptly of any proposal to amend or replace the Offering Circular, (iii) advise the Dealers promptly of any proposal to supplement the Offering Circular and (iv) provide the Sole Arranger and the Permanent Dealers with a copy of any such proposed amendment, supplement or replacement immediately prior to its publication.

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SUMMARY

The following summary is qualified in its entirety by, and is subject to, the detailed information contained or referred to elsewhere in this Offering Circular. For a discussion of certain considerations that should be made in connection with an investment in the Notes, see “Investment Considerations”.

OVERVIEW

Incorporated in 1918, BEA is the largest independent local bank in Hong Kong in terms of assets. As at 31 December 2013, the Group’s total consolidated assets, advances to customers and total deposits were HK\$753,954 million (U.S.\$96,661 million), HK\$405,357 million (U.S.\$51,969 million) and HK\$577,900 million (U.S.\$74,090 million), respectively.

The shares of BEA have been listed on The Stock Exchange of Hong Kong Limited (the “**HKSE**”) since the 1930s. As at 30 April 2014, approximately 2,328.21 million ordinary shares have been issued and are outstanding and have been fully paid. Based on the closing price of its shares on the HKSE as at 30 April 2014, BEA’s market capitalisation was approximately HK\$74,386.3 million (U.S.\$9,536.7 million). BEA’s shares have been a constituent stock of the Hang Seng Index since 1984.

The Group provides commercial and retail banking, financial and insurance services through its Corporate Banking, Personal Banking, Wealth Management, Insurance & Retirement Benefits, Treasury Markets, China and International divisions. The Group’s core business products and services include syndicated loans, trade finance, deposit taking, foreign currency savings, remittances, mortgage loans, consumer loans, credit cards, Cyberbanking retail investment, retail investment and wealth management services, foreign exchange margin trading, services related to the mandatory provident fund scheme (“**MPF Scheme**”) under the Mandatory Provident Fund Schemes Ordinance (Cap. 485) of Hong Kong (the “**MPF Schemes Ordinance**”), internet banking services and general and life insurance.

In addition, through BEA’s wholly-owned subsidiaries, the Group is able to extend other services to its customers. BEA Life Limited (“**BEA Life**”) and Blue Cross (Asia-Pacific) Insurance Limited (“**Blue Cross**”) serve as the Group’s life insurance and general insurance arms respectively providing a comprehensive range of insurance solutions including life and non-life insurance products and services for individual and corporate customers. Tricor, together with its subsidiaries, offers outsourced expertise in business support functions and provides its customers with a range of integrated business, corporate and investor services.

As at 30 April 2014, the Group offered a broad range of banking and related financial services in Hong Kong through a network of 89 branches, 62 wealth management centres called “SupremeGold Centres” and nine i-Financial Centres.

As at 30 April 2014, the Group’s overseas operations had in total 40 branches, 102 sub-branches and two representative offices as well as several affiliates and joint ventures in Mainland China, Taiwan, Macau, the United States, the United Kingdom, Canada and South East Asia.

BEA is one of the first foreign banks to receive approval to establish a locally-incorporated bank in Mainland China. As a locally-incorporated bank and a wholly-owned subsidiary of BEA, BEA (China) obtained its business licence from the State Administration for Industry and Commerce on 29 March 2007 and officially commenced business on 2 April 2007. BEA (China) provides comprehensive RMB and foreign currency banking services to all customers. Services include but are not limited to deposit-taking, loans and advances, debit cards, credit cards, Cyberbanking and cash management, wealth management services, private banking, investment and derivative products, agency services for life and general insurance, remittance and settlement, RMB cross-border trade settlement services, domestic and international trade finance facilities, supply chain financing, standby letters of credit,

bank guarantees, distribution of local mutual funds, and third-party payment. In May 2013, the State Administration of Foreign Exchange (“SAFE”) granted BEA (China) the right to conduct RMB and foreign currency swap business for its customers, further broadening the range of treasury products offered by BEA (China). In June 2013, BEA (China) became one of the first locally-incorporated foreign banks to be granted a local fund distribution licence. Such licence enables BEA (China) to offer a greater range of wealth management products to its customers.

As at 30 April 2014, BEA (China), with its headquarters in Shanghai, operated 27 branches and 98 sub-branches in Mainland China. In addition to the BEA (China) network, BEA operates a representative office in Fuzhou, and a rural bank in Fuping County, Weinan City in Shaanxi province. Having effectively positioned itself to capture opportunities in the region, the Group has recorded constant healthy growth for its operations in Mainland China. As at 31 December 2013, the Group’s total loans to customers and trade bills increased by 14.5% while its customer deposits increased by 7.3% over the figures reported at 31 December 2012.

As at 30 April 2014, BEA maintains one branch in each of Taipei and Kaohsiung in Taiwan, and provides a full range of wealth management services through BEA Wealth Management Services (Taiwan) Limited (“BEAWMS”). As at 30 April 2014, BEA also operates one branch, four sub-branches and 13 automatic teller machines (“ATMs”) in Macau.

As at 31 December 2011, 2012 and 2013, the assets of the Group’s operations in Mainland China, Taiwan and Macau collectively accounted for approximately 45.6%, 47.7% and 47.7% of the total assets of the Group, respectively. The corresponding figures for Hong Kong as at 31 December 2011, 2012 and 2013 were 58.3%, 55.6% and 56.0%, respectively. For the years ended 31 December 2011, 2012 and 2013, the profit before taxation of the Group’s operations in Mainland China, Taiwan and Macau collectively accounted for approximately 44.1%, 30.8% and 34.1% of the Group’s consolidated profit before taxation, respectively. The corresponding figures for Hong Kong as at 31 December 2011, 2012 and 2013 were 34.1%, 48.4% and 45.9%, respectively.

The majority of the Group’s lending is on a secured, floating-rate basis and adheres to pre-established loan-to-value limitations depending on the underlying collateral and the credit risk of customers. Security typically consists of a first legal charge over real property, listed securities and cash deposits. Some of the Group’s lending is on a guaranteed basis.

As at 31 December 2011, 2012 and 2013, the Group’s total capital ratio was approximately 13.7%, 14.3% and 15.9%, respectively, compared with the statutory minimum requirement of 8.0%, and its loan to deposit ratio was approximately 65.8%, 66.7% and 70.1%, respectively. For the years ended 31 December 2011, 2012 and 2013, the Group’s average liquidity ratio was approximately 42.8%, 46.6% and 47.0%, respectively. See “*Selected Statistical and Other Information*” for further details.

The Group relies on its deposit base for the majority of its funding requirements. As at 31 December 2011, 2012 and 2013, the Group’s customer deposits accounted for approximately 90.2%, 86.1% and 85.6%, respectively, of its borrowed funds. The remainder of the Group’s funding requirements as at 31 December 2011, 2012 and 2013 were primarily satisfied through the issuance of certificates of deposit and debt securities and, particularly for its RMB funding requirements, through interbank borrowings.

In order to diversify the Group’s RMB funding sources, BEA (China) issued RMB4 billion in aggregate principal amount of RMB-denominated bonds in Hong Kong in July 2009. BEA (China) issued its first and second batch of RMB financial bonds with the issue sizes of RMB2 billion and RMB3 billion in PRC’s interbank bond market in March and November 2011, respectively, and issued RMB1 billion in aggregate principal amount of senior unsecured bonds in Hong Kong in May 2012.

For the year ended 31 December 2013, the Group's profit after taxation was HK\$6,707 million (U.S.\$860 million), representing an increase of approximately 9.0% from the year ended 31 December 2012. For the year ended 31 December 2012, the Group's profit after taxation was HK\$6,154 million (U.S.\$789 million), representing an increase of approximately 38.3% from the year ended 31 December 2011.

For the years ended 31 December 2011, 2012 and 2013, the Group achieved a return on average assets of approximately 0.7%, 0.9% and 0.9%, respectively, and a return on average equity of approximately 9.5%, 11.9% and 11.0%, respectively.

STRATEGY

BEA's core objectives are to strengthen its position and to further develop its domestic franchise as the largest independent local bank in Hong Kong, and to further diversify its operations and expand in Mainland China and other overseas countries. The Group will continue to maintain its growth strategy for its businesses and operations and, at the same time, keep up the progress of enhancing its cost-to-income performance. Given the increasingly close economic connection among Mainland China, Hong Kong and the countries of Southeast Asia, the Group will continue to enhance the momentum of its business under the "China-Hong Kong Link (中港聯動)" initiatives. The key components of the Group's strategy are as follows:

- Expansion in Mainland China and other overseas countries;
- Diversification of non-interest income;
- Enhancement of profitability via active asset and liability management;
- Transformation of its branch network;
- Acquisitions and organic growth; and
- Focus on enhancing operational efficiency.

SUMMARY OF THE PROGRAMME

The following summary is qualified in its entirety by the remainder of this Offering Circular. Words and expressions defined in “Terms and Conditions of the Notes” below shall have the same meaning in this summary.

The Issuer	The Bank of East Asia, Limited 東亞銀行有限公司.
Description	Medium Term Note Programme.
Size	Up to U.S.\$6,000,000,000 (or the equivalent in other currencies at the date of issue) aggregate nominal amount of Notes outstanding at any one time.
Sole Arranger.	The Hongkong and Shanghai Banking Corporation Limited.
Dealers	<p>The Hongkong and Shanghai Banking Corporation Limited Barclays Bank PLC Citigroup Global Markets Limited CLSA Limited DBS Bank Ltd. Deutsche Bank AG, Hong Kong Branch Deutsche Bank AG, Singapore Branch J.P. Morgan Securities plc Mizuho Securities Asia Limited Morgan Stanley & Co. International plc Standard Chartered Bank Standard Chartered Bank (Hong Kong) Limited UBS AG, Hong Kong Branch United Overseas Bank Limited</p> <p>The Issuer may from time to time terminate the appointment of any dealer under the Programme or appoint additional dealers either in respect of one or more Tranches or in respect of the whole Programme. References in this Offering Circular to “Permanent Dealers” are to the persons listed above as Dealers and to such additional persons that are appointed as dealers in respect of the whole Programme (and whose appointment has not been terminated) and to “Dealers” are to all Permanent Dealers and all persons appointed as a dealer in respect of one or more Tranches.</p>
Trustee.	DB Trustees (Hong Kong) Limited.
Issuing and Paying Agent.	Deutsche Bank AG, Hong Kong Branch.
Transfer Agents	Deutsche Bank AG, Hong Kong Branch Deutsche Bank Luxembourg S.A..
Registrars	Deutsche Bank AG, Hong Kong Branch Deutsche Bank Luxembourg S.A..
CMU Lodging and Paying Agent .	Deutsche Bank AG, Hong Kong Branch.

Method of Issue	<p>The Notes may be issued on a syndicated or non-syndicated basis. The Notes may be issued in series (each a “Series”) having one or more issue dates (each tranche within such Series a “Tranche”) and on terms otherwise identical (or identical other than in respect of the first payment of interest), the Notes of each Series being intended to be interchangeable with all other Notes of that Series. Each Series may be issued in tranches on the same or different issue dates. The specific terms of each Tranche (which will be supplemented, where necessary, with supplemental terms and conditions and, save in respect of the issue date, issue price, first payment of interest and nominal amount of the Tranche, will be identical to the terms of other Tranches of the same Series) will be set out in a pricing supplement (a “Pricing Supplement”).</p>
Issue Price	<p>Notes may be issued at their nominal amount or at a discount or premium to their nominal amount. Partly Paid Notes may be issued, the issue price of which will be payable in two or more instalments.</p>
Form of Notes	<p>The Notes may be issued in bearer form only (“Bearer Notes”), in bearer form exchangeable for Registered Notes (“Exchangeable Bearer Notes”) or in registered form only (“Registered Notes”). Each Tranche of Bearer Notes and Exchangeable Bearer Notes will be represented on issue by a temporary Global Note if (i) definitive Notes are to be made available to Noteholders following the expiry of 40 days after their issue date or (ii) such Notes have an initial maturity of more than one year and are being issued in compliance with the D Rules (as defined in “<i>Summary of the Programme — Selling Restrictions</i>” below), otherwise such Tranche will be represented by a permanent Global Note. Registered Notes will be represented by Certificates, one Certificate being issued in respect of each Noteholder’s entire holding of Registered Notes of one Series. Certificates representing Registered Notes that are registered in the name of a nominee for one or more clearing systems are referred to as “Global Certificates”.</p> <p>Registered Notes sold in an “offshore transaction” within the meaning of Regulation S will initially be represented by a Global Certificate.</p>
Clearing Systems	<p>The CMU, Clearstream, Luxembourg, Euroclear and, in relation to any Tranche, such other clearing system as may be agreed between the Issuer, the Issuing and Paying Agent, the Trustee and the relevant Dealer.</p>

Initial Delivery of Notes	On or before the issue date for each Tranche, the Global Note representing Bearer Notes or Exchangeable Bearer Notes or the Global Certificate representing Registered Notes may be deposited with a common depositary for Euroclear and Clearstream, Luxembourg or deposited with a sub-custodian for the HKMA as operator of the CMU or deposited with a depositary or sub-custodian for any other clearing system or may be delivered outside any clearing system provided that the method of such delivery has been agreed in advance by the Issuer, the Trustee, the Issuing and Paying Agent and the relevant Dealers. Registered Notes that are to be credited to one or more clearing systems on issue will be registered in the name of, or in the name of nominees or a common nominee for, such clearing systems.
Currencies	Subject to compliance with all relevant laws, regulations and directives, Notes may be issued in any currency agreed between the Issuer and the relevant Dealers.
Maturities	Subject to compliance with all relevant laws, regulations and directives, any maturity, including for the avoidance of doubt, undated perpetual Notes with no fixed maturity.
Specified Denomination	Definitive Notes will be in such denominations as may be specified in the relevant Pricing Supplement, save that unless otherwise permitted by then current laws and regulations, Notes (including Notes denominated in sterling) which must be redeemed before the first anniversary of their date of issue and in respect of which the issue proceeds are to be accepted by the Issuer in the United Kingdom or whose issue otherwise constitutes a contravention of section 19 of the Financial Services and Markets Act 2000 will have a minimum denomination of £100,000 (or its equivalent in other currencies).
Fixed Rate Notes	Fixed interest will be payable in arrear on the date or dates in each year specified in the relevant Pricing Supplement.
Floating Rate Notes	<p>Floating Rate Notes will bear interest determined separately for each Series as follows:</p> <ul style="list-style-type: none"> (i) on the same basis as the floating rate under a notional interest rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the 2006 ISDA Definitions, as published by the International Swaps and Derivatives Association, Inc., as amended, supplemented or replaced; or (ii) by reference to LIBOR or EURIBOR or HIBOR or CNH HIBOR or SHIBOR (or such other benchmark as may be specified in the relevant Pricing Supplement) as adjusted for any applicable margin. <p>Interest periods will be specified in the relevant Pricing Supplement.</p>

Zero Coupon Notes	Zero Coupon Notes may be issued at their nominal amount or at a discount to it and will not bear interest.
Dual Currency Notes	Payments (whether in respect of principal or interest and whether at maturity or otherwise) in respect of Dual Currency Notes will be made in such currencies, and based on such rates of exchange as may be specified in the relevant Pricing Supplement.
Index Linked Notes	Payments of principal in respect of Index Linked Redemption Notes or of interest in respect of Index Linked Interest Notes will be calculated by reference to such index and/or formula as may be specified in the relevant Pricing Supplement.
Interest Periods and Interest Rates	The length of the interest periods for the Notes and the applicable interest rate or its method of calculation may differ from time to time or be constant for any Series. Notes may have a maximum interest rate, a minimum interest rate, or both. The use of interest accrual periods permits the Notes to bear interest at different rates in the same interest period. All such information will be set out in the relevant Pricing Supplement.
Redemption and Redemption Amounts	The relevant Pricing Supplement will specify the basis for calculating the redemption amounts payable. Unless permitted by then current laws and regulations, Notes (including Notes denominated in sterling) which must be redeemed before the first anniversary of their date of issue and in respect of which the issue proceeds are to be accepted by the Issuer in the United Kingdom or whose issue otherwise constitutes a contravention of section 19 of the Financial Services and Markets Act 2000 must have a minimum redemption amount of £100,000 (or its equivalent in other currencies).
Redemption by Instalments	The Pricing Supplement issued in respect of each issue of Notes that are redeemable in two or more instalments will set out the dates on which, and the amounts in which, such Notes may be redeemed.
Other Notes	Terms applicable to high interest Notes, low interest Notes, step-up Notes, step-down Notes, reverse dual currency Notes, optional dual currency Notes, partly paid Notes and any other type of Note that the Issuer and any Dealer or Dealers may agree to issue under the Programme will be set out in the relevant Pricing Supplement.
Optional Redemption	The Pricing Supplement issued in respect of each issue of Notes will state whether such Notes may be redeemed prior to their stated maturity at the option of the Issuer (either in whole or in part) and/or the holders, and if so the terms applicable to such redemption.
Notes that can be issued under the Programme	The Issuer may issue Senior Notes and Dated Subordinated Notes.

Status of the Senior Notes	The Senior Notes issued by the Issuer will constitute direct unconditional, unsubordinated and (subject to Condition 4) unsecured obligations of the Issuer and will rank <i>pari passu</i> without any preference among themselves and <i>pari passu</i> with all other present and future unsecured and unsubordinated obligations of the Issuer other than any such obligations as are preferred by law, all as further described in Condition 3(a).
Status of the Dated Subordinated Notes and Set-off	The Dated Subordinated Notes issued by the Issuer will constitute direct, unsecured and subordinated obligations of the Issuer and will rank <i>pari passu</i> without any preference among themselves. The rights of the holders of the Dated Subordinated Notes will, in the event of the Winding-Up of the Issuer, be subordinated in right of payment in the manner provided in Condition 3 and the Trust Deed, all as further described in Conditions 3(b) and 3(c).
Negative Pledge in respect of Senior Notes	Applicable to Senior Notes only. See “ <i>Terms and Conditions of the Notes — Negative Pledge in respect of Senior Notes</i> ”.
Subordination and Set-off in respect of Dated Subordinated Notes	Applicable to Dated Subordinated Notes only. See “ <i>Terms and Conditions of the Notes — Subordination of Dated Subordinated Notes</i> ” and “ <i>Terms and Conditions of the Notes — Set-off in respect of Dated Subordinated Notes</i> ”.
Loss Absorption upon a Non-Viability Event in respect of Dated Subordinated Notes . .	The applicable Pricing Supplement issued in respect of each issue of Dated Subordinated Notes may provide that the Loss Absorption Option shall be a Write-off in accordance with Condition 6(i) for Dated Subordinated Notes.
Events of Default	Applicable to Senior Notes and Dated Subordinated Notes. See “ <i>Terms and Conditions of the Notes — Events of Default</i> ”.
Cross Default.	Applicable to Senior Notes only. See the relevant sub-condition under “ <i>Terms and Conditions of the Notes — Events of Default</i> ”.
Ratings	Moody’s is expected to rate Senior Notes issued under the Programme “A2” and Dated Subordinated Notes issued under the Programme “Ba1”. S&P is expected to rate Senior Notes issued under the Programme “A” and Dated Subordinated Notes issued under the Programme “BBB-”. Tranches of Notes will be rated or unrated. Where a Tranche of Notes is to be rated, such rating will be specified in the relevant Pricing Supplement. A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency.
Early Redemption	Except as provided in “Optional Redemption” above, Notes will be redeemable at the option of the Issuer prior to maturity only for tax reasons. See “ <i>Terms and Conditions of the Notes — Redemption, Purchase, Options and Non-Viability Event in respect of Dated Subordinated Notes</i> ”. Dated Subordinated Notes may only be redeemed prior to their stated maturity date with the consent of the HKMA, if such consent is required.

Withholding Tax	All payments of principal and interest in respect of the Notes will be made free and clear of withholding taxes of Hong Kong, subject to customary exceptions, all as described in “ <i>Terms and Conditions of the Notes — Taxation</i> ”.
Governing Law	English law, except that the provisions of the Notes relating to subordination shall be governed by Hong Kong law.
Listing	Application has been made to the SGX-ST for permission to deal in, and for the listing and quotation of, any Notes which are agreed at the time of issue to be so listed on the SGX-ST. Such permission will be granted when such Notes have been admitted to the Official List of the SGX-ST. There is no guarantee that an application to the SGX-ST will be approved. As specified in the relevant Pricing Supplement, a Series of Notes may be unlisted. For so long as any Notes are listed on the SGX-ST and the rules of the SGX-ST so require, such Notes will be traded on the SGX-ST in a minimum board lot size of S\$200,000 (or its equivalent in other currencies).
Selling Restrictions	<p>The United States, the Public Offer Selling Restriction under the Prospectus Directive in the European Economic Area (in respect of Notes having a specified denomination of less than €50,000 (or €100,000, to the extent that Directive 2010/73/EU has been implemented in the relevant Member State) or its equivalent in any other currency as at the date of issue of the Notes), the United Kingdom, Hong Kong, Singapore and Japan. See “<i>Subscription and Sale</i>”.</p> <p>For the purposes of Regulation S, the relevant Pricing Supplement shall indicate whether Category 1 or Category 2 restrictions apply.</p> <p>Notes in bearer form will be issued in compliance with U.S. Treas. Reg. §1.163-5(c)(2)(i)(D) (the “D Rules”) unless (i) the relevant Pricing Supplement states that such Notes are issued in compliance with U.S. Treas. Reg. §1.163-5(c)(2)(i)(C) (the “C Rules”) or (ii) such Notes are issued other than in compliance with the D Rules or the C Rules but in circumstances in which such Notes will not constitute “registration required obligations” under the United States Tax Equity and Fiscal Responsibility Act of 1982 (“TEFRA”), which circumstances will be referred to in the relevant Pricing Supplement as a transaction to which TEFRA is not applicable.</p>
Transfer Restrictions	In relation to Notes in respect of which the relevant Pricing Supplement specifies Regulation S Category 2 as being applicable, there are restrictions on the transfer of such Notes prior to the expiration of the relevant distribution compliance period. See “ <i>Subscription and Sale</i> ”.

SUMMARY FINANCIAL INFORMATION

The following tables set forth the summary consolidated financial information and other selected financial data of the Issuer and the Group as at and for the periods indicated. The summary consolidated historical financial data as at and for the years ended 31 December 2011, 2012 and 2013 set forth below are derived from the Group's consolidated financial statements. The consolidated financial statements of the Group for the years ended 31 December 2012 and 2013 have been audited by KPMG. The Group's audited consolidated income statement for the year ended 31 December 2012 and 2013 and the Group's audited consolidated statement of financial position as at 31 December 2012 and 2013 are included elsewhere in this Offering Circular. The Group's consolidated financial statements are prepared and presented in accordance with HKFRS.

The 2011 figures of fee and commission income and net trading profits have been restated to better reflect upfront income and expense in respect of certain derivatives entered into in relation to structured deposits products.

CONSOLIDATED INCOME STATEMENT

	Year ended 31 December		
	2011 (Restated)	2012	2013
	(in HK\$ millions)	(in HK\$ millions)	(in HK\$ millions)
Interest income	20,868	22,635	25,084
Interest expense	(11,605)	(12,911)	(12,917)
Net interest income	9,263	9,724	12,167
Fee and commission income	3,813	4,159	4,874
Fee and commission expense	(763)	(780)	(882)
Net fee and commission income	3,050	3,379	3,992
Net trading (losses)/profits	175	765	878
Net result from financial instruments designated at fair value through profit or loss	(354)	664	(387)
Net hedging loss	(5)	(15)	(22)
Other operating income	586	592	625
Non-interest (expense)/income	3,452	5,385	5,086
Operating income	12,715	15,109	17,253
Operating expenses	(7,992)	(8,725)	(9,583)
Operating profit before impairment losses	4,723	6,384	7,670
Impairment losses on loans and advances	(75)	(213)	(458)
Write back of/(charge for) impairment losses on held-to-maturity investments	(11)	11	—
Impairment losses on available-for-sale financial assets	(49)	(63)	(69)
Impairment losses	(135)	(265)	(527)
Operating (loss)/profit after impairment losses	4,588	6,119	7,143
Net profit on sale of available-for-sale financial assets	59	82	80
Net profit on sale of loans and receivables	3	35	—
Net (loss)/profit on sale of subsidiaries/associates	122	203	27
Net profit/(loss) on sale of fixed assets	140	139	164
Valuation (losses)/gains on investment properties	404	451	388
Share of profits less losses of associates	435	536	684

	Year ended 31 December		
	2011 (Restated)	2012	2013
	(in HK\$ millions)	(in HK\$ millions)	(in HK\$ millions)
Profit before taxation	5,751	7,565	8,486
Income tax			
Current tax			
- Hong Kong	(128)	(568)	(708)
- Overseas	(855)	(730)	(958)
Deferred tax	(317)	(113)	(113)
Profit after taxation	<u>4,451</u>	<u>6,154</u>	<u>6,707</u>
Attributable to:			
Owners of the parent	4,358	6,056	6,613
Non-controlling interests	<u>93</u>	<u>98</u>	<u>94</u>
Profit after taxation	<u>4,451</u>	<u>6,154</u>	<u>6,707</u>
Per share			
- Basic earnings	HK\$1.96	HK\$2.72	HK\$2.78
- Diluted earnings	HK\$1.96	HK\$2.72	HK\$2.78
- Dividends	HK\$0.94	HK\$1.06	HK\$1.11

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	As at 31 December		
	2011 (Restated)	2012	2013
	(in HK\$ Millions)	(in HK\$ Millions)	(in HK\$ Millions)
ASSETS			
Cash and balances with banks and other financial institutions	71,761	85,512	68,777
Placements with banks and other financial institutions	58,598	50,618	57,372
Trade bills	46,891	55,740	59,932
Trading assets	5,600	7,338	8,956
Financial assets designated at fair value through profit or loss	16,663	15,169	11,606
Advances to customers and other accounts	341,341	387,273	448,255
Available-for-sale financial assets	44,910	64,731	71,589
Held-to-maturity investments	4,587	4,320	5,048
Investments in associates	3,820	4,677	4,779
Fixed assets	12,639	12,552	13,530
- Investment properties	2,940	3,100	4,400
- Other property and equipment	9,699	9,452	9,130
Goodwill and intangible assets	4,215	4,041	3,990
Deferred tax assets	<u>377</u>	<u>143</u>	<u>120</u>
Total Assets	<u>611,402</u>	<u>692,114</u>	<u>753,954</u>

As at 31 December			
	2011 (Restated)	2012	2013
	(in HK\$ Millions)	(in HK\$ Millions)	(in HK\$ Millions)
EQUITY AND LIABILITIES			
Deposits and balances of banks and other financial institutions	15,923	30,597	28,923
Deposits from customers	467,354	498,770	534,971
Trading liabilities	4,548	3,827	4,556
Certificates of deposit issued	11,483	27,370	42,929
- At fair value through profit or loss	5,272	6,095	8,509
- At amortised cost	6,211	21,275	34,420
Current taxation	473	988	1,353
Debt securities issued	6,393	8,657	4,728
Deferred tax liabilities	461	626	647
Other accounts and provisions	35,982	45,377	53,981
Loan capital	16,741	14,263	13,632
- At fair value through profit or loss	3,178	—	—
- At amortised cost	13,563	14,263	13,632
Total Liabilities	559,358	630,475	685,720
Share capital	5,190	5,568	5,724
Reserves	<u>42,426</u>	<u>51,585</u>	<u>57,958</u>
Total equity attributable to owners of the parent	47,616	57,153	63,682
Non-controlling interests	<u>4,428</u>	<u>4,486</u>	<u>4,552</u>
Total Equity	<u>52,044</u>	<u>61,639</u>	<u>68,234</u>
Total Equity and Liabilities	<u>611,402</u>	<u>692,114</u>	<u>753,954</u>
OTHER SELECTED FINANCIAL DATA			
	(%)	(%)	(%)
Loan to Deposit Ratio	65.8	66.7	70.1
Capital Adequacy Ratio	13.7	14.3	15.9
Average Liquidity Ratio	42.8	46.6	47.0
Return on Average Assets	0.7	0.9	0.9
Return on Average Shareholders' Funds	9.5	11.9	11.0

INVESTMENT CONSIDERATIONS

Prospective investors should carefully take into account the considerations described below, in addition to the other information contained herein, before investing in the Notes. The occurrence of one or more events described below could have an adverse effect on the Group's business, financial condition, or results of operations, and could affect its ability to make payments of principal and interest under the Notes. Additional considerations and uncertainties not currently known to BEA, or which BEA currently deems immaterial, may also have an adverse effect on an investment in the Notes.

CONSIDERATIONS RELATING TO THE GROUP

Hong Kong Economy

The Group conducts most of its operations⁽¹⁾ and generates most of its revenue in Hong Kong. The Group's performance and the quality and growth of its assets are necessarily dependent on the overall economy in Hong Kong. As a result, any downturn in the Hong Kong economy may adversely affect the Group's business, financial condition and the results of its operations.

In 2003, the Hong Kong economy was severely affected by the Severe Acute Respiratory System ("SARS") epidemic, which resulted in, among other things, increased provisions which negatively affected the Group's profitability. Although the Hong Kong economy had, to a great extent, recovered from the impact of SARS in the subsequent years, the global credit markets have experienced, and may continue to experience, significant dislocation and turbulence which originated from the liquidity disruptions in the US credit and sub-prime residential mortgage markets since the second half of 2007. Sub-prime mortgage loans in the United States have experienced increased rates of delinquencies, foreclosures and losses. These and other related events, such as the collapse of a number of financial institutions, have resulted in an economic slowdown in the US and most economies around the world, substantial volatility in equity securities markets globally, fluctuations in foreign currency exchange rates and volatility and tightening of liquidity in global credit markets. Although there has been evidence of economic recovery mounting since the second half of 2009, recent economic downturns and sovereign debt concerns in the United States and certain European countries have led to renewed doubts regarding the sustainability of the global economic recovery. If there is any renewed economic downturn or slowdown in global economic recovery, there can be no assurance that the Hong Kong economy or the Group's business, financial condition and results of operations will not be adversely affected.

Although Hong Kong's gross domestic product in real terms (after adjustment for inflation) rose by 4.8% in 2011, 1.5% in 2012 and 2.9% in 2013 (year-on-year), BEA expects the recovery of, and the continued growth in, the Hong Kong economy to depend in part upon the economic performance of the US and the PRC, as well as certain other developed countries. There can be no assurance that future global events will not have an adverse effect on the Hong Kong economy and the Group.

Competition

The Group is subject to significant competition from many other Hong Kong and foreign banks and financial institutions, including competitors which have significantly more financial and other capital resources, higher market share, and stronger brand recognition than the Group. In particular, the banking and financial services industry in Hong Kong is a mature market and, according to statistics published by the HKMA, supported 21 Hong Kong incorporated licensed banks and 151 banks incorporated outside Hong Kong as at 30 April 2014 competing for a customer population of approximately 7 million people. Therefore, many of the international and local banks and niche

⁽¹⁾ Operations based on size of total assets.

players operating in Hong Kong compete for substantially the same customers as the Group. There is a limited market, especially for retail banking products such as investment and insurance products, home mortgage loans, credit cards, personal loans and transport lending businesses. The strength of competition in the past few years has had an adverse impact on the pricing of certain products.

In recent years, competition among banks in Hong Kong for investment and insurance products, home mortgage loans, credit cards, personal loans and transport lending business has become very aggressive. There can be no assurance that increased competition will not have a material adverse effect on the Group's business, financial condition or results of operations.

In particular, since 2000, certain banks in Hong Kong, including BEA, have lowered interest rates charged on non-Hong Kong government guaranteed new home mortgage advances ("**Mortgage Interest Rates**"). As at 31 December 2012 and 2013, BEA charged an average of 1.84% (P-3.41%) and 1.86% (P-3.39%), respectively, on its home mortgage advances portfolio in Hong Kong, excluding the Government Home Ownership Scheme ("**GHOS**"), Private Sector Participation Scheme ("**PSPS**") and Tenants Purchase Scheme ("**TPS**") mortgages and staff advances, before accounting for the effect of cash incentive payments. Competition among banks in Hong Kong for home mortgage loans could result in further reductions in mortgage interest rates. Such reductions could have an adverse effect on the Group's business, financial condition or results of operations.

As a result of the intensified competition among banks, BEA has experienced downward pressure on its profit margins in recent years. To counter the effects of increased competition, BEA has actively pursued a strategy of diversifying its income sources by focusing on increasing its fee-based income, introducing innovative products and, at the same time, improving the cost efficiency of its operations. However, there can be no assurance that BEA will be able to compete successfully in the mature Hong Kong banking market and sustain its profitability in future.

The banking industry in Mainland China is highly competitive. The market has been dominated by the large state-owned commercial banks, which have long operating histories, well-established branch networks, large customer bases and better brand recognition.

Moreover, the banking industry in Mainland China has been facing more challenges in recent years as the PRC government implemented a series of measures to liberalise the banking industry. BEA expects competition from foreign commercial banks to increase significantly as a number of foreign banks have established locally-incorporated banks in Mainland China and previous restrictions on their geographical presence, customer base and operating licences in Mainland China were removed in April 2007 pursuant to the PRC's World Trade Organisation ("**WTO**") commitments. Besides, the China Banking Regulatory Commission ("**CBRC**") will allow privately-owned banks to be set up in the cities of Shanghai and Tianjin and in Guangdong and Zhejiang provinces, which will intensify the competition of the banking sector in these regions.

In addition, the PRC's Closer Economic Partnership Arrangement ("**CEPA**") with Hong Kong and Macau allows smaller banks from these jurisdictions to operate in Mainland China, which has also increased competition in the banking industry in Mainland China. Many of these banks compete with the Group for the same customer base and some of them may have greater financial, management and technical resources than the Group.

The intensified competition in the markets where the Group operates may adversely affect the Group's business and prospects, the effectiveness of its strategies, its results of operations and financial condition by potentially:

- reducing the Group's market share in its principal products and services;
- reducing the growth of the Group's loan and deposit portfolios and other products and services;
- reducing the Group's interest income and net interest margin;

- reducing the Group’s fee and commission income;
- increasing the Group’s interest and operating expenses; and
- increasing competition for qualified managers and employees.

Expansion in Hong Kong and Mainland China Markets

The Group’s strategy involves expansion of its business in the Hong Kong and Mainland China markets organically and through mergers and acquisitions (“M&A”) and alliances, if suitable opportunities arise. BEA (China) obtained its business licence from the State Administration for Industry and Commerce as a locally-incorporated bank on 29 March 2007 and officially commenced business on 2 April 2007. The establishment of a locally-incorporated bank is one of the prerequisites for RMB retail banking service in Mainland China.

Further expansion into Mainland China may present the Group with new risks and challenges, such as more stringent and changing regulatory requirements, and new competition from online money market funds. For discussion of recent or proposed acquisitions and disposals of the Group’s businesses, see “*Business of the Group — Mainland China and Other Asian Countries*”. Expansion and integration of new M&A and alliances in the Hong Kong and Mainland China markets may also require significant financial, operational, administrative and management resources. The success of any M&A and alliances will depend in part on the ability of BEA’s management to integrate the operations of newly acquired businesses with its existing operations and, where applicable, to integrate various departments, systems and processes. Consequently, the Group’s ability to implement its business strategy may be constrained and the timing of such implementation may be affected due to the demand placed on existing resources by the process. There can be no assurance that the acquired entities will achieve the level of performance that BEA anticipates or that the projected demand for and margins of the Group’s products and services will be realised. The failure to manage expansion effectively could have an adverse effect on the Group’s business, financial condition and results of operations.

Changes in Regulations in the Mainland China Market

The regulations which apply to the Group’s business in the PRC are extensive, complex and frequently changing. The PRC banking regulatory regime has been evolving continuously. Some of the changes in rules and regulations may result in additional costs or restrictions on BEA (China)’s operations and business expansion in China.

BEA (China)’s business and operations are directly affected by the changes in laws, rules, regulations or policies relating to the PRC banking industry. As some of the banking laws, rules, regulations or policies are relatively new, there is uncertainty regarding their interpretation and application. If BEA (China) fails to comply with any of these laws, rules, regulations or policies, it may result in enforcement actions, which may include fines to be imposed on BEA (China), restrictions on its business activities, or in extreme cases, suspension or revocation of its business licences, which would materially and adversely affect BEA (China)’s operations, reputation, business and financial position.

BEA (China) operates in a highly regulated industry. The principal regulators of the PRC banking industry are CBRC, the People’s Bank of China (“PBOC”) and SAFE. CBRC requires all commercial banks in China to maintain certain financial ratios, including but not limited to loan-to-deposit ratio and Capital Adequacy Ratio (“CAR”).

In accordance with the Commercial Banking Law of the PRC, CBRC requires all commercial banks in China to maintain a loan-to-deposit ratio of not more than 75%. If BEA (China) fails to fulfill this mandatory requirement, it may result in restrictions on its business expansion imposed by CBRC, such as suspension of new business application and establishment of new branch or sub-branch.

In recent years, CBRC has issued new regulations and guidelines governing the capital management of all commercial banks in the PRC. According to the Regulation Governing Capital of Commercial Bank (Provisional) released in June 2012, the new capital requirements of CBRC should be fulfilled by all commercial banks in China on or before 31 December 2018. The minimum capital requirements of CAR, Tier 1 CAR and Core Tier 1 CAR for non-systemically important banks in China are 8%, 6% and 5% respectively. On top of the minimum capital requirements, all commercial banks should make an additional provision of 2.5% on their risk weighted assets.

Dependence on Key Personnel and Recruitment

The Group's ability to sustain its growth and meet future business demands depends on its ability to attract, recruit and retain suitably skilled and qualified staff. Given the Group's rapid expansion in the Mainland China market, there can be no assurance that the Group will be able to recruit staff in sufficient numbers or with sufficient experience, or that pressure on recruitment will not lead to significant increases in the Group's employment costs. Competition for suitably skilled and qualified staff is particularly acute in Mainland China. Any of these factors could adversely affect the Group's business, financial condition and results of operations.

In addition, the Group also faces strong competition to retain skilled and qualified staff, and the loss of key personnel or any inability to manage attrition levels in different employee categories may have an adverse effect on the Group's business, its ability to grow, increased employment and training and development costs and its control over various business functions.

In 2012 and 2013, there were departures from BEA's senior management, including Mr. William Chu Kwan Lim (the former General Manager and Head of Corporate Banking Division), who resigned from his office, and Mr. Chan Shuen Yuk (the former General Manager and Head of Operations Support Division) and Mr. Simon Lau Chung Kwan (the former General Manager and Head of Personal Banking Division), who retired from their offices. There can be no assurance that there will be no further departures of personnel from the senior management of BEA and that, if future departures do occur, the Group's business and operations will not be adversely affected.

Expanding Range of Products and Services Offered in Mainland China

In order to meet the needs of its customers and to expand its business, the Group has widened the range of products and services offered by BEA (China). Expansion of the business of the Group in Mainland China is subject to certain risks and challenges, including:

- may not be able to obtain regulatory approval for new products or services;
- new products and services may not be accepted by customers or are not able to generate the Group's expected return;
- difficulties in recruiting experienced professionals or qualified personnel to offer new products and services, due to keen competition in the labour market; and
- may not be able to enhance risk management capabilities and information technology systems to support a broader range of products and services.

If the Group is not able to achieve the intended results with respect to its new products and services to be offered in Mainland China, this could have an adverse effect on the business, financial condition and results of operations of the Group.

Exposure to Mainland China Market

As at 30 April 2014, BEA's wholly-owned subsidiary, BEA (China), headquartered in Shanghai, operated 27 branches in Shanghai, Beijing, Tianjin, Harbin, Dalian, Shenyang, Qingdao, Shijiazhuang, Zhengzhou, Urumqi, Hangzhou, Nanjing, Suzhou, Chengdu, Chongqing, Wuhan, Hefei, Xi'an, Shenzhen, Guangzhou, Zhuhai, Xiamen, Changsha, Kunming, Ningbo, Jinan and Wuxi as well as 98 sub-branches (including 16 cross-location sub-branches in Guangdong province established under the liberalisation measures of Supplement VI to the CEPA). BEA (China) also operated seven 24-hour self-service banking centres and more than 230 ATMs in major urban areas in Mainland China. In addition to the BEA (China) network, BEA operates a representative office in Fuzhou, and a rural bank in Fuping County, Weinan City in Shaanxi province. BEA (China) has also obtained preliminary approval to establish two new branches in Mainland China. In addition, BEA maintains two branches in Taiwan, which are located in Taipei and Kaohsiung, and one branch and four sub-branches in Macau. In addition, BEA offers a full array of wealth management services in Taiwan through its wholly-owned subsidiary, BEAWMS.

As at 31 December 2011, 2012 and 2013, advances to customers made by the Group's operations in Mainland China, Taiwan and Macau collectively amounted to HK\$119,313 million, HK\$137,675 million and HK\$156,479 million, respectively, representing approximately 37.8%, 39.3% and 38.6%, respectively, of the Group's total advances to customers. The value of the Group's advances in Mainland China, as well as its advances to companies that have business interests in Mainland China, may be influenced by the general state of the PRC economy and may be affected by significant political, social or legal uncertainties or changes in Mainland China (including changes in political leadership, inflation rate, exchange controls and exchange rate, and the impact on the changes in regulations governing banking and other businesses). There can be no assurance that the Group's continued exposure to Mainland China or its strategy to grow its business in Mainland China will not have a negative impact on the Group's earnings or an adverse effect on the Group's business, financial condition or results of operations or that the economic and political environment in Mainland China will remain favourable to the Group's business in Mainland China in the future.

Concentration Risk — Exposure to the Property Market

The Group has significant direct and indirect exposure to the property market particularly in Hong Kong and Mainland China through its portfolio of property related advances and property used as collateral.

As at 31 December 2013, the Group's property related loans amounted to HK\$195,959 million, representing approximately 48.34% of the Group's total loan portfolio. As at 31 December 2013, the Group's property related loans in Mainland China, Taiwan and Macau collectively amounted to HK\$70,802 million, representing approximately 45.2% of the Group's total outstanding customer advances in those locations.

As at 31 December 2011, 2012 and 2013, home mortgage advances (including advances under GHOS, PSPS and TDS) in Hong Kong represented one of the most significant segments of the Group's total advances to customers, which amounted to HK\$28,625 million, HK\$26,508 million and HK\$29,633 million, respectively, which accounted for approximately 9.1%, 7.6% and 7.3%, respectively, of the Group's total advances to customers. In particular, advances under GHOS, PSPS and TPS accounted for HK\$1,379 million, HK\$1,171 million and HK\$1,096 million, respectively, or approximately 0.4%, 0.3% and 0.3%, respectively, of the Group's total advances to customers. Advances for property development and investment in Hong Kong amounted to HK\$52,693 million, HK\$52,982 million and HK\$51,317 million, which accounted for approximately 16.7%, 15.1% and 12.7%, respectively, of the Group's total advances to customers.

The Hong Kong and the PRC property markets are highly cyclical and property prices in general have been volatile. For example, Hong Kong residential property prices, after reaching record highs in 1997, fell significantly as a result of the Asian economic downturn. In addition, while the Hong Kong property market showed improvement during the period from 2004 to the first half of 2008, property prices in Hong Kong declined in the second half of 2008 and early 2009, and have generally increased since the second half of 2009. Despite the introduction by the HKMA of prudential measures for mortgage lending and the implementation by the Hong Kong government of cooling measures from time to time as means to address the increasing risk of property price bubble, property prices in Hong Kong continued to follow an upward trend in recent years.

Property prices in Hong Kong are affected by a number of factors, including, among other things, the supply of, and demand for, comparable properties, the rate of economic growth in Hong Kong, political and economic developments in the PRC, and the relationship between the PRC, Hong Kong and other countries. In Hong Kong, the HKMA has implemented regulatory measures in recent years to mitigate risks in residential mortgage lending in the banking sector. This has included prudential measures implemented gradually between late 2009 and mid-2011 to lower loan-to-value ratio caps for mortgages on various ranges of high end properties, from 60 per cent. to 50 per cent. currently, which has had a negative impact on property values in Hong Kong.

In the PRC, a build-up in inflationary pressure, resulting from changes in the external economic and political environment and a prolonged period of negative interest rates, fuelled a strong housing demand for wealth preservation during 2010. From time to time, the PRC government has launched various initiatives to rein in excessive appreciation in housing prices and as a result of these regulatory measures, the property market in the PRC has showed significant volatility in recent years.

Accordingly, any prolonged decrease or fluctuations in property values or liquidity of the Hong Kong and the PRC property markets could adversely affect the Group's business, financial condition and results of operations.

Liquidity and Short-Term Funding

Most of the Group's funding requirements are met through short-term funding sources, primarily in the form of customer and interbank deposits. As at 31 December 2011, 2012 and 2013, approximately 80.3%, 77.4% and 75.6%, respectively, of the Group's customer deposits had a remaining maturity of three months or less. Historically, a substantial portion of such customer deposits has been rolled over upon maturity and these deposits have been, in essence, a stable source of long-term funding. However, there can be no assurance that this pattern will continue. If a substantial number of depositors fail to roll over deposited funds upon maturity, the Group's liquidity position would be adversely affected and the Group may need to seek alternative sources of short-term or long-term funding to finance its operations, which may be more expensive than existing deposits.

Although the Group has issued debt securities to diversify its funding sources, customer deposits remain its primary funding source in Hong Kong. In Mainland China, the Group's strategy is to increase the growth of customer RMB deposits in order to maintain stability in its source of funds and to minimise costs associated with interbank lending. From 31 December 2011 to 31 December 2013, the Group's total deposits increased from HK\$478,837 million to HK\$577,900 million, and the Group's retail deposits grew from HK\$467,354 million to HK\$534,971 million. However, there are many factors affecting the growth of the Group's deposits, some of which are beyond the Group's control, such as economic and political conditions, the availability of alternative investment choices (including but not limited to securities issued by governmental or corporate entities, unit trusts and mutual funds, investment-linked assurance schemes and structured investment products) and retail customers' changing perceptions toward savings. There can be no assurance that the Group will be able to grow its customer deposits at a pace sufficient to support its expanding business.

As part of its measures to maintain the liquidity of, and confidence in, the Hong Kong financial markets, the Hong Kong government introduced in 2006 a Deposit Protection Scheme to provide a level of protection to depositors with deposits held with authorised institutions in Hong Kong. An enhanced Deposit Protection Scheme with an increased protection limit of HK\$500,000 and expanded coverage including deposits pledged as security for banking services, came into effect on 1 January 2011. However, there can be no assurance that the level of customer deposits, and therefore of the Group's liquidity, will not be adversely affected by the withdrawal of, or any changes to, the Deposit Protection Scheme in the future.

The HKMA acts as the lender of last resort to all authorised institutions in Hong Kong to provide liquidity support in the banking system generally as well as to specific institutions. As at 31 December 2013, 10.2% of BEA's interest-earning assets are acceptable to the HKMA for such emergency funding support, and such asset figures are subject to review by HKMA twice a month. Although the Hong Kong government has in the past taken measures on a case-by-case basis to maintain or restore public confidence in individual banks with an isolated liquidity crisis, there can be no assurance that the HKMA will provide such assistance in the future or that it would elect to provide such assistance in the future to BEA in the event of a liquidity crisis.

If the Group fails to maintain its expected growth rate in deposits or if a substantial portion of the Group's depositors withdraw their demand deposits or do not roll over their time deposits upon maturity, the liquidity position, financial condition and results of operations of the Group may be materially and adversely affected and the Group may need to seek more expensive sources of funding to meet its funding requirements.

Interest Rate Risk

As with most banks, the Group's net interest income is a significant factor in determining its overall financial performance. For the years ended 31 December 2011, 2012 and 2013, the Group's net interest income represented approximately 72.9%, 64.4% and 70.5%, respectively, of its operating income. Interest rates in Hong Kong have remained relatively low and have been falling steadily in recent years, however there can be no assurance that interest rates will not be raised or that increases in interest rates will not be frequent. The Group realises income from the margin between income earned on its assets and interest paid on its liabilities. The Group's net interest rate margins, as the weighted average of the difference between interest rates on the loan advances made by, and the cost of debt funding for BEA, for the years ended 31 December 2011, 2012 and 2013 were approximately 1.75%, 1.67% and 1.90%, respectively. As some of its assets and liabilities are repriced at different times, the Group is vulnerable to fluctuations in market interest rates. As a result, volatility in interest rates could have an adverse effect on the Group's business, financial condition, liquidity and results of operations.

An increase in interest rates could lead to a decline in the value of securities in the Group's portfolio. A sustained increase in interest rates could also raise the Group's funding costs without a proportionate increase, or any increase at all, in loan demand. Rising interest rates would therefore require the Group to re-balance its assets and liabilities in order to minimise the risk of potential mismatches and maintain its profitability. In addition, high interest rate levels may adversely affect the economy in Hong Kong and the financial condition and repayment ability of its corporate and retail borrowers, including holders of credit cards, which in turn may lead to a deterioration in the Group's credit portfolio.

Classification of Advances and Adequacy of Allowance for Advance Losses

In 2007, Hong Kong implemented the Revised Framework of International Convergence of Capital Measurement and Capital Standards ("**Basel II**"). In accordance with guidelines set by the HKMA, BEA obtained approval to adopt the Foundation Internal Ratings-based Approach, and classifies its advances into twenty grades under which impaired loans are classified into one of the following three categories corresponding to levels of risk: "Sub-standard", "Doubtful" and "Loss". See "*Selected*

Statistical and Other Information". The classification of impaired advances depends on various quantitative and qualitative factors, including the number of months by which payments have fallen into arrears, the type of advance, the tenor of the advance and the expected recovery status of the advance.

In December 2010, the Basel Committee on Banking Supervision (the "**Basel Committee**") issued the final regulatory framework under the new Basel Capital Accord of the Bank for International Settlements (known as "**Basel III**") presenting the Committee's reforms to strengthen capital and liquidity standards in order to promote a more resilient banking sector.

In line with the international implementation timetable set by the Basel Committee, the Basel III rules pertaining to capital standards have been enacted into local banking regulations and implemented in Hong Kong on 1 January 2013. While transitional implementation is allowed for some of the standards, a substantial portion of the Basel III capital framework has already been implemented in full since 1 January 2013 and is reflected in the Group's position for the financial year ended 31 December 2013.

The laws, regulations and guidelines governing the banking industry in Hong Kong differ from those applicable in certain other countries in certain respects and may result in particular advances being classified as impaired loan advances at a different time or being classified in a category reflecting a different degree of risk than would be required in certain other countries. While BEA believes that the Group's lending policies are more prudent than those that are required under Hong Kong laws and regulations, the Group is not required to maintain such policies at levels above those generally applicable to banks in Hong Kong. For a description of the banking regulations that apply to banks in Hong Kong, see "*Regulation and Supervision — Regulation and Supervision in Hong Kong*".

Currency Risks

The majority of the Group's revenue is generated spot in Hong Kong dollars. Nonetheless, as at 31 December 2011, 2012 and 2013, the Group held a substantial part of its spot assets in U.S. dollars amounting to HK\$156,922 million, HK\$150,217 million and HK\$185,817 million, respectively. Although the Hong Kong dollar has been linked to the U.S. dollar since 1983, there can be no assurance that such linkage will be maintained in the future. In order to ensure continued liquidity of the Hong Kong dollar, the HKMA has entered into bilateral repurchase agreements with the central banks of Australia, Mainland China, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand. In addition, the Hong Kong government has in the past expressed its commitment to maintaining exchange rate stability under the Linked Exchange Rate System, an automatic interest rate adjustment mechanism. However, there can be no assurance that the Hong Kong dollar will continue to be linked to the U.S. dollar or that, in the event of a liquidity problem affecting the Hong Kong dollar, such bilateral repurchase agreements or automatic interest rate adjustment mechanism will help to maintain adequate liquidity of the Hong Kong dollar. The Group's business, financial condition and results of operations could be adversely affected by the impact on the Hong Kong economy of the discontinuation of the link of the Hong Kong dollar to the U.S. dollar or any revaluation of the Hong Kong dollar.

The Group's Unsecured Lending Portfolio

A part of the Group's corporate loan portfolio comprises unsecured loans, the repayment of which is largely dependent on the cashflow of the borrower and adherence to the financial covenants contained in the loans. The majority of the Group's personal banking loan portfolio comprises loans secured by properties while the remaining portion comprises mainly unsecured personal loans and credit card receivables, which generally carry higher rates of interest. As at 31 December 2011, 2012 and 2013, at least 70% of the Group's advances were secured by collateral. Although the Group carefully assesses the repayment ability of such borrowers, loan products which are not secured by any collateral entail a higher degree of credit risk than secured loan products. If there is a downturn in the economy, the credit quality and charge-off rates experienced by the Group may deteriorate.

Investments in Debt Securities

The Group holds a portfolio of debt securities with different investment grades. The Group has analysed its investments in debt securities according to the designation of external credit institutions such as Moody's. As at 31 December 2013, the Group had a total investment in debt securities of HK\$88,948 million, of which approximately 12% were rated Aaa, approximately 25% were rated between Aa1 to Aa3, approximately 34% were rated between A1 to A3, approximately 18% were rated lower than A3 and approximately 11% were unrated.

Given the uncertainties in the current credit and capital markets, there can be no assurance that the Group will not suffer any future marked-to-market losses on its original investment amount in its portfolio of debt securities.

Operational Risks Associated with the Group's Industry

Like all other financial institutions, the Group is exposed to many types of operational risks, including the risk of fraud, unauthorised transactions or other misconduct by employees (including the violation of regulations for the prevention of corrupt practices, and other regulations governing the Group's business activities), or operational errors, including clerical or record keeping errors or errors resulting from faulty computer or telecommunications systems. There can be no assurance that any of such operational risks or operational errors will not materialise or occur in the future, or that, if such risks or errors do materialise or occur, the Group's business, reputation, results of operations and financial conditions will not be adversely affected. The Group is further exposed to the risk that external vendors may be unable to fulfil their contractual obligations to it (or will be subject to the same risk of fraud or operational errors by their employees). For example, the Group uses direct marketing associates to market its retail credit products, and the Group also outsources some functions to other agencies. Moreover, the Group is exposed to the risk that its (or its vendors') business continuity and data security systems prove not to be sufficient in case of a system failure or natural disaster.

Given the Group's high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. In addition, the Group's dependence upon automated systems to record and process transactions may further increase the risk of technical system flaws or employee tampering or manipulation of those systems that will result in losses that may be difficult to detect. The Group may also be subject to disruptions of its operating systems, arising from events that are wholly or partially beyond its control (including, for example, computer viruses or electrical or telecommunication outages), which may give rise to a deterioration in customer service and to loss or liability to it. The Group also faces the risk that the design of its controls and procedures may prove inadequate or are circumvented, thereby causing delays in detection of errors in information. Although, like all other financial institutions, the Group maintains a system of controls designed to reduce operational risks to a reasonably low level, the Group has suffered losses from operational risks and there can be no assurance that the Group will not suffer material losses from operational risks in the future. The Group's reputation could be adversely affected by the occurrence of any such events involving its employees, customers or third parties. In addition to internal factors that may affect the Group's operations, the rapid growth and expansion of its business in recent years as compared to other banks may have also resulted in increasing complexity in its internal and external control systems and risk management measures, which may add to its operational risks.

Information Technology Systems

The Group is highly dependent on the ability of its information technology systems to process accurately a large number of transactions across numerous and diverse markets and its broad range of products in a timely manner. The proper functioning of its financial control, risk management, accounting, customer service and other data processing systems, together with the communication networks between its various branches and sub-branches and its main data processing centres, are critical to its business and its ability to compete effectively. Although there is backup data for key data

processing systems and the Group has established a backup system to carry on principal functions in the event of a catastrophe or a failure of its primary systems, there can be no assurance that the Group's operations will not be materially disrupted if there is a partial or complete failure of any of these primary information technology systems or communications networks. Such failures could be caused by, among other things, software bugs, computer virus attacks or conversion errors due to system upgrading. In addition, any security breach caused by unauthorised access to information or systems, loss or corruption of data and malfunction of software, hardware or other computer equipment could have a material adverse effect on the Group's business, reputation, results of operations and financial condition.

In addition, the Group's ability to remain competitive will depend in part on its ability to upgrade its information technology systems on a timely and cost-effective basis. Additionally, the information available to and received by the Group through its existing information technology systems may not be timely or sufficient for the Group to manage risks and plan for, and respond to, market changes and other developments in its current operating environment. The Group is making, and intends to continue to make, investments to improve or upgrade its information technology systems. Any substantial failure to improve or upgrade its information technology systems effectively or on a timely basis could have a material adverse effect on the Group's competitiveness, financial condition and results of operations.

Internet Banking Services

To the extent that the Group's internet banking activities involve the storage and transmission of confidential information, security breaches could expose the Group to possible liability and damage the Group's reputation. The Group's networks may be vulnerable to unauthorised access, computer viruses and other disruptive problems. Costs incurred in rectifying any such disruptive problems may be high and may adversely affect the Group's business, financial condition and results of operations. Concerns regarding security risks may deter the Group's existing and potential customers from using its internet banking products and services. Eliminating computer viruses and alleviating other security problems may result in interruptions, delays or termination of service to users accessing the Group's Cyberbanking services. Undetected defects in software products that the Group uses when providing its Cyberbanking services, and the Group's inability to sustain a high volume of traffic, may have a material adverse effect on the Group's internet banking business.

Different Corporate Disclosure and Regulatory Requirements

BEA's issued shares are listed on HKSE and, as such, BEA is required to publish annual audited and semi-annual unaudited financial information. The amount of information publicly available to investors in Hong Kong is governed by the Listing Rules of HKSE and the Banking (Disclosure) Rules regulated by the HKMA.

Under the Banking Ordinance (Cap. 155) of Hong Kong (the "**Banking Ordinance**"), the HKMA regulates the business activities and operations of commercial banks and has the ability to influence banking and financial markets generally. Potential investors should be aware that regulatory requirements in Hong Kong may differ from those that prevail in other countries. See "*Regulation and Supervision — Regulation and Supervision in Hong Kong*." Since the Group operates in the highly regulated banking and securities industries in Hong Kong, potential investors should also be aware that the regulatory authorities have been consistently imposing higher standards and developing new guidelines and regulatory requirements such as the Basel III capital adequacy standards which have been recently adopted in Hong Kong.

In December 2010 and January 2011, the Basel Committee issued the Basel III requirements to raise the quality, consistency and transparency of banks' capital base and new global liquidity standards. Among other things, Basel III will increase the minimum capital adequacy ratio requirements in relation to risk-weighted assets, with the common equity requirement rising from 2 per cent. to 4.5 per cent. and the Tier 1 capital requirements rising from 4 per cent. to 6 per cent. The total minimum capital requirement remains unchanged at 8 per cent.

The Basel Committee's press release dated 13 January 2011 entitled "Minimum requirements to ensure loss absorbency at the point of non-viability" included the following statements:

"The terms and conditions of all non-common Tier 1 and Tier 2 instruments issued by an internationally active bank must have a provision that requires such instruments, at the option of the relevant authority, to either be written off or converted into common equity upon the occurrence of the trigger event unless:

- (a) the governing jurisdiction of the bank has in place laws that (i) require such Tier 1 and Tier 2 instruments to be written off upon such event, or (ii) otherwise require such instruments to fully absorb losses before tax payers are exposed to loss;*
- (b) a peer group review confirms that the jurisdiction conforms with clause (a); and*
- (c) it is disclosed by the relevant regulator and by the issuing bank, in issuance documents going forward, that such instruments are subject to loss under clause (a) in this paragraph."*

The release also states as follows:

"The trigger event is the earlier of: (1) a decision that a write-off, without which the firm would become non-viable, is necessary, as determined by the relevant authority; and (2) the decision to make a public sector injection of capital, or equivalent support, without which the firm would have become non-viable, as determined by the relevant authority"

(for the purposes of this Offering Circular, each a "**Non-Viability Event**").

The initial stage of these proposed Basel III reforms has been implemented by the government of Hong Kong since the beginning of 2013, and the full implementation of the reforms is expected to be completed by 2019.

These standards require banks to disclose key pieces of information on capital, risk exposures, risk assessment processes and hence capital adequacy. The aim of the new standards is to encourage banks to demonstrate to the market participants that their risk management systems are robust and that all relevant risks have been identified and controlled. While transitional implementation is allowed for some of the standards, a substantial portion of the Basel III capital framework has already been implemented in full since 1 January 2013 and is reflected in the Group's position for the financial year ended 31 December 2013.

Regarding the Basel III liquidity standards, the HKMA has expressed its intention to implement the standards in full following the Basel schedule as closely as practicable. The legislative procedures to enact the liquidity standards into local regulations are underway. To better prepare for compliance with the Basel III liquidity standards, the Group has actively participated in the global quantitative impact studies initiated by the Basel Committee to assess the impact of the Basel III liquidity standards on its position and incorporated the potential impact in its asset mix strategy. The Group has also started identifying any gaps in data collection and reporting systems. Compliance with the new liquidity standards may require adjustments to the Group's asset mix and impact existing business models, and the Group may incur additional costs in monitoring compliance with the new standards.

Certain products and services provided by the Group are regulated by other regulators including the Securities and Futures Commission (the “SFC”) in Hong Kong. The Group carefully manages legal and compliance risks, including in relation to the sale of financial products and anti-money laundering regulations. Since 2007, the regulators in Hong Kong have introduced recommendations which are intended to provide tighter control and more transparency in the Hong Kong banking sector, in particular, in relation to the marketing and sale of investment products.

In May 2010, the HKMA and the SFC each launched new investor protection measures. The HKMA measures apply to the sale of non-listed derivative products to retail customers. Authorised institutions are required to offer a pre-investment cooling-off period to certain groups of customers, such as elderly customers and first-time buyers with a high concentration (over 20 per cent. of the customer’s assets). The SFC measures apply to the sale of unlisted structured investment products with a tenor of more than a year. Issuers of unlisted structured investment products are required to provide a five-day ‘cooling-off’ period to investors. On 28 December 2010, the Group implemented the pre-investment cooling-off period. The Group continues to review its internal procedures and controls on risk exposures and implement new measures governing the sale process for financial products. Other recent measures that the Group implemented include, for example, the implementation on 4 September 2011 of investor characterisation measures, which were required to be implemented as part of the “Know Your Client” process, which seek from clients information in relation to each client’s knowledge of derivative products.

The Group has taken steps to implement the recommendations by relevant regulators and to comply with any new or modified regulations. Increased regulation and the requirement for more stringent investor protections have increased its operational and compliance expenses. Any changes in regulation, governmental policies, income tax laws or rules and accounting principles, as well as international conventions and standards relating to commercial banking operations in Hong Kong, could affect the Group’s operations. There can be no assurance that the relevant regulatory authorities will not implement further regulations and that such change will not materially increase the Group’s operational and compliance cost or adversely affect its business or operations. There can also be no assurance that breaches of legislation or regulations by the Group will not occur and, to the extent that such a breach does occur, that significant liability or penalties will not be incurred.

Minimum Regulatory Capital and Liquidity Requirements

The Group is subject to the risk, inherent in all regulated financial businesses, of having insufficient capital resources to meet the minimum regulatory capital requirements. Currently, under Basel II, capital requirements are inherently more sensitive to market movements than under previous regimes and capital requirements will increase if economic conditions or negative trends in the financial markets worsen. Any failure of the Group to maintain its minimum regulatory capital ratios could result in administrative actions or sanctions, which in turn may have a material adverse impact on the Group’s results of operations. A shortage of available capital might restrict the Group’s opportunities for expansion.

In the future, under Basel III, capital and liquidity requirements are expected to increase. On 17 December 2009, the Basel Committee proposed a number of fundamental reforms to the regulatory capital framework in its consultative document entitled ‘Strengthening the resilience of the banking sector’. On 16 December 2010 and on 13 January 2011, the Basel Committee issued its final guidance on Basel III. The Basel Committee’s package of reforms includes increasing the minimum common equity (or equivalent) requirement and the total Tier 1 capital requirement. In addition, banks will be required to maintain, in the form of common equity (or equivalent), a capital conservation buffer to withstand future periods of stress. If there is excess credit growth in any given country resulting in a system-wide build up of risk, a countercyclical buffer of common equity is to be applied as an extension of the conservation buffer. The role of any other fully loss absorbing capital in the context of any countercyclical buffer remains under discussion according to the guidance issued by the Basel Committee on 16 December 2010 (as revised in June 2011). Furthermore, systemically important banks should have loss absorbing capacity beyond these standards. The Basel III reforms also require

Tier 1 and Tier 2 capital instruments to be more loss-absorbing. The reforms therefore increase the minimum quantity and quality of capital which banks are obliged to maintain. There can be no assurance as to the availability or cost of such capital. The capital requirements are to be supplemented by a leverage ratio, and a liquidity coverage ratio and a net stable funding ratio will also be introduced. The initial stage of the proposed reforms has been implemented since the beginning of 2013, however the requirements are subject to a series of transitional arrangements and will be phased in over a period of time, to be fully effective by 2019.

There can be no assurance that, prior to its full implementation by 2019, the Basel Committee will not amend the package of reforms described above. Further, the HKMA or other authorities having oversight of the Issuer at the relevant time (the “**Relevant Authority**”) may implement the package of reforms in a manner that is different from that which is currently envisaged, or may impose additional capital requirements on authorised institutions. If the regulatory capital requirements, liquidity restrictions or ratios applied to the Group are increased in the future, any failure of the Group to maintain such increased regulatory capital ratios could result in administrative actions or sanctions, which may have an adverse effect on the Group’s results of operations.

Recurrence of SARS, Human Swine Influenza A (H1N1), Avian or Swine Influenza or Other Highly Contagious Diseases in Asia and Elsewhere

In 2003, there was an outbreak of SARS, a highly contagious and potentially deadly disease in Hong Kong, along with many other countries in Asia. The SARS outbreak had a significant adverse impact on the economies of the affected countries. Since the latter half of 2005, there have been media reports regarding the spread of the H5N1 virus or “Avian Influenza A” among birds and poultry and, in some isolated cases, transmission of Avian Influenza A virus from animals to human beings. Similarly, since early 2009, there have been reports regarding the spread of the H1N1 virus or “Swine Influenza A” from animals to humans and, in some isolated cases, of human-to-human transmission of Swine Influenza A. As at 30 April 2014, a number of cases of the H7N9 and H10N8 viruses, different strands of Avian Influenza A, were reported in the PRC, while a few cases of the H7N9 virus were reported in Hong Kong. In December 2013, the “Serious Response Level” under the Hong Kong government’s Preparedness Plan for Influenza Pandemic was activated.

There can be no assurance that there will not be a recurrence of the outbreak of SARS or other epidemics, or that incidents of avian or swine influenza or Human Swine Influenza A (H1N1) will not increase. The SARS outbreak caused an adverse effect on the economies of the affected regions, including Hong Kong and Mainland China. Like other financial institutions, the Group’s operations in those affected regions were influenced by a number of SARS-related factors including, but not limited to, a decline in demand for residential mortgage advances, a reduction in the number of customers visiting the Group’s branches and an adverse impact on asset quality due to a weakened economy and higher unemployment rate. There can be no assurance that the Group’s business, financial condition and result of operations would not be adversely affected if another outbreak of SARS or another highly contagious disease occurs.

Further Issuance of Securities

The Group’s financial condition, results of operations and capital position are affected by a range of factors such as economic conditions, interest rates, the credit environment, asset quality, operating income and level of provisioning. A slowdown in the economy could lead to a deterioration in the Group’s asset quality and an increase in provisions for bad and doubtful debts, which may result in a deterioration of BEA’s capital adequacy position or breach capital requirements under Hong Kong law, rules and regulations (including guidelines issued by the HKMA).

In order to strengthen its capital adequacy position or to ensure that it remains in compliance with applicable capital requirements under Hong Kong law, rules and regulations (including guidelines issued by the HKMA), the Group may from time to time raise additional capital through such means

and in such manner as it may consider appropriate including, without limitation, the issue of further subordinated notes or other hybrid capital instruments, subject to any regulatory approval that may be required. There can be no assurance that such future capital raising activities will not adversely affect the market price of the Notes in the secondary market.

CONSIDERATIONS RELATING TO THE NOTES

The Notes may not be a suitable investment for potential investors

Each potential investor must determine the suitability of any Notes in light of its own circumstances. In particular, each potential investor should:

- (i) have sufficient knowledge and experience to make a meaningful evaluation of the relevant Notes, the merits and risks of investing in the relevant Notes and the information contained or incorporated by reference in this Offering Circular or any applicable supplement;
- (ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the relevant Notes and the impact such investment will have on its overall investment portfolio;
- (iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the relevant Notes, including where principal or interest is payable in one or more currencies, or where the currency for principal or interest payments is different from its currency;
- (iv) understand thoroughly the terms of the relevant Notes and be familiar with the behaviour of any relevant indices and financial markets; and
- (v) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

Some Notes may be complex financial instruments and such instruments may be purchased as a way to reduce risk or enhance yield with an understood, measured, appropriate addition of risk to a potential investor's overall portfolios. No potential investor should invest in Notes which are complex financial instruments unless it has the expertise (either alone or with the help of a financial adviser) to evaluate how the Notes will perform under changing conditions, the resulting effects on the value of such Notes and the impact this investment will have on its overall investment portfolio.

Modification, Waivers and Substitution

The Conditions contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority.

The Conditions also provide that the Trustee may, without the consent of the Noteholders, (i) agree to any modification of the Conditions or the Trust Deed if such modification will not in its opinion be materially prejudicial to the interests of Noteholders and to any modification of the Notes, the Trust Deed or the Agency Agreement which is of a formal, minor or technical nature or is to correct a manifest error or to comply with any mandatory provision of law or (ii) authorise or waive any proposed breach or breach of the Notes or the Trust Deed if in its opinion the interests of the Noteholders will not be materially prejudiced or (iii) agree to the substitution of another entity as principal debtor under the Notes in place of BEA, in the circumstances described in the Trust Deed and Condition 11(c). Such power, however, does not extend to any such modification as is mentioned in the provision to paragraph 2 of Schedule 3 to the Trust Deed.

Change of Law

The Conditions, and any non-contractual obligations arising out of or in connection with them, are governed by English law (except for the provisions relating to subordination which are governed by Hong Kong law). No assurance can be given as to the impact of any possible judicial decision or change to English or Hong Kong law or administrative practice after the date of issue of the relevant Notes.

Secondary Market

The Notes may have no established trading market when issued and one may never develop. If a market does develop, it may not be liquid. Therefore, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. Illiquidity may have a material adverse effect on the market value of Notes.

The Trustee may request Noteholders to provide an indemnity and/or security and/or prefunding to its satisfaction.

In certain circumstances (including without limitation the giving of notice to the Issuer pursuant to Condition 10 and the taking of enforcement steps under Condition 12), the Trustee may (at its sole discretion) request Noteholders to provide an indemnity and/or security and/or prefunding to its satisfaction before it takes actions on behalf of Noteholders. The Trustee shall not be obliged to take any such actions if not indemnified and/or secured and/or prefunded to its satisfaction. Negotiating and agreeing to an indemnity and/or security and/or prefunding can be a lengthy process and may impact on when such actions can be taken. The Trustee may not be able to take actions, notwithstanding the provision of an indemnity or security or prefunding to it, in breach of the terms of the Trust Deed (as defined in the Conditions) or in circumstances where there is uncertainty or dispute as to applicable laws or regulations and/or its rights to do so under the Trust Deed and/or the Conditions and, to the extent permitted by the Trust Deed and the Conditions and applicable law and regulations, it will be for the Noteholders to take such actions directly.

Exchange rate risks and exchange controls may result in a potential investor receiving less interest or principal than expected

The Issuer will pay principal and interest on the Notes in the currency specified. This presents certain risks relating to currency conversions if a potential investor's financial activities are denominated principally in a currency or currency unit (the “**Investor's Currency**”) other than the Currency in which the Notes are denominated. These include the risk that exchange rates may significantly change (including changes due to devaluation of the currency in which the Notes are denominated or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to the Currency in which the Notes are denominated would decrease (i) the Investor's Currency equivalent yield on the Notes, (ii) the Investor's Currency equivalent value of the principal payable on the Notes and (iii) the Investor's Currency equivalent market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, a potential investor may receive less interest or principal than expected, or no interest or principal.

Lack of Public Market for the Notes

There can be no assurance as to the liquidity of the Notes or that an active trading market will develop. If such a market were to develop, the Notes may trade at prices that may be higher or lower than the initial issue price depending on many factors, including prevailing interest rates, the Group's

operations and the market for similar securities. The Dealers are not obliged to make a market in the Notes and any such market making, if commenced, may be discontinued at any time at the sole discretion of the relevant Dealers. No assurance can be given as to the liquidity of, or trading market for, the Notes.

Inability to comply with the restrictions and covenants contained in the Group's debt agreements

If the Group is unable to comply with the restrictions and covenants in its current or future debt and other agreements, there could be a default under the terms of these agreements. In the event of a default under these agreements, the holders of the debt could terminate their commitments to lend to the Group, accelerate the debt and declare all amounts borrowed due and payable or terminate the agreements, whichever the case may be.

Majority interests in Noteholder meetings

The Conditions of the Notes contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority.

Credit ratings may not reflect all risks

One or more independent credit rating agencies may assign credit ratings to the Notes. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time. Rating agencies may also revise or replace entirely the methodology applied to derive credit ratings.

Noteholders may be adversely affected by proposals to reform key benchmarks such as LIBOR

A change in the method of calculation or discontinuance of key benchmarks such as the London Inter-Bank Offered Rate could have a negative impact on the value of any Floating Rate Notes where the interest rate is calculated with reference to such benchmarks. The British Banker's Association, has recently handed over the administration of LIBOR to Intercontinental Exchange Benchmark Administration Ltd ("ICEX") on 1 February 2014. As ICEX is a new administrator, it may make methodological changes that could change the level of LIBOR, which in turn may adversely affect the value of the Notes or alter, discontinue or suspend the calculation or dissemination of LIBOR. ICEX will not have any obligation to any investor in respect of any Notes. ICEX may take any actions in respect of LIBOR without regard to the interests of any investor in the Notes, and any of these actions could have an adverse effect on the value of the Notes.

In addition, the proposals suggest reducing the number of currencies and tenors for which LIBOR is calculated. If the rate of interest on the relevant Floating Rate Notes is calculated with reference to a discontinued currency or tenor, or the proposed changes when implemented otherwise change the way in which LIBOR is calculated under such Floating Rate Notes, this could result in the rate of interest being lower than anticipated, which would adversely affect the value of the Floating Rate Notes.

The proposals to reform LIBOR also include compelling more banks to provide LIBOR submissions, and basing these submissions on data from actual transactions. This may cause LIBOR to be more volatile than it has been in the past, which may adversely affect the value of the Notes.

Legal investment considerations may restrict certain investments

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers

to determine whether and to what extent (i) Notes are legal investments for it, (ii) Notes can be used as collateral for various types of borrowing, and (iii) other restrictions apply to its purchase or pledge of any Note. Financial institutions should consult their legal advisors or the appropriate regulators to determine the appropriate treatment of Notes under any applicable risk-based capital or similar rules.

FATCA Withholding

Certain provisions of U.S. law, commonly known as “**FATCA**”, impose a new reporting regime and, potentially, a 30 per cent. withholding tax with respect to certain payments to (i) non-U.S. financial institutions that do not comply with this new reporting regime, and (ii) certain investors that do not provide identification information with respect to interests issued by a participating non-U.S. financial institution. Whilst the Notes are in global form and held within the Clearing Systems, in all but the most remote circumstances, it is not expected that FATCA will affect the amount of any payment received by the Clearing Systems. However, FATCA may affect payments made to custodians or intermediaries in the subsequent payment chain leading to the ultimate investor if any such custodian or intermediary generally is unable to receive payments free of FATCA withholding. It also may affect payment to any ultimate investor that is a financial institution that is not entitled to receive payments free of withholding under FATCA, or an ultimate investor that fails to provide its broker (or other custodian or intermediary from which it receives payment) with any information, forms, other documentation or consents that may be necessary for the payments to be made free of FATCA withholding. Investors should choose the custodians or intermediaries with care (to ensure each is compliant with FATCA or other laws or agreements related to FATCA) and provide each custodian or intermediary with any information, forms, other documentation or consents that may be necessary for such custodian or intermediary to make a payment free of FATCA withholding. As a result, investors may receive less interest or principal than expected. Prospective investors should refer to the section “*Taxation — FATCA Withholding*”.

EU Directive on the Taxation of Savings Income

EC Council Directive 2003/48/EC on the taxation of savings income (the “**Savings Directive**”) requires EU Member States to provide to the tax authorities of other EU Member States details of payments of interest and other similar income paid by a person established within its jurisdiction to (or for the benefit of) an individual resident, or certain other types of entity established, in that other EU Member State, except that Austria and Luxembourg will instead impose a withholding system for a transitional period (subject to a procedure whereby, on meeting certain conditions, the beneficial owner of the interest or other income may request that no tax be withheld) unless during such period they elect otherwise. The Luxembourg government has announced its intention to elect out of the withholding system in favour of an automatic exchange of information with effect from 1 January 2015.

The Council of the European Union has adopted a Directive (the “**Amending Directive**”) which will, when implemented, amend and broaden the scope of the requirements described above. The Amending Directive will expand the range of payments covered by the Savings Directive, in particular to include additional types of income payable on securities, and the circumstances in which payments must be reported or paid subject to withholding. For example, payments made to (or for the benefit of) (i) an entity or legal arrangement effectively managed in an EU Member State that is not subject to effective taxation, or (ii) a person, entity or legal arrangement established or effectively managed outside of the EU (and outside any third country or territory that has adopted similar measures to the Savings Directive) which indirectly benefit an individual resident in an EU Member State, may fall within the scope of the Savings Directive, as amended. The Amending Directive requires EU Member States to adopt national legislation necessary to comply with it by 1 January 2016, which legislation must apply from 1 January 2017.

If a payment were to be made or collected through an EU Member State which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment pursuant to the Savings Directive or any other Directive implementing the conclusions of the ECOFIN

Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to such Directive, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. Furthermore, once the Amending Directive is implemented and takes effect in EU Member States, such withholding may occur in a wider range of circumstances than at present, as explained above.

The Issuer is required to maintain a Paying Agent with a specified office in an EU Member State that is not obliged to withhold or deduct tax pursuant to any law implementing the Savings Directive or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000, which may mitigate an element of this risk if the Noteholder is able to arrange for payment through such a Paying Agent. However, investors should choose their custodians and intermediaries with care, and provide each custodian and intermediary with any information that may be necessary to enable such persons to make payments free from withholding and in compliance with the Savings Directive.

Investors who are in any doubt as to their position should consult their professional advisers.

CONSIDERATIONS RELATING TO THE STRUCTURE OF A PARTICULAR ISSUE OF NOTES

A wide range of Notes may be issued under the Programme. A number of these Notes may have features which contain particular risks for any potential investor. Set out below is a description of certain of those features:

Notes subject to optional redemption by the Issuer may have a lower market value than Notes that cannot be redeemed

An optional redemption feature is likely to limit the market value of Notes. During any period when the Issuer may elect to redeem Notes, the market value of those Notes generally will not rise substantially above the price at which they can be redeemed. This also may be true prior to any redemption period.

The Issuer may be expected to redeem Notes when its cost of borrowing is lower than the interest rate on the Notes. At those times, a potential investor generally would not be able to reinvest the redemption proceeds at an effective interest rate as high as the interest rate on the Notes being redeemed and may only be able to do so at a significantly lower rate. Each potential investor should consider reinvestment risk in light of other investments available at that time.

Dual Currency Notes have features which are different from single currency issues

The Issuer may issue Notes with principal or interest payable in one or more currencies which may be different from the currency in which the Notes are denominated. Each potential investor should be aware that:

- (i) the market price of such Notes may be volatile;
- (ii) they may receive no interest;
- (iii) payment of principal or interest may occur at a different time or in a different currency than expected;
- (iv) the amount of principal payable at redemption may be less than the nominal amount of such Notes or even zero;

- (v) a Relevant Factor (as defined below) may be subject to significant fluctuations that may not correlate with changes in interest rates, currencies or other indices;
- (vi) if a Relevant Factor is applied to Notes in conjunction with a multiplier greater than one or contains some other leverage factor, the effect of changes in the Relevant Factor on principal or interest payable likely will be magnified; and
- (vii) the timing of changes in a Relevant Factor may affect the actual yield to investors, even if the average level is consistent with their expectations. In general, the earlier the change in the Relevant Factor, the greater the effect on yield.

Failure by a potential investor to pay a subsequent instalment of partly-paid Notes may result in it losing all of its investment

The Issuer may issue Notes where the issue price is payable in more than one instalment. Failure to pay any subsequent instalment could result in a potential investor losing all of its investment.

The market price of floating rate Notes with a multiplier or other leverage factor may be volatile

Notes with floating interest rates can be volatile investments. If they are structured to include multipliers or other leverage factors, or caps or floors, or any combination of those features or other similar related features, their market values may be even more volatile than those for securities that do not include those features.

Notes, the interest rate of which may be converted from fixed to floating interest rates, and vice-versa, may have lower market values than other Notes

Fixed/Floating Rate Notes may bear interest at a rate that the Issuer may elect to convert from a fixed rate to a floating rate, or from a floating rate to a fixed rate. The Issuer's ability to convert the interest rate will affect the secondary market and the market value of such Notes since it may be expected to convert the rate when it is likely to produce a lower overall cost of borrowing.

If the Issuer converts from a fixed rate to a floating rate, the spread on the Fixed/Floating Rate Notes may be less favourable than then prevailing spreads on comparable Floating Rate Notes tied to the same reference rate. In addition, the new floating rate at any time may be lower than the rates on other Notes. If the Issuer converts from a floating rate to a fixed rate, the fixed rate may be lower than then prevailing rates on its Notes.

The market prices of Notes issued at a substantial discount or premium tend to fluctuate more in relation to general changes in interest rates than do prices for conventional interest-bearing securities

The market values of securities issued at a substantial discount or premium to their nominal amount tend to fluctuate more in relation to general changes in interest rates than do prices for conventional interest-bearing securities. Generally, the longer the remaining term of the securities, the greater the price volatility as compared to conventional interest-bearing securities with comparable maturities.

Risks associated with Index Linked Notes

The Issuer may issue Notes with principal or interest determined by reference to an index or formula, to changes in the prices of securities or commodities, to movements in currency exchange rates or other factors (each, a “**Relevant Factor**”). Each potential investor should be aware that:

- (i) the market price of such Notes may be volatile;
- (ii) they may receive no interest;

- (iii) payment of principal or interest may occur at a different time or in a different currency than expected;
- (iv) they may lose all or a substantial portion of their principal;
- (v) a Relevant Factor may be subject to significant fluctuations that may not correlate with changes in interest rates, currencies or other indices;
- (vi) if a Relevant Factor is applied to Notes in conjunction with a multiplier greater than one or contains some other leverage factor, the effect of changes in the Relevant Factor on principal or interest payable likely will be magnified; and
- (vii) the timing of changes in a Relevant Factor may affect the actual yield to investors, even if the average level is consistent with their expectations. In general, the earlier the change in the Relevant Factor, the greater the effect on yield.

The historical experience of an index should not be viewed as an indication of the future performance of such index during the term of any Index Linked Notes. Accordingly, each potential investor should consult its own financial and legal advisers about the risk entailed by an investment in any Index Linked Notes and the suitability of such Notes in light of its particular circumstances.

Variable rate Notes with a multiplier or other leverage factor

Notes with variable interest rates can be volatile investments. If they are structured to include multipliers or other leverage factors, or caps or floors, or any combination of those features or other similar related features, their market values may be even more volatile than those for securities that do not include those features.

Bearer Notes where denominations involve integral multiples: Definitive Notes

In relation to any issue of Bearer Notes which have denominations consisting of a minimum Specified Denomination plus one or more higher integral multiples of another smaller amount, it is possible that such Notes may be traded in amounts that are not integral multiples of such minimum Specified Denomination. In such a case a holder who, as a result of trading such amounts, holds an amount which is less than the minimum Specified Denomination in his account with the relevant clearing system at the relevant time may not receive a Definitive Note in respect of such holding (should Definitive Notes be printed) and would need to purchase a principal amount of Notes such that its holding amounts to a Specified Denomination.

If Definitive Notes are issued, each potential investor should be aware that Definitive Notes which have a denomination that is not an integral multiple of the minimum Specified Denomination may be illiquid and difficult to trade.

CONSIDERATIONS RELATING TO DATED SUBORDINATED NOTES

Limited rights of enforcement and subordination of the Dated Subordinated Notes could impair an investor's ability to enforce its rights or realise any claims on the Dated Subordinated Notes

In most circumstances, the sole remedy against the Issuer available to the Trustee (on behalf of the holders of Dated Subordinated Notes) to recover any amounts owing in respect of the principal or interest on the Dated Subordinated Notes will be to institute proceedings for the winding-up of the Issuer in Hong Kong. See *"Terms and Conditions of the Notes — Events of Default"*.

If the Issuer defaults on the payment of principal or interest on the Dated Subordinated Notes, the Trustee will only institute a proceeding in Hong Kong for the winding-up of the Issuer if it is so contractually obliged. The Trustee will have no right to accelerate payment of the Dated Subordinated Notes in the case of default in payment or failure to perform a covenant except as they may be so permitted in the Trust Deed.

The Dated Subordinated Notes will be direct, unsecured and subordinated obligations of the Issuer and will rank junior in priority to the claims of the relevant Senior Noteholders. Upon the occurrence of any winding-up proceeding, the rights of the holders of the relevant Dated Subordinated Notes to payments on such Dated Subordinated Notes will be subordinated in right of payment to the prior payment in full of all deposits and other liabilities of the Issuer except those liabilities which rank equally with or junior to the relevant Dated Subordinated Notes. In a winding-up proceeding, the holders of the relevant Dated Subordinated Notes may recover less than the holders of deposit liabilities or the holders of other unsubordinated liabilities of the Issuer. As there is no precedent for a winding-up of a major financial institution in Hong Kong, there is uncertainty as to the manner in which such a proceeding would occur and the results thereof. Although Dated Subordinated Notes may pay a higher rate of interest than comparable Notes which are not subordinated, there is a risk that an investor in Dated Subordinated Notes will lose all or some of its investment should the Issuer become insolvent.

In addition, payments of principal and interest in respect of the Dated Subordinated Notes are conditional upon the Issuer being solvent. No such principal or interest will be payable in respect of Dated Subordinated Notes except to the extent that the Issuer could make such payment in whole or in part and still be solvent immediately thereafter. See Condition 3 of *“Terms and Conditions of the Notes”* for a full description of subordination and the payment obligations of the Issuer under the Dated Subordinated Notes.

Any suspension of payments under the Dated Subordinated Notes will likely have an adverse effect on the market price of the Dated Subordinated Notes. In addition, as a result of the conditional payment provisions of the Dated Subordinated Notes, the market price of the Dated Subordinated Notes may be more volatile than the market prices of other debt securities on which original issue discount or interest accrues that are not subject to such deferrals and may be more sensitive generally to adverse changes in the Issuer’s financial condition.

The terms of Dated Subordinated Notes may contain non-viability loss absorption provisions

To the extent that a series of Dated Subordinated Notes contains provisions relating to loss absorption upon the occurrence of a Non-Viability Event of the Issuer as determined by the Relevant Authority, the Issuer may be required, subject to the terms of the relevant series of Dated Subordinated Notes, irrevocably (without the need for the consent of the holders of such Dated Subordinated Notes) to effect either a full write-off of the outstanding principal and accrued and unpaid interest in respect of such Dated Subordinated Notes, or a conversion of such Dated Subordinated Notes into the ordinary shares of the Issuer. To the extent relevant in the event that Dated Subordinated Notes are written off, any written-off amount shall be irrevocably lost and holders of such Dated Subordinated Notes will cease to have any claims for any principal amount and accrued but unpaid interest which has been subject to write-off. In the event that Dated Subordinated Notes feature a conversion to the ordinary shares of the Issuer upon the occurrence of a Non-Viability Event, holders would not be entitled to any reconversion of ordinary shares to Dated Subordinated Notes.

The occurrence of a Non-Viability Event may be inherently unpredictable and may depend on a number of factors which may be outside of the Group’s control

The occurrence of a Non-Viability Event is dependent on a determination by the Relevant Authority (a) that a write-off, without which the Issuer would become non-viable, is necessary; or (b) a decision has been made to make a public sector injection of capital, or equivalent support, without which the Issuer would have become non-viable. As a result, the Relevant Authority may require or may cause

a write-off in circumstances that are beyond the control of the Issuer and the Group and with which neither the Issuer nor the Group agree. Because of the inherent uncertainty regarding the determination of whether a Non-Viability Event exists, it will be difficult to predict when, if at all, a write-off will occur. Accordingly, the trading behaviour in respect of Dated Subordinated Notes which have the non-viability loss absorption feature is not necessarily expected to follow trading behaviour associated with other types of securities. Any indication that the Issuer is trending towards a Non-Viability Event could have a material adverse effect on the market price of the relevant Dated Subordinated Notes.

Potential investors should consider the risk that a holder of Dated Subordinated Notes which have the non-viability loss absorption feature may lose all of their investment in such Dated Subordinated Notes, including the principal amount plus any accrued but unpaid interest, in the event that a Non-Viability Event occurs.

There is no assurance that any contractual provisions with non-viability loss absorption features, to the extent applicable, will be sufficient to satisfy the Basel III-compliant requirements that the Relevant Authorities may implement in the future. There is a risk that any Relevant Authority may deviate from the Basel III proposals by implementing reforms which differ from those envisaged by the Basel Committee.

The Dated Subordinated Notes may be subject to a full or partial Write-off

Investors may lose the entire amount of their investment in any Dated Subordinated Notes in which Write-off (as defined in the Terms and Conditions of the Notes) upon the occurrence of a Non-Viability Event is specified, which will lead to a full or partial Write-off. Upon the occurrence of a Write-off, the principal amount and any accrued but unpaid interest of such Dated Subordinated Notes will automatically be written down and if there is a full Write-off, the principal amount and any accrued but unpaid interest may be written down completely and such Dated Subordinated Notes will be automatically cancelled.

In addition, the subordination and set off provisions set out in Condition 3 are effective only upon the occurrence of any winding-up proceedings of the Issuer. In the event that a Non-Viability Event occurs the rights of holders of Dated Subordinated Notes and the Receipts and Coupons relating to them shall be subject to Condition 6. This may not result in the same outcome for Dated Subordinated Noteholders as would otherwise occur under Condition 3 upon the occurrence of any winding-up proceedings of the Issuer.

Furthermore, upon the occurrence of a Write-off of any Dated Subordinated Notes, interest will cease to accrue and all interest amounts that were not due and payable prior to the Write-off shall become null and void. Consequently, Noteholders will not be entitled to receive any interest that has accrued on such Dated Subordinated Notes from (and including) the last Interest Payment Date falling on or prior to the Non-Viability Event Notice.

Any such Write-off will be irrevocable and the Noteholders will, upon the occurrence of a Write-off, not receive any shares or other participation rights of the Issuer or be entitled to any other participation in the upside potential of any equity or debt securities issued by the Issuer or any other member of the Group, or be entitled to any subsequent write-up or any other compensation in the event of a potential recovery of the Issuer or the Group.

Tax treatment of Dated Subordinated Notes that contain non-viability loss absorption provisions is unclear

It is not clear whether any particular tranche of the Dated Subordinated Notes which contains non-viability loss absorption provisions will be regarded as deposits for the purposes of the Inland Revenue Ordinance (Cap. 112) of Hong Kong and whether the exemption for deposits (as set out in “*Taxation — Hong Kong — Profits Tax*”) would apply to such tranche of the Dated Subordinated Notes.

If any tranche of the Dated Subordinated Notes is not regarded as a deposit for the purposes of the Inland Revenue Ordinance (Cap. 112) of Hong Kong and/or holders thereof are not eligible for the tax exemption under such regime, the tax treatment to holders may differ. Investors and holders of any tranche of the Dated Subordinated Notes should consult their own accounting and tax advisers regarding the Hong Kong income tax consequences of their acquisition, holding and disposal of such tranche of the Dated Subordinated Notes.

Upon the occurrence of a Non-Viability Event, clearance and settlement of the Notes will be suspended and there may be a delay in updating the records of the relevant clearing system to reflect the amount written-off

Following the receipt of a Non-Viability Event Notice, all clearance and settlement of the Notes will be suspended. As a result, Noteholders will not be able to settle the transfer of any Notes from the commencement of the Suspension Period (as defined herein), and any sale or other transfer of the Notes that a holder may have initiated prior to the commencement of the Suspension Period that is scheduled to settle during the Suspension Period will be rejected by the relevant clearing system and will not be settled within the relevant clearing systems.

While a Tranche of Dated Subordinated Notes that contains non-viability loss absorption provisions is represented by one or more Global Notes or Global Certificates and a Non-Viability Event occurs, the records of Euroclear and Clearstream, Luxembourg or any other clearing system (other than the CMU) in respect of their respective participants' position held in such Tranche of Dated Subordinated Notes may not be immediately updated to reflect the amount to be written-off (where applicable) and may continue to reflect the nominal amount of such Dated Subordinated Notes prior to the Write-off as being outstanding, for a period of time. The update process of the relevant clearing system may only be completed after the date on which the Write-off is scheduled. Notwithstanding such delay, holders of such Dated Subordinated Notes may lose the entire value of their investment in such Dated Subordinated Notes on the date on which the Write-off occurs. No assurance can be given as to the period of time required by the relevant clearing system to complete the update of their records. Further, the conveyance of notices and other communications by the relevant clearing system to their respective participants, by those participants to their respective indirect participants, and by the participants and indirect participants to beneficial owners of interests in the Global Bond or Global Certificate will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Regulations on non-viability loss absorption are new, untested and subject to interpretation and application by regulations in Hong Kong

The regulations on non-viability loss absorption are new and untested, and will be subject to the interpretation and application by the Relevant Authority. It is uncertain how the Relevant Authority would determine the occurrence of a Non-Viability Event, and it is possible that the grounds that constitute Non-Viability Events may change (including that additional grounds are introduced). Accordingly, the operation of any such future legislation may have an adverse effect on the position of holders of any Dated Subordinated Notes.

A potential investor should not invest in the Dated Subordinated Notes unless it has the knowledge and expertise to evaluate how the Dated Subordinated Notes will perform under changing conditions, the resulting effects on the likelihood of a Write-off and the value of the Dated Subordinated Notes, and the impact this investment will have on the potential investor's overall investment portfolio. Prior to making an investment decision, potential investors should consider carefully, in light of their own financial circumstances and investment objectives, all the information contained in the Offering Circular.

CONSIDERATIONS RELATING TO RENMINBI-DENOMINATED NOTES

Notes denominated in Renminbi (“**Renminbi Notes**”) may be issued under the Programme. Renminbi Notes contain particular risks for potential investors.

Renminbi is not freely convertible; there are significant restrictions on remittance of Renminbi into and outward from the PRC

Renminbi is not freely convertible at present. The PRC government continues to regulate conversion between Renminbi and foreign currencies, including the Hong Kong dollar, despite the significant reduction over the years by the PRC government of control over routine foreign exchange transactions under current accounts. Participating banks in Hong Kong have been permitted to engage in the settlement of RMB trade transactions under a pilot scheme introduced in July 2009. This represents a current account activity. The pilot scheme was extended in August 2011 to cover all provinces and cities in the PRC and to make RMB trade and other current account item settlement available in all countries worldwide. Subject to limited exceptions, there is currently no specific PRC regulation on the remittance of Renminbi into the PRC for settlement of capital account items. Foreign investors may only remit offshore RMB into the PRC for capital account purposes such as shareholders’ loan or capital contribution upon obtaining specific approvals from the relevant authorities on a case by case basis.

On 13 October 2011, Measures on Administration of Renminbi Settlement in relation to Foreign Direct Investment (the “**PBOC RMB FDI Measures**”) issued by PBOC set out operating procedures for PRC banks to handle Renminbi settlement relating to RMB Foreign Direct Investment (“**FDI**”) and borrowing by foreign invested enterprises of offshore Renminbi loans. Prior to the PBOC RMB FDI Measures, cross-border Renminbi settlement for RMB FDI required approvals from PBOC on a case-by-case basis. The new rules replace the PBOC approval requirement with a less onerous post-event registration and filing requirement. Under the new rules, foreign invested enterprises (whether established or acquired by foreign investors) need to (i) register their corporate information after the completion of a RMB FDI transaction, and (ii) make post-event registration or filing with the PBOC of any changes in registration information or in the event of increase or decrease of registered capital, equity transfer or replacement, merger, division or other material changes.

On 3 December 2013, the Ministry of Commerce of the PRC (“**MOFCOM**”) promulgated the Announcement on Issues Concerning Cross-border RMB Direct Investment (the “**New MOFCOM Announcement**”), which provides that the old Circular on Issues Concerning Cross-border RMB Direct Investment published by MOFCOM on 12 October 2011 has ceased to be implemented from 1 January 2014. The New MOFCOM Announcement further eased rules on cross-border RMB direct investments. Pursuant to the New MOFCOM Announcement, a direct investment using offshore Renminbi will be approved by MOFCOM and its local counterparts in accordance with the existing PRC laws and regulations regarding foreign investment, and MOFCOM and its local counterparts will specify in its approvals that the direct investment is in Renminbi. Moreover, if a foreign investor intends to change the investment currency from a certain foreign currency to Renminbi, no additional approval for the revision to its joint venture contract or articles of association is required (although it is still subject to the applicable registration, account opening and currency conversion procedures required by the competent authorities). In any event, a cross-border RMB direct investment is subject to the relevant laws, regulations and requirements on foreign investment and shall comply with the national industry policies in terms of foreign investment and the relevant rules on security review of merger and acquisitions and anti-monopoly review. In addition, the proceeds of RMB FDI may not be used towards investment in securities, financial derivatives or entrusted loans except for strategic investments in listed companies.

As the above measures and circulars are still relatively new, how they will be applied in practice still remain subject to the interpretation by the relevant PRC authorities. There is no assurance that the PRC government will continue to gradually liberalise the control over cross-border Renminbi remittances in the future, that the pilot scheme introduced in July 2009 will not be discontinued or that new PRC regulations will not be promulgated in the future which have the effect of restricting or eliminating the remittance of Renminbi into or outside the PRC.

Further, if any new PRC regulations are promulgated in the future which have the effect of permitting or restricting (as the case may be) the remittance of Renminbi for payment of transactions categorised as capital account items, then such remittances will need to be made subject to the specific requirements or restrictions set out in such rules. In the event that the Group is not able to repatriate funds outside the PRC in Renminbi, the Issuer will need to source Renminbi offshore to finance their respective obligations under Renminbi Notes, and its ability to do so will be subject to the overall availability of Renminbi outside the PRC.

Holders of beneficial interests in Renminbi Notes may be required to provide certifications and other information (including Renminbi account information) in order to allow such holder to receive payments in Renminbi in accordance with the Renminbi clearing and settlement mechanism for participating banks in Hong Kong.

There is only limited availability of Renminbi outside the PRC, which may affect the liquidity of Renminbi Notes and the Issuer's ability to source Renminbi outside the PRC to service such Renminbi Notes

As a result of the restrictions by the PRC Government on cross-border Renminbi fund flows, the availability of Renminbi outside the PRC is limited. Since February 2004, in accordance with arrangements between the PRC Central Government and the Hong Kong Government, licensed banks in Hong Kong may offer limited Renminbi-denominated banking services to Hong Kong residents and designated business customers. PBOC has also established a Renminbi clearing and settlement mechanism for participating banks in Hong Kong. On 19 July 2010, further amendments were made to the Settlement Agreement on the Clearing of RMB Business (the “**Settlement Agreement**”) between PBOC and the Issuer as the RMB clearing bank (the “**RMB Clearing Bank**”) to further expand the scope of RMB business for participating banks in Hong Kong. Pursuant to the revised arrangements, all corporations are allowed to open RMB accounts in Hong Kong; there is no longer any limit on the ability of corporations to convert RMB; and there is no longer any restriction on the transfer of RMB funds between different accounts in Hong Kong.

However, the current size of Renminbi-denominated financial assets outside the PRC is limited. As at the end of April 2014, the total amount of Renminbi deposits held by institutions authorised to engage in Renminbi banking business in Hong Kong amounted to approximately RMB959,898 million (source: Hong Kong Monetary Authority Monthly Statistical Bulletin). In addition, participating banks are also required by the HKMA to maintain a total amount of Renminbi (in the form of cash, its settlement account balance and/or fiduciary account balance with the RMB Clearing Bank) of no less than 25 per cent. of their Renminbi deposits, which further limits the availability of Renminbi that participating banks can utilise for conversion services for their customers. Renminbi business participating banks do not have direct Renminbi liquidity support from PBOC. They are only allowed to square their open positions with the RMB Clearing Bank after consolidating the RMB trade position of banks outside Hong Kong that are in the same bank group of the participating banks concerned with their own trade position, and the RMB Clearing Bank only has access to onshore liquidity support from PBOC only for the purpose of squaring open positions of participating banks for limited types of transactions, including open positions resulting from conversion services for corporations relating to cross-border trade settlement, for individual customers of up to RMB20,000 per person per day and for the designated business customers relating to the RMB received in providing their services. The RMB Clearing Bank is not obliged to square for participating banks any open positions resulting from other foreign exchange transactions or conversion services and the participating banks will need to source Renminbi from the offshore market to square such open positions.

On 14 June 2012, the HKMA introduced a facility for providing Renminbi liquidity to authorised institutions participating in Renminbi business (“**Participating AIs**”) in Hong Kong. The facility will make use of the currency swap arrangement between PBOC and the HKMA. With effect from 15 June 2012, the HKMA will, in response to requests from individual Participating AIs, provide Renminbi term funds to the Participating AIs against eligible collateral acceptable to the HKMA. The facility is intended to address short-term Renminbi liquidity tightness which may arise from time to time, for example, due to capital market activities or a sudden need for Renminbi liquidity by the Participating AIs’ overseas bank customers.

Although it is expected that the offshore Renminbi market will continue to grow in depth and size, its growth is subject to many constraints as a result of PRC laws and regulations on foreign exchange. There is no assurance that no new PRC regulations will be promulgated or the Settlement Agreement will not be terminated or amended in the future which will have the effect of restricting availability of Renminbi offshore. The limited availability of Renminbi outside the PRC may affect the liquidity of its Renminbi Notes. To the extent the Issuer is required to source Renminbi in the offshore market to service its Renminbi Notes, there is no assurance that the Issuer will be able to source such Renminbi on satisfactory terms, if at all.

Investment in Renminbi Notes is subject to exchange rate risks

The value of Renminbi against the U.S. dollar and other foreign currencies fluctuates and is affected by changes in the PRC and international political and economic conditions and by many other factors. All payments of interest and principal with respect to Renminbi Notes will be made in Renminbi. As a result, the value of these Renminbi payments in U.S. dollar terms may vary with the prevailing exchange rates in the marketplace. If the value of Renminbi depreciates against the U.S. dollar or other foreign currencies, the value of investment in U.S. dollar or other applicable foreign currency terms will decline.

Payments in respect of Renminbi Notes will only be made to investors in the manner specified in such Renminbi Notes

All payments to investors in respect of Renminbi Notes will be made solely by (i) when Renminbi Notes are represented by global certificates, transfer to a Renminbi bank account maintained in Hong Kong in accordance with prevailing CMU rules and procedures, or (ii) when Renminbi Notes are in definitive form, transfer to a Renminbi bank account maintained in Hong Kong in accordance with prevailing rules and regulations. The Issuer cannot be required to make payment by any other means (including, but not limited to, in any other currency, by bank notes, by cheques or drafts or by transferring to a bank account in the PRC).

USE OF PROCEEDS

The Issuer intends to use the net proceeds from each issue of Notes for its general corporate purposes.

CAPITALISATION AND INDEBTEDNESS

As at 31 December 2013, BEA had an authorised share capital of HK\$10,000 million consisting of 4,000 million ordinary shares, and an authorised share capital of U.S.\$500 million consisting of 0.5 million substitute preference shares, and issued and fully paid up share capital of approximately HK\$5,724 million consisting of approximately 2,290 million ordinary shares.

The following table sets out the Group's consolidated capitalisation and indebtedness as at 31 December 2013.

	As at 31 December 2013	
	Actual	Actual
	HK\$ (in millions)	U.S.\$ (in millions) ⁽⁵⁾
Short-term borrowings ⁽¹⁾		
Customer deposit accounts	512,830	65,747
Certificates of deposits issued	35,576	4,561
Debt securities issued	3,448	442
Deposits and balances of banks and other financial institutions	27,850	3,571
Loan capital	—	—
Total short-term borrowings	<u>579,704</u>	<u>74,321</u>
Medium-term borrowings ⁽²⁾		
Customer deposit accounts	22,141	2,839
Certificates of deposits issued	7,353	943
Debt securities issued ⁽³⁾	1,280	164
Deposits and balances of banks and other financial institutions	1,073	138
Loan capital	<u>8,817</u>	<u>1,130</u>
Total medium-term borrowings	<u>40,664</u>	<u>5,214</u>
Long-term borrowings ⁽⁴⁾		
Loan capital	4,815	617
Customer deposit accounts	—	—
Certificates of deposits issued	—	—
Deposits and balances of banks and other financial institutions	—	—
Total Notes to be issued	—	—
Total long-term borrowings	<u>4,815</u>	<u>617</u>
Capital resources		
Share capital ⁽⁵⁾	5,724	734
Reserves ⁽⁶⁾⁽⁷⁾	<u>57,958</u>	<u>7,430</u>
Shareholders' funds	<u>63,682</u>	<u>8,164</u>
Non-controlling interests	<u>4,552</u>	<u>584</u>
Total capital resources	<u>68,234</u>	<u>8,748</u>
Total capitalisation ⁽⁸⁾	<u>113,713</u>	<u>14,579</u>
Short-term borrowings and total capitalisation	<u>693,417</u>	<u>88,900</u>

Notes:

- (1) Short-term borrowings refer to borrowings of remaining maturity of not more than one year.
- (2) Medium-term borrowings refer to borrowings of remaining maturity of over one year to five years.
- (3) On 24 April 2014, the Issuer completed the issuance of U.S.\$700,000,000 2.375 per cent. Senior Notes due 2017.
- (4) Long-term borrowings refer to borrowings of remaining maturity of more than five years.
- (5) Total capitalisation comprises total medium-term borrowings, total long-term borrowings and total capital resources.
- (6) On 3 March 2014, the share capital increased approximately by HK\$17,770 million and the reserves decreased approximately by HK\$17,770 million because of the transfer of share premium balance to share capital.
- (7) The second interim dividend in lieu of the final dividend declared by the directors of the Issuer on 18 February 2014 for the year ended 31 December 2013 has not been recognised as a liability as at 31 December 2013.
- (8) This amount has been translated into US\$ for convenience purpose at a rate of US\$1.00 to HK\$7.80.

Save as disclosed in this Offering Circular, there has been no material change in the Group's total capitalisation since 31 December 2013.

BUSINESS OF THE GROUP

INTRODUCTION

Overview

Incorporated in 1918, BEA is the largest independent local bank in Hong Kong in terms of assets. As at 31 December 2013, the Group's total consolidated assets, advances to customers and total deposits were HK\$753,954 million (U.S.\$96,661 million), HK\$405,357 million (U.S.\$51,969 million) and HK\$577,900 million (U.S.\$74,090 million), respectively.

The shares of BEA have been listed on the HKSE since the 1930s. As at 30 April 2014, approximately 2,328.21 million ordinary shares have been issued and are outstanding and have been fully paid. Based on the closing price of its shares on the HKSE as at 30 April 2014, BEA's market capitalisation was approximately HK\$74,386.3 million (U.S.\$9,536.7 million). BEA's shares have been a constituent stock of the Hang Seng Index since 1984.

The Group provides commercial and retail banking, financial and insurance services through its Corporate Banking, Personal Banking, Wealth Management, Insurance & Retirement Benefits, Treasury Markets, China and International divisions. The Group's core business products and services include syndicated loans, trade finance, deposit taking, foreign currency savings, remittances, mortgage loans, consumer loans, credit cards, Cyberbanking retail investment, retail investment and wealth management services, foreign exchange margin trading, services related to the MPF Scheme, internet banking services and general and life insurance.

In addition, through BEA's wholly-owned subsidiaries, the Group is able to extend other services to its customers. BEA Life and Blue Cross serve as the Group's life insurance and general insurance arms respectively providing a comprehensive range of insurance solutions including life and non-life insurance products and services for individual and corporate customers. Tricor, together with its subsidiaries, offers outsourced expertise in business support functions and provides its customers with a range of integrated business, corporate and investor services.

As at 30 April 2014, the Group offered a broad range of banking and related financial services in Hong Kong through a network of 89 branches, 62 wealth management centres called "SupremeGold Centres" and nine i-Financial Centres.

As at 30 April 2014, the Group's overseas operations had in total 40 branches, 102 sub-branches and two representative offices as well as several affiliates and joint ventures in Mainland China, Taiwan, Macau, the United States, the United Kingdom, Canada and South East Asia.

BEA is one of the first foreign banks to receive approval to establish a locally-incorporated bank in Mainland China. As a locally-incorporated bank and a wholly-owned subsidiary of BEA, BEA (China) obtained its business licence from the State Administration for Industry and Commerce on 29 March 2007 and officially commenced business on 2 April 2007. BEA (China) provides comprehensive RMB and foreign currency banking services to all customers. Services include but are not limited to deposit-taking, loans and advances, debit cards, credit cards, Cyberbanking and cash management, wealth management services, private banking, investment and derivative products, agency services for life and general insurance, remittance and settlement, RMB cross-border trade settlement services, domestic and international trade finance facilities, supply chain financing, standby letters of credit, bank guarantees, distribution of local mutual funds, and third-party payment. In May 2013, SAFE granted BEA (China) the right to conduct RMB and foreign currency swap business for its customers, further broadening the range of treasury products offered by BEA (China). In June 2013, BEA (China) became one of the first locally-incorporated foreign banks to be granted a local fund distribution licence. Such licence enables BEA (China) to offer a greater range of wealth management products to its customers.

As at 30 April 2014, BEA (China), with its headquarters in Shanghai, operated 27 branches and 98 sub-branches in Mainland China. In addition to the BEA (China) network, BEA operates a representative office in Fuzhou, and a rural bank in Fuping County, Weinan City in Shaanxi province. Having effectively positioned itself to capture opportunities in the region, the Group has recorded constant healthy growth for its operations in Mainland China. As at 31 December 2013, the Group's total loans to customers and trade bills increased by 14.5% while its customer deposits increased by 7.3% over the figures reported at 31 December 2012.

As at 30 April 2014, BEA maintains one branch in each of Taipei and Kaohsiung in Taiwan, respectively, and provides a full range of wealth management services through BEAWMS. As at 30 April 2014, BEA also operates one branch, four sub-branches and 13 ATMs in Macau.

As at 31 December 2011, 2012 and 2013, the assets of the Group's operations in Mainland China, Taiwan and Macau collectively accounted for approximately 45.6%, 47.7% and 47.7% of the total assets of the Group, respectively. The corresponding figures for Hong Kong as at 31 December 2011, 2012 and 2013 were 58.3%, 55.6% and 56.0%, respectively. For the years ended 31 December 2011, 2012 and 2013, the profit before taxation of the Group's operations in Mainland China, Taiwan and Macau collectively accounted for approximately 44.1%, 30.8% and 34.1% of the Group's consolidated profit before taxation, respectively. The corresponding figures for Hong Kong as at 31 December 2011, 2012 and 2013 were 34.1%, 48.4% and 45.9%, respectively.

The majority of the Group's lending is on a secured, floating-rate basis and adheres to pre-established loan-to-value limitations depending on the underlying collateral and the credit risk of customers. Security typically consists of a first legal charge over real property, listed securities and cash deposits. Some of the Group's lending is on a guaranteed basis.

As at 31 December 2011, 2012 and 2013, the Group's total capital ratio was approximately 13.7%, 14.3% and 15.9%, respectively, compared with the statutory minimum requirement of 8.0%, and its loan to deposit ratio was approximately 65.8%, 66.7% and 70.1%, respectively. For the years ended 31 December 2011, 2012 and 2013, the Group's average liquidity ratio was approximately 42.8%, 46.6% and 47.0%, respectively. See "*Selected Statistical and Other Information*" for further details.

The Group relies on its deposit base for the majority of its funding requirements. As at 31 December 2011, 2012 and 2013, the Group's customer deposits accounted for approximately 90.2%, 86.1% and 85.6%, respectively, of its borrowed funds. The remainder of the Group's funding requirements as at 31 December 2011, 2012 and 2013 were primarily satisfied through the issuance of certificates of deposit and debt securities and, particularly for its RMB funding requirements, through interbank borrowings.

In order to diversify the Group's RMB funding sources, BEA (China) issued RMB4 billion in aggregate principal amount of RMB-denominated bonds in Hong Kong in July 2009. BEA (China) issued its first and second batch of RMB financial bonds with the issue sizes of RMB2 billion and RMB3 billion in PRC's interbank bond market in March and November 2011, respectively, and issued RMB1 billion in aggregate principal amount of senior unsecured bonds in Hong Kong in May 2012.

For the year ended 31 December 2013, the Group's profit after taxation was HK\$6,707 million (U.S.\$860 million), representing an increase of approximately 9.0% from the year ended 31 December 2012. For the year ended 31 December 2012, the Group's profit after taxation was HK\$6,154 million (U.S.\$789 million), representing an increase of approximately 38.3% from the year ended 31 December 2011.

For the years ended 31 December 2011, 2012 and 2013, the Group achieved a return on average assets of approximately 0.7%, 0.9% and 0.9%, respectively, and a return on average equity of approximately 9.5%, 11.9% and 11.0%, respectively.

History

Incorporated in 1918, BEA is one of Hong Kong's first independent local banks. BEA set up its first branch in Shanghai in 1920 and has operated in Mainland China ever since. BEA believes that the Group is well positioned to provide banking services to customers in Mainland China and Chinese customers abroad.

In 1975, BEA launched the first Hong Kong dollar credit card in conjunction with Bank of America, called the East Asia BankAmericard/VISA. In 1979, the East Asia BankAmericard/VISA credit card became the first credit card that was accepted in Mainland China as a result of an agreement between BEA and the Bank of China on foreign currency credit card settlement services.

BEA is one of the founders of Joint Electronic Teller Services Ltd. (“**JETCO**”), which was formed to set up a network of ATMs in Hong Kong and Macau. BEA is also one of the founders of EPS Company (Hong Kong) Limited (“**EPSCO**”) in Hong Kong, which was formed to facilitate the electronic transfer of funds at the point of sale. In 1999, BEA was the first bank in Hong Kong to launch online stock trading through its wholly-owned subsidiary, East Asia Securities Company Limited (“**East Asia Securities**”). BEA was also the first bank in Hong Kong to provide comprehensive internet banking services to its customers, through its Cyberbanking service.

BEA established its first PRC branch in Shanghai in 1920 and has been continuously operating in the PRC since then. In April 2007, BEA (China), with the approval of CBRC, formally commenced business as one of the first locally-incorporated banks in Mainland China. In 2008, BEA (China) became the first foreign bank to launch RMB debit cards and RMB credit cards in Mainland China.

In June 2009, BEA entered into a number of strategic co-operation agreements with Criteria CaixaCorp, S.A. (which changed its name to CaixaBank S.A. on 30 June 2011) (“**CaixaBank**”), a Spanish listed holding company controlled by “la Caixa”, a major shareholder of BEA and a leading financial institution in Spain. The agreements set out the framework and conditions on which any future changes in CaixaBank's investment in BEA would be effected, whilst preserving BEA's independence. The alliance with “la Caixa” Group enhances BEA's access to the financial industry in Spain, Europe and Latin America, and creates opportunities for potential joint business development in the Asia-Pacific region.

In July 2009, BEA (China) became the first locally-incorporated foreign bank to issue RMB retail bonds to retail investors and raised RMB4 billion through its debut issue of RMB bonds in Hong Kong. In September 2009, BEA (China) was granted the status of Domestic Settlement Bank and Domestic Agent Bank for cross-border RMB trade settlement services, and completed its first cross-border RMB trade settlement transaction. In November 2010, BEA (China) completed its first cross-border RMB transaction for foreign direct investment.

In March and November 2011, BEA (China) completed the issue of its first and second batches of RMB financial bonds in an aggregate principal amount of RMB2 billion and RMB3 billion, respectively, in the PRC's interbank bond market. In May 2012, BEA (China) completed the second issuance of RMB bonds for an aggregate principal amount of RMB1 billion in Hong Kong.

In June 2013, BEA (China) was among the first batch of foreign banks to be granted a local mutual fund distribution licence in Mainland China. In February 2014, BEA (China) was approved by PBOC to be the first foreign bank as a reserve bank for payment institutions.

Over the years, the Group has continuously expanded its network in Mainland China. As at 30 April 2014, the Group operated a total of 128 outlets in Mainland China, including the headquarters of BEA (China) in Shanghai, 27 branches, 98 sub-branches as well as Shaanxi Fuping BEA Rural Bank Corporation and Fuzhou Representative Office.

The following chart highlights some of the milestone developments of the Group’s business operations in the PRC:

Year	Events
1920	BEA established its first branch in Shanghai, China.
1979	BEA launched foreign currency credit card settlement services in the PRC through an agreement with the Bank of China. East Asia BankAmericard became the first credit card accepted in Mainland China.
1986	BEA co-founded Mainland China’s first Sino-foreign joint-venture finance company.
1988	BEA was the first foreign bank to pioneer the property mortgage business in Mainland China.
1995	BEA received the “Best Foreign Bank in China” award from Euromoney magazine.
1998	BEA Shanghai and Shenzhen branches were among the first foreign bank branches approved to provide RMB business services to foreigners and foreign-invested enterprises.
2002	BEA was the first foreign bank in Mainland China to receive government approval for providing comprehensive foreign currency banking services to local residents and enterprises. BEA was one of the first foreign banks in Mainland China to receive government approval for providing Internet banking services in Mainland China.
2004	BEA was one of the first foreign banks in Mainland China to receive government approval for providing RMB services to local enterprises.
2005	BEA was one of the first foreign banks in Mainland China to receive government approval for offering agency services for both general and life insurance products in Mainland China.
2006	BEA was one of the first foreign banks in Mainland China to receive CBRC approval as a Qualified Domestic Institutional Investor (“ QDII ”), and the first foreign bank to obtain foreign exchange quota to conduct all QDII business activities. BEA was one of the first foreign banks in Mainland China to receive government approval for providing fixed deposits services with a minimum amount of RMB 1 million to local residents. BEA was one of the first foreign banks in Mainland China to receive government approval for conversion into a locally-incorporated foreign-invested banking corporation in Mainland China.

2007	BEA (China), a wholly owned subsidiary of BEA, was incorporated in Mainland China as one of the first four locally-incorporated foreign banks.
2008	BEA (China) was the first locally-incorporated foreign bank in the PRC to offer RMB credit cards and RMB debit cards in Mainland China. BEA (China) was one of the first locally-incorporated foreign banks in Mainland China to launch RMB trust products.
2009	BEA (China) was the first locally-incorporated foreign bank to issue RMB retail bonds in Hong Kong, raising RMB4 billion through its debut RMB bond issue. BEA (China) became both a domestic settlement bank and domestic agent bank in Mainland China for cross-border RMB trade settlement services.
2010	BEA (China) became the first foreign bank to open its own data centre in Mainland China (in Shanghai). BEA (China) celebrated the grand opening of its new flagship in Mainland China - BEA Finance Tower in Lujiazui, Shanghai. BEA (China) received approval from PBOC in December 2010 to issue RMB financial bonds worth up to RMB5 billion in the PRC's interbank bond market, with a maximum tenor of 3 years.
2011	<p>In March, BEA (China) completed the issue of its first batch of RMB financial bonds with an issue size of RMB2 billion in the PRC's interbank bond market.</p> <p>In November, BEA (China) completed the issue of its second batch of RMB financial bonds with an issue size of RMB3 billion in the PRC's interbank bond market.</p>
2012	In May, BEA (China) completed the issue of RMB senior unsecured bonds with an issue size of RMB1 billion in Hong Kong.
2013	<p>BEA (China) was among the first batch of foreign banks to be granted a local mutual fund distribution licence in Mainland China.</p> <p>BEA was approved as a RMB Qualified Foreign Institutional Investor (“RQFII”) by the China Securities Regulatory Commission (“CSRC”).</p>
2014	<p>BEA (China) was approved by PBOC to be the first foreign bank as a reserve bank for payment institutions.</p> <p>BEA (China) became the first foreign bank to provide cross-border electronic RMB payment service in the China (Shanghai) Pilot Free Trade Zone (“Shanghai FTZ”).</p>

In 2013, BEA received a number of awards in recognition of its performance, including “2013 Best SME’s Partner Award” organised by the Hong Kong General Chamber of Small and Medium Business Limited (for the sixth consecutive year); Wen Wei Po’s “2013/14 Distinguished Banking & Finance Award — Outstanding Corporate Banking Services”; Metro Finance, Metro Finance Digital and Wen Wei Po’s “2013 RMB Business Outstanding Awards — Outstanding Innovative Products/Services — Connecting China and Hong Kong Award”; BENCHMARK magazine’s “Outstanding Achiever for

Customer Commitment (Retail Bank)”; MasterCard Worldwide’s “The Highest Growth Rate in 2012 Cardholder Spending in Hong Kong — Winner”, “The Highest Growth Rate in 2012 Outstandings in Hong Kong - 2nd Runner Up” (for card issuance) and “The Highest Market Share in 2012 Cross-border Merchant Purchase Volume in Hong Kong — 2nd Runner Up” (for merchant acquiring); UnionPay International’s “2012 Innovative Award — Exclusive Year — Round Reward Platform” (for card issuance) and “Outstanding Acquiring Performance Award in 2012 — UnionPay Online Payment Volume” (for merchant acquiring); and Visa Inc.’s “Risk Management Best Fraud Control, Issuing” (for card issuance) and “Lowest Non-Fraud Chargeback Rate, Acquirer — Visa 2012 Global Service Quality Performance Awards” (for merchant acquiring).

BEA Union Investment Asian Bond and Currency Fund of BEA Union Investment Management Limited also received a number of awards in 2013, including “Best Bond Fund, Asia Pacific” (3-year performance) in Lipper Fund Awards Programme 2013 Hong Kong; Asia Asset Management’s “2012 Best of the Best Performance Awards — Asian Bonds, Hard Currency” (3-year performance); AsianInvestor’s “AsianInvestor Investment Performance Awards 2013 — Best Asian Fixed Income, US Dollar”; Fundsupermart.com’s “FSM Recommended Mutual Fund Awards 2013/14 — Asian Fixed Income”; and BENCHMARK magazine’s “BENCHMARK Fund of the Year Awards 2013: Asia Fixed Income within Funds Awards, Best-In-Class”. BEA (MPF) Greater China Equity Fund of BEA Union Investment Management Limited was awarded “BENCHMARK Fund of the Year Awards 2013: Greater China Equity within MPF Awards, Best-In-Class” by BENCHMARK magazine.

STRATEGY

BEA’s core objectives are to strengthen its position and to further develop its domestic franchise as the largest independent local bank in Hong Kong, and to further diversify its operations and expand its operations in Mainland China and other overseas countries. The Group will continue to maintain its growth strategy for its businesses and operations and, at the same time, keep up the process of enhancing its cost-to-income performance. Given the increasingly close economic connection among Mainland China, Hong Kong and the countries of Southeast Asia, the Group will continue to enhance the momentum of its business under the “China-Hong Kong Link (中港聯動)” initiatives. The key components of the Group’s strategy are below.

Expansion in Mainland China and Other Overseas Countries

The Group intends to continue to develop its business in Mainland China and other overseas markets, particularly Singapore and the United Kingdom. The Mainland China market remains an important focus for the Group. The Group intends to consolidate and strengthen its position in Mainland China through capitalising on opportunities arising from the liberalisation of the banking sector and the internationalisation of RMB. Through the establishment of a locally-incorporated bank, BEA (China), the Group is able to provide a comprehensive range of RMB and foreign currency banking products and services to customers in Mainland China. BEA (China) will continue to optimise the use of its assets and of its Mainland China - Hong Kong connection to deliver a wide range of tailored services for its clients. As a key driver of growth, BEA (China) will further strengthen cross-referral businesses between Mainland China, Hong Kong and overseas to capture opportunities arising from increasing business flows to and from the Mainland China. Leveraging from the Group’s international banking experience and long history of presence in Mainland China, BEA (China) aims to position itself as a “Chinese foreign bank” — a foreign bank run by ethnic Chinese which understands the local culture and needs of its customers.

Given the size of the Mainland China market and the already extensive physical presence of the domestic banks, the Group does not intend to compete with the domestic banks by opening an extensive branch network. The Group currently focuses on supply chain financing programme, trade finance, treasury products, cash management, and wealth management and considers other major foreign banks and city commercial banks to be its main competitors.

In 2013, through the Outlet Repositioning Programme, BEA (China) reallocated its branch resources and refined its services based on location and customer profile of each outlet, in order to optimise the business potential of its branch network. BEA (China) also piloted its supply chain financing programme in early 2013 and rolled it out more widely in 2014 to expand its customer reach. In view of the internationalisation of RMB, the Group intends to further strengthen collaboration among its branch networks in Hong Kong, Mainland China and overseas. To capture opportunities arising from increasing business flows to and from Mainland China, BEA (China) provides integrated cross-border financial services for both trade and non-trade transactions, so as to meet clients' growing needs in overseas acquisition and business expansion.

As in the past, the Group intends to continue to expand its branch network strategically according to the business demand and the market environment in Mainland China.

Diversification of non-interest income

The Group implements its strategy in Hong Kong by continuing to broaden its product range, upgrading product features and exploring new market opportunities. The Group's wealth management and private banking business will continue to be the focus of the Group's core business development in the near future. The Group will further develop and enhance its corporate services and share registration businesses through BEA's subsidiary, Tricor. The Group will also continue to develop the insurance business of Blue Cross and BEA Life, and intensify cross-selling opportunities to its existing customer base. In addition, the Group will drive and implement ongoing improvements on customer platforms, such as the Cyberbanking and BEA apps, to further enhance service quality and offer communication for new customers that are less readily accessible through traditional physical channels.

Enhancement of profitability via active asset and liability management

The Group intends to continue to optimise its asset mix through active asset and liability management and allocation in order to enhance its profitability and net worth.

Transformation of its branch network

Through repositioning and rationalising its branch network and re-distributing resources, the Group seeks to transform its Hong Kong branches into sales centres to provide banking products and services to its customers and in particular, to target high net worth customers. The Group will endeavour to enhance its appeal to capture affluent individuals and further raise its profile through presence in Central Business District and other prime high-end shopping areas. As at 30 April 2014, BEA's network covered 89 branches, 62 SupremeGold Centres and nine i-Financial Centres in Hong Kong, offering a comprehensive platform for the Group to provide priority services to high net worth customers. The Group also piloted its first "digital branch" in February 2014 to meet the needs of an increasingly tech-savvy consumer base. The digital branch model allows the Group to serve customers more efficiently.

The Group intends to increase investments in innovation to contain the distribution cost of providing banking services. The Group will continue to empower its customers by applying the latest banking technologies to banking.

Acquisitions and organic growth

The Group maintains a close focus on creating value for customers and investors, providing high quality financial services and seeking investment opportunities that generate favourable returns. The Group aims to grow organically, by providing one-stop financial services to customers, and through acquisitions, by seeking expansion opportunities in Hong Kong, Mainland China and overseas that have the potential to enhance the Group's return on equity.

Focus on enhancing operational efficiency

The Group aims to further enhance efficiency and market competitiveness. The Group will continue to implement a range of cost-management initiatives across the Group and maintain cost discipline while investing in areas that offer good growth potential. The Group will also continue to enforce and explore technological innovation to streamline the selling, servicing and operation processes. A selection of banking products will be sold with the transaction processed via a wide range of e-channels. The Group will focus on growth across its operations and implement strategies to optimise its asset and portfolio mix, as well as remaining vigilant in managing its risks and striving to enhance efficiency and productivity.

BUSINESS OVERVIEW

The Group's core businesses are the acceptance of deposits and home mortgage lending in Hong Kong. As at 31 December 2011, 2012 and 2013, approximately 9.1%, 7.6% and 7.3%, respectively, of the Group's total advances to customers constituted advances to individuals for the purchase of residential property (including advances under GHOS, PSPS and TPS), and approximately 16.7%, 15.1% and 12.7% , respectively, comprised advances for property development and property investment in Hong Kong. As at 30 April 2014, BEA had over 1.5 million personal customers in Hong Kong. BEA's general banking services include the provision of chequing and deposit accounts, ATMs, telephone banking, internet banking, mobile banking, foreign exchange services and money remittance. Other operations offered by the Group include consumer finance, credit cards, insurance, investment services, Mandatory Provident Fund ("MPF") services, trade finance, project finance, loan syndication, stock broking and asset management services.

As at 30 April 2014, BEA had 89 branches, 62 SupremeGold Centres and nine i-Financial Centres in Hong Kong. BEA is a founding member of JETCO, which provided over 3,000 ATMs throughout Hong Kong, Macau and major cities in Mainland China as at 30 April 2014. BEA is also one of the founding members of EPSCO, which currently processes debit card transactions at more than 40,000 acceptance locations in Hong Kong, Macau and Shenzhen.

BEA introduced multi-function ATM terminals in February 2011 at strategic locations that allow customers to withdraw cash, deposit cash with instant credit to accounts and deposit cheques. In August 2011, BEA introduced chip-based ATM technology to enhance customer protection against ATM fraud. BEA was one of the first banks in Hong Kong to issue an ATM chip card and introduce chip-enabled ATM terminals.

As of 30 April 2014, BEA has 30 branches, 102 sub-branches and one representative office in Mainland China, Taiwan and Macau. In addition, BEA has two subsidiaries, Shaanxi Fuping BEA Rural Bank Corporation in Mainland China and BEAWMS in Taiwan. Headquartered in Shanghai, BEA (China) operates 27 branches and 98 sub-branches and plans to strategically expand its network in Mainland China.

BEA (China) provides comprehensive RMB and foreign currency banking services to all customers. Services include but are not limited to deposit-taking, loans and advances, debit cards, credit cards, cyberbanking and cash management, wealth management services, private banking, investment and derivative products, agency services for life and general insurance, remittance and settlement, RMB cross-border trade settlement services, domestic and international trade finance facilities, supply chain financing, standby letters of credit, bank guarantees, distribution of local mutual funds, and third-party payment. As at 31 December 2011, 2012 and 2013, the assets of the Group's operations in Mainland China, Taiwan and Macau collectively accounted for approximately 45.6%, 47.7% and 47.7% of the Group's total assets, respectively, and the profit before taxation of the Group's operations in Mainland China, Taiwan and Macau collectively accounted for approximately 44.1%, 30.8% and 34.1% of the Group's consolidated profit before taxation for the years ended 31 December 2011, 2012 and 2013, respectively.

For the years ended 31 December 2011, 2012 and 2013, the Group's operating income and profit before taxation by business segment were as follows:

	Operating income/(expense)		
	Year ended 31 December		
	2011	2012	
	Restated	Restated ⁽¹⁾	2013
	(in HK\$ millions)	(in HK\$ millions)	(in HK\$ millions)
Hong Kong Region			
Personal Banking ⁽²⁾	2,365	2,867	2,834
Corporate Banking ⁽³⁾	2,462	1,940	3,055
Treasury Markets ⁽⁴⁾	(1,500)	535	53
Wealth Management ⁽⁵⁾	555	461	608
Financial Institutions ⁽⁶⁾	123	190	115
Others ⁽⁷⁾	742	684	789
China Operations ⁽⁸⁾	5,642	5,740	6,986
Overseas Operations ⁽⁹⁾	1,309	1,305	1,389
Corporate Services ⁽¹⁰⁾	984	1,053	1,074
Others ⁽¹¹⁾	381	663	684
Inter-segment elimination	(348)	(329)	(334)
Total	12,715	15,109	17,253
	Profit/(Loss) before taxation		
	Year ended 31 December		
	2011	2012	
	Restated	Restated ⁽¹⁾	2013
	(in HK\$ millions)	(in HK\$ millions)	(in HK\$ millions)
Hong Kong Region			
Personal Banking ⁽²⁾	982	1,274	1,151
Corporate Banking ⁽³⁾	2,330	1,686	2,797
Treasury Markets ⁽⁴⁾	(1,570)	481	(80)
Wealth Management ⁽⁵⁾	417	318	428
Financial Institutions ⁽⁶⁾	111	177	101
Others ⁽⁷⁾	278	211	245
China Operations ⁽⁸⁾	2,373	2,155	2,783
Overseas Operations ⁽⁹⁾	1,288	1,502	1,623
Corporate Services ⁽¹⁰⁾	311	312	284
Others ⁽¹¹⁾	(772)	(551)	(846)
Inter-segment elimination	3	—	—
Total	5,751	7,565	8,486

Notes:

- (1) The 2012 figures have been restated due to the modification of the internal fund transfer pricing methodology of the Issuer with a view to further enhancing the allocation process of interest income and expenses of Hong Kong banking operations.
- (2) Personal banking includes branch operations, personal internet banking, consumer finance, property loans and credit card business in Hong Kong.

- (3) Corporate banking includes corporate lending and loan syndication, asset based lending, commercial lending and securities lending in Hong Kong.
- (4) Treasury markets includes treasury operations and securities dealing in Hong Kong.
- (5) Wealth management includes private banking business and related assets in Hong Kong.
- (6) Financial institutions includes trade financing activities with correspondent banks in Hong Kong.
- (7) Other Hong Kong banking operations include insurance business, trust business, securities & futures broking, money lender activities and corporate financial advisory in Hong Kong.
- (8) China operations include the back office unit for China operations in Hong Kong, all branches, subsidiaries and associates operated in China, except those subsidiaries carrying out corporate services, data processing and other back office operations in China.
- (9) Overseas operations include the back office unit for overseas banking operations in Hong Kong, all branches, subsidiaries and associates operated in overseas, except those subsidiaries carrying out corporate services in overseas.
- (10) Corporate services include company secretarial services, share registration and business services, and offshore corporate and trust services.
- (11) Other businesses include property related business, supporting units of Hong Kong operations, investment properties, bank premises, the net results of other subsidiaries in Hong Kong except for those subsidiaries which are included in other Hong Kong banking operations.

For the year ended 31 December 2013, the Group achieved a record high profit attributable to owners of the parent of HK\$6,613 million, representing an increase of HK\$557 million or approximately 9.2%, compared to the HK\$6,056 million earned for the year ended 31 December 2012. For the year ended 31 December 2013, the Group's net interest income amounted to HK\$12,167 million, representing an increase of HK\$2,443 million or approximately 25.1%, compared to the HK\$9,724 million reported for year ended 31 December 2012, primarily due to growth in advances to customers and a widening of the net interest margin. The Group's impairment losses for the year ended 31 December 2013 amounted to HK\$527 million, representing an increase of HK\$262 million or approximately 98.9%, compared to the HK\$265 million reported for year ended 31 December 2012. The increase was mainly related to loans and advances. The Group's operating profit after impairment losses for the year ended 31 December 2013 was HK\$7,143 million, representing an increase of HK\$1,024 million or approximately 16.7%, compared to the HK\$6,119 million reported for year ended 31 December 2012.

For the years ended 31 December 2011, 2012 and 2013, the Group's operating income and profit before taxation by geographical location were as follows:

	Operating income		
	Year ended 31 December		
	2011 Restated	2012 Restated	2013
	(in HK\$ millions)	(in HK\$ millions)	(in HK\$ millions)
Hong Kong	5,595	7,856	8,719
People's Republic of China ⁽¹⁾	5,821	5,920	7,150
Other Asian Countries	745	907	1,019
Others	906	798	760
Inter-segment elimination	(352)	(372)	(395)
Total	<u>12,715</u>	<u>15,109</u>	<u>17,253</u>

Profit/(Loss) before taxation			
Year ended 31 December			
	2011 Restated	2012 Restated	2013
	(in HK\$ millions)	(in HK\$ millions)	(in HK\$ millions)
Hong Kong	1,961	3,661	3,898
People's Republic of China ⁽¹⁾	2,538	2,328	2,892
Other Asian Countries	728	852	929
Others	521	724	767
Inter-segment elimination	3	—	—
Total	<u>5,751</u>	<u>7,565</u>	<u>8,486</u>

Note:

(1) This includes Mainland China, Taiwan and Macau but excludes Hong Kong.

HONG KONG

Home Mortgages

As at 31 December 2011, 2012 and 2013, home mortgages (including advances under GHOS, PSPS and TPS) in Hong Kong represented one of the most significant segments of the Group's total advances to customers, accounting for HK\$28,625 million, HK\$26,508 million and HK\$29,633 million, respectively, or approximately 9.1%, 7.6% and 7.3%, respectively, of the Group's total advances to customers. As at 31 December 2011, 2012 and 2013, advances under GHOS, PSPS and TPS accounted for HK\$1,379 million, HK\$1,171 million and HK\$1,096 million, respectively, or approximately 0.4%, 0.3% and 0.3%, respectively, of the Group's total advances to customers.

The majority of home mortgages are extended to buyers of housing units in Hong Kong who intend to occupy the premises, which include advances guaranteed by the Hong Kong Government under GHOS, PSPS and TPS to assist lower income families in purchasing homes. Other home mortgages are extended to individuals purchasing residential units for investment purposes.

The Group intends to continue maintaining its market share in the mortgage business by diversifying and customising the mortgage loans offered to its customers and providing tailor-made services to its existing and potential customers.

All home mortgage advances are secured by a first legal charge on the property and, in certain circumstances, the Group may also require personal guarantees as additional security. The Group provides various different mortgage plans, including floating Prime-based rate and floating HIBOR-based rate mortgage plans which are repayable by instalments. As at 31 December 2013, the average original advance maturity is approximately 21 years for home mortgages (excluding advances under GHOS, PSPS and TPS). The average size of a home mortgage advance (excluding advances under GHOS, PSPS and TPS) at origination is approximately HK\$2.1 million. For a discussion of the Group's loan-to-value lending limits applicable to home mortgage advances, see "*Selected Statistical and Other Information — Risk Management and Credit Policies*". For a discussion of the Group's lending rates applicable to home mortgage advances, see "*Selected Statistical and Other Information — Advance Portfolio — Advance Analysis*". The Group maintains close relationships with most property developers in Hong Kong, which has enabled the Group to source a significant amount of home mortgage and commercial mortgage advance business.

Trade Finance and Commercial Mortgages

Commercial mortgages comprise advances to individuals and small-to-medium-sized enterprises (“SMEs”) to purchase retail shops, office space, factories and residential properties, whereas trade finance comprises loans to companies to accommodate their working capital requirements through overdraft facilities, short-term advances, trust receipts, invoice financing loans, corporate tax loans, export credit, packing loans and factoring facilities. The Group also provides treasury products and other trade finance related services to its customers, including advice on export documentary credits to be received by the customer, shipping guarantees, issuance of all types of documentary credits, negotiation of bills under documentary credits and collection of bills.

All commercial mortgage advances are secured by a first legal charge over the property and, in some circumstances, by additional collateral such as time deposits, listed securities and other financial instruments that the Group deems acceptable. The average advance maturity is approximately 15 years for commercial mortgages. For a discussion of commercial mortgage advances, see “*Selected Statistical and Other Information — Advance Portfolio — Advance Analysis*”.

The customers of the Group’s trade finance services range from manufacturing companies to large trading companies and multinational corporations. The Group intends to continue to increase income contribution and market share from trade finance by providing its customers with more market-oriented products through its business managers. The trade finance sector in Hong Kong is well developed and, consequently, the Group is seeking to capitalise on its network in Mainland China to market its trade finance services to the increasing number of customers with operations in Mainland China. In 2013, the Group created a dedicated department to focus on the development of cross-border business, and on the regions and industries with the greatest potential nationwide. This further enhanced collaboration with BEA (China) and helped drive growth in the Group’s trade bills portfolio. As a result of these efforts, and underpinned by rising external trade and the cost benefit of financing in Hong Kong, BEA believes that the Group is in a position to take advantage of the demand from Chinese corporations.

Trade finance advances are made on either a fully or partially secured basis by way of a mortgage of property or cash collateral or on an unsecured basis. Factoring facilities are offered to exporters to provide financing through purchase of receivables as well as offering credit protection and receivables collection services. The receivables managed under factoring are assigned to the Group, and credit protection is supported by back-to-back credit insurance issued by accredited insurance agencies or covered by inter-factoring arrangements. The Group has guidelines in place for assessing mortgage credit, based on asset criteria (including, in the case of individual customers, price, appraised value of the property, location, current market conditions and liquidity of the property) and customer criteria (including, in the case of individual customers, occupation, age, income and debt servicing ability). Trade finance advances typically have a relatively short maturity. For example, advances used to finance imports often have a maturity of only 90 to 120 days.

As at 31 December 2013, trade finance and commercial mortgage advances amounted to HK\$25,098 million, representing an increase of approximately 12.4% as compared with the figure reported as at 31 December 2012, and accounted for approximately 6.2% of the Group’s total advances to customers as at 31 December 2013. As at 31 December 2012, trade finance and commercial mortgage advances amounted to HK\$22,321 million, representing an increase of approximately 2% as compared with the figure reported as at 31 December 2011, and accounted for approximately 6.4% of the Group’s total advances to customers as at 31 December 2012.

Consumer Finance

Consumer advances include unsecured advances to individuals for purposes such as education, tax payments, travel and home improvement and decoration, and also include overdrafts. In addition, the Group also offers its consumers application facilities for personal advances through its Cyberbanking and ATM services.

The Group offers a series of lending programmes with varied product features including a personalised interest rate based on the relevant customer's credit standing, payment holidays and tax advance packages.

The Group runs an annual tax loan promotion campaign, the "Tax Loan Programme", during the tax season in Hong Kong. The Tax Loan Programme offered to customers during the 2013/2014 tax season achieved a loan book of HK\$2,023 million as at 30 April 2014, representing an increase of approximately 8.4% in programme drawdowns as compared with Tax Loan Programme for 2012/2013 tax season.

In 2013, the Group launched a number of consumer loan packages with competitive offers in order to broaden its customer base and expand its market share in the consumer lending business. In March 2013, the Group launched the new "Debt Clearance Plan Programme", which offers a personalised interest rate with an annualised percentage rate as low as 4.66%. With a larger loan size of 21 times customer's monthly salary and a longer tenor of 96 months offered under the loan package, customers may solve their financial difficulty by consolidating all debts into one loan at greater ease.

The Group also launched instalment loan cross-selling programmes in 2013 to satisfy the diverse borrowing needs of customers. One of the programmes targeted professionals with tiered pricing based on a drawdown amount from 3.0% (P-2.25%) to 4.75% (P-0.5%) per annum and BEA mortgage loan customers with personalised interest rate ranging from an annualised percentage rate of 4.36% to 26.40%.

As at 31 December 2013, total outstanding consumer advances amounted to HK\$3,965 million, representing an increase of approximately 25.7% as compared with the figure reported as at 31 December 2012, which accounted for approximately 1.0% of the Group's total advances to customers as at 31 December 2013. As at 31 December 2012, total outstanding consumer advances amounted to HK\$3,154 million, representing a decrease of approximately 1.5% as compared with the figure reported as at 31 December 2011, which accounted for approximately 0.9% of the Group's total advances to customers as at 31 December 2012. As at 31 December 2011, total outstanding consumer advances amounted to HK\$3,202 million, representing an increase of approximately 19.1% as compared with the figure reported as at 31 December 2010, which accounted for approximately 1.0% of the Group's total advances to customers as at 31 December 2011.

Credit Gain Finance Company Limited ("CGFC") is a wholly-owned subsidiary of BEA which has engaged in the Hong Kong sub-prime loan business since late 2006. As at 30 April 2014, CGFC operated through 20 branches across Hong Kong. In addition to unsecured loans, CGFC also offers various secured loan products to diversify its asset portfolio. CGFC intends to capitalise on the potential of the Mainland China market by establishing a presence in major cities nationwide. It opened two outlets in Shenzhen in 2013 and established a subsidiary, Chongqing Dongrong Business Consultancy Company Limited, in Chongqing in 2014. As at 31 December 2011, 2012 and 2013, the total portfolio balance of CGFC was HK\$416 million, HK\$498 million and HK\$599 million, respectively, representing approximately 0.1%, 0.1% and 0.1%, respectively, of the total advances to customers of the Group.

CGFC was awarded "Prime Awards for Banking and Finance Corporations 2013 — The Best Brand in Loans" by MetroBox Magazine and "Capital Weekly Service Awards 2013 — Finance Service" by Capital Weekly Magazine in 2013.

Credit Cards

As at 31 December 2013, credit card advances amounted to HK\$4,137 million, which accounted for approximately 1.0% of the Group's total advances to customers and represented an increase of approximately 8.8% as compared with the figure reported as at 31 December 2012. As at 31 December 2012, credit card advances amounted to HK\$3,802 million, which accounted for approximately 1.1% of the Group's total advances to customers and represented an increase of 4.2% as compared with the

figure reported as at 31 December 2011. As at 31 December 2011, credit card advances amounted to HK\$3,649 million, which accounted for approximately 1.2% of the Group's total advances to customers and represented an increase of approximately 18.2% as compared with the figure reported as at 31 December 2010.

The Group launched various promotional activities throughout 2013, with a focus on dining and entertainment in order to build habitual card usage, and has also participated in offering promotional deals with renowned dining groups, restaurants and retail shopping merchants. The best in market entertainment platform, including concert priority booking promotions and exclusive discounts for movie tickets at popular cinema chains as well as karaoke discounts, has proved to be appealing to the Group's customers. Different spending programmes with tailor made incentives were also offered to boost up the spending level.

In addition, to reward loyalty cardholders, a "BE A VIP" Disneyland Halloween buyout event in partnership with Visa was organised in September 2013. Over 13,000 BEA's guests were among the first to experience Disney's Haunted Halloween and the Park was open exclusively for the Bank's guests. BEA also invited over 200 representatives from the Children's Cancer Foundation, Ebenezer School, Hong Kong Society for the Protection of Children, and New Life Psychiatric Rehabilitation Association to join the fun-filled outing.

The Group intends to continue to develop the credit card business and expects profits to increase as more customers increase their spending using BEA's credit cards.

Insurance Products and Services

Blue Cross, acquired by BEA in December 1999, is a wholly-owned subsidiary of BEA and a part of BEA's bancassurance services. With over 40 years of operational experience in the insurance industry, Blue Cross provides a comprehensive range of non-life products and services, including medical, travel, and general insurance, to cater for the needs of both individual and corporate customers. BEA believes that Blue Cross is one of the market leaders in the medical and travel insurance industry.

To enhance customer experience and convenience riding on the rapid growth of e-channel, a wide range of personal general insurance products (relating to travel, household, domestic helpers, decoration and personal accident) are available for direct purchase through Blue Cross' and BEA's insurance websites.

Blue Cross is one of the market leaders in the medical and travel insurance industry. It has received a number of awards in recognition of its contributions in the spheres of insurance provision and customer service. In 2013, Blue Cross was assigned a financial strength rating of A- (Excellent) and an issuer credit rating of "a-" by A.M. Best Company, a global full-service credit rating firm specialising in the financial services industry.

BEA Life commenced business in January 2008. BEA Life is a wholly-owned subsidiary of BEA and serves as BEA's life insurance arm. It underwrites and distributes a full range of life insurance products and services including whole life, endowment, annuity, term plans, and investment-linked products. In addition, RMB-denominated short-term savings products have been launched to tie in with general public's anticipation of Renminbi's appreciation in the long run. BEA Life also offers critical illness and medical savings plans with various benefits features to meet the diverse needs of its customers.

Blue Cross and BEA Life distribute their products through BEA's 89 branches, 63 SupremeGold Centres and nine i-Financial Centres, insurance agents, brokers, allied partners, and the BEA and Blue Cross websites.

The total premium income of Blue Cross and BEA Life for the year ended 31 December 2013 was HK\$2,481 million, approximately a 4% increase as compared with the figure reported for the year ended 31 December 2012. The non-life insurance premium income of Blue Cross for the year ended 31 December 2013 was HK\$1,060 million, approximately a 11% increase as compared with the figure reported for the year ended 31 December 2012.

The total premium income of Blue Cross and BEA Life for the year ended 31 December 2012 was HK\$2,387 million, approximately a 18% increase as compared with the figure reported for the year ended 31 December 2011. The non-life insurance premium income of Blue Cross for the year ended 31 December 2012 was HK\$955 million, approximately a 15% increase as compared with the figure reported for the year ended 31 December 2011.

The life insurance premium income of BEA Life for the year ended 31 December 2013 as calculated by the New Business Index, an index defined as the total amount of all regular premium plus 10% of single premiums (life insurance policies which require one lump sum payment), was HK\$605 million, representing approximately a 14% increase as compared with the figure reported for the year ended 31 December 2012.

The life insurance premium income of BEA Life for the year ended 31 December 2012 as calculated by the New Business Index was HK\$532 million, representing approximately a 23% increase as compared with the figure reported for the year ended 31 December 2011.

MPF Services and Other Trustee Services

In October 1999, Bank of East Asia (Trustees) Limited (“**BEAT**”), a wholly-owned subsidiary of BEA, was granted the status of an approved trustee under the MPF Schemes Ordinance. Through this subsidiary, the Group offers a full-range of MPF services, including trustee, scheme administration, investment management and custody services, to employers, employees and the self-employed persons. BEAT is one of two approved trustees under the MPF Schemes Ordinance licensed to offer both the Master Trust Schemes and the Industry Scheme in Hong Kong.

BEAT has committed to offer its scheme members a wide range of investment choices. As at 30 April 2014, BEA (MPF) Master Trust Scheme offered 16 constituent funds for investment including BEA (MPF) Growth Fund, BEA (MPF) Balanced Fund, BEA (MPF) Stable Fund, BEA (MPF) Global Equity Fund, BEA (MPF) European Equity Fund, BEA (MPF) North American Equity Fund, BEA (MPF) Asian Equity Fund, BEA (MPF) Greater China Equity Fund, BEA (MPF) Hong Kong Equity Fund, BEA (MPF) Japan Equity Fund, BEA China Tracker Fund, BEA Hong Kong Tracker Fund, BEA (MPF) Global Bond Fund, BEA (MPF) RMB & HKD Money Market Fund, BEA (MPF) Long Term Guaranteed Fund and BEA (MPF) Conservative Fund. As at 30 April 2014, BEA (MPF) Value Scheme consisted of 10 constituent funds including BEA Growth Fund, BEA Balanced Fund, BEA Stable Fund, BEA Global Equity Fund, BEA Asian Equity Fund, BEA Greater China Equity Fund, BEA Greater China Tracker Fund, BEA Hong Kong Tracker Fund, BEA Global Bond Fund and BEA MPF Conservative Fund. BEA (MPF) Industry Scheme consists of 10 constituent funds including BEA (Industry Scheme) Growth Fund, BEA (Industry Scheme) Balanced Fund, BEA (Industry Scheme) Stable Fund, BEA (Industry Scheme) Asian Equity Fund, BEA (Industry Scheme) Greater China Equity Fund, BEA (Industry Scheme) Hong Kong Equity Fund, BEA China Tracker Fund, BEA Hong Kong Tracker Fund, BEA (Industry Scheme) RMB & HKD Money Market Fund and BEA (Industry Scheme) MPF Conservative Fund.

All constituent funds under BEA (MPF) Master Trust Scheme and BEA (MPF) Industry Scheme (except RMB & HKD Money Market Fund, China Tracker Fund, Hong Kong Tracker Fund, BEA (MPF) Long Term Guaranteed Fund and Conservative Fund) invest in two or more approved pooled investment funds based on the “fund-of funds” approach. This investment strategy seeks to diversify risks and aims at enabling BEAT to obtain competitive investment returns for its MPF customers by taking advantage of the strengths of different fund houses. To satisfy the different needs of the Group’s customers, a new Master Trust Scheme, BEA (MPF) Value Scheme, was launched on 25 October 2012. The investment strategy under this scheme is single investment manager which is totally different from our BEA (MPF) Master Trust Scheme which has a multi investment managers approach. Most constituent funds are solely investing in approved pool investment fund(s) managed by our Investment Manager, BEA Union Investment Management Limited.

Since their launch, the Group’s Master Trust Schemes and Industry Scheme have recorded stable growth in both membership and assets. Offering a wide range of products and providing some of the strongest investment returns in the market, the Group has built a reputation as one of Hong Kong’s premier MPF providers.

In recognition of the performance of the Group’s MPF services, BEA was the winner of MetroBox Magazine’s “Prime Awards for Banking and Finance Corporations 2012” and won “The Best MPF Scheme” for the second consecutive year in August 2012.

In addition to MPF services, BEAT also offers a complete range of trustee services to both individual and corporate clients. BEAT acts as executor and trustee of wills, an administrator of estates, attorney administrator for overseas estates having assets in Hong Kong and as escrow agent for commercial transactions. BEAT also acts as trustee for family or other trusts and settlement, investment funds, unit trusts, charities, public funds and capital market issues. For the year ended 31 December 2013, BEAT’s revenue from its private trust business was HK\$17.53 million, representing an increase of approximately 17.18% and 37.06%, respectively, compared with the figures reported for the year ended 31 December 2012 (HK\$14.96 million) and for the year ended 31 December 2011 (HK\$12.79 million).

Internet Banking Services

Internet banking services provided by the Group include BEA’s Cyberbanking and Cybertrading services.

Cyberbanking

Launched in September 1999, BEA’s Cyberbanking allows customers to manage up to 12 separate bank accounts by accessing a single account on the internet, over fixed-line telephones and mobile phones. BEA’s Cyberbanking offers a variety of banking functions, including balance enquiry, statement & advice, rate enquiry, change of address, funds transfer, remittance, placement and renewal of time deposit, bill payment, credit card transactions and redemption of bonus points for gifts, an online application for mortgages and free property valuation services, stock and gold trading, foreign exchange margin and option margin trading, unit trust subscription and redemption, linked deposits, electronic initial public offering and other investment products, purchase of TravelSafe insurance and MPF account enquiry and deposit. In order to provide more flexibility for scheme members to manage their MPF accounts effectively, the Group launched a new service, Cyberbanking (MPF), in February 2008. Cyberbanking (MPF) enables scheme members to access their BEA MPF accounts via the internet to review their account balance, deposit and withdrawal history and current investments and obtain fund information. In 2013, the Group started offering electronic bill presentment and payment service to its Cyberbanking customers.

Mobile Application

To extend its reach into mobile banking market, the Group rolled out a number of innovative products and services, including applications for iPhone and Android users in August and November 2010 respectively. In addition to providing customers with convenient access to banking and financial services, the application offers useful features such as a BEA branch and ATM locator, stock trading, “one-touch” service hotlines and information on the latest BEA credit card, consumer and property loan offers. BEA introduced additional features to its mobile application in 2013, including stock watch and fast trade, application for travel insurance, gold trading, property loan application, MPF account enquiry and latest fund price enquiry.

Corporate Cyberbanking

Launched in July 2001, Corporate Cyberbanking has been designed to help companies enhance their efficiency by centralising and streamlining their financial management. Through one highly secure, flexible, and easy to operate account, companies can effectively manage their cashflow, payroll, expenses, and much more via the internet. Subsequently, Corporate Cyberbanking launched mobile phone channel in January 2010 including account balance enquiry, today activity enquiry, account history enquiry and funds transfer to associated & pre-designated accounts. In 2013, an enhanced liquidity management service and an electronic bill presentment and payment service were launched.

As at 30 April 2014, the number of registered Cyberbanking users and Corporate Cyberbanking users were up approximately 10.9% and 17.1%, respectively, as compared with the respective number of users as at 30 April 2013.

Cybertrading

In June 1999, BEA’s Cybertrading service was launched by BEA’s wholly-owned subsidiary, East Asia Securities. It was the first internet-based brokerage service offered by a bank in Hong Kong. The service allows customers to trade securities via the internet, mobile phone and automated phone. In November 2000, East Asia Securities began to use its Broker Supplied System under AMS/3, which allowed its dealing operations to run under a fully automated straight-through processing environment. In 2010, East Asia Securities launched various promotional campaigns for its securities trading services, intended to gain new securities clients and increase its volume of transactions in anticipation of a potential recovery of the financial markets. East Asia Securities saw the number of Cybertrading accounts rise by 1% for the year ended 31 December 2013 and, as at 31 December 2013, more than 60% of East Asia Securities clients had subscribed to Cybertrading. With a view to further enhancing the Cybertrading service, the trading platform will be upgraded to an advanced version from July 2014.

Futures Cybertrading Services was launched by BEA’s wholly-owned subsidiary, East Asia Futures Limited (“**East Asia Futures**”) in August 2004. The Futures Cybertrading Services provides clients with access to the futures market, which in turn allows them to leverage their investment exposure, take advantage of price volatility in the market and hedge against existing positions, as well as exploit spread trading or arbitrage opportunities.

East Asia Futures recorded an approximately 33.52% increase in net fees and commission income for the year ended 31 December 2013 as compared with the corresponding period in 2012. Its net fees and commission income was up approximately 30.02% in 2011 but down approximately 36.86% in 2012. As at 30 April 2014, approximately 71.8% of East Asia Futures’ total number of transactions were traded via the Cybertrading platform; whereas for East Asia Securities, the volume of transactions executed via the Cybertrading platform, expressed as a percentage of total turnover, reached 69%, 70%, 73% of the number of trades, respectively, and 47%, 48%, 47%, respectively, of the gross transaction value for the years ended 31 December 2011, 2012 and 2013. BEA believes that the high volume of online trading recorded by East Asia Securities and East Asia Futures suggests that online trading is becoming increasingly popular with retail investors.

Bilateral Advances and Syndicated Advances

The Group's corporate lending activities include meeting general corporate funding requirements, financing and refinancing of property development, property investment and M&A as well as infrastructure projects. The majority of borrowers are medium to large-sized Hong Kong companies and Mainland China state-owned and private enterprises in Hong Kong, which typically use the funds for general working capital, projects and investments in Hong Kong and Mainland China.

The Group acts as arranger and participant in the Hong Kong syndicated lending market. The majority of the Group's syndicated advances are to local companies engaging in property development or investment in completed developments, large local conglomerates and large private or state-owned enterprises in Mainland China. The Group also acts as a co-arranger in club deal facilities which generally command better pricing than traditional syndicated loans.

Since the commencement of 2014, the Hong Kong corporate loan market has remained stable on the back of the greater funding requirement of local property developers to finance their land acquisition during land tenders which are held more frequently, the strong demand of Mainland China enterprises in Hong Kong to seek lower cost of financing as well as the escalating needs of corporate loans to finance business expansion in China and overseas acquisition under the Going-out policy of the PRC Central Government.

The majority of the project financing in which the Group participates is extended on a recourse basis and is secured by the underlying project. Typically, the average maturity of BEA's corporate advances is between one and five years. Loan-to-value ratios for project financings are determined on a case-by-case basis. For construction projects, the maximum loan-to-value ratio is 60% of the total estimated completion value of the project. For most property financing, the advance is secured by a first legal charge over the underlying property and a charge over all receivables derived from the property. The Group has been targeting medium-sized borrowers as the margins on advances to these borrowers are generally more attractive than margins on unsecured syndicated advances to large property developers.

As at 31 December 2013, bilateral advances and syndicated advances outstanding totalled HK\$68,759 million, representing approximately a 7.3% increase from 31 December 2012, and accounted for approximately 17.0% of the Group's total advances to customers as at 31 December 2013. As at 31 December 2012, bilateral advances and syndicated advances outstanding totalled HK\$64,062 million, representing approximately a 8.2% increase from 31 December 2011, and accounted for approximately 18.3% of the Group's total advances to customers as at 31 December 2012.

Wealth Management

In July 2004, BEA's Wealth Management Division commenced operations with the objective of assisting clients to manage and accumulate their wealth by providing wealth management and financial planning services. By offering a wide range of products and services, the Wealth Management Division caters to clients who are searching for asset allocation, wealth preservation, better investment returns than bank deposits, better risk diversification, and other tailor made investment solutions.

Services and products offered by the Wealth Management Division include, but are not limited to, investment services, structured and treasury products, mutual funds, insurance and premium financing, succession and estate planning services, services relating to the Capital Investment Entrance Scheme to Hong Kong, immigration service to other countries, asset custodian services, trusts, discretionary asset management services and general banking services such as time deposits and loans. The division provides private banking services to the very high net worth segment, and is also responsible for providing investment products support to Personal Banking Division and also BEA

(China)'s personal banking customers through the Investment Products and Advisory Department. As from 1 April 2010, the division is also responsible for BEA's private trust business. Hence there are three departments in the Wealth Management Division, namely the Private Banking Department, the Investment Products and Advisory Department and the Trusts and Fiduciary Services Department.

BEA's private banking service ("**BEA Private Banking**") was re-launched in late 2005, providing tailor made financial services to high net worth clients. The business has now been in operation for approximately eight years and has achieved a critical mass in terms of clients and business acquisition. BEA continues to anticipate sizeable growth in its private banking business with particular emphasis in the Greater China region, capitalising on its major network. BEA believes that Hong Kong is increasingly the investment destination of choice for wealthy Mainland Chinese. As at 31 December 2013, Mainland Chinese customers accounted for 30% of BEA's private banking client base, and BEA expects that such proportion will continue to increase given Mainland China's gradual economic opening and the ongoing internationalisation of the Renminbi. As at 30 April 2014, BEA Private Banking had over 42 relationship managers supported by more than 10 investment professionals. The Group will continue to explore new avenues to leverage its extensive network in Mainland China to drive business.

As at 30 April 2014, the assets under management of BEA Private Banking amounted to HK\$59.44 billion. The net profit of the department increased from HK\$256.4 million for the year ended 31 December 2012 to HK\$389.1 million for the year ended 31 December 2013.

The Group continues to focus on the diversification of investments. Following the financial crisis in 2008, customers' interest in investment products has shifted increasingly towards more transparent and simpler products such as vanilla bonds, outright stocks and simple structured products rather than complicated structures incorporating various derivatives.

Regulatory changes as a result of the collapse of Lehman Brothers have been introduced since early 2009, and have continued into the present with new requirements in the investment selling process and risk monitoring measures for customers for the wealth management industry. Since 2009, the Group has enhanced its process and procedures to follow the regulations and requirements that have been introduced.

In respect of the trust business, the profit captured in Hong Kong is insignificant.

BEA's Investment Products and Advisory Department continues to provide service in product provision and analysis to BEA's front line staff. BEA's Trust and Fiduciary Services Department enhances high net worth clients' family inheritance and planning to complete the wealth management and preservation objectives.

For the year ended 31 December 2013, the Wealth Management Division's profit before taxation was HK\$437.63 million, approximately a 35.6% increase compared with the figure reported for the year ended 31 December 2012.

Stock Broking and other Fee-based Activities

In addition to the range of traditional banking products and services offered by the Group to its customers, the Group also provides equity and futures stock broking. Stock broking activities and dealings in Hang Seng Index futures, options and other derivative products are conducted through BEA and its wholly-owned subsidiaries, East Asia Securities and East Asia Futures, on an agency basis for the execution of customers' orders.

The Group, through Tricor, provides business, corporate and investor services in the Asia Pacific region. These services include accounting, company formation, corporate compliance and company secretarial, executive search and selection, initial public offerings and share registration, payroll outsourcing and fund and trust administration.

Tricor is one of the key revenue contributors to the Group's fees and commission income. For the years ended 31 December 2011, 2012 and 2013, fees and commission income attributable to Tricor was approximately 26%, 25% and 22%, respectively, of the Group's total fees and commission income. During 2013, Tricor acquired a 30% interest in International Outsourcing Inc., a reputable, well established professional services firm in Korea, to further enhance the Group's servicing capabilities in Asia. Korea, one of the Four Asian Tigers (which includes Hong Kong, Singapore, South Korea and Taiwan), is a fast growing developed economy. With the addition of the Korean office, Tricor now operates a network covering 29 cities in 16 economies throughout Asia and other parts of the world.

MAINLAND CHINA AND OTHER ASIAN COUNTRIES

BEA first established its presence in Mainland China when it set up its Shanghai branch in 1920. In 1979, BEA established the first Sino-foreign joint venture in Mainland China and pioneered the provision of direct credit card settlement services in Mainland China. In 1988, it became the first foreign bank to provide foreign currency mortgages for foreign individuals (including residents of Hong Kong, Taiwan and Macau). In 1995, BEA was awarded the "Best Foreign Bank in China" by Euromoney magazine. In 2002, BEA was the first foreign bank authorised to conduct internet banking business in Mainland China and became one of the first foreign banks to obtain a licence to offer full foreign currency services at all its branches in Mainland China. In 2005, BEA was among the first batch of foreign banks that received approval to provide agency services for life insurance products in Mainland China. In 2006, BEA was one of the first foreign banks in China granted QDII status by CBRC and was the first foreign bank in Mainland China to obtain a foreign exchange quota to conduct QDII business.

In 2007, BEA was one of the first foreign banks to establish a locally-incorporated bank in Mainland China and to conduct RMB business with local residents.

In 2008, BEA (China) was the first foreign bank to launch RMB debit cards and RMB credit cards in Mainland China.

In 2009, BEA (China) was the first locally-incorporated foreign bank in Mainland China to issue RMB bonds to retail investors in Hong Kong and BEA (China) was granted the status of domestic settlement bank and domestic agent bank for cross-border RMB trade settlement services.

In March and November 2011, BEA (China) completed the issue of its first and second batches of RMB financial bonds with the issue sizes of RMB2 billion and RMB3 billion, respectively, in the PRC's interbank bond market.

In May 2012, BEA (China) completed the issuance of RMB senior unsecured bonds in an aggregate principal amount of RMB1 billion in Hong Kong.

In June 2013, BEA (China) was among the first batch of foreign banks to be granted a local mutual fund distribution licence in Mainland China. In August 2013, BEA was approved as a RQFII by CSRC.

In February 2014, BEA (China)'s registered capital increased from RMB8 billion to RMB10 billion after BEA injected an additional capital of RMB2 billion into BEA (China). In addition, BEA (China) became the first foreign bank approved by PBOC as a reserve bank for payment institutions.

In April 2014, BEA (China) signed a co-operation agreement with Shanghai Shengpay e-payment Service Company Limited ("SDP") to provide electronic RMB payment service to SDP's customers. With the signing of this agreement, BEA (China) became the first foreign bank to provide cross-border electronic RMB payment service in the Shanghai FTZ.

Recently, BEA (China) has been honoured to receive a variety of awards including the following:

Year	Awards
2011	<p>“2011 Best Customer Services Award — Banking Institutions in Shanghai” by Shanghai Banking Association</p> <p>“Asian Banks Competitiveness Ranking — 2011 Best Retail Bank in Asia” by the 21st Century Business Herald</p> <p>“2011 China Internet Banking Union Most Innovative Personal Internet Banking Product Award” for BEA (China)’s Cyberbanking service by China Internet Banking Union and China Computer Users Association</p> <p>“2011 Most Respected Foreign Bank in China” by Moneyweek in The Most Respected Bank & Best Retail Bank Rankings in China awards programme</p> <p>“2011 Distinctive Financial Services for Small Enterprises among Financial Institutions in China Award” by China Banking Regulatory Commission</p>
2012	<p>“2012 Best Foreign Retail Bank Award” by National Business Daily</p> <p>“Best Cross-border Renminbi Business Bank (Foreign-invested) Award” by Global Entrepreneur in 2012</p> <p>“China Treasury Awards 2012 — Best Foreign Cash Management Bank in China” by Treasury China</p> <p>“Golden Award — Most Popular Product Award” for the Bull Bear Series of Investment Financial Products” by Money Weekly and VNU Exhibitions in 2012</p> <p>“UnionPay Award for Business Collaboration” by China UnionPay in 2012</p> <p>“2012 Best Customer Service Centre among Banking Institutions in Shanghai” by Shanghai Banking Association</p> <p>“2012 Preferred Service Provider for Small and Medium Enterprises in China” by China Centre for the Promotion of Small and Medium Enterprise Development, Ministry of Industry and Information Technology of the People’s Republic of China</p> <p>“2012 Best Innovation Award for the Promotion of Financial Knowledge in China’s Banking Industry” by China Banking Association</p>
2013	<p>“Best Brand Building among Foreign Banks” in the 2013 Golden-shell Award of China Programme by the 21st Century Business Herald</p> <p>“Best Internet Banking among Foreign Banks Award” in the China Business News Financial Value Ranking 2013 by China Business News</p> <p>“2013 Best Wealth Management Product Design Award” by Money Weekly</p> <p>“2013 Best Wealth Management Bank Award” by SOHU.com</p>
2014	<p>“2013 Best Foreign Retail Bank in China” by Beijing Youth Daily</p> <p>“2013 Innovative China Internet Finance Award” by China Electronic Finance Industry Alliance</p> <p>“2014 Outstanding SME Service Provider (Bank)” organised by Quam (H.K.) Limited</p>

As at 30 April 2014, BEA's wholly-owned subsidiary, BEA (China), headquartered in Shanghai, operated 27 branches in Shanghai, Beijing, Tianjin, Harbin, Dalian, Shenyang, Qingdao, Shijiazhuang, Zhengzhou, Urumqi, Hangzhou, Nanjing, Suzhou, Chengdu, Chongqing, Wuhan, Hefei, Xi'an, Shenzhen, Guangzhou, Zhuhai, Xiamen, Changsha, Kunming, Ningbo, Jinan and Wuxi as well as 98 sub-branches (including 16 cross-location sub-branches in Guangdong province established under the liberalisation measures of Supplement VI to the CEPA). As at 30 April 2014, BEA operated two branches in Taiwan, located in Taipei and Kaohsiung, to provide corporate banking services. It also operated an offshore banking unit in Taipei, which provides a wide range of foreign currency services, including RMB financing and deposit, to offshore clients. In February 2013, the domestic banking units of BEA's Taiwan Branches launched RMB services to serve the RMB financing needs of domestic companies in Taiwan. The Group provides a wide range of wealth management services in Taiwan through BEAWMS, which include securities brokerage, wealth management, insurance brokerage, and securities investment consultancy services for high net worth clients.

In order to expand its presence in the Mainland China market, the Group has been expanding the range of products and services it provides in Mainland China and will seek to capitalise on the opportunities that it expects to arise following the liberalisation of the banking sector and from the CEPA between Hong Kong and Mainland China. BEA (China)'s strategy is to increase the growth of customer RMB deposits in order to maintain stability in its source of funds and to minimise costs associated with interbank lending. However, there are many factors affecting the growth of deposits such as economic and political conditions, the availability of alternative investment choices (including but not limited to securities issued by governmental or corporate entities, unit trusts and mutual funds, investment-linked assurance schemes and structured investment products) and retail customers' changing perceptions towards savings.

BEA (China) aims at optimising the allocation and utilisation of its resources to better develop its retail banking in areas with business potential by strategically repositioning some of the business outlets. Selected existing outlets provide both corporate and retail banking services, while the rest of the existing outlets and newly established outlets focus on corporate banking services supported by basic retail banking services. The Group will continue to expand its branch network strategically according to the business demand and the market environment in Mainland China.

In January 2011, the Securities and Futures Bureau of the Financial Supervisory Commission granted approval to BEAWMS to conduct wealth management business under trust. In addition to BEAWMS' headquarters in Taipei, the Group set up a branch office in Taichung in January 2012.

For the years ended 31 December 2011, 2012 and 2013, the profit before taxation of the Group's operations in Mainland China, Taiwan and Macau collectively accounted for approximately 44.1%, 30.8%, and 34.1% of the Group's total profit before taxation, respectively, and the assets of the Group's operations in Mainland China, Taiwan and Macau collectively accounted for approximately 45.6%, 47.7%, and 47.7% of the Group's total assets as at 31 December 2011, 2012 and 2013, respectively.

The main source of income for the Group's operations in Mainland China, Taiwan and Macau is interest income generated from loans business. As part of the Group's expansion plan, the Group aims to strengthen its marketing efforts in other business areas (including trade finance, personal banking, wealth management, treasury and cash management) to increase its fee income.

As at 31 December 2011, 2012 and 2013, the total outstanding customer advances of the Group's operations in Mainland China, Taiwan and Macau by business segments were as follows:

	As at 31 December		
	2011	2012	2013
	(in HK\$ millions)		
Trade Finance	608	568	453
Property Related Loans	52,643	64,994	70,802
Non-Property Related Loans	66,036	72,090	84,838
Others	26	23	386
Total	119,313	137,675	156,479

As at 31 December 2011, 2012 and 2013, BEA (China)'s RMB-denominated lending amounted to HK\$93,914 million, HK\$115,176 million and HK\$129,949 million, respectively, accounting for approximately 83.9%, 90.0% and 90.1% of the total customer advances of BEA (China), respectively. Borrowers comprise companies registered to do business in Mainland China and individual customers including local residents. BEA expects to further expand its RMB-denominated lending business as its existing customers continue to grow and demand for RMB advances remains strong.

INTERNATIONAL

The Group's international operations were commenced to meet the requirements of its core customers as their interests expanded overseas from Hong Kong. The Group seeks to establish a presence in cities with large concentrations of overseas Chinese. The following table sets out BEA's branches and representative offices outside Hong Kong, the PRC, Macau and Taiwan as at 30 April 2014.

Country	Location	Year Opened
Malaysia	Branch in Labuan; Representative Office in Kuala Lumpur	1997 and 1997
Singapore	Branch in Singapore	1952
United States	Branches in New York and Los Angeles	1984 and 1991
United Kingdom	Branches in London, Birmingham and Manchester	1990, 1997 and 2013

On 6 July 2012, BEA sold its 80% interest in The Bank of East Asia (U.S.A.) N.A. to the Industrial and Commercial Bank of China Limited ("ICBC") in accordance with terms and conditions stipulated in the Share Sale Agreement between BEA and ICBC dated 21 January 2011. After the completion of the transaction, the Group continues to operate and focus on its wholesale and corporate banking business through the New York and Los Angeles branches in the United States.

Following the sale of its 70% stake in Industrial and Commercial Bank of China (Canada) ("ICBC (Canada)") (formerly known as Bank of East Asia (Canada) ("BEA (Canada)")) in January 2010, the Bank completed the disposal of its additional 10% interest in ICBC (Canada) to ICBC under a call option in August 2011. Subsequent to the disposal of the additional shares, the Bank's interest in ICBC (Canada) is reduced from 30% to 20%. The 20% interest in ICBC (Canada) will remain as a long-term investment of the Group which looks forward to participating in the growth of the company as ICBC further develops its Canadian business.

The Singapore branch of BEA sustains strong growth in loan assets and revenue, underpinned by strong economic fundamentals in the country as well as robust trade activities between China and Singapore. BEA believes that its Singapore branch will continue to leverage its presence in Southeast Asia and the Group's extensive network in China to capture new business opportunities arising from

the trade and investment flows between China and member states of the Association of Southeast Asian Nations (“ASEAN”). In addition, the Singapore branch intends to increase its efforts to provide financing to well-established SMEs in Singapore, and syndicated loans to top-tier ASEAN corporations.

In Malaysia, BEA’s representative office in Kuala Lumpur continues to take an active role in cross-referrals of business between Tricor Malaysia and AFFIN Bank Berhad, a subsidiary of AFFIN Holdings Berhad, in which BEA was holding a 23.52% interest as at 30 April 2014.

Group Structure

BEA is the holding company and the principal operating company of the Group. In addition, BEA has a number of significant subsidiaries and associated companies through which the Group conducts various operations such as stock-broking, asset management and certain fee-based activities.

For the year ended and as at 31 December 2013, except for BEA (China), none of BEA’s subsidiaries accounted for more than 10% of the consolidated net profit and loss of the Group or had a book value in excess of 10% of the Group’s consolidated total assets.

As at 31 December 2013, the Group’s principal subsidiaries were as follows:

Name of subsidiary of the Issuer	Place of incorporation and operation of the Group	Issued and paid-up capital	% held by		Nature of business
			The Issuer	The Group	
Ample Delight Limited	Hong Kong	HK\$450,000,000		100%	Investment holding
Bank of East Asia (Trustees) Limited	Hong Kong	HK\$150,000,000	100%		Trustee
BEA Life Limited.	Hong Kong	HK\$500,000,000	100%		Life insurance
Blue Cross (Asia-Pacific) Insurance Limited.	Hong Kong	HK\$625,000,000	100%		Insurance
BEA Union Investment Management Limited	Hong Kong	HK\$374,580,000	51%		Asset management
BEA Wealth Management Services (Taiwan) Limited	Taiwan, Republic of China	NTD273,200,000		100%	Wealth management services
Central Town Limited.	Hong Kong	HK\$2	100%		Property investment
Century Able Limited.	Hong Kong	HK\$929,752,849		100%	Investment holding
Corona Light Limited.	BVI	HK\$929,752,849		100%	Investment holding
Credit Gain Finance Company Limited.	Hong Kong	HK\$370,000,000	100%		Money lenders
Crystal Gleaming Limited	BVI	HK\$929,752,849	100%		Investment holding
East Asia Electronic Data Processing (Guangzhou) Limited (Note 1)	PRC	US\$3,000,000		100%	Servicing
East Asia Holding Company, Inc.	US	US\$5	100%		Bank holding company
East Asia Investments Holdings (BVI) Ltd.	BVI	HK\$186,038,725	100%		Investment holding
East Asia Properties (US), Inc	US	US\$5		100%	Property holding
East Asia Property Holdings (Jersey) Limited	BVI	GBP9	100%		Property holding
East Asia Secretaries (BVI) Limited	BVI	HK\$300,000,000		75.61%	Investment holding
East Asia Securities Company Limited.	Hong Kong	HK\$25,000,000	100%		Securities broking
East Asia Strategic Holdings Limited	BVI	US\$50,000,000	100%		Investment holding
Innovate Holdings Limited	BVI	US\$1 (Ordinary) US\$500,000,000 (with a liquidation preference of US\$1,000 per share)	100%		Special purpose vehicle company
Shaanxi Fuping BEA Rural Bank Corporation (Note 1)	PRC	CNY20,000,000	100%		Banking and other financial businesses
Shenzhen Credit Gain Finance Company Limited (Note 1).	PRC	CNY300,000,000	100%		Micro-finance loan
Skyray Holdings Limited	BVI	HK\$450,000,000	100%		Investment holding
Speedfull Limited.	BVI	HK\$450,000,000		100%	Investment holding
The Bank of East Asia (China) Limited (Note 1).	PRC	CNY8,000,000,000	100%		Banking and related financial services

Name of subsidiary of the Issuer	Place of incorporation and operation of the Group	Issued and paid-up capital	% held by		Nature of business
			The Issuer	The Group	
Tricor Consultancy (Beijing) Limited (<i>Note 1</i>)	PRC	US\$1,850,000		75.61%	Business consultancy in China
Tricor Holdings Limited	BVI	US\$7,001		75.61%	Investment holding
Tricor Holdings Pte. Ltd.	Singapore	S\$5,000,002		75.61%	Investment holding
Tricor Investor Services Limited	Hong Kong	HK\$2		75.61%	Investor services
Tricor Services Limited.	Hong Kong	HK\$2		75.61%	Business, corporate and investor services
Tricor Services (Malaysia) Sdn. Bhd.	Malaysia	RM5,672,484		68.05%	Investment holding
Tung Shing Holdings Company Limited	BVI	US\$20,000,000	100%		Investment holding

Notes

1. Represents a wholly foreign-owned enterprise registered under the PRC laws.
2. The above subsidiaries have no non-controlling interests material to the Group.
3. BVI denotes the British Virgin Islands.

ORGANISATION

The Board of Directors of BEA is responsible for the overall management of the Group. To assist the Board of Directors in managing the Group, a number of committees have been established, including the Executive Committee, the Audit Committee, the Remuneration Committee, the Nomination Committee and the Risk Committee. The Executive Committee is responsible for reviewing all major functions and critical issues relating to the businesses and operations of the Group. The Audit Committee is responsible for reviewing corporate governance functions, financial controls, internal control and risk management systems, the adequacy of resources, staff qualifications and experience, training programmes and budget of the accounting and financial reporting function, annual report and accounts, and half-year interim report. The Remuneration Committee is responsible for making recommendations to the Board of Directors regarding BEA's remuneration policy, and for the formulation and review of the remuneration packages of the Directors, Chief Executive, senior management and key personnel of the Group. The Nomination Committee is responsible for making recommendations to the Board of Directors on relevant matters relating to appointments, re-appointment, removal and succession planning of Directors, Chief Executive, Senior Management and Division Heads, Chief Compliance Officer and Group Chief Auditor of BEA, defining succession planning and diversity of the Board of Directors and performing evaluation of the Board performance and Directors' contribution to the effectiveness of the Board. The Risk Committee is responsible for dealing with risk management related issues, in particular strategic issues, of the Group, including risk appetite, risk management strategies, risk management framework, risk management policies and risk profile.

In addition to the Executive Committee, the Audit Committee, the Remuneration Committee, the Nomination Committee and the Risk Committee, BEA has a number of other committees which assist management in the operation of BEA. These include the Risk Management Committee, which is responsible for assisting the Risk Committee in the daily management of the risk-related issues of the Group including risk profile, regulatory updates and stress-testing; the Credit Committee, which is responsible for dealing with all credit risk related issues of the Group; the Asset and Liability Management Committee ("ALCO"), which is responsible for dealing with all issues related to the market, interest rate, liquidity, strategic risks and capital management of the Group; the Operational Risk Management Committee, which is responsible for dealing with all issues relating to the operational, legal and reputation risks of the Group; the Investment Committee, which is responsible for reviewing and formulating investment strategies as well as making investment decisions in respect of fixed income, equity and equity related investments for BEA and The Bank of East Asia, Limited Employees' Provident Fund; the Policy Committee, which is responsible for discussing and

formulating various strategies and policies for managing businesses and operations of the Group; and the Crisis Management Committee, which is responsible for dealing with the Group's management of crisis scenarios which jeopardise or have the potential to jeopardise the Group in its reputation, liquidity/financial position and business continuity.

BEA has 13 divisions, each of which is responsible for a specific operational function. The divisions are the Personal Banking Division, the Corporate Banking Division, the Wealth Management Division, the Insurance & Retirement Benefits Division, the Treasury Markets Division, the China Division, the International Division, the Strategic Planning & Control Division, the Operations Support & Services Division, the Technology & Productivity Division, the Human Resources & Corporate Communications Division, the Risk Management Division and the Legal, Secretarial & Tax Division.

PROPERTIES

As at 30 April 2014, BEA owns properties with aggregate floor areas of approximately 413,145 square feet, 469,464 square feet and 37,678 square feet on Hong Kong Island, in Kowloon and in the New Territories, respectively. Most of BEA's properties are used as banking offices, as branches or for storage. The remainder are currently leased to third parties. In addition, BEA also leases properties with aggregate floor areas of approximately 49,240 square feet, 116,553 square feet and 72,341 square feet on Hong Kong Island, in Kowloon and in the New Territories, respectively. These leased properties are used as banking offices, as branches or for storage. As at 31 December 2013, the fair value for the Group's investment properties and bank premises amounted to HK\$4,400 million and HK\$9,848 million, respectively.

INTELLECTUAL PROPERTY

The Group relies on domain name registrations to establish and protect its internet domain names. The Group has registered a number of internet domain names. The Group has also registered "The Bank of East Asia Limited cyber banking" as a trademark with the Hong Kong government.

INSURANCE

The Group currently maintains insurance cover to mitigate its risk. Such insurance can broadly be categorised into property insurance to cover the loss of or damage to building structure and content, electronic equipment and motor vehicles; public liability insurance to cover legal liability as a result of physical bodily injury and/or property damage caused to third parties; bankers' blanket bonds insurance to cover the loss resulting from fraudulent acts by employees, loss of money on premises and in transit and forgery of bank instruments; professional indemnity insurance to indemnify the Group for loss arising out of claims for wrongful or negligent professional acts; and directors' and officers' liability insurance to cover the personal liability of BEA's directors and officers against any claims resulting from any wrongful act. There is a centralised independent function within the Group that handles the validity and adequacy of insurance cover.

COMPETITION

The banking industry in Mainland China is highly competitive. The market has been dominated by the large state-owned commercial banks, which have a long operating history, well-established branch networks, strong customer bases and better brand recognition.

Although BEA is the largest independent local bank in Hong Kong in terms of assets, given increasing competition among the local banks in Hong Kong, the Group has placed greater focus on diversifying its revenue sources and increasing its fee-based income, particularly from its wealth management and retail investment businesses. In addition, the Group focuses on expanding its presence in Mainland

China through BEA (China) by strategically establishing new branches and sub-branches in major cities in Mainland China. However, in view of the fact that banking business in Mainland China was opened to foreign banks in early 2007 as part of the PRC's WTO commitments, BEA expects competition in Mainland China to continue to increase.

For a further discussion of the risks of competition faced by the Group in Hong Kong and China, see *“Investment Considerations — Considerations Relating to the Group — Competition”*.

LITIGATION

Save as disclosed below, neither BEA nor any of its subsidiaries is currently involved in any material litigation, arbitration or similar proceedings, and BEA is not aware of any such proceedings pending or threatened against it or any of its subsidiaries, which are or might be material in the context of Notes to be issued under the Programme.

Repurchase of Lehman Brothers Mini-Bonds subscribed or purchased through BEA

On 22 July 2009, on a without-liability basis, BEA entered into an agreement with the HKMA, the SFC and 15 other distributing banks pursuant to which BEA has made an offer to eligible persons to repurchase their holdings in the Mini-Bonds subscribed or purchased through BEA. BEA made an announcement on the same date setting out the details of the offer.

As at 30 April 2014, approximately 99.77% of the eligible persons have accepted the offer and the remaining 0.23% (i.e. two Mini-Bonds holders, with amounts due totaling HK\$200,000) have rejected the offer. It is still uncertain at this stage whether the remaining two Mini-Bonds holders will make monetary or compensatory claims against BEA.

EMPLOYEES

As at 30 April 2014, the Group had a total of 12,698 employees as set forth in the following table:

	<u>No. of employees</u>
Hong Kong	5,681
Greater China excluding Hong Kong	5,806
Overseas	<u>1,211</u>
Total	<u>12,698</u>

Management believes that BEA maintains a good relationship with its employees and has not experienced any material employment disputes. Other than all local employees of BEA (China) and certain local employees at its Singapore branch, none of BEA's employees are members of a trade union. BEA provides attractive remuneration and benefits packages to its employees including medical health care plans, group life insurance, various paid leave, staff housing loan with preferential interest rate, staff account with preferential deposit interest rate and retirement benefits under either the MPF Scheme or the MPF exempted ORSO Scheme. In addition, BEA operates share options schemes under which options to purchase ordinary shares of BEA have been granted to eligible employees and executive director(s). As at 30 April 2014, approximately 20,199,000 shares, representing approximately 0.86% of BEA's issued capital on a fully diluted basis, were issuable upon the exercise of options granted under BEA's staff share option schemes adopted in 2007 and 2011.

In addition to benefits packages, BEA continues to provide career advancement opportunities and a healthy, positive working environment to its employees. BEA offers a wide range of training courses to support its employees' ongoing professional development.

PROTECTION OF DEPOSITORS

BEA is a member of the Deposit Protection Scheme, which was launched in September 2006. Accordingly, all eligible depositors of BEA are automatically protected under the Deposit Protection Scheme. As part of its measures to maintain the liquidity of, and confidence in, the Hong Kong financial markets, the Hong Kong government introduced in 2006 a Deposit Protection Scheme to provide a level of protection to depositors with deposits held with authorised institutions in Hong Kong. An enhanced Deposit Protection Scheme with an increased protection limit of HK\$500,000 and expanded coverage including deposits pledged as security for banking services, came into effect on 1 January 2011.

SELECTED STATISTICAL AND OTHER INFORMATION

The selected statistical and other information set forth below relates only to the Group and has, except where otherwise indicated, been compiled as at and for each of the years ended 31 December 2011, 2012 and 2013, and should be read in conjunction with the information contained elsewhere in this Offering Circular, including “*Business of the Group*”.

ADVANCE PORTFOLIO

Overview

As at 31 December 2011, 2012 and 2013, the Group’s total outstanding advances to customers were HK\$315,281 million, HK\$350,720 million and HK\$405,357 million, respectively, which represented approximately 51.6%, 50.7% and 53.8%, respectively, of its total assets.

The majority of the Group’s advances are in respect of home mortgages and advances for property investment and development (excluding advances under GHOS, PSPS and TPS) , which together, as at 31 December 2011, 2012 and 2013, represented approximately 25.4%, 22.3% and 19.7%, respectively, of the Group’s total advances to customers.

The table below sets forth a summary of the Group’s gross advances by sector as at the dates indicated.

The Group

As at 31 December						
	2011 (Restated)	Percentage of total	2012	Percentage of total	2013	Percentage of total
(in HK\$ millions, except percentages)						
Loans for use in Hong Kong						
Industrial, commercial and financial						
- Property development . . .	10,946	3.5%	13,460	3.8%	13,743	3.4%
- Property investment	41,747	13.2%	39,522	11.3%	37,574	9.3%
- Financial concerns	9,430	3.0%	11,557	3.3%	13,780	3.4%
- Stockbrokers	422	0.1%	804	0.2%	1,222	0.3%
- Wholesale and retail trade	7,790	2.5%	10,232	2.9%	14,296	3.5%
- Manufacturing	5,392	1.7%	6,331	1.8%	6,963	1.7%
- Transport and transport equipment	4,642	1.5%	5,414	1.5%	5,954	1.5%
- Recreational activities . .	272	0.1%	215	0.1%	96	—
- Information technology .	589	0.2%	1,170	0.3%	1,063	0.3%
- Others ⁽¹⁾	5,758	1.8%	7,580	2.2%	10,189	2.5%
- Sub-total	<u>86,988</u>	<u>27.6%</u>	<u>96,285</u>	<u>27.4%</u>	<u>104,880</u>	<u>25.9%</u>

As at 31 December						
	2011 (Restated)	Percentage of total	2012	Percentage of total	2013	Percentage of total
(in HK\$ millions, except percentages)						
Individuals						
- Loans for the purchase of flats in the GHOS, PSPS and TPS	1,379	0.4%	1,171	0.3%	1,096	0.3%
- Loans for the purchase of other residential properties	27,246	8.6%	25,337	7.2%	28,537	7.0%
- Credit card advances . . .	3,649	1.2%	3,802	1.1%	4,137	1.0%
- Others ⁽²⁾	14,457	4.6%	16,297	4.7%	19,453	4.8%
- Sub-total	46,731	14.8%	46,607	13.3%	53,223	13.1%
Total loans for use in Hong Kong	133,719	42.4%	142,892	40.7%	158,103	39.0%
Trade finance	5,948	1.9%	5,156	1.5%	5,895	1.5%
Loans for use outside Hong Kong ⁽³⁾	175,614	55.7%	202,672	57.8%	241,359	59.5%
Total advances to customers.	315,281	100.0%	350,720	100.0%	405,357	100.0%

Notes:

- (1) "Others" includes the industry sectors of civil engineering works, electricity and gas, hotels, boarding houses and catering, non-stockbroking companies and individuals for the purchase of shares, professional and private individuals for other business purposes and all others not specified.
- (2) "Others" includes professional and private individuals for other private purposes.
- (3) This refers to loans to customers the proceeds of which are not used in Hong Kong.

Geographical Concentration

The table below sets forth a summary of the Group's gross advances to customers by geographical location as at the dates indicated.⁽¹⁾

As at 31 December						
	2011 (Restated)	Percentage of total	2012	Percentage of total	2013	Percentage of total
(in HK\$ millions, except percentages)						
Hong Kong	149,309	47.4%	159,038	45.3%	172,436	42.5%
People's Republic of China ⁽²⁾	129,757	41.1%	151,588	43.2%	189,924	46.9%
Other Asian Countries ⁽³⁾ . . .	15,625	5.0%	19,446	5.6%	22,124	5.5%
Others ⁽⁴⁾	20,590	6.5%	20,648	5.9%	20,873	5.1%
Total	315,281	100.0%	350,720	100.0%	405,357	100.0%

Notes:

- (1) The above geographical analysis has been classified by the location of the counterparties, after taking into account any transfer of risk.

- (2) This includes Mainland China, Taiwan and Macau.
- (3) This includes all Asian countries other than Mainland China, Taiwan and Macau.
- (4) This includes North America, Western Europe and other countries.

Customer Advance Concentration

The Banking Ordinance generally prohibits any bank incorporated in Hong Kong from maintaining a financial exposure to any single person or group of connected persons in excess of 25% of its capital base. For a discussion of “financial exposure”, see “*Regulation and Supervision — Regulation and Supervision in Hong Kong — Principal Obligations of Licensed Banks — Financial Exposure to Any One Customer*”. As at 31 December 2013, the Group’s exposure to its 20 largest borrowers (including groups of individuals and companies) amounted to approximately HK\$45,354 million, or approximately 11.2% of the Group’s gross advances, with the largest representing HK\$4,450 million, or approximately 1.1% of the Group’s gross advances. As at 31 December 2012, the Group’s exposure to its 20 largest borrowers (including groups of individuals and companies) amounted to approximately HK\$43,290 million, or approximately 12.3% of the Group’s gross advances, with the largest representing HK\$4,242 million, or approximately 1.2% of the Group’s gross advances. As at 31 December 2011, the Group’s exposure to its 20 largest borrowers (including groups of individuals and companies) represented approximately HK\$39,814 million, or approximately 12.6% of the Group’s gross advances, with the largest accounting for HK\$4,262 million, or approximately 1.4% of the Group’s gross advances.

Advance Analysis

As a significant proportion of the Group’s gross advances are made for the purchase of residential property, as at 31 December 2011, 2012 and 2013, approximately 23.2%, 22.1% and 20.5% of advances had a remaining maturity of more than five years, respectively.

The table below sets forth a summary of the Group’s gross advances by remaining maturity as at the dates indicated.

As at 31 December						
	2011 Restated	Percentage of total	2012	Percentage of total	2013	Percentage of total
(in HK\$ millions, except percentages)						
Repayable on demand ⁽¹⁾	5,213	1.6%	5,499	1.6%	6,897	1.7%
3 months or less	54,547	17.3%	62,941	17.9%	71,914	17.7%
1 year or less but over 3 months	64,415	20.4%	72,805	20.8%	81,073	20.0%
5 years or less but over 1 year	117,511	37.3%	130,953	37.3%	161,367	39.8%
Over 5 years	73,060	23.2%	77,567	22.1%	82,974	20.5%
Undated	535	0.2%	955	0.3%	1,132	0.3%
Gross advances to customers	<u>315,281</u>	<u>100.0%</u>	<u>350,720</u>	<u>100.0%</u>	<u>405,357</u>	<u>100.0%</u>

Note:

- (1) Includes overdrafts.

As at 31 December 2011, 2012 and 2013, approximately 85.2%, 80.7% and 79.9% of advances made by the Group were at floating rates of interest, respectively. See “— *Asset and Liability Management*”. The current rate for home mortgage advances in Hong Kong generally ranges from 1.7% to 2.25% above the 1-month HIBOR. The interest rate for Hong Kong dollar consumer finance advances is typically calculated on the initial principal amounts of such advances and typically ranges from 0.2% to 1.2% per month flat for fixed rate products and from 3.5% (P-1.75%) to 8.25% (P+3%) per annum for prime based products. The interest rate for Hong Kong dollar trade finance advances made by the Group is typically a margin over the prime rate. The interest rate for project finance lending and syndicated lending is typically a margin over HIBOR. As at 31 December 2011, 2012 and 2013, approximately 47.4%, 43.3% and 40.2%, respectively, of advances made by the Group were denominated in Hong Kong dollars, approximately 15.5%, 15.0% and 18.9%, respectively, were denominated in U.S. dollars and approximately 29.8%, 33.5% and 32.9%, respectively, were denominated in RMB. Rates which are lower than the above rates may be offered by the Group under appropriate circumstances subject to internal approvals.

An important component of the Group’s asset and liability policy is its management of interest rate risk, which is the relationship between market interest rates and the Group’s interest rates on its interest-earning assets and interest-bearing liabilities. See “— *Asset and Liability Management*”.

As at 31 December 2011, the amounts, in Hong Kong dollars, and percentages represented by fixed and floating-rate advances denominated in Hong Kong dollars and foreign currencies, respectively, were as follows:

Advances outstanding as at 31 December 2011						
	HK dollar advances		Foreign currency advances		Total	
	Amount	Percentage of total	Amount	Percentage of total	Amount	Percentage of total
(in HK\$ millions, except percentages)						
Fixed rate	29,525	19.8%	17,154	10.3%	46,679	14.8%
Floating rate	119,818	80.2%	148,784	89.7%	268,602	85.2%
Total	<u>149,343</u>	<u>100.0%</u>	<u>165,938</u>	<u>100.0%</u>	<u>315,281</u>	<u>100.0%</u>

As at 31 December 2012, the amounts, in Hong Kong dollars, and percentages represented by fixed and floating-rate advances denominated in Hong Kong dollars and foreign currencies, respectively, were as follows:

Advances outstanding as at 31 December 2012						
	HK dollar advances		Foreign currency advances		Total	
	Amount	Percentage of total	Amount	Percentage of total	Amount	Percentage of total
(in HK\$ millions, except percentages)						
Fixed rate	33,895	22.3%	33,684	17.0%	67,579	19.3%
Floating rate	118,239	77.7%	164,902	83.0%	283,141	80.7%
Total	<u>152,134</u>	<u>100.0%</u>	<u>198,586</u>	<u>100.0%</u>	<u>350,720</u>	<u>100.0%</u>

As at 31 December 2013, the amounts, in Hong Kong dollars, and percentages represented by fixed and floating-rate advances denominated in Hong Kong dollars and foreign currencies, respectively, were as follows:

Advances outstanding as at 31 December 2013						
	HK dollar advances		Foreign currency advances		Total	
	Amount	Percentage of total	Amount	Percentage of total	Amount	Percentage of total
(in HK\$ millions, except percentages)						
Fixed rate	35,335	21.6%	46,168	19.1%	81,503	20.1%
Floating rate	128,310	78.4%	195,544	80.9%	323,854	79.9%
Total	<u>163,645</u>	<u>100.0%</u>	<u>241,712</u>	<u>100.0%</u>	<u>405,357</u>	<u>100.0%</u>

As at 31 December 2011, 2012 and 2013, at least 70% of the Group's advances were secured by collateral. Home mortgages are secured by a first legal charge over the underlying property. Working capital advances for businesses are typically secured by fixed and floating charges over land, buildings, machinery, inventory and receivables. Term advances for specific projects or developments are typically secured against the underlying project's assets and its receivables, while additional guarantees are typically provided by the sponsors or shareholders. The Group also receives guarantees in relation to certain of its other advances to cover, in the case of trade finance, any shortfall in security or, in the case of consumer advances to younger or less financially secure customers, to provide security on what are normally unsecured advances.

All forms of security taken as collateral against credit facilities are monitored by the respective departments which extended the advances. In general, the collateral is periodically valued by an independent valuer to determine whether any additional collateral is required.

RISK MANAGEMENT AND CREDIT POLICIES

The Group's lending policies have been formulated on the basis of its own experience, the Banking Ordinance, HKMA guidelines and policies issued by the Hong Kong Association of Banks and other statutory requirements (and, in the case of overseas branches and subsidiaries, the relevant local laws and regulations). BEA believes it has a history of, and reputation for, prudent lending practices. The majority of the Group's lending is on a secured basis, and the Group has established loan-to-value lending limits based on the appraised market value of the relevant collateral.

Risk Management

The risk management mechanisms are built around a centralised framework and include the Risk Committee, Crisis Management Committee, Risk Management Committee, specialised risk management committees (namely, Credit Committee, Asset and Liability Management Committee and Operational Risk Management Committee), and the Risk Management Division.

These mechanisms capture the different risk-related management activities on a group basis, including the formulation of policies, risk assessment, setting up of procedures and control limits, and ongoing monitoring before the same are reported to the Board of Directors via the Risk Committee. The mechanisms ensure compliance with the Group's policies, and legal and regulatory requirements in Hong Kong, Mainland China and overseas. They are supplemented by active management involvement, effective internal controls, and comprehensive audits.

The Risk Management Division is headed by the Group Chief Risk Officer & General Manager, who reports directly to the Chairman & Chief Executive and is responsible for initiating, implementing and monitoring risk management policies throughout the Group with regard to different types of risk. The Risk Management Division assesses regulatory requirements, in particular the requirements under the Supervisory Policy Manuals issued by the HKMA, and is responsible for:

- (i) formulating risk management policies and guidelines and performing regular reviews in order to ensure that such policies and guidelines are kept up to date;
- (ii) monitoring risk exposure and compliance with the risk management framework using a risk-based approach that incorporates independent risk assessment and review of regular reports and new products/specific issues;
- (iii) co-ordinating risk-related projects; and
- (iv) reporting monitoring results and significant risk related issues to the specialised risk management committees, and/or the Risk Management Committee, and/or the Risk Committee and/or the Board, where appropriate, so as to assist them to discharge their duty of oversight of risk management activities. Departments within the Risk Management Division have been assigned responsibility for different types of risk, including credit risk, interest rate risk, legal risk, liquidity risk, market risk, operational risk, reputational risk and strategic risk.

For interest rate risk, ALCO sets the strategy and policy for managing interest rate risk and the means for ensuring that such strategy and policy are implemented. The Risk Management Division is responsible for monitoring interest rate related activities to ensure compliance with the related bank policies, rules and regulations. The Internal Audit Department performs periodic review, to make sure the interest rate risk management functions are effectively carried out.

For the banking book, additional monitoring focuses on the repricing mismatches. Gap analysis provides a static view of the maturity and repricing characteristics of the Group's balance sheet positions. Repricing gap limits are set to control the Group's interest rate risk.

Sensitivity analysis on earnings and economic value to interest rate changes is assessed through a hypothetical interest rate shock of 200 basis points across the yield curve on both sides of the balance sheet and performed on a monthly basis. Sensitivity limits are set to control the Group's interest rate risk exposure under both earnings and economic value perspectives. The ALCO monitors the results thereof and decides remedial action if required.

In addition to the above, the ALCO sets the strategy and policy for managing liquidity risk and the means for ensuring that such strategy and policy are implemented.

The Group monitors its liquidity position on a daily basis to ensure the Group's funding needs can be met and the statutory liquidity ratio is complied with. The Group's average liquidity ratio was approximately 42.8%, 46.6% and 47.0% for the years ended 31 December 2011, 2012 and 2013, respectively, which is above the statutory minimum ratio of 25%.

By holding sufficient liquid assets (e.g. cash and short term funds and securities) of appropriate quality, the Group ensures that short term funding requirements are covered within prudent limits. Contingent funding sources are maintained to provide strategic liquidity to meet unexpected and material cash outflows.

Stress testing is regularly conducted to analyse liquidity risk. With reference to the stress-testing results, the Group identifies potential vulnerabilities within the Group and formulates a Contingency Funding Plan that describes the Group's strategy for dealing with any liquidity problem and the procedures for making up cash flow deficits in emergency situations.

Credit Policies

The Group's primary credit approval body is the Credit Committee, which comprises two Senior Advisors, four Deputy Chief Executives, two General Managers (one of whom is the Group Chief Risk Officer). The Credit Committee has overall responsibility for the Group's credit policies and oversees the credit quality of the Group's advance portfolio. Under the oversight of the Credit Committee, officers of the Group are authorised to approve credit based on the size of the advance, the collateral provided, the credit standing of the applicant and other prescribed credit guidelines. The following table sets out the credit approval limits for various types of advances in Hong Kong:

	Hong Kong	
	Corporate Lending	Retail Lending
	(in HK\$ millions)	
Credit Committee	Any amount	Any amount
Division Head	100 (25) ⁽¹⁾	100 (25) ⁽¹⁾
Department Head	60 (10) ⁽¹⁾	60 (10) ⁽¹⁾
Manager (Levels M4 to SM2)	1.5 (0.5) ⁽¹⁾ to 10 (3.5) ⁽¹⁾	0.6 (0.05) ⁽¹⁾ to 20 (1.8) ⁽¹⁾

Note:

(1) The numbers in parentheses represent credit limits for unsecured portions of advances.

The Credit Risk Management Department under the Risk Management Division is responsible for reviewing credit applications for significant loan amounts. When a customer fills out an advance application or requests a credit line, the branch or lending department account officer collects information through customer interviews, documentation requests and feasibility studies as well as other sources. After a thorough evaluation, the account officer may approve the application if the amount is within his lending authority. If the amount exceeds his lending authority, then the application is submitted to the appropriate person having a higher level of lending authority.

The Group has adopted lending policies with loan-to-value limits which apply to advances secured by a legal charge over an asset or property. Loan-to-value ratios on owner-occupied residential mortgages in Hong Kong (excluding advances under GHOS, PSPS and TPS) are limited to 50% (for property value at or above HK\$10 million); 60% (for property value at HK\$7 million or above but below HK\$10 million, and maximum loan amount being capped at HK\$5 million); 70% (for property value below HK\$7 million, and maximum loan amount being capped at HK\$4.2 million). Loan-to-value ratios on non-owner occupied residential mortgages and commercial / industrial mortgages are limited to 50% and 40% respectively. Lower loan-to-value limits will be applied to applicants whose income is mainly derived from outside HK. Underlying property values are based on the lower of the purchase price and the independently appraised value of the property.

Besides, the Group's lending policies limit the maximum customer debt servicing ratio to 40% to 50%, while stress test on the borrower's repayment ability by assuming a rise in interest rate of 3% is imposed for property mortgages.

Meanwhile, for property mortgages under the approach of assessment by net worth of the borrower (with the asset-to-total debt obligation ratio of the borrower of at least 100%), the loan-to-value ratio is limited to 20% to 40%.

Hong Kong has adopted the Basel II Accord capital adequacy standards from the beginning of 2007. In December 2007, BEA received the approval from the HKMA to adopt the advanced approaches under the Basel II Accord, namely the Foundation Internal Ratings-based (“**IRB**”) Approach for credit risk, the Internal Models Approach for market risk and the Standardised Approach for operational risk. Since 31 December 2007, the Group has used the IRB Approach to determine its credit risk weighted assets for calculating the CAR. The business benefits of adopting these advanced approaches are significant, including enhanced risk management, more efficient use of capital and higher transparency in the disclosure of risk-related information.

In December 2010, the Basel Committee issued the final Basel III regulatory framework presenting the Committee’s reforms to strengthen capital and liquidity standards in order to promote a more resilient banking sector.

In line with the international implementation timetable set by the Basel Committee, the Basel III rules pertaining to capital standards have been enacted into local banking regulations and implemented in Hong Kong on 1 January 2013. While transitional implementation is allowed for some of the standards, a substantial portion of the Basel III capital framework has already been implemented in full since 1 January 2013 and is reflected in the Group’s position for the financial year ended 31 December 2013.

ASSET QUALITY

Overview

The performance of the Hong Kong economy is heavily dependent on the property sector, and, as at 31 December 2011, 2012 and 2013, home mortgages and advances for property investment and development (excluding advances under GHOS, PSTS and TPS) together accounted for approximately 25.4%, 22.3% and 19.7%, respectively, of the Group’s total advances to customers. As a result, the Group’s asset quality is vulnerable to deflation in property prices. The ability of borrowers, including homeowners, to make timely repayment of their advances may be adversely affected by rising interest rates or a slowdown in economic growth. See “*Investment Considerations — Considerations Relating to the Group — Hong Kong Economy*” and “*Investment Considerations — Considerations Relating to the Group — Interest Rate Risk*”. As at 31 December 2011, 2012 and 2013, home mortgage advances (including advances under GHOS, PSPS and TPS) in Hong Kong amounted to HK\$28,625 million, HK\$26,508 million and HK\$29,633 million, respectively, or approximately 9.1%, 7.6% and 7.3%, respectively, of the Group’s total advances to customers and was one of the most significant segments of the Group’s total advances to customers. See “*Investment Considerations — Considerations Relating to the Group — Concentration Risk — Exposure to the Property Market*”.

The Group is committed to expanding its business and operations in the PRC and remains susceptible to risks associated with lending in the PRC, which could lead to an increase in the Group’s classified advances. As at 31 December 2011, 2012 and 2013, the Group’s PRC exposure is approximately 39.1%, 39.3% and 38.6%, respectively, of the Group’s total advances and its PRC classified advances account for approximately 0.1%, 0.3% and 0.5%, respectively, of its total PRC exposure. See “*Investment Considerations — Considerations Relating to the Group — Exposure to Mainland China Market*”.

Advance classification

The Group classifies the advances in a “two dimensional” structure: one dimension reflects exclusively the borrower’s repayment ability and another dimension reflects the transaction specific characteristics.

The dimension that reflects the borrower ’s repayment ability is classified into the following grading:

- Grades 1 through 15 — pass;
- Grade 16-17 — special mention;
- Grade 18 — sub-standard;
- Grade 19 — doubtful; and
- Grade 20 — loss.

In classifying the individual borrowers into one of the 20 gradings, the Group considers relevant factors including: (i) estimation of probability of default from the internal rating systems comprising statistical measurement and expert judgment with consideration of quantitative and qualitative elements such as the borrower ’s financial condition, the management and operation of the borrower’s business, market conditions affecting the borrower ’s industry and demographic characteristics; (ii) the payment history of the borrower; and (iii) the history of the Group’s dealings with the borrower concerned.

Another dimension that reflects the transaction specific characteristics considers relevant factors including: (i) type of advance; (ii) seniority of the advance; and (iii) credit mitigation such as collateral and guarantee.

BEA believes that its advance classification policy is in compliance with the Banking Ordinance and the applicable guidelines of the HKMA.

Recognition of impaired loans

The Group’s impaired loans are sub-divided into three categories: “sub-standard” (Grade 18), “doubtful” (Grade 19) and “loss” (Grade 20). When the repayment of an advance is uncertain (for example, there is a past-due record of 90 days or more), the Group downgrades the advance to sub-standard. If full recovery of the advance is in doubt and the Group expects to sustain a loss of principal or interest, the Group classifies the advance as doubtful. Loss advances are those which are considered non-collectible after exhausting all collection efforts, such as the realisation of collateral and the institution of legal proceedings, and the liquidator or official receiver has ascertained the relevant recovery ratio.

Impairment of Loans and Receivables

At each balance sheet date, the carrying amount of the Group’s assets are reviewed to determine whether there is objective evidence of impairment. If internal and external sources of information indicate such evidence exists, the carrying amount is reduced to the estimated recoverable amount and an impairment loss is recognised in the profit and loss account.

The total allowance for impairment losses consists of two components: individual impairment allowances, and collective impairment allowances.

The individual impairment allowance is based upon management's best estimate of the present value of the cash flows which are expected to be received discounted at the original effective interest rate. In estimating these cash flows, management makes judgments about the borrower's financial situation and the net realisable value of any underlying collateral or guarantees in favour of the Group. Each impaired asset is assessed on its own merits.

In assessing the need for collective loan loss allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required allowance, the Group makes assumptions both to define the way the Group models inherent losses and to determine the required input parameters, based on historical experience and current economic conditions.

The accuracy of the impairment allowances the Group makes depends on how well the Group can estimate future cash flows for individually assessed impairment allowances and the model assumptions and parameters used in determining collective impairment allowances. While this necessarily involves judgment, the Group believes that the impairment allowances on loans and advances to customers are reasonable and supportable and that its provisioning policies are in compliance with the Banking Ordinance and the applicable guidelines of the HKMA.

Where there is no reasonable prospect of recovery, the loan and the related interest receivables are written off.

The table below sets forth a summary of the Group's impairment allowance for the periods indicated:

	Year ended 31 December		
	2011	2012	2013
	(in HK\$ millions, except percentages)		
Beginning balance	1,142	1,063	954
Provision during the period	262	435	634
Bad debts charges recovered	(197)	(222)	(175)
Loans written off	(221)	(402)	(473)
Other movements	77	80	114
Closing balance	<u>1,063</u>	<u>954</u>	<u>1,054</u>
Impairment allowance as a percentage of:			
Total loans at period/year end	0.3%	0.3%	0.3%
Total impaired loans at period/year end	72.1%	83.8%	66.7%
Write-offs as a percentage of:			
Average total loans during the period/year end	0.1%	0.1%	0.1%
Total loans at period/year end	0.1%	0.1%	0.1%
Total impaired loans at period/year end	15.0%	35.3%	29.9%

As at 31 December 2013, the provision for impairment allowance was HK\$634 million which had increased by HK\$199 million as compared with the provision as at 31 December 2012 (HK\$435 million). As at 31 December 2012, the provision for impairment allowance was HK\$435 million which had increased by HK\$173 million as compared with the provision as at 31 December 2011 (HK\$262 million). BEA believes its provisions for impaired loans are appropriate and more adequate in the current uncertain economic environment.

For the year ended 31 December 2013, HK\$175 million of bad debts had been recovered, which represents a decrease of HK\$47 million as compared against the bad debts recovered for the year 31 December 2012. For the year ended 31 December 2012, HK\$222 million of bad debts had been recovered, which represents an increase of HK\$25 million as compared against the bad debts recovered for the year ended 31 December 2011.

Top Ten Impaired Loans

As at 31 December 2013, the Group's ten largest impaired loans accounted for approximately 0.1% of its total advances and approximately 36.1% of its gross impaired loan portfolio. The majority of the borrowers of such ten largest impaired loans were engaged in wholesale and retail trade and property investment and accounted for approximately 59.7% of the aggregate exposure relating to such ten largest impaired loans as at 31 December 2013. As at 31 December 2013, the Group's exposure under its ten largest impaired loans ranged from HK\$28 million to HK\$97 million per impaired loan, and amounted to approximately HK\$571 million in the aggregate. As at 31 December 2012, the Group's exposure under its ten largest impaired loans ranged from HK\$25 million to HK\$89 million per impaired loan, and amounted to approximately HK\$535 million in the aggregate. As at 31 December 2011, the Group's exposure under its ten largest impaired loans ranged from HK\$39 million to HK\$254 million per impaired loan, and amounted to approximately HK\$868 million in the aggregate.

Impaired Loans That Have Been Restructured

The Group's classified advances/impaired loans are restructured on a case-by-case basis, subject to the approval of the appropriate lending parties for both the restructured limits and recovery measures. The Group believes that it maintains a prudent reclassification policy. For example, if payments under an advance are rescheduled, that advance will not be reclassified and will remain under adverse classification (either as a "sub-standard" or "doubtful" advance) and may only be upgraded to a pass advance if the revised payment terms are honoured for a period of six months, in the case of monthly payments, and 12 months, in the case of quarterly or semi-annual repayments.

As at 31 December 2011, 2012 and 2013, the Group's impaired loans including those that have been restructured through the rescheduling of principal repayments and deferral or waiver of interest were as follows:

	As at 31 December		
	2011	2012	2013
	(in HK\$ millions, except percentages)		
Gross impaired loans	1,475	1,138	1,581
Aggregate individual impairment loss allowance	205	238	323
Net impaired loans	<u>1,270</u>	<u>900</u>	<u>1,258</u>
Gross impaired loans as a percentage of total loan portfolio	0.5%	0.3%	0.4%
Net impaired loans as a percentage of total loan portfolio	0.4%	0.3%	0.3%

Held-to-maturity Debt Securities

The Group's held-to-maturity debt securities included listed and unlisted debt securities. As at 31 December 2011, 2012 and 2013, the book value of these securities were HK\$4,587 million, HK\$4,320 million and HK\$5,048 million, respectively, which represented approximately 6.7%, 4.9% and 5.4% of the Group's total investments in securities, respectively. These debt securities included both Hong Kong dollar and U.S. dollar denominated bonds and notes. See "— Asset and Liability Management".

The table below sets forth a summary of the carrying values of the Group's held-to-maturity debt securities, categorised by the types of issuers as at the dates indicated:

	As at 31 December					
	2011	Percentage	2012	Percentage	2013	Percentage
	(in HK\$ millions, except percentages)					
Held-to-maturity securities issued by:						
Central governments and central banks	1,372	29.9%	1,552	35.9%	1,745	34.6%
Public sector entities	428	9.3%	316	7.3%	153	3.0%
Banks and other financial institutions	2,335	50.9%	1,108	25.7%	803	15.9%
Corporate entities	<u>452</u>	<u>9.9%</u>	<u>1,344</u>	<u>31.1%</u>	<u>2,347</u>	<u>46.5%</u>
Total	4,587	100.0%	4,320	100.0%	5,048	100.0%

ASSET AND LIABILITY MANAGEMENT

The Group's objective on asset and liability management is to maximise its net interest income and return on assets and equity while providing for liquidity and effective risk management. Recommendations to management on liquidity, interest rate policy and other significant asset and liability management matters are made by ALCO, which consists of three Senior Advisors; four Deputy Chief Executives; Head of Risk Management Division; Head of Strategic Planning & Control Division and Head of Treasury Markets Division. The Head of Asset and Liability Management Department acts as the secretary of ALCO.

One of the key components of the Group's asset and liability management is the management of market risk, interest rate risk, liquidity risk and strategic risk. The Group's policies regarding the management of these risks are formulated, and their implementation are co-ordinated, by ALCO. ALCO meets on a weekly basis to formulate the asset and liability strategy, such as the deposit rates and advance pricing strategies. The Treasury Markets Division is responsible for the daily operating management of the discretionary portion of the Group's assets and liabilities within the approved internal limits, including re-pricing gap limits. The derivative transactions entered into by the Group are substantially in response to customer demands, in addition to BEA book hedging, and no significant proprietary trading positions are maintained by the Group.

The Group measures the exposure of its assets and liabilities to fluctuations in interest rates primarily by way of gap analysis which provides the Group with a static view of the maturity and re-pricing characteristics of balance sheet positions. An interest rate gap report is prepared by classifying all assets and liabilities into various time period categories according to contracted maturities or anticipated re-pricing dates whichever is earlier. The difference in the amount of assets and liabilities maturing or being re-priced in any time period category would then give the Group an indication of the extent to which the Group is exposed to the risk of potential changes in the net interest income.

As at 31 December 2011, the combined currency asset-liability gap position the Group was as follows:

	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non-interest bearing	Total
HK\$ Mn						
ASSETS						
Cash and balances with banks and other financial institutions	66,976	125	8	—	4,652	71,761
Placements with banks and other financial institutions	33,654	24,944	—	—	—	58,598
Trade bills	24,848	20,774	1,127	—	142	46,891
Trading assets	—	572	684	61	4,283	5,600
Financial assets designated at fair value through profit or loss	1,208	826	11,559	2,737	333	16,663
Advances to customers and other accounts	270,793	33,637	9,120	1,291	26,500	341,341
Available-for-sale financial assets	17,465	7,243	15,257	2,961	1,984	44,910
Held-to-maturity investments	1,907	827	1,622	231	—	4,587
Non-interest bearing assets .	—	—	—	—	21,051	21,051
Total assets	416,851	88,948	39,377	7,281	58,945	611,402
LIABILITIES						
Deposits and balances of banks and other financial institutions	14,147	880	43	—	853	15,923
Deposits from customers . .	368,135	74,389	11,123	—	13,707	467,354
Trading liabilities	—	—	—	—	4,548	4,548
Certificates of deposit issued	6,242	4,195	1,046	—	—	11,483
Debt securities issued	241	—	6,152	—	—	6,393
Loan capital	7,837	—	—	8,904	—	16,741
Non-interest bearing liabilities	—	—	—	—	36,916	36,916
Total liabilities	396,602	79,464	18,364	8,904	56,024	559,358
Interest rate sensitivity gap .	20,249	9,484	21,013	(1,623)		

As at 31 December 2012, the combined currency asset-liability gap position for the Group was as follows:

	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non-interest bearing	Total
HK\$ Mn						
ASSETS						
Cash and balances with banks and other financial institutions	80,508	91	8	—	4,905	85,512
Placements with banks and other financial institutions	31,486	19,132	—	—	—	50,618
Trade bills	36,317	19,416	—	—	7	55,740
Trading assets	610	1,327	1,017	93	1,166	4,213
Financial assets designated at fair value through profit or loss	554	1,291	10,535	2,371	418	15,169
Positive fair value of derivatives	—	—	—	—	3,125	3,125
Advances to customers and other accounts	291,083	42,152	15,886	1,667	36,485	387,273
Available-for-sale financial assets	30,052	5,236	22,268	4,773	2,402	64,731
Held-to-maturity investments	1,524	985	1,765	46	—	4,320
Non-interest bearing assets .	—	—	—	—	21,413	21,413
Total assets	472,134	89,630	51,479	8,950	69,921	692,114
LIABILITIES						
Deposits and balances of banks and other financial institutions	28,585	360	—	—	1,652	30,597
Deposits from customers . . .	373,704	98,532	10,409	—	16,125	498,770
Trading liabilities	—	—	—	—	21	21
Negative fair value of derivatives	—	—	—	—	3,806	3,806
Certificates of deposit issued	6,818	14,760	5,792	—	—	27,370
Debt securities issued	3,146	4,152	1,359	—	—	8,657
Loan capital	—	—	9,125	5,138	—	14,263
Non-interest bearing liabilities	—	—	—	—	46,991	46,991
Total liabilities	412,253	117,804	26,685	5,138	68,595	630,475
Interest rate sensitivity gap .	59,881	(28,174)	24,794	3,812	—	—

As at 31 December 2013, the combined currency asset-liability gap position for the Group was as follows:

		Over				
	3 months	3 months	Over 1 year	Over	Non-interest	
	or less	to 1 year	to 5 years	5 years	bearing	Total

The following table sets out the Group's sensitivity analysis on interest rate risk as at 31 December 2011, 2012 and 2013, which measures the potential effect of changes in interest rates on its net interest income and economic value change:

	As at 31 December								
	2011			2012			2013		
	HK\$	U.S.\$	RMB	HK\$	U.S.\$	RMB	HK\$	U.S.\$	RMB
	(HK\$ millions)								
Impact on earnings over the next 12 months if interest rates rise by 200 basis points	116	(12)	346	235	(74)	475	289	(76)	706
Impact on economic value if interest rates rise by 200 basis points	(156)	195	126	(126)	8	58	(117)	122	622

Given the re-pricing position of the assets and liabilities for the Group as at 31 December 2013, if interest rates increased by 200 basis points (a basis point being a unit that is equal to one hundredth of 1%), BEA would expect that the annualised net interest income in respect of the Group's dealings in Hong Kong dollar, U.S. dollar and Renminbi (CNY) to increase by HK\$289 million, decrease by HK\$76 million and increase by HK\$706 million, respectively, and the economic value for the Group to decrease by HK\$117 million, increase by HK\$122 million and increase by HK\$622 million, respectively. As at 31 December 2012, if interest rate increased by 200 basis points, BEA would expect the annualised net interest income in respect of the Group's dealings in Hong Kong dollar, U.S. dollar and Renminbi to increase by HK\$235 million, decrease by HK\$74 million and increase by HK\$475 million, respectively, and the economic value for the Group to decrease by HK\$126 million, increased by HK\$8 million and increase by HK\$58 million, respectively.

The analysis is based on the following assumptions:

- (i) there is a parallel shift in the yield curve and in interest rates;
- (ii) there are no other changes to the portfolio;
- (iii) no loan prepayment is assumed as the majority of loans is on a floating rate basis; and
- (iv) deposits without fixed maturity dates are assumed to be repriced on the next day.

Liquidity pertains to the Group's ability to meet obligations as they fall due. To manage liquidity risk, the Group has established a liquidity risk management policy which is reviewed by ALCO and approved by BEA's Board of Directors. The Group measures its liquidity through statutory liquidity ratio, loan-to-deposit ratio and the maturity mismatch portfolio.

The Group monitors its liquidity position on a daily basis to ensure the Group's funding needs can be met and the statutory liquidity ratio is complied with. The average consolidated liquidity ratio was approximately 42.8%, 46.6% and 47.0% for the years ended 31 December 2011, 2012 and 2013, respectively, which is above the statutory minimum ratio of 25%.

As at 31 December 2011, 2012 and 2013, approximately 85.2%, 80.7% and 79.9%, respectively, of the Group's advances were made at floating rates of interest. The Group's interest earning assets have floating interest rates fixed by reference to BEA's BLR, prime rate and interbank rates, and the Group's interest-bearing liabilities have floating interest rates by reference to interbank rates and

savings deposit rates. ALCO continuously monitors the gap between HIBOR and the prime rate and, consequently, the Group's net interest margin. If the Group's net interest margin declines due to the squeeze of the spread between BEA's prime rate and HIBOR, ALCO may recommend the adjustment of BEA's prime rate charged on advances and/or the expansion of higher-yield lending business.

The following table sets out the Group's average balances of interest-earning assets and interest-bearing liabilities, interest and related average interest rates for the years ended 31 December 2011, 2012 and 2013. Average balances of interest-earning assets and interest-bearing liabilities for the years ended 31 December 2011, 2012 and 2013 are based on the arithmetic mean of the respective balances at the beginning and the end of such period.

	Years ended 31 December								
	2011			2012			2013		
	Average balance	Interest	Average rate (%)	Average balance	Interest	Average rate (%)	Average balance	Interest	Average rate (%)
	HK\$ Mn	HK\$ Mn	%	HK\$ Mn	HK\$ Mn	%	HK\$ Mn	HK\$ Mn	%
ASSETS									
Interest-earning assets									
Customers loans and credit									
Advances to customers.	311,565			327,842			379,315		
Trade bills less provision	37,196			51,510			57,091		
Total	348,761	12,880	3.7	379,352	15,598	4.1	436,406	17,747	4.1
Interbank placements and loans									
Cash and balances with banks	52,966			52,282			51,927		
Money at call and short notice	43,972			37,372			41,084		
Placements	19,875			40,428			28,717		
Advances to banks	795			272			34		
Total	117,608	2,362	2.0	130,354	2,672	2.0	121,762	3,014	2.5
Securities									
Treasury bills	8,405			15,459			15,868		
Certificates of deposit	5,613			4,273			3,743		
Debt securities	48,267			54,020			62,440		
Total	62,285	2,044	3.3	73,752	2,297	3.1	82,051	2,650	3.2
Total interest-earning assets	528,654	17,286	3.3	583,458	20,567	3.5	640,219	23,411	3.7
Allowance for possible loan losses	(1,093)			(1,000)			(1,004)		
Non-interest earning assets	58,619			63,778			73,292		
Total assets	586,180			646,236			712,507		

Years ended 31 December									
2011			2012			2013			
Average balance	Interest	Average rate (%)	Average balance	Interest	Average rate (%)	Average balance	Interest	Average rate (%)	
HK\$ Mn	HK\$ Mn	%	HK\$ Mn	HK\$ Mn	%	HK\$ Mn	HK\$ Mn	%	
LIABILITIES									
Interest-bearing liabilities									
Deposits									
Deposits from customers	444,864	6,896	1.6	470,580	9,033	1.9	501,155	9,105	1.8
Deposits and balances of banks	19,170	275	1.4	27,085	447	1.7	30,442	483	1.6
Total	464,034	7,171	1.5	497,665	9,480	1.9	531,597	9,588	1.8
Other liabilities									
Certificates of deposits	10,672			21,885			37,197		
Debt securities issued	5,237			8,844			7,016		
Loan capital	13,938			15,721			13,899		
Total	29,847	636	2.1	46,450	1,365	2.9	58,112	1,455	2.5
Total interest-bearing liabilities	493,881	7,807	1.6	544,115	10,845	2.0	589,709	11,043	1.9
Non interest-bearing liabilities	41,841			46,852			58,079		
Total liabilities	535,722			590,967			647,788		
NET INTEREST INCOME									
	9,479			9,722			12,368		
NET INTEREST SPREAD									
		1.7			1.5			1.8	

INTERNAL AUDIT

The Internal Audit Department has responsibility for auditing the Group's operations, including BEA (China). Through regular audits of all of the departments, subsidiaries and branches of BEA, the Internal Audit Department reviews and evaluates the adequacy and effectiveness of internal controls, safeguards the Group's assets, reviews operations in terms of efficiency and effectiveness, secures the accuracy and reliability of information and reviews compliance with established policies, procedures and relevant statutory requirements. The results of an internal audit are reported to the head of the audited department, subsidiary or branch, and any internal audit recommendations are generally expected to be implemented shortly after the issuance of the internal audit report. Significant findings arising from an internal audit are summarised by the Group Chief Auditor in bi-monthly reports to the Chairman of the Audit Committee and top management, and in semi-annual reports submitted to the full Audit Committee and top management. The Internal Audit Department also shares its findings with the HKMA and KPMG, BEA's external auditors, on a two-month basis.

Upon the incorporation of BEA (China) in April 2007, BEA (China) established a separate Internal Audit Division that reports to its own Audit Committee established under the board. The reporting process adopted is similar to BEA's reporting process described above.

COMPLIANCE

The Compliance Department was established in 2001 to administer regulatory compliance issues concerning the Group's business. It is responsible for reviewing new products and business proposals, conducts periodic review of the Group's activities and advises senior management of the Group in accordance with applicable laws, rules and regulations. Another key function of the Compliance Department is to raise compliance awareness amongst staff members. A Compliance Policy has been issued to relevant staff members of the Group. A Group Policy on the Prevention of Money Laundering, which adheres to those anti-money laundering requirements laid down by the HKMA, has also been issued to relevant staff members of the Group. In addition, the Group's internal controls are also reviewed by its internal auditors. Regular training sessions are conducted and newsletters are issued to update the Group's staff members on any significant regulatory changes relevant to the operations of the Group.

BOARD OF DIRECTORS AND SENIOR MANAGEMENT

BOARD OF DIRECTORS

BEA is managed by its Board of Directors, which is responsible for the direction and management of BEA. The Articles of Association of BEA require that there must be not less than five Directors, unless and until otherwise determined by an ordinary resolution of the shareholders of BEA. Directors are appointed at any time either at a general meeting of shareholders or by the Board of Directors.

As at 30 April 2014, the Board of Directors of BEA comprised the following individuals:

Name	Age	Title	Address
Dr. the Hon. Sir David LI Kwok-po	75	Chairman & Chief Executive	10 Des Voeux Road Central, Hong Kong
Professor Arthur LI Kwok-cheung	68	Non-executive Director (Deputy Chairman)	Room 2502, 25/F., BEA Harbour View Centre 56 Gloucester Road Wanchai, Hong Kong
Dr. Allan WONG Chi-yun	63	Independent Non-executive Director (Deputy Chairman)	23rd Floor, Block 1, Tai Ping Industrial Centre, 57 Ting Kok Road, Tai Po, New Territories
Mr. WONG Chung-hin	80	Independent Non-executive Director	Prince's Building, 12th Floor, 10 Chater Road, Hong Kong
Mr. Aubrey LI Kwok-sing	64	Non-executive Director	7th Floor, 9 Queen's Road Central, Hong Kong
Mr. Winston LO Yau-lai	72	Independent Non-executive Director	3/F., No. 1 Kin Wong Street, Tuen Mun, New Territories
Tan Sri Dr. KHOO Kay-peng	75	Independent Non-executive Director	189 Jalan Ampang 50450 Kuala Lumpur Malaysia
Dr. Thomas KWOK Ping-kwong	62	Independent Non-executive Director	46/F., Sun Hung Kai Centre, 30 Harbour Road, Hong Kong
Mr. Richard LI Tzar-kai	47	Non-executive Director	42/F., PCCW Tower, Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong
Mr. Kenneth LO Chin-ming	72	Independent Non-executive Director	99, Sec. 2, Tiding Blvd., Neihu District, Taipei, Taiwan
Mr. Eric LI Fook-chuen	84	Non-executive Director	5/F., Kowloon Dairy Building, 17-19 On Lan Street, Central, Hong Kong
Mr. Stephen Charles LI Kwok-sze	54	Non-executive Director	Unit 26-F, StarCrest — Tower 1, 9 Star Street, Hong Kong
Mr. William DOO Wai-hoi	69	Independent Non-executive Director	Room 3401, New World Tower, 16-18 Queen's Road, Central, Hong Kong

Name	Age	Title	Address
Mr. KUOK Khoon-ean.	58	Independent Non-executive Director	31st Floor, Kerry Centre 683 King's Road Quarry Bay Hong Kong
Mr. Valiant CHEUNG Kin-piu	68	Independent Non-executive Director	14A Yukon Court, No. 2 Conduit Road, Hong Kong
Dr. Isidro FAINÉ CASAS . .	71	Non-executive Director	Avenida Diagonal 621-629, 08028 Barcelona, Spain
Mr. Peter LEE Ka-kit	50	Non-executive Director	75th Floor, Two International Finance Centre, 8 Finance Street, Central, Hong Kong

Dr. the Hon. Sir David LI Kwok-po, *GBM, GBS, OBE, MA Cantab. (Economics & Law), Hon. LLD (Cantab), Hon. DSc. (Imperial), Hon. LLD (Warwick), Hon. DBA (Edinburgh Napier), Hon. D.Hum.Litt. (Trinity, USA), Hon. LLD (Hong Kong), Hon. DSocSc (Lingnan), Hon. DLitt (Macquarie), Hon. DSocSc (CUHK), FCA, FCPA, FCPA (Aust.), FCIB, FHKIB, FBCS, CITP, FCIArb, JP, Officier de l'Ordre de la Couronne, Grand Officer of the Order of the Star of Italian Solidarity, The Order of the Rising Sun, Gold Rays with Neck Ribbon, Commandeur dans l'Ordre National de la Légion d'Honneur*

Chairman & Chief Executive, Chairman of the Nomination Committee and the Risk Committee

Sir David, aged 75, joined BEA in 1969. He was appointed a Director in 1977, Chief Executive in 1981, Deputy Chairman in 1995 and Chairman in 1997. Sir David is the Chairman or a Director of various members of BEA Group, and he is also the Chairman or a Member of various committees appointed by the Board.

Sir David is a Member of the Council of the Treasury Markets Association. He is the Pro-Chancellor of the University of Hong Kong, an Advisory Committee Member of the Chinese University of Hong Kong S.H. Ho College, an Honorary Fellow of the School of Accountancy, Central University of Finance and Economics and a Companion of the Chartered Management Institute. He was a Member of the Legislative Council of Hong Kong from 1985 to 2012.

Sir David is the Chairman of The Chinese Banks' Association, Limited. He is the Honorary Chairman of The Chamber of Hong Kong Listed Companies. Sir David is Vice President of the Council of the Hong Kong Institute of Bankers, Chairman of the Saint Joseph's College Foundation Limited and a Member of the International Advisory Council of the Cambridge Commonwealth Trust and Cambridge Overseas Trust. He is also an Emeritus Trustee of the Cambridge Foundation and a Trustee Emeritus of the Institute for Advanced Study in Princeton. Sir David is Chairman of the Advisory Board of The Salvation Army, Hong Kong and Macau Command, Chairman of the Executive Committee of St. James' Settlement and he also serves on the Hong Kong Red Cross Advisory Board. He is a Council Member of the Employers' Federation of Hong Kong, a Director of the David Li Kwok-po Charitable Foundation Limited, a Founder Member and an Executive Committee Member of the Heung Yee Kuk Foundation Limited, Chairman of The Légion d'Honneur Club Hong Kong Chapter Association Limited and Chairman of the Executive Committee of The Marco Polo Society Limited.

Sir David is a Director of CaixaBank, S.A. (listed in Spain), an Independent Non-executive Director of Guangdong Investment Limited, The Hong Kong and China Gas Company Limited, The Hongkong and Shanghai Hotels, Limited, PCCW Limited, San Miguel Brewery Hong Kong Limited, SCMP Group Limited and Vitasoy International Holdings Limited. He is also a Director of Hong Kong Interbank Clearing Limited. He was a Non-independent Non-executive Director of AFFIN Holdings Berhad (listed in Malaysia), an Independent Non-executive Director of China Overseas Land & Investment Limited and COSCO Pacific Limited.

Sir David is a Member of the Board of Trustees of the Asia Society International Council, a Member of the Asia Business Council, a Member of the Munich Re Greater China Advisory Board, and Chairman Emeritus of the Asian Youth Orchestra Board. He serves on the advisory boards of Federal Reserve Bank of New York's International Advisory Committee and Hospital for Special Surgery. Sir David is the Chairman of the INSEAD East Asia Council, the Non-executive Chairman for Edelman Asia-Pacific and a Senior Adviser of Metrobank.

Professor Arthur LI Kwok-cheung, GBS, MA, MD, M.B.B.Chir (Cantab), DSc (Hon), DLitt (Hon), Hon DSc (Med), LLD (Hon), Hon Doc (Soka), FRCS (Eng & Edin), FRACS, Hon FACS, Hon FRCS (Glasg & I), Hon FRSM, Hon FPCS, Hon FCSHK, Hon FRCP (Lond), JP
Deputy Chairman, Non-executive Director

Professor Li, aged 68, was a Director of BEA (1995-2002) and was re-appointed a Director in 2008 and was appointed a Deputy Chairman in 2009.

Professor Li is a Member of the Executive Council of the Hong Kong Special Administrative Region (he was also a Member during 2002 to June 2007). He is also a Member of the National Committee of the Chinese People's Political Consultative Conference.

Professor Li is an Independent Non-executive Director of Shangri-La Asia Limited and Nature Flooring Holding Company Limited (formerly known as China Flooring Holding Company Limited), a Non-Independent Non-executive Director of AFFIN Holdings Berhad (listed in Malaysia) and a Non-executive Director of BioDiem Ltd. (delisted from Australian Securities Exchange in November 2013). He was an Independent Non-executive Director of The Wharf (Holdings) Limited.

Professor Li was the Secretary for Education and Manpower of the Government of HKSAR (2002-June 2007). Before these appointments, he was the Vice Chancellor of the Chinese University of Hong Kong (1996-2002) and was the Chairman of Department of Surgery and the Dean of Faculty of Medicine of the Chinese University of Hong Kong.

Professor Li had held many important positions in various social service organisations, medical associations, and educational bodies, including the Education Commission, Committee on Science and Technology, the Hospital Authority, the Hong Kong Medical Council, the University Grants Committee, the College of Surgeons of Hong Kong, and the United Christian Medical Services Board. He was a Member of the Board of Directors of the Hong Kong Science and Technology Parks Corporation and the Hong Kong Applied Science and Technology Research Institute, and Vice President of the Association of University Presidents of China. He was a Hong Kong Affairs Adviser to China.

Dr. Allan WONG Chi-yun, GBS, MBE, BSc, MSEE, Hon. DTech, JP
Deputy Chairman, Independent Non-executive Director, Chairman of the Remuneration Committee, Member of the Audit Committee and the Nomination Committee

Dr. Wong, aged 63, was appointed a Director in 1995 and a Deputy Chairman in 2009. He is the Chairman and Group Chief Executive Officer of VTech Holdings Limited. Dr. Wong is an Independent Non-executive Director of China-Hongkong Photo Products Holdings Ltd. and Li & Fung Ltd.

Dr. Wong holds a Bachelor of Science degree in electrical engineering from the University of Hong Kong, a Master of Science degree in electrical and computer engineering from the University of Wisconsin and an honorary degree of Doctor of Technology from the Hong Kong Polytechnic University.

Mr. WONG Chung-hin, CBE, JP

Independent Non-executive Director and Member of the Audit Committee

Mr. Wong, aged 80, is a solicitor. He was appointed a Director in 1977. Mr. Wong is the Consultant of P.C. Woo & Co. He is also an Independent Non-executive Director of Power Assets Holdings Limited and Hutchison Whampoa Limited.

Mr. Aubrey LI Kwok-sing, ScB, MBA

Non-executive Director, Member of the Nomination Committee, the Remuneration Committee and the Risk Committee

Mr. Li, aged 64, was appointed a Director in 1995. He is Chairman of IAM (Hong Kong) Limited (formerly known as MCL Partners Limited) a Hong Kong based financial advisory and investment firm. Mr. Li possesses extensive experience in the fields of investment banking, merchant banking and capital markets. He is also an Independent Non-executive Director of Cafe de Coral Holdings Limited, China Everbright International Limited, Kunlun Energy Company Limited, Kowloon Development Co. Ltd, Pokfulam Development Company Limited, Tai Ping Carpets International Limited and a Director of AFFIN Bank Berhad.

Mr. Li has an ScB in Civil Engineering from Brown University and a Master of Business Administration from Columbia University.

Mr. Winston LO Yau-lai, SBS, BSc, MSc

Independent Non-executive Director, Chairman of the Audit Committee, Member of the Nomination Committee, the Remuneration Committee and the Risk Committee

Mr. Lo, aged 72, was appointed a Director in 2000. He is the Executive Chairman of Vitasoy International Holdings Limited.

Mr. Lo graduated from the University of Illinois with a Bachelor of Science degree in Food Science and gained his Master of Science degree in Food Science from Cornell University.

Mr. Lo is a Director of Ping Ping Investment Company Ltd.

Mr. Lo is a Life Member of the Cornell University Council.

Tan Sri Dr. KHOO Kay-peng, PSM, DPMJ, KMN, JP, Hon. DLitt, Hon. LLD, Hon. Ph.D

Independent Non-executive Director

Tan Sri Dr. Khoo, aged 75, was appointed a Director in 2001. Dr. Khoo is the Chairman and Chief Executive of The MUI Group, a Malaysia-based corporation with diversified business operations in the Asia Pacific, the United States of America (“USA”) and the United Kingdom (“UK”). He is the Chairman and Chief Executive of Malayan United Industries Berhad and MUI Properties Berhad (both listed in Malaysia). Dr. Khoo is also the Chairman of Laura Ashley Holdings plc (listed in London) and Corus Hotels Limited in UK and Pan Malaysian Industries Berhad (listed in Malaysia). He is also a Non-executive Director of SCMP Group Limited.

Dr. Khoo is a Trustee of Regent University, Virginia, USA, and a Board Member of Northwest University, Seattle, USA. He also serves as a Council Member of the Malaysian-British Business Council, the Malaysia-China Business Council and the Asia Business Council. Previously, Dr. Khoo had served as the Chairman of the Malaysia Tourist Development Corporation (a Government Agency), the Vice Chairman of Malayan Banking Berhad (Maybank) and a Trustee of the National Welfare Foundation, Malaysia.

Dr. Thomas KWOK Ping-kwong, SBS, MSc (Bus Adm), BSc (Eng), Hon DBA, Hon DEng, FCPA (Aust.), JP

Independent Non-executive Director, Member of the Nomination Committee and the Remuneration Committee

Dr. Kwok, aged 62, was appointed a Director in 2001. Dr. Kwok is Chairman and Managing Director of Sun Hung Kai Properties Limited, Chairman of Route 3 (CPS) Company Limited and Joint Chairman of IFC Development Limited. He was a Non-executive Director of SUNeVision Holdings Ltd. Dr. Kwok holds a Master's degree in Business Administration from The London Business School, University of London and a Bachelor's degree in Civil Engineering from Imperial College, University of London. He also holds an Honorary Doctorate in Engineering from The Hong Kong Polytechnic University and an Honorary Doctorate in Business Administration from The Open University of Hong Kong. He is a Fellow of The Hong Kong Management Association and also a Fellow of The Australia Certified Public Accountants.

Dr. Kwok is the Chairman of the Board of Directors of the Faculty of Business and Economics, The University of Hong Kong. He is also an Executive Vice President and a Member of the Executive Committee of The Real Estate Developers Association of Hong Kong. In July 2007, the Government of the Hong Kong Special Administrative Region awarded Dr. Kwok the Silver Bauhinia Star for his distinguished community service. He is an Honorary Citizen of Guangzhou and a Standing Committee Member of the Chinese People's Political Consultative Conference Shanghai Committee.

In the past, Dr. Kwok served as a government appointed Member of the Commission on Strategic Development, a Member of the Exchange Fund Advisory Committee, the Construction Industry Council, the Council for Sustainable Development, Business Facilitation Advisory Committee and as a Non-official Member of the Provisional Minimum Wage Commission. He also previously served as a Board Member of the Community Chest of Hong Kong and as a Council Member of the Hong Kong Construction Association.

Mr. Richard LI Tzar-kai

Non-executive Director

Mr. Li, aged 47, was appointed a Director in 2001. Mr. Li is an Executive Director and the Chairman of PCCW Limited, one of Asia's leading companies in Information and Communications Technologies (ICT). He is also the Executive Chairman and an Executive Director of HKT Limited and HKT Management Limited, the trustee-manager of the HKT Trust. He is also the Chairman and Chief Executive of the Pacific Century Group, an Executive Director and the Chairman of Pacific Century Premium Developments Limited, the Chairman and an Executive Director of Singapore-based Pacific Century Regional Developments Limited (listed in Singapore). Mr. Li is a representative of Hong Kong, China to the APEC Business Advisory Council, a Member of the Center for Strategic and International Studies' International Councillors' Group in Washington, D.C., and a Member of the Global Information Infrastructure Commission. Mr. Li was awarded the Lifetime Achievement Award by the Cable & Satellite Broadcasting Association of Asia in November 2011.

Mr. Kenneth LO Chin-ming, MA, BA

Independent Non-executive Director, Member of the Audit Committee and the Nomination Committee

Mr. Lo, aged 72, was appointed a Director in 2005. Mr. Lo is the Chairman and Chief Executive Officer of the Industrial Bank of Taiwan and the Chairman of EverTrust Bank (USA) and the Honorary Chairman of the Chailease Group. He is also a Director of Boston Life Science Venture Corp. and Taiwan Cement Corp (listed in Taiwan). He has been with the banking and finance industry for over

40 years and had abundant experience in securities, trust, leasing, commercial banking, investment banking and venture capital. He was the President of Chinatrust Commercial Bank, the Chairman of IBT Venture Co., the Vice Chairman of China Trust Bank (USA), the Managing Director of International Bank of Taipei and a Director of Hua Nan Commercial Bank.

In addition to his highly recognized professional accomplishments, Mr. Lo is also active in public service. He is the Chairman of the Chinese National Association of Industry and Commerce, Taiwan, the Managing Director of the Bankers Association of the Republic of China, a Member of Asian Executive Board of the Sloan School of Management at the Massachusetts Institute of Technology, and a Member of the National Palace Museum Advisory Committee and Taipei Fine Arts Museum Advisory Board. He was the President of Asian Leasing Association, and the Supervisor of the Bankers Association of the Republic of China.

Mr. Lo holds a B.A. in Economics from National Taiwan University and an M.A. in Finance from the University of Alabama.

Mr. Eric LI Fook-chuen, BscEE, MscEE, MBA, FIM

Non-Executive Director, Deputy Chairman of the Nomination Committee, Member of the Remuneration Committee and the Risk Committee

Mr. Li, aged 84, was appointed a Director in 2006. Mr. Li is a Non-executive Director of BEA Life and Blue Cross, both wholly-owned subsidiaries of BEA. Mr. Li is currently the Chairman and Chief Executive Officer of the Kowloon Dairy Limited. He is an Independent Non-executive Director of Joyce Boutique Holdings Limited.

Mr. Li holds a Bachelor of Science Degree in Electrical Engineering from the University of Arkansas, U.S.A., a Master of Science Degree in Electrical Engineering from the University of Michigan, U.S.A., and a Master Degree in Business Administration from the University of California, U.S.A. He is also a Fellow of the Chartered Management Institute.

Mr. Stephen Charles LI Kwok-sze, BSc (Hons.), ACA

Non-executive Director

Mr. Li, aged 54, was appointed a Director in 2006. He is a Member of the Institute of Chartered Accountants in England and Wales. Mr. Li holds a Bachelor of Science (Hons.) Degree in Mathematics from King's College, University of London, U.K. He is a Director of hedge funds based in the UK and the EU. He is also a Director of AFFIN Investment Bank Berhad. He has extensive experience in investment banking, having held senior capital markets positions with international investment banks in London and Hong Kong.

Mr. William DOO Wai-hoi, BSc, MSc, G.G., Chevalier de la Légion d'Honneur, JP

Independent Non-executive Director and Member of the Audit Committee

Mr. Doo, aged 69, was appointed a Director in 2008. He is currently the Vice-chairman and Non-executive Director of New World Development Company Limited. He is an Executive Director of Lifestyle International Holdings Limited, an Independent Non-executive Director of Shanghai Industrial Urban Development Group Limited and the Chairman of Fung Seng Enterprises Limited. He was the Vice-chairman of New World China Land Limited and the Deputy Chairman of NWS Holdings Limited.

Mr. Doo is a Member of the National Committee of the Twelfth Chinese People's Political Consultative Conference. He is a Governor of the Canadian Chamber of Commerce in Hong Kong and the Honorary Consul General of the Kingdom of Morocco in Hong Kong and Macau.

Mr. Doo holds a Degree of Bachelor of Science from the University of Toronto, Canada and a Master Degree in Science from the University of California, U.S.A. He also holds a Diploma of Graduate Gemologist from the Gemologist Institute of America.

Mr. KUOK Khoon-ean

Independent Non-executive Director and Member of the Nomination Committee

Mr. Kuok, aged 58, was appointed a Director in 2008. He is the Chairman of Kuok (Singapore) Limited, a Director of Kerry Group Limited and Managing Director of Kerry Holdings Limited. Mr. Kuok is also a Non-executive Director of Shangri-La Asia Limited, the Chairman and Non-executive Director of PACC Offshore Services Holdings Ltd. and a Non-executive Director of Wilmar International Limited (both listed in Singapore); a Non-executive Director (Independent) of IHH Healthcare Berhad (listed in Malaysia and Singapore) and a Director of Shangri-La Hotel Public Company Limited (listed in Thailand).

Mr. Kuok was Chairman and Executive Director of SCMP Group Limited from January 1998 until January 2013. He also served on the Board of The Post Publishing Public Company Limited from April 1999 to January 2013.

Mr. Kuok is a graduate in Economics from the Nottingham University, U.K.

Mr. Valiant CHEUNG Kin-piu, FCPA, FCA

Independent Non-executive Director, Member of the Audit Committee and the Risk Committee

Mr. Cheung, aged 68, was appointed a Director in 2008. He was a Partner at KPMG, a leading international accounting firm in Hong Kong, until his retirement in 2001. He has extensive experience in assurance and corporate finance work, particularly in trading and manufacturing corporations in Hong Kong and the PRC. Mr. Cheung is a Fellow Member of the Institute of Chartered Accountants in England and Wales and the Hong Kong Institute of Certified Public Accountants.

Mr. Cheung is an Independent Non-executive Director of Vitasoy International Holdings Limited, Pacific Century Premium Developments Limited and Dah Chong Hong Holdings Limited.

Mr. Cheung is currently an Independent Non-executive Director, the Chairman of the Audit Committee and the Chairman of the Connected Transactions Control Committee of BEA (China), a wholly-owned subsidiary of BEA.

Dr. Isidro FAINÉ CASAS

Non-executive Director and Member of the Nomination Committee

Dr. Fainé, aged 71, was appointed a Director in 2009. Dr. Fainé is the Chairman of the following companies:

- (i) CaixaBank, S.A., is an integrated financial group and listed on the Spanish Stock Exchange - with a banking business, insurance activity and investments in international banks - the leader in retail banking in Spain
- (ii) Caja de Ahorros y Pensiones de Barcelona “la Caixa”, the first Spanish and European savings bank and controlling shareholder of CaixaBank, S.A.
- (iii) “la Caixa” Foundation
- (iv) Criteria CaixaHolding, is a non-listed investment company that brings together the industrial investments and property assets of “la Caixa”

Dr. Fainé currently holds chairmanships and directorships in other listed companies, where “la Caixa Group” has an interest, as follows:

- (i) First Vice Chairman of Abertis Infraestructuras, S.A. (infrastructure manager, listed in Spain)
- (ii) First Vice Chairman of Telefónica, S.A. (integrated operator in the telecommunication sector, listed in Spain)
- (iii) First Vice Chairman of Repsol, S.A. (oil company, listed in Spain)
- (iv) Board Member of Banco BPI, S.A. (financial and multi-specialist group focusing on the banking business, listed in Portugal)

Dr. Fainé is Second Vice Chairman of Sociedad General de Aguas de Barcelona, S.A. He was a Director of Grupo Financiero Inbursa, S.A.B. de C.V. (financial and banking group, listed in Mexico) until 2011.

Dr. Fainé is a Member of the Royal Academy of Economics and Finance and of the Royal Academy of Doctorate Holders, Chairman of the Spanish Confederation of Savings Banks (CECA), First Vice Chairman of the European Savings Bank Group (ESBG) and Chairman of the Association of Catalan Savings Banks. He is also Chairman of the Spanish Confederation of Directors and Executives (CEDE) and the Spanish Chapter of the Club of Rome. He is Founder and Chairman of the Círculo Financiero. He is also Vice Chairman of the World Savings Banks Institute (WSBI). In February 2011 he was appointed as a Member of the Executive Committee of the Business Council for Competitiveness (CEC). In December 2011, Dr. Fainé was appointed Vice Chairman of Institut de Prospective Économique du Monde Méditerranéen (IPEMED). He is also Merited Member of the Association of Economists of Catalonia. In 2012 he was awarded “Business Leader of the Year” by the U.S. Chamber of Commerce and was appointed Doctor Honoris Causa by the San Ignacio de Loyola University (Perú).

Dr. Fainé began his professional banking career as Investment Manager for Banco Atlántico in 1964, later becoming General Manager of Banco de Asunción in Paraguay in 1969. On his return to Barcelona, he held various managerial posts in financial entities: Human Resources Director at Banca Riva y García (1973), CEO of Banca Jover (1974) and CEO of Banco Unión (1978).

Dr. Fainé joined “la Caixa” and was appointed Deputy Executive General Manager in 1982. He was appointed CEO in 1999 and was further appointed Chairman of “la Caixa” in 2007.

Among other academic and professional qualifications, Dr. Fainé holds a PhD in Economics, an International Senior Managers Program in Business Administration from Harvard University, and a Diploma in Executive Management from the IESE Business School.

Mr. Peter LEE Ka-kit, JP

Non-executive Director

Mr. Lee, aged 50, was appointed a Director in May 2013. Mr. Lee is a Member of the Standing Committee of the 12th National Committee of the Chinese People’s Political Consultative Conference. He is the Vice Chairman of Henderson Land Development Company Limited and Henderson Investment Limited, both of which are listed public companies, as well as Henderson Development Limited. He is also a Non-executive Director of The Hong Kong and China Gas Company Limited. He was a Non-executive Director of Intime Department Store (Group) Company Limited (now known as Intime Retail (Group) Company Limited).

Mr. Lee has been appointed as a Justice of the Peace by the Government of the Hong Kong Special Administrative Region and awarded an Honorary University Fellowship by The University of Hong Kong since 2009. He was educated in the United Kingdom.

SENIOR MANAGEMENT

Mr. Adrian David LI Man-kiu, MA (Cantab), MBA, LPC, JP
Deputy Chief Executive

Mr. Li, aged 40, joined BEA in 2000 as General Manager & Head of Corporate Banking Division. In April 2009, he was promoted to Deputy Chief Executive for Hong Kong Business, and in his current capacity he is responsible for the overall management of BEA's business activities in Hong Kong, including corporate banking, personal banking, wealth management, and insurance and retirement benefits. He is also a Director of various members of BEA Group and a Member of various committees appointed by the Board.

Mr. Li is currently an Independent Non-executive Director of Sino Land Company Limited, Tsim Sha Tsui Properties Limited, Sino Hotels (Holdings) Limited, China State Construction International Holdings Limited, COSCO Pacific Limited and Shanghai Fosun Pharmaceutical (Group) Co., Ltd (which is dual listed in Hong Kong and Shanghai), and a Non-executive Director of The Berkeley Group Holdings plc (listed in London). He is an Alternate Independent Non-executive Director of San Miguel Brewery Hong Kong Limited, and an Alternate Director of AFFIN Holdings Berhad (listed in Malaysia). He also serves as a Member of the International Advisory Board of Abertis Infraestructuras, S.A. (listed in Spain).

Mr. Li is a Member of the Guangdong Provincial Committee of the Chinese People's Political Consultative Conference, a Member of the All-China Youth Federation, Deputy Chairman of the Beijing Youth Federation and a Counsellor of the Hong Kong United Youth Association. He is a Board Member of The Community Chest of Hong Kong, a Member of the HKSAR Government-mandated Banking Industry Training Advisory Committee, and a Member of the MPF Industry Schemes Committee of the MPFA. Mr. Li is an Advisory Committee Member of the Hong Kong Baptist University's School of Business, a Vice President of The Hong Kong Institute of Bankers' Council and a Steering Committee Member of the Asian Financial Forum. He also serves as a Member of the Election Committees responsible for electing the Chief Executive of the HKSAR and deputies of the HKSAR to the 12th National People's Congress.

Mr. Li holds a Master of Management Degree from Kellogg School of Management, Northwestern University in the US, and a Master of Arts Degree and a Bachelor of Arts Degree in Law from the University of Cambridge in Britain. He is a Member of The Law Society of England and Wales, and The Law Society of Hong Kong.

Mr. Brian David LI Man-bun, MA (Cantab), MBA, FCA, JP
Deputy Chief Executive

Mr. Li, aged 39, joined BEA Group in 2002. He was General Manager & Head of Wealth Management Division of BEA from July 2004 to March 2009. He was promoted to Deputy Chief Executive for China and International Business in April 2009. Mr. Li is primarily responsible for the Bank's China and international businesses, as well as the management of BEA Union Investment Management Limited. He is also a Director of various members of BEA Group and a Member of various committees appointed by the Board.

Mr. Li is currently an Independent Non-executive Director of Towngas China Company Limited, Hopewell Highway Infrastructure Limited and China Overseas Land & Investment Limited.

Mr. Li holds a number of public and honorary positions, including being a Member of the National Committee of the Chinese People's Political Consultative Conference, a Member of the Advisory Committee of the SFC, Chairman of the Traffic Accident Victims Assistance Advisory Committee of the Government of Hong Kong Special Administrative Region ("HKSARG"), a Member of the HKSARG Small and Medium Enterprises Committee, a Member of the HKSARG Standing Committee

on Judicial Salaries and Conditions of Service, a Member of the HKSARG Harbourfront Commission, a Member of the HKSARG Aviation Development Advisory Committee, a Member of the Hong Kong-Europe Business Council and a Member of the Hong Kong-Taiwan Business Cooperation Committee.

Mr. Li is a Fellow of the Hong Kong Institute of Certified Public Accountants and a Full Member of the Treasury Markets Association. Mr. Li is also a Fellow of the Institute of Chartered Accountants in England and Wales and he holds an MBA from Stanford University as well as MA and BA from the University of Cambridge.

Mr. Samson LI Kai-cheong, FCCA, CPA, FCIS, FCS, HKSI
Deputy Chief Executive & Chief Investment Officer

Mr. Li, aged 53, joined BEA in 1987 as Chief Internal Auditor. He was promoted to Deputy Chief Executive & Chief Investment Officer in April 2009. Mr. Li is primarily responsible for BEA's investment activities and treasury & broking operations including treasury markets. He is also a Director of various members of BEA Group and a Member of various committees appointed by the Board.

Mr. Li is a Fellow of The Hong Kong Institute of Chartered Secretaries, the Institute of Chartered Secretaries & Administrators, and The Association of Chartered Certified Accountants. In addition, he is an Associate of the Hong Kong Institute of Certified Public Accountants, a Member of the Hong Kong Securities and Investment Institute and a Member of the Listing Committee of The Stock Exchange of Hong Kong Limited. Mr. Samson Li received his Professional Diploma in Accountancy from The Hong Kong Polytechnic University.

Mr. TONG Hon-shing, BSc, ACIB, AHKIB, FCIS, FCS
Deputy Chief Executive & Chief Operating Officer

Mr. Tong, aged 55, joined BEA in 1975. He was promoted to Assistant General Manager in 1995 and to General Manager in 2000. He was General Manager & Head of Personal Banking Division from 2001 to March 2009. He was further promoted to Deputy Chief Executive and Chief Operating Officer in April 2009. Mr. Tong is primarily responsible for strategic planning and control, operations support, compliance, human resources, and corporate communications of BEA. He is also a Director of various members of BEA Group and a Member of various committees appointed by the Board. Mr. Tong is a Fellow of The Hong Kong Institute of Chartered Secretaries and The Institute of Chartered Secretaries & Administrators as well as an Associate of The Hong Kong Institute of Bankers and The Chartered Institute of Bankers. He holds a BSc from the University of Manchester.

TERMS AND CONDITIONS OF THE NOTES

The following is the text of the terms and conditions that, subject to completion and amendment and as supplemented or varied in accordance with the provisions of the relevant Pricing Supplement, shall be applicable to the Notes in definitive form (if any) issued in exchange for the Global Note(s) or the Global Certificate representing each Series. Either (i) the full text of these terms and conditions together with the relevant provisions of the Pricing Supplement or (ii) these terms and conditions as so completed, amended, supplemented or varied (and subject to simplification by the deletion of non-applicable provisions), shall be endorsed on such Bearer Notes or on the Certificates relating to such Registered Notes. All capitalised terms that are not defined in these Conditions will have the meanings given to them in the relevant Pricing Supplements. Those definitions will be endorsed on the definitive Notes or Certificates, as the case may be. References in the Conditions to “Notes” are to the Notes of one Series only, not to all Notes that may be issued under the Programme.

The Notes are constituted by an amended and restated Trust Deed (as amended or supplemented as at the date of issue of the Notes (the “**Issue Date**”), the “**Trust Deed**”) dated 16 June 2014 between the Issuer and DB Trustees (Hong Kong) Limited (the “**Trustee**”, which expression shall include all persons for the time being the trustee or trustees under the Trust Deed) as trustee for the Noteholders (as defined below). These terms and conditions (the “**Conditions**”) include summaries of, and are subject to, the detailed provisions of the Trust Deed, which includes the form of the Bearer Notes, Certificates, Receipts, Coupons and Talons referred to below. An amended and restated Agency Agreement (as amended or supplemented as at the Issue Date, the “**Agency Agreement**”) dated 16 June 2014 has been entered into in relation to the Notes between the Issuer, the Trustee, Deutsche Bank AG, Hong Kong Branch as initial issuing and paying agent, Deutsche Bank AG, Hong Kong Branch as CMU lodging and paying agent, transfer agent and as registrar for Registered Notes to be held in the Central Moneymarkets Unit Service operated by the Hong Kong Monetary Authority (the “**CMU**”), Deutsche Bank AG, Hong Kong Branch as registrar of each series of CMU Notes and Deutsche Bank Luxembourg S.A. as registrar of each series of Notes (other than CMU Notes) and the other agents named in it. The issuing and paying agent, the CMU lodging and paying agent, the other paying agents, the registrars, the transfer agent(s) and the calculation agent(s) for the time being (if any) are referred to below respectively as the “**Issuing and Paying Agent**”, the “**CMU Lodging and Paying Agent**”, the “**Paying Agents**” (which expression shall include the Issuing and Paying Agent and the CMU Lodging and Paying Agent), the “**Registrars**”, the “**Transfer Agents**” (which expression shall include the Registrars) and the “**Calculation Agent(s)**” (such Issuing and Paying Agent, CMU Lodging and Paying Agent, Paying Agents, Registrars and Transfer Agents being together referred to as the “**Agents**”). For the purposes of these Conditions, all references to the Issuing and Paying Agent shall, with respect to a Series of Notes to be held in the CMU, be deemed to be a reference to the CMU Lodging and Paying Agent and all such references shall be construed accordingly. Copies of the Trust Deed and the Agency Agreement are available for inspection during usual business hours at the principal office of the Trustee (presently at Level 52, International Commercial Centre, 1 Austin Road West, Kowloon, Hong Kong) and at the specified offices of the Paying Agents and the Transfer Agents.

The Noteholders, the holders of the interest coupons (the “**Coupons**”) relating to interest bearing Notes in bearer form and, where applicable in the case of such Notes, talons for further Coupons (the “**Talons**”) (the “**Couponholders**”) and the holders of the receipts for the payment of instalments of principal (the “**Receipts**”) relating to Notes in bearer form of which the principal is payable in instalments are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and are deemed to have notice of those provisions applicable to them of the Agency Agreement.

As used in these Conditions, “**Tranche**” means Notes which are identical in all respects.

All capitalised terms that are not defined in these Conditions will have the meanings given to them in the Trust Deed.

1 Form, Denomination and Title

The Notes are issued in bearer form (“**Bearer Notes**”) or in registered form (“**Registered Notes**”) in each case in the Specified Denomination(s) shown hereon. References to “hereon” is to the applicable Pricing Supplement (or the relevant provisions thereof) attached to or endorsed on this Note.

This Note is a Fixed Rate Note, a Floating Rate Note, a Zero Coupon Note, an Index Linked Interest Note, an Index Linked Redemption Note, an Instalment Note, a Senior Note, a Dated Subordinated Note, a Dual Currency Note or a Partly Paid Note, a combination of any of the foregoing or any other kind of Note, depending upon the Interest and Redemption/Payment Basis shown hereon.

Bearer Notes are serially numbered and are issued with Coupons (and, where appropriate, a Talon) attached, save in the case of Zero Coupon Notes in which case references to interest (other than in relation to interest due after the Maturity Date), Coupons and Talons in these Conditions are not applicable. Instalment Notes are issued with one or more Receipts attached.

Registered Notes are represented by registered certificates (“**Certificates**”) and, save as provided in Condition 2(c), each Certificate shall represent the entire holding of Registered Notes by the same holder.

Title to the Bearer Notes and the Receipts, Coupons and Talons shall pass by delivery. Title to the Registered Notes shall pass by registration in the register that the Issuer shall procure to be kept by the relevant Registrar in accordance with the provisions of the Agency Agreement (the “**Register**”). Except as ordered by a court of competent jurisdiction or as required by law, the holder (as defined below) of any Note, Receipt, Coupon or Talon shall be deemed to be and may be treated as its absolute owner for all purposes whether or not it is overdue and regardless of any notice of ownership, trust or an interest in it, any writing on it (or on the Certificate representing it) or its theft or loss (or that of the related Certificate) and no person shall be liable for so treating the holder.

In these Conditions, “**Noteholder**” means the bearer of any Bearer Note and the Receipts relating to it or the person in whose name a Registered Note is registered (as the case may be), “**holder**” (in relation to a Note, Receipt, Coupon or Talon) means the bearer of any Bearer Note, Receipt, Coupon or Talon or the person in whose name a Registered Note is registered (as the case may be) and capitalised terms have the meanings given to them hereon, the absence of any such meaning indicating that such term is not applicable to the Notes, and the expression “**Senior Noteholder**” shall be construed accordingly in relation to Senior Notes and the expression “**Dated Subordinated Noteholder**” shall be construed accordingly in relation to Dated Subordinated Notes.

2 No Exchange of Notes and Transfers of Registered Notes

- (a) **No Exchange of Notes:** Registered Notes may not be exchanged for Bearer Notes. Bearer Notes of one Specified Denomination may not be exchanged for Bearer Notes of another Specified Denomination. Bearer Notes may not be exchanged for Registered Notes.
- (b) **Transfer of Registered Notes:** One or more Registered Notes may be transferred upon the surrender (at the specified office of the relevant Registrar or any Transfer Agent) of the Certificate representing such Registered Notes to be transferred, together with the form of transfer endorsed on such Certificate, (or another form of transfer substantially in the same form and containing the same representations and certifications (if any), unless otherwise

agreed by the Issuer), duly completed and executed and any other evidence as the relevant Registrar or Transfer Agent may reasonably require to prove the title of the transferor and the authority of the individuals that have executed the form of transfer. In the case of a transfer of part only of a holding of Registered Notes represented by one Certificate, a new Certificate shall be issued to the transferee in respect of the part transferred and a further new Certificate in respect of the balance of the holding not transferred shall be issued to the transferor. All transfers of Notes and entries on the Register will be made subject to the detailed regulations concerning transfers of Notes scheduled to the Agency Agreement. The regulations may be changed by the Issuer, with the prior written approval of the relevant Registrar and the Trustee. A copy of the current regulations will be made available by the relevant Registrar to any Noteholder upon request.

Transfers of interests in the Notes evidenced by the Global Certificate will be effected in accordance with the rules of the relevant clearing systems.

- (c) **Exercise of Options or Partial Redemption in Respect of Registered Notes:** In the case of an exercise of an Issuer's or Noteholders' option in respect of, or a partial redemption of, a holding of Registered Notes represented by a single Certificate, a new Certificate shall be issued to the holder to reflect the exercise of such option or in respect of the balance of the holding not redeemed. In the case of a partial exercise of an option resulting in Registered Notes of the same holding having different terms, separate Certificates shall be issued in respect of those Notes of that holding that have the same terms. New Certificates shall only be issued against surrender of the existing Certificates to the relevant Registrar or any Transfer Agent. In the case of a transfer of Registered Notes to a person who is already a holder of Registered Notes, a new Certificate representing the enlarged holding shall only be issued against surrender of the Certificate representing the existing holding.
- (d) **Delivery of New Certificates:** Each new Certificate to be issued pursuant to Conditions 2(b) or 2(c) shall be available for delivery within three business days of receipt of the form of transfer or Exercise Notice (as defined in Condition 6(e)) and surrender of the Certificate for exchange. Delivery of the new Certificate(s) shall be made at the specified office of the relevant Registrar or any Transfer Agent (as the case may be) to whom delivery or surrender of such form of transfer, Exercise Notice or Certificate shall have been made or, at the option of the holder making such delivery or surrender as aforesaid and as specified in the relevant form of transfer, Exercise Notice or otherwise in writing, be mailed by uninsured post at the risk of the holder entitled to the new Certificate to such address as may be so specified, unless such holder requests otherwise and pays in advance to the relevant Transfer Agent the costs of such other method of delivery and/or such insurance as it may specify. In this Condition 2(d), "**business day**" means a day, other than a Saturday or Sunday, on which banks are open for business in the place of the specified office of the relevant Registrar or the relevant Transfer Agent (as the case may be).
- (e) **Transfers Free of Charge:** Transfers of Notes and Certificates on registration, transfer, exercise of an option or partial redemption shall be effected without charge by or on behalf of the Issuer, the relevant Registrar or the Transfer Agents, but upon payment of any tax or other governmental charges that may be imposed in relation to it (or the giving of such indemnity and/or security and/or pre-funding as the relevant Registrar or the relevant Transfer Agent may require) in respect of taxes or charges.
- (f) **Closed Periods:** No Noteholder may require the transfer of a Registered Note to be registered (i) during the period of 15 days ending on (and including) the due date for redemption of, or payment of any Instalment Amount in respect of, that Note, (ii) during the period of 15 days prior to any date on which Notes may be called for redemption by the Issuer at its option pursuant to Condition 6(d), (iii) after any such Note has been called for redemption, (iv) during the period of seven days ending on (and including) any Record Date or (v) during a Suspension Period.

In this Condition 2(f):

“**Business Day**” has the meaning given to such term in Condition 5(k) and, in respect of any Dated Subordinated Notes, shall also be deemed to include a day (other than a Saturday or Sunday) on which commercial banks and foreign exchange markets are open for business in Hong Kong; and

“**Suspension Period**” means the period commencing on (and including) the Business Day immediately following the date of a Non-Viability Event Notice and ending on (and including) the close of business in Hong Kong on the effective date of the related Write-off.

- (g) ***Exercise of Options or Partial Write-off in Respect of Definitive Registered Notes:*** In the case of an exercise of the Issuer’s option in respect of, or a partial Write-off of (as the case may be), a holding of Registered Notes represented by a single Certificate, a new Certificate shall be issued to the relevant Noteholder to reflect the exercise of such option, or such partial Write-off, or in respect of the balance of the holding not redeemed or Written-off (as the case may be). New Certificates shall only be issued against surrender of the existing Certificates to the relevant Registrar or any Transfer Agent.

3 Status, Subordination and Set-off

- (a) ***Status of Senior Notes:*** The Senior Notes (being those Notes that specify their status as Senior in the applicable Pricing Supplement) and the Receipts and the Coupons relating to them constitute direct, unconditional, unsubordinated and (subject to Condition 4) unsecured obligations of the Issuer and shall at all times rank *pari passu* and without any preference among themselves. The payment obligations of the Issuer under the Senior Notes and the Receipts and the Coupons relating to them shall, save for such exceptions as may be provided by applicable legislation and subject to Condition 4, at all times rank at least equally with all other unsecured and unsubordinated indebtedness and monetary obligations of the Issuer, present and future.
- (b) ***Status of Dated Subordinated Notes:*** The Dated Subordinated Notes (being those Notes that specify their status as Dated Subordinated in the applicable Pricing Supplement) and the Receipts and Coupons relating to them constitute direct, unsecured and subordinated obligations of the Issuer and rank *pari passu* and without any preference among themselves.
- (c) ***Subordination of Dated Subordinated Notes:*** Subject to the insolvency laws of Hong Kong and other applicable laws, in the event of a Winding-Up (as defined below in Condition 10(a)(iv)) of the Issuer, the rights of the Noteholders in respect of Dated Subordinated Notes to payment of principal and interest, and any other obligations in respect of the Notes, will rank:
- (i) subordinate and junior in right of payment to, and of all claims of:
 - (A) all unsubordinated creditors of the Issuer (including its depositors); and
 - (B) all other Subordinated Creditors of the Issuer whose claims are stated to rank senior to the Dated Subordinated Notes or rank senior to the Dated Subordinated Notes by operation of law or contract;
 - (ii) *pari passu* in right of payment to and of all claims of Parity Obligations; and
 - (iii) senior in right of payment to and of:
 - (A) all claims of Junior Obligations; and

(B) creditors in respect of Tier 1 Capital Instruments of the Issuer,
in each case in the manner provided in the Trust Deed.

In the event of a Winding-Up that requires the Noteholders or the Trustee to provide evidence of their claim to principal or interest under the Dated Subordinated Notes, such claims of the Noteholders of such Dated Subordinated Notes will only be satisfied after all senior ranking obligations of the Issuer have been satisfied in whole.

In the event that (A) the Noteholders do not receive payment in full of principal due and payable in respect of the Dated Subordinated Notes plus interest thereon accrued to the date of repayment in any Winding-Up and (B) the winding-up order or resolution passed for the Winding-up of the Issuer or the dissolution of the Issuer is subsequently stayed, discharged, rescinded, avoided, annulled or otherwise rendered inoperative, then to the extent that such Noteholders did not receive payment in full of such principal of and interest on such Dated Subordinated Notes, such unpaid amounts shall remain payable in full; provided that payment of such unpaid amounts shall be subject to the provisions under this Condition 3, Condition 11 and Condition 12, and Clause 5 and Clause 7 of the Trust Deed.

The subordination provisions set out in this Condition 3(c) are effective only upon the occurrence of any Winding-Up proceedings of the Issuer. In the event that a Non-Viability Event occurs, the rights of holders of Dated Subordinated Notes shall be subject to Condition 6(i). This may not result in the same outcome for the holders of Dated Subordinated Notes as would otherwise occur under this Condition 3(c) upon the occurrence of any Winding-Up proceedings of the Issuer.

On a Winding-Up of the Issuer, there may be no surplus assets available to meet the claims of the Noteholders after the claims of the parties ranking senior to the Noteholders (as provided in this Condition 3 and Clause 5 of the Trust Deed) have been satisfied.

In these Conditions:

“**Authorised Institution**” has the meaning given to that term in the Capital Regulations;

“**Banking (Capital) Rules**” means the Banking (Capital) Rules (Cap. 155L), the Banking (Capital) (Amendment) Rules 2012, or any successor legislation, or any statutory guidelines issued by the HKMA;

“**Banking Ordinance**” means the Banking Ordinance (Cap.155) of Hong Kong;

“**Capital Regulations**” means capital regulations applicable to the regulatory capital of Authorised Institutions in Hong Kong as published by the HKMA;

“**HKMA**” means the Monetary Authority appointed pursuant to Section 5A of the Exchange Fund Ordinance (Cap. 66 of the laws of Hong Kong) or its successors or such other authority having primary bank supervisory authority with respect to the Issuer;

“**Issuer Group**” means the Issuer and its subsidiaries;

“**Junior Obligation**” means the Shares, and any other class of the Issuer’s share capital and any instrument or other obligation (including without limitation any preference share and the 500,000 Units comprising Step-Up Subordinated Notes due 2059 issued by the Issuer and liquidation preference of Non-cumulative Step-Up Preference Shares issued by Innovate Holdings Limited) issued or guaranteed by the Issuer that ranks or is expressed to rank junior to the Dated Subordinated Notes by operation of law or contract;

“Parity Obligation” means any instrument or other obligation issued (including, without limitation, the U.S.\$600,000,000 Subordinated Notes due 2020 issued by the Issuer, the U.S.\$500,000,000 Subordinated Notes due 2022 issued by the Issuer, and the S\$800,000,000 Subordinated Notes due 2022 issued by the Issuer), entered into, or guaranteed by the Issuer that constitutes or qualifies as a Tier 2 Capital Instrument (or its equivalent) under applicable Capital Regulations or that ranks or is expressed to rank *pari passu* with the Dated Subordinated Notes by operation of law or contract;

“Share” has the meaning given to that term in the Capital Regulations;

“Subordinated Creditors” means all creditors the indebtedness of which is subordinated, in the event of the Winding-Up of the Issuer, in right of payment to the claims of depositors and other unsubordinated creditors of the Issuer other than those whose claims rank or is expressed to rank by operation of law or contract *pari passu* with, or junior to, the claims of the Noteholders. For this purpose indebtedness shall include all liabilities, whether actual or contingent;

“Tier 1 Capital Instruments” means:

- (i) any security issued by the Issuer; or
- (ii) any other similar obligation issued by any subsidiary of the Issuer that is guaranteed by the Issuer,

that, in each case, constitutes Tier 1 capital of (x) the Issuer, on an unconsolidated basis, or (y) the Issuer Group, on a consolidated basis, pursuant to the relevant requirements set out in the Banking (Capital) Rules, including without limitation the 500,000 Units comprising Step-Up Subordinated Notes due 2059 issued by the Issuer and the Non-cumulative Step-Up Preference Shares issued by Innovate Holdings Limited;

“Tier 2 Capital Instruments” means:

- (i) any security issued by the Issuer; or
- (ii) any other similar obligation issued by any subsidiary of the Issuer that is guaranteed by the Issuer,

that, in each case, constitutes Tier 2 capital of (x) the Issuer, on an unconsolidated basis, or (y) the Issuer Group, on a consolidated basis, pursuant to the relevant requirements set out in the Banking (Capital) Rules including, for the avoidance of doubt, securities categorised as Lower Tier 2 Capital (but excluding Upper Tier 2 Capital) pursuant to applicable Capital Regulations.

- (d) ***Set-off in respect of Dated Subordinated Notes:*** Subject to applicable law, no Noteholder, Receiptholder or Couponholder may exercise, claim or plead any right of set-off, counter-claim or retention in respect of any amount owed to it by the Issuer arising under or in connection with the Dated Subordinated Notes, the related Receipts or the Coupons and each Noteholder, Receiptholder and Couponholder shall, by virtue of being the holder of any Dated Subordinated Note, Receipt or Coupon, be deemed to have waived all such rights of such set-off, counter-claim or retention.

In the event that any Noteholder, Receiptholder, or Couponholder nevertheless receives (whether by set-off or otherwise) directly in any Winding-Up Proceedings in respect of the Issuer any payment by, or distribution of assets of, the Issuer of any kind or character, whether in cash, property or securities, in respect of any amount owing to it by the Issuer arising under or in connection with the Dated Subordinated Notes, other than in accordance

with this Condition 3, such Noteholder, Receiptholder or Couponholder shall, subject to applicable law, immediately pay an amount equal to the amount of such payment or discharge to the liquidator for the time being in the Winding-Up of the Issuer for distribution and each Noteholder, Receiptholder or Couponholder, by virtue of becoming a holder or any Dated Subordinated Note, Receipt or Coupon, shall be deemed to have so agreed and undertaken with, and to, the Issuer and all depositors and other unsubordinated creditors of the Issuer for good consideration.

4 Negative Pledge in respect of Senior Notes

So long as any Senior Note or Coupon (in respect thereof) remains outstanding (as defined in the Trust Deed), the Issuer will not, and will ensure that none of its Subsidiaries will, create, or have outstanding, any mortgage, charge, lien, pledge or other security interest, upon the whole or any part of its present or future undertaking, assets or revenues (including any uncalled capital) to secure any Relevant Indebtedness, or any guarantee or indemnity in respect of any Relevant Indebtedness, without at the same time or prior thereto according to the Senior Notes and such Coupons the same security as is created or subsisting to secure any such Relevant Indebtedness, guarantee or indemnity or such other security as either (i) the Trustee shall in its absolute discretion deem not materially less beneficial to the interest of the Noteholders or (ii) shall be approved by the Trustee or by an Extraordinary Resolution (as defined in the Trust Deed) of the Senior Noteholders.

In these Conditions:

- (i) **“Relevant Indebtedness”** means any indebtedness which is in the form of, or represented or evidenced by, bonds, notes, debentures, loan stock or other securities which for the time being are, or are intended to be or capable of being, quoted, listed or dealt in or traded on any stock exchange or over-the-counter or other securities market; and
- (ii) **“Subsidiary”** means any entity whose financial statements at any time are required by law or in accordance with generally accepted accounting principles to be fully consolidated with those of the Issuer.

5 Interest and other Calculations

- (a) ***Interest on Fixed Rate Notes:*** Each Fixed Rate Note bears interest on its prevailing nominal amount from the Interest Commencement Date at the rate per annum (expressed as a percentage) equal to the Rate of Interest, such interest being payable in arrear on each Interest Payment Date. The amount of interest payable shall be determined in accordance with Condition 5(h).
- (b) ***Interest on Floating Rate Notes and Index Linked Interest Notes:***
 - (i) ***Interest Payment Dates:*** Each Floating Rate Note and Index Linked Interest Note bears interest on its prevailing nominal amount from the Interest Commencement Date at the rate per annum (expressed as a percentage) equal to the Rate of Interest, such interest being payable in arrear on each Interest Payment Date. The amount of interest payable shall be determined by the Calculation Agent in accordance with Condition 5(h). Such Interest Payment Date(s) is/are either shown hereon as Specified Interest Payment Dates or, if no Specified Interest Payment Date(s) is/are shown hereon, **“Interest Payment Date”** shall mean each date which falls the number of months or other period shown hereon as the Interest Period after the preceding Interest Payment Date or, in the case of the first Interest Payment Date, after the Interest Commencement Date.

- (ii) *Business Day Convention*: If any date referred to in these Conditions that is specified to be subject to adjustment in accordance with a Business Day Convention would otherwise fall on a day that is not a Business Day, then, if the Business Day Convention specified is (A) the Floating Rate Business Day Convention, such date shall be postponed to the next day that is a Business Day unless it would thereby fall into the next calendar month, in which event (x) such date shall be brought forward to the immediately preceding Business Day and (y) each subsequent such date shall be the last Business Day of the month in which such date would have fallen had it not been subject to adjustment, (B) the Following Business Day Convention, such date shall be postponed to the next day that is a Business Day, (C) the Modified Following Business Day Convention, such date shall be postponed to the next day that is a Business Day unless it would thereby fall into the next calendar month, in which event such date shall be brought forward to the immediately preceding Business Day or (D) the Preceding Business Day Convention, such date shall be brought forward to the immediately preceding Business Day.
- (iii) *Rate of Interest for Floating Rate Notes*: The Rate of Interest in respect of Floating Rate Notes for each Interest Accrual Period shall be determined by the Calculation Agent in the manner specified hereon and the provisions below relating to either ISDA Determination or Screen Rate Determination shall apply, depending upon which is specified hereon.

(A) ISDA Determination for Floating Rate Notes

Where ISDA Determination is specified hereon as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Accrual Period shall be determined by the Calculation Agent as a rate equal to the relevant ISDA Rate. For the purposes of this sub-paragraph (A), “**ISDA Rate**” for an Interest Accrual Period means a rate equal to the Floating Rate that would be determined by the Calculation Agent under a Swap Transaction under the terms of an agreement incorporating the ISDA Definitions and under which:

- (x) the Floating Rate Option is as specified hereon;
- (y) the Designated Maturity is a period specified hereon; and
- (z) the relevant Reset Date is the first day of that Interest Accrual Period unless otherwise specified hereon.

For the purposes of this sub-paragraph (A), “**Floating Rate**”, “**Calculation Agent**”, “**Floating Rate Option**”, “**Designated Maturity**”, “**Reset Date**” and “**Swap Transaction**” have the meanings given to those terms in the ISDA Definitions.

(B) Screen Rate Determination for Floating Rate Notes

- (x) Where Screen Rate Determination is specified hereon as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Accrual Period will, subject as provided below, be either:
 - (1) the offered quotation; or
 - (2) the arithmetic mean of the offered quotations,

(expressed as a percentage rate per annum) for the Reference Rate which appears or appear, as the case may be, on the Relevant Screen Page as at either 11.00 a.m. (London time in the case of LIBOR, Brussels time in the case of EURIBOR, Hong Kong time in the case of HIBOR or Beijing time in the case of SHIBOR) or 11.15 a.m. (Hong Kong time in the case of CNH HIBOR) or if, at around that time it is notified that the fixing will be published at 2.30 p.m. (Hong Kong time), then as of 2.30 p.m. (Hong Kong time in the case of CNH HIBOR), as the case may be, on the Interest Determination Date in question as determined by the Calculation Agent. If five or more of such offered quotations are available on the Relevant Screen Page, the highest (or, if there is more than one such highest quotation, one only of such quotations) and the lowest (or, if there is more than one such lowest quotation, one only of such quotations) shall be disregarded by the Calculation Agent for the purpose of determining the arithmetic mean of such offered quotations.

If the Reference Rate from time to time in respect of Floating Rate Notes is specified hereon as being other than LIBOR or EURIBOR or HIBOR or CNH HIBOR or SHIBOR, the Rate of Interest in respect of such Notes will be determined as provided hereon.

- (y) if the Relevant Screen Page is not available or if, sub-paragraph (x)(1) applies and no such offered quotation appears on the Relevant Screen Page or if sub-paragraph (x)(2) above applies and fewer than three such offered quotations appear on the Relevant Screen Page in each case as at the time specified above, subject as provided below, the Calculation Agent shall request, if the Reference Rate is LIBOR, the principal London office of each of the Reference Banks or, if the Reference Rate is EURIBOR, the principal Euro-zone office of each of the Reference Banks, or, if the Reference Rate is HIBOR or CNH HIBOR, the principal Hong Kong office of each of the Reference Banks, or, if the Reference Rate is SHIBOR, the principal Beijing office of each of the Reference Banks,, to provide the Calculation Agent with its offered quotation (expressed as a percentage rate per annum) for the Reference Rate if the Reference Rate is LIBOR, at approximately 11.00 a.m. (London time) or, if the Reference Rate is EURIBOR, at approximately 11.00 a.m. (Brussels time) or, if the Reference Rate is HIBOR, at approximately 11.00 a.m. (Hong Kong time), or, if the Reference Rate is CNH HIBOR, at approximately 11.15 a.m. (Hong Kong time), or, if the Reference Rate is SHIBOR, at approximately 11.30 a.m. (Beijing time), on the Interest Determination Date in question. If two or more of the Reference Banks provide the Calculation Agent with such offered quotations, the Rate of Interest for such Interest Accrual Period shall be the arithmetic mean of such offered quotations as determined by the Calculation Agent; and
- (z) if paragraph (y) above applies and the Calculation Agent determines that fewer than two Reference Banks are providing offered quotations, subject as provided below, the Rate of Interest shall be the arithmetic mean of the rates per annum (expressed as a percentage) as communicated to (and at the request of) the Calculation Agent by the Reference Banks or any two or more of them, at which such banks were offered, if the Reference Rate is LIBOR, at approximately 11.00 a.m. (London time) or, if the Reference Rate is EURIBOR, at approximately 11.00 a.m. (Brussels time) or, if the Reference Rate is HIBOR, at approximately 11.00 a.m. (Hong Kong time), or, if the Reference Rate is CNH HIBOR, at approximately 11.15 a.m. (Hong Kong time), or, if the Reference Rate is SHIBOR, at approximately

11.30 a.m. (Beijing time), on the relevant Interest Determination Date, deposits in the Specified Currency for a period equal to that which would have been used for the Reference Rate by leading banks in, if the Reference Rate is LIBOR, the London inter-bank market or, if the Reference Rate is EURIBOR, the Euro-zone inter-bank market or, if the Reference Rate is HIBOR or CNH HIBOR, the Hong Kong inter-bank market, or, if the Reference Rate is SHIBOR, the Beijing inter bank market, as the case may be, or, if fewer than two of the Reference Banks provide the Calculation Agent with such offered rates, the offered rate for deposits in the Specified Currency for a period equal to that which would have been used for the Reference Rate, or the arithmetic mean of the offered rates for deposits in the Specified Currency for a period equal to that which would have been used for the Reference Rate, at which, if the Reference Rate is LIBOR, at approximately 11.00 a.m. (London time) or, if the Reference Rate is EURIBOR, at approximately 11.00 a.m. (Brussels time) or, if the Reference Rate is HIBOR, at approximately 11.00 a.m. (Hong Kong time), or, if the Reference Rate is CNH HIBOR, at approximately 11.15 a.m. (Hong Kong time), or, if the Reference Rate is SHIBOR, at approximately 11.30 a.m. (Beijing time), on the relevant Interest Determination Date, any one or more banks (which bank or banks is or are in the opinion of the Trustee and the Issuer suitable for such purpose) informs the Calculation Agent it is quoting to leading banks in, if the Reference Rate is LIBOR, the London inter-bank market or, if the Reference Rate is EURIBOR, the Euro-zone inter-bank market or, if the Reference Rate is HIBOR or CNH HIBOR, the Hong Kong inter-bank market, or, if the Reference Rate is SHIBOR, the Beijing inter bank market, as the case may be, provided that, if the Rate of Interest cannot be determined in accordance with the foregoing provisions of this paragraph, the Rate of Interest shall be determined as at the last preceding Interest Determination Date (though substituting, where a different Margin or Maximum Rate of Interest or Minimum Rate of Interest is to be applied to the relevant Interest Accrual Period from that which applied to the last preceding Interest Accrual Period, the Margin or Maximum Rate of Interest or Minimum Rate of Interest relating to the relevant Interest Accrual Period, in place of the Margin or Maximum Rate of Interest or Minimum Rate of Interest relating to that last preceding Interest Accrual Period).

- (iv) *Rate of Interest for Index Linked Interest Notes:* The Rate of Interest in respect of Index Linked Interest Notes for each Interest Accrual Period shall be determined by the Calculation Agent in the manner specified hereon and interest will accrue by reference to an Index or Formula as specified hereon.
- (c) **Zero Coupon Notes:** Where a Note the Interest Basis of which is specified to be Zero Coupon is repayable prior to the Maturity Date and is not paid when due, the amount due and payable prior to the Maturity Date shall be the Early Redemption Amount of such Note. As from the Maturity Date, the Rate of Interest for any overdue principal of such a Note shall be a rate per annum (expressed as a percentage) equal to the Amortisation Yield (as described in Condition 6(b)(i)).
- (d) **Dual Currency Notes:** In the case of Dual Currency Notes, if the rate or amount of interest falls to be determined by reference to a Rate of Exchange or a method of calculating Rate of Exchange, the rate or amount of interest payable shall be determined by the Calculation Agent in the manner specified hereon.

- (e) **Partly Paid Notes:** In the case of Partly Paid Notes (other than Partly Paid Notes which are Zero Coupon Notes), interest will accrue as aforesaid on the paid-up nominal amount of such Notes and otherwise as specified hereon.
- (f) **Accrual of Interest:** Interest shall cease to accrue on each Note on the due date for redemption unless, upon due presentation, payment is improperly withheld or refused, in which event interest shall continue to accrue (both before and after judgment) at the Rate of Interest in the manner provided in this Condition 5 to the Relevant Date (as defined in Condition 8).
- (g) **Margin, Maximum/Minimum Rates of Interest, Instalment Amounts and Redemption Amounts and Rounding:**
 - (i) If any Margin is specified hereon (either (x) generally, or (y) in relation to one or more Interest Accrual Periods), an adjustment shall be made to all Rates of Interest, in the case of (x), or the Rates of Interest for the specified Interest Accrual Periods, in the case of (y), calculated in accordance with Condition 5(b) above by adding (if a positive number) or subtracting the absolute value (if a negative number) of such Margin, subject always to the next paragraph.
 - (ii) If any Maximum Rate of Interest or Minimum Rate of Interest, Instalment Amount or Redemption Amount is specified hereon, then any Rate of Interest, Instalment Amount or Redemption Amount shall be subject to such maximum or minimum, as the case may be.
 - (iii) For the purposes of any calculations required pursuant to these Conditions (unless otherwise specified), (x) all percentages resulting from such calculations shall be rounded, if necessary, to the nearest one hundred-thousandth of a percentage point (with halves being rounded up), (y) all figures shall be rounded to seven significant figures (with halves being rounded up) and (z) all currency amounts that fall due and payable shall be rounded to the nearest unit of such currency (with halves being rounded up), save in the case of yen, which shall be rounded down to the nearest yen. For these purposes “unit” means the lowest amount of such currency that is available as legal tender in the country or countries of such currency.
- (h) **Calculations:** The amount of interest payable per Calculation Amount in respect of any Note for any Interest Accrual Period shall be equal to the product of the Rate of Interest, the Calculation Amount specified hereon, and the Day Count Fraction for such Interest Accrual Period, unless an Interest Amount (or a formula for its calculation) is applicable to such Interest Accrual Period, in which case the amount of interest payable per Calculation Amount in respect of such Note for such Interest Accrual Period shall equal such Interest Amount (or be calculated in accordance with such formula). Where any Interest Period comprises two or more Interest Accrual Periods, the amount of interest payable per Calculation Amount in respect of such Interest Period shall be the sum of the Interest Amounts payable in respect of each of those Interest Accrual Periods. In respect of any other period for which interest is required to be calculated, the provisions above shall apply save that the Day Count Fraction shall be for the period for which interest is required to be calculated.
- (i) **Determination and Publication of Rates of Interest, Interest Amounts, Final Redemption Amounts, Early Redemption Amounts, Optional Redemption Amounts and Instalment Amounts:** The Calculation Agent shall, as soon as practicable on each Interest Determination Date, or such other time on such date as the Calculation Agent may be required to calculate any rate or amount, obtain any quotation or make any determination or calculation, determine such rate and calculate the Interest Amounts for the relevant Interest Accrual Period, calculate the Final Redemption Amount, Early Redemption

Amount, Optional Redemption Amount or Instalment Amount, obtain such quotation or make such determination or calculation, as the case may be, and cause the Rate of Interest and the Interest Amounts for each Interest Accrual Period and the relevant Interest Payment Date and, if required to be calculated, the Final Redemption Amount, Early Redemption Amount, Optional Redemption Amount or any Instalment Amount to be notified to the Trustee, the Issuer, each of the Paying Agents, the Noteholders, any other Calculation Agent appointed in respect of the Notes that is to make a further calculation upon receipt of such information and, if the Notes are listed on a stock exchange and the rules of such exchange or other relevant authority so require, such exchange or other relevant authority as soon as possible after their determination but in no event later than (i) the commencement of the relevant Interest Period, if determined prior to such time, in the case of notification to such exchange of a Rate of Interest and Interest Amount, or (ii) in all other cases, the fourth Business Day after such determination. Where any Interest Payment Date or Interest Period Date is subject to adjustment pursuant to Condition 5(b)(ii), the Interest Amounts and the Interest Payment Date so published may subsequently be amended (or appropriate alternative arrangements made with the consent of the Trustee by way of adjustment) without notice in the event of an extension or shortening of the Interest Period. If the Notes become due and payable under Condition 10, the accrued interest and the Rate of Interest payable in respect of the Notes shall nevertheless continue to be calculated as previously in accordance with this Condition 5(i) but no publication of the Rate of Interest or the Interest Amount so calculated need be made unless the Trustee otherwise requires. The determination of any rate or amount, the obtaining of each quotation and the making of each determination or calculation by the Calculation Agent(s) shall (in the absence of manifest error) be final and binding upon all parties and the Noteholders.

- (j) ***Determination or Calculation by Trustee:*** If the Calculation Agent does not at any time for any reason determine or calculate the Rate of Interest for an Interest Accrual Period or any Interest Amount, Instalment Amount, Final Redemption Amount, Early Redemption Amount or Optional Redemption Amount, the Trustee shall appoint an agent on its behalf to do so and such determination or calculation shall be deemed to have been made by the Calculation Agent. In doing so, such agent shall apply the foregoing provisions of this Condition 5, with any necessary consequential amendments, to the extent that, in its opinion, it can do so, and, in all other respects it shall do so in such manner as it shall deem fair and reasonable in all the circumstances.
- (k) ***Definitions:*** In these Conditions, unless the context otherwise requires, the following defined terms shall have the meanings set out below:

“Business Day” means:

- (i) in the case of a currency other than euro and Renminbi, a day (other than a Saturday or Sunday) on which commercial banks and foreign exchange markets settle payments in the principal financial centre for such currency; and/or
- (ii) in the case of euro, a day on which the TARGET System is operating (a **“TARGET Business Day”**); and/or
- (iii) in the case of Renminbi, a day (other than a Saturday, Sunday or public holiday) on which commercial banks in Hong Kong are generally open for business and settlement of Renminbi payments in Hong Kong; and/or
- (iv) in the case of a currency and/or one or more Business Centres a day (other than a Saturday or a Sunday) on which commercial banks and foreign exchange markets settle payments in such currency in the Business Centre(s) or, if no currency is indicated, generally in each of the Business Centres.

“Day Count Fraction” means, in respect of the calculation of an amount of interest on any Note for any period of time (from and including the first day of such period to but excluding the last) (whether or not constituting an Interest Period or an Interest Accrual Period, the **“Calculation Period”**):

- (i) if **“Actual/Actual”** or **“Actual/Actual - ISDA”** is specified hereon, the actual number of days in the Calculation Period divided by 365 (or, if any portion of that Calculation Period falls in a leap year, the sum of (A) the actual number of days in that portion of the Calculation Period falling in a leap year divided by 366 and (B) the actual number of days in that portion of the Calculation Period falling in a non-leap year divided by 365)
- (ii) if **“Actual/365 (Fixed)”** is specified hereon, the actual number of days in the Calculation Period divided by 365
- (iii) if **“Actual/360”** is specified hereon, the actual number of days in the Calculation Period divided by 360
- (iv) if **“30/360”**, **“360/360”** or **“Bond Basis”** is specified hereon, the number of days in the Calculation Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 \times (Y_2 - Y_1)] + [30 \times (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

“Y1” is the year, expressed as a number, in which the first day of the Calculation Period falls;

“Y2” is the year, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;

“M1” is the calendar month, expressed as a number, in which the first day of the Calculation Period falls;

“M2” is the calendar month, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;

“D1” is the first calendar day, expressed as a number, of the Calculation Period, unless such number would be 31, in which case D1 will be 30; and

“D2” is the calendar day, expressed as a number, immediately following the last day included in the Calculation Period, unless such number would be 31 and D1 is greater than 29, in which case D2 will be 30

- (v) if **“30E/360”** or **“Eurobond Basis”** is specified hereon, the number of days in the Calculation Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 \times (Y_2 - Y_1)] + [30 \times (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

“**Y1**” is the year, expressed as a number, in which the first day of the Calculation Period falls;

“**Y2**” is the year, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;

“**M1**” is the calendar month, expressed as a number, in which the first day of the Calculation Period falls;

“**M2**” is the calendar month, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;

“**D1**” is the first calendar day, expressed as a number, of the Calculation Period, unless such number would be 31, in which case D1 will be 30; and

“**D2**” is the calendar day, expressed as a number, immediately following the last day included in the Calculation Period, unless such number would be 31, in which case D2 will be 30

- (vi) if “**30E/360 (ISDA)**” is specified hereon, the number of days in the Calculation Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 \times (Y_2 - Y_1)] + [30 \times (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

“**Y1**” is the year, expressed as a number, in which the first day of the Calculation Period falls;

“**Y2**” is the year, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;

“**M1**” is the calendar month, expressed as a number, in which the first day of the Calculation Period falls;

“**M2**” is the calendar month, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;

“**D1**” is the first calendar day, expressed as a number, of the Calculation Period, unless (i) that day is the last day of February or (ii) such number would be 31, in which case D1 will be 30; and

“**D2**” is the calendar day, expressed as a number, immediately following the last day included in the Calculation Period, unless (i) that day is the last day of February but not the Maturity Date or (ii) such number would be 31, in which case D2 will be 30

(vii) if “**Actual/Actual-ICMA**” is specified hereon,

- (a) if the Calculation Period is equal to or shorter than the Determination Period during which it falls, the number of days in the Calculation Period divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Periods normally ending in any year; and
- (b) if the Calculation Period is longer than one Determination Period, the sum of:
 - (x) the number of days in such Calculation Period falling in the Determination Period in which it begins divided by the product of (1) the number of days in such Determination Period and (2) the number of Determination Periods normally ending in any year; and
 - (y) the number of days in such Calculation Period falling in the next Determination Period divided by the product of (1) the number of days in such Determination Period and (2) the number of Determination Periods normally ending in any year

where:

“**Determination Period**” means the period from and including a Determination Date in any year to but excluding the next Determination Date; and

“**Determination Date**” means the date(s) specified as such hereon or, if none is so specified, the Interest Payment Date(s)

“**Euro-zone**” means the region comprised of member states of the European Union that adopt the single currency in accordance with the Treaty establishing the European Community, as amended.

“**Interest Accrual Period**” means the period beginning on (and including) the Interest Commencement Date and ending on (but excluding) the first Interest Period Date and each successive period beginning on (and including) an Interest Period Date and ending on (but excluding) the next succeeding Interest Period Date.

“**Interest Amount**” means:

- (i) in respect of an Interest Accrual Period, the amount of interest payable per Calculation Amount for that Interest Accrual Period and which, in the case of Fixed Rate Notes, and unless otherwise specified hereon, shall mean the Fixed Coupon Amount or Broken Amount specified hereon as being payable on the Interest Payment Date ending the Interest Period of which such Interest Accrual Period forms part; and
- (ii) in respect of any other period, the amount of interest payable per Calculation Amount for that period.

“**Interest Commencement Date**” means the Issue Date or such other date as may be specified hereon.

“**Interest Determination Date**” means, with respect to a Rate of Interest and Interest Accrual Period, the date specified as such hereon or, if none is so specified, (i) the first day of such Interest Accrual Period if the Specified Currency is Sterling or Hong Kong dollars or Renminbi other than where the Specified Currency is Renminbi and the Reference Rate is CNH HIBOR or (ii) the day falling two Business Days in London for the Specified

Currency prior to the first day of such Interest Accrual Period if the Specified Currency is neither Sterling nor euro nor Hong Kong dollars nor Renminbi or (iii) the day falling two TARGET Business Days prior to the first day of such Interest Accrual Period if the Specified Currency is euro or (iv) the day falling two Business Days in Hong Kong prior to the first day of such Interest Accrual Period if the Specified Currency is Renminbi and the Reference Rate is CNH HIBOR.

“Interest Period” means the period beginning on and including the Interest Commencement Date and ending on but excluding the first Interest Payment Date and each successive period beginning on and including an Interest Payment Date and ending on but excluding the next succeeding Interest Payment Date.

“Interest Period Date” means each Interest Payment Date unless otherwise specified hereon.

“ISDA Definitions” means the 2006 ISDA Definitions, as published by the International Swaps and Derivatives Association, Inc., unless otherwise specified hereon.

“Rate of Interest” means the rate of interest payable from time to time in respect of this Note and that is either specified or calculated in accordance with the provisions hereon.

“Reference Banks” means, in the case of a determination of LIBOR, the principal London office of four major banks in the London inter-bank market and, in the case of a determination of EURIBOR, the principal Euro-zone office of four major banks in the Euro-zone inter-bank market and, in the case of a determination of HIBOR, the principal Hong Kong office of four major banks in the Hong Kong inter-bank market and, in the case of a determination of CNH HIBOR, the principal Hong Kong office of four major banks dealing in Chinese Yuan in the Hong Kong inter-bank market, in each case selected by the Calculation Agent or as specified hereon.

“Reference Rate” means the rate specified as such hereon.

“Relevant Screen Page” means such page, section, caption, column or other part of a particular information service as may be specified hereon.

“Specified Currency” means the currency specified as such hereon or, if none is specified, the currency in which the Notes are denominated.

“TARGET System” means the Trans-European Automated Real-Time Gross Settlement Express Transfer (known as TARGET2) System which was launched on 19 November 2007 or any successor thereto.

- (1) **Calculation Agent:** The Issuer shall procure that there shall at all times be one or more Calculation Agents if provision is made for it or them hereon and for so long as any Note is outstanding (as defined in the Trust Deed). Where more than one Calculation Agent is appointed in respect of the Notes, references in these Conditions to the Calculation Agent shall be construed as each Calculation Agent performing its respective duties under the Conditions. If the Calculation Agent is unable or unwilling to act as such or, if the Calculation Agent fails duly to establish the Rate of Interest for an Interest Accrual Period or to calculate any Interest Amount, Instalment Amount, Final Redemption Amount, Early Redemption Amount or Optional Redemption Amount, as the case may be, or to comply with any other requirement, the Issuer shall (with the prior approval of the Trustee) appoint a leading bank or financial institution engaged in the interbank market (or, if appropriate, money, swap or over-the-counter index options market) that is most closely connected with

the calculation or determination to be made by the Calculation Agent (acting through its principal London office or any other office actively involved in such market) to act as such in its place. The Calculation Agent may not resign its duties without a successor having been appointed as aforesaid.

6 Redemption, Purchase, Options and Non-Viability Event in respect of Dated Subordinated Notes

(a) *Redemption by Instalments and Final Redemption:*

- (i) Unless previously redeemed, purchased and cancelled as provided in this Condition 6, each Note that provides for Instalment Dates and Instalment Amounts shall be partially redeemed on each Instalment Date at the related Instalment Amount specified hereon. The prevailing nominal amount of each such Note shall be reduced by the Instalment Amount (or, if such Instalment Amount is calculated by reference to a proportion of the nominal amount of such Note, such proportion) for all purposes with effect from the related Instalment Date, unless payment of the Instalment Amount is improperly withheld or refused, in which case, such amount shall remain outstanding until the Relevant Date relating to such Instalment Amount.
- (ii) Unless previously redeemed, purchased and cancelled as provided below, each Note shall be finally redeemed on the Maturity Date specified hereon at its Final Redemption Amount (which, unless otherwise provided hereon, is its prevailing nominal amount) or, in the case of a Note falling within Condition 6(a)(i), its final Instalment Amount.

(b) *Early Redemption:*

(i) *Zero Coupon Notes:*

- (A) The Early Redemption Amount payable in respect of any Zero Coupon Note, the Early Redemption Amount of which is not linked to an index and/or a formula, upon redemption of such Note pursuant to Condition 6(c) or upon it becoming due and payable as provided in Condition 10 shall be the Amortised Face Amount (calculated as provided below) of such Note unless otherwise specified hereon.
- (B) Subject to the provisions of sub-paragraph (C) below, the Amortised Face Amount of any such Note shall be the scheduled Final Redemption Amount of such Note on the Maturity Date discounted at a rate per annum (expressed as a percentage) equal to the Amortisation Yield (which, if none is shown hereon, shall be such rate as would produce an Amortised Face Amount equal to the issue price of the Notes if they were discounted back to their issue price on the Issue Date) compounded annually.
- (C) If the Early Redemption Amount payable in respect of any such Note upon its redemption pursuant to Condition 6(c) or upon it becoming due and payable as provided in Condition 10 is not paid when due, the Early Redemption Amount due and payable in respect of such Note shall be the Amortised Face Amount of such Note as defined in sub-paragraph (B) above, except that such sub-paragraph shall have effect as though the date on which the Note becomes due and payable were the Relevant Date. The calculation of the Amortised Face Amount in accordance with this sub-paragraph shall continue to be made (both before and after judgment) until the Relevant Date, unless the Relevant Date falls on or after the Maturity Date, in which case the amount due and payable shall be the scheduled Final Redemption Amount of such Note on the Maturity Date together with any interest that may accrue in accordance with Condition 5(c).

Where such calculation is to be made for a period of less than one year, it shall be made on the basis of the Day Count Fraction shown hereon.

- (ii) *Other Notes*: The Early Redemption Amount payable in respect of any Note (other than Notes described in (i) above), upon redemption of such Note pursuant to Condition 6(c) or upon it becoming due and payable as provided in Condition 10, shall be the Final Redemption Amount unless otherwise specified hereon.
- (c) *Redemption for Taxation Reasons*: The Notes may be redeemed at the option of the Issuer in whole, but not in part, (but subject, if required, to consent thereto having been obtained from the HKMA in the case of Dated Subordinated Notes) on any Interest Payment Date (if this Note is either a Floating Rate Note or an Index Linked Note) or at any time (if this Note is neither a Floating Rate Note nor an Index Linked Note), on giving not less than 30 nor more than 60 days' notice to the Noteholders (which notice shall be irrevocable) at their Early Redemption Amount (as described in Condition 6(b) above) (together with interest accrued to the date fixed for redemption), if (i) the Issuer satisfies the Trustee immediately before the giving of such notice that it has or will become obliged to pay additional amounts as described under Condition 8 as a result of any change in, or amendment to, the laws or regulations of Hong Kong or any political subdivision or any authority thereof or therein having power to tax, or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after the date on which agreement is reached to issue the first Tranche of the Notes, and (ii) such obligation will apply on the occasion of the next payment due in respect of the Notes and cannot be avoided by the Issuer taking reasonable measures available to it, provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would be obliged to pay such additional amounts were a payment in respect of the Notes then due. Prior to the publication of any notice of redemption pursuant to this Condition 6(c), the Issuer shall deliver to the Trustee a certificate signed by two Directors of the Issuer stating that the obligation referred to in (i) above cannot be avoided by the Issuer taking reasonable measures available to it, and an opinion of independent legal or tax advisers of recognised international standing to the effect that such change or amendment has occurred (irrespective of whether such amendment or change is then effective) and the Trustee shall be entitled without further enquiry to accept such certificate and opinion as sufficient evidence of the satisfaction of the condition precedent set out in (ii) above, in which event it shall be conclusive and binding on Noteholders and Couponholders.
- (d) *Redemption at the Option of the Issuer*: If Call Option is specified hereon, the Issuer may, on giving not less than 15 nor more than 30 days' irrevocable notice to the Noteholders (or such other notice period as may be specified hereon) redeem all or, if so provided, some of the Notes on any Optional Redemption Date. Any such redemption of Notes shall be at their Optional Redemption Amount together with interest accrued to the date fixed for redemption. Any such redemption or exercise must relate to Notes of a nominal amount at least equal to the Minimum Redemption Amount to be redeemed specified hereon and no greater than the Maximum Redemption Amount to be redeemed specified hereon.

All Notes in respect of which any such notice is given shall be redeemed on the date specified in such notice in accordance with this Condition.

In the case of a partial redemption the notice to Noteholders shall also contain the certificate numbers of the Bearer Notes, or in the case of Registered Notes shall specify the nominal amount of Registered Notes drawn and the holder(s) of such Registered Notes, to be redeemed, which shall have been drawn in such place and in such manner as the Issuer deems appropriate, subject to compliance with any applicable laws and stock exchange or other relevant authority requirements.

- (e) **Redemption at the Option of Noteholders:** If Put Option is specified hereon, the Issuer shall, at the option of the holder of any such Note, upon the holder of such Note giving not less than 15 nor more than 30 days' notice to the Issuer (or such other notice period as may be specified hereon) redeem such Note on the Optional Redemption Date(s) at its Optional Redemption Amount together with interest accrued to the date fixed for redemption.

To exercise such option the holder must deposit (in the case of Bearer Notes) such Note (together with all unmatured Receipts and Coupons and unexchanged Talons) with any Paying Agent or (in the case of Registered Notes) the Certificate representing such Note(s) with the relevant Registrar or any Transfer Agent at its specified office, together with a duly completed option exercise notice (an **"Exercise Notice"**) in the form obtainable from any Paying Agent, the relevant Registrar or any Transfer Agent (as applicable) within the notice period. No Note or Certificate so deposited and option exercised may be withdrawn (except as provided in the Agency Agreement) without the prior consent of the Issuer.

- (f) **Partly Paid Notes:** Partly Paid Notes will be redeemed, whether at maturity, early redemption or otherwise, in accordance with the provisions of this Condition 6 and the provisions specified hereon.
- (g) **Purchases:** The Issuer and its Subsidiaries (with, if required, the consent of the HKMA in the case of Dated Subordinated Notes) may at any time purchase Notes (provided that all unmatured Receipts and Coupons and unexchanged Talons relating thereto are attached thereto or surrendered therewith) in the open market or otherwise at any price.
- (h) **Cancellation:** All Notes purchased by or on behalf of the Issuer or any of its Subsidiaries may be surrendered for cancellation, in the case of Bearer Notes, by surrendering each such Note together with all unmatured Receipts and Coupons and all unexchanged Talons to the Issuing and Paying Agent or the CMU Lodging and Paying Agent and, in the case of Registered Notes, by surrendering the Certificate representing such Notes to the relevant Registrar and, in each case, if so surrendered, shall, together with all Notes redeemed by the Issuer, be cancelled forthwith (together with all unmatured Receipts and Coupons and unexchanged Talons attached thereto or surrendered therewith). Any Notes so surrendered for cancellation may not be reissued or resold and the obligations of the Issuer in respect of any such Notes shall be discharged.
- (i) **Non-Viability Event in respect of Dated Subordinated Notes:**

Any Write-off of any Dated Subordinated Notes under this Condition 6 with respect to the clearing and/or settlement of any Dated Subordinated Notes is subject to the availability of procedures to effect any such Write-off in the relevant clearing system(s). For the avoidance of doubt, however, any Write-off of any Dated Subordinated Notes with respect to the Issuer under this Condition 6 will be effective upon the date that the Issuer specifies in the Non-Viability Event Notice notwithstanding any inability to operationally effect any such Write-off in the relevant clearing system(s).

- (i) If this Condition 6(i) and "Write-off" is specified as the Loss Absorption Option in the applicable Pricing Supplement for any Dated Subordinated Notes, if a Non-Viability Event occurs and is continuing, the Issuer shall, upon the giving by it of a Non-Viability Event Notice, irrevocably (without the need for the consent of the holders of the Dated Subordinated Notes) reduce the then prevailing principal amount and cancel any accrued but unpaid interest of each Dated Subordinated Note (in each case in whole or in part) by an amount equal to the Non-Viability Event Write-off Amount per Dated Subordinated Note (such reduction and cancellation, and the reduction and cancellation of any other Dated Subordinated Notes so reduced and cancelled upon the occurrence of a Non-Viability Event, where applicable, being referred to herein as the **"Write-off"** and **"Written-off"** shall be construed

accordingly). Once any principal amount of, and any accrued but unpaid interest under, the Dated Subordinated Notes has been Written-off, it will not be restored in any circumstances, including where the relevant Non-Viability Event ceases to continue.

- (ii) No Noteholder may exercise, claim or plead any right to any Non-Viability Event Write-off Amount, and each Noteholder shall be deemed to have waived all such rights to such Non-Viability Event Write-off Amount.
- (iii) Any reference in these Conditions to principal in respect of the Notes shall thereafter refer to the principal amount of the Notes, subject to any applicable Write-off(s).
- (iv) Any Series of Dated Subordinated Notes may be subject to one or more Write-offs in part (as the case may be), except where such Series of Dated Subordinated Notes has been Written-off in its entirety.

If a Non-Viability Event Notice has been given in respect of any Dated Subordinated Notes in accordance with this Condition 6(i), transfers of any such Dated Subordinated Notes that are the subject of such notice shall not be permitted during the Suspension Period (as defined in Condition 2). From the date on which a Non-Viability Event Notice in respect of any Dated Subordinated Notes in accordance with this Condition 6(i) is given by the Issuer to the end of the Suspension Period, the Transfer Agents and the relevant Registrar, if applicable, shall not register any attempted transfer of any Dated Subordinated Notes. As a result, such an attempted transfer will not be effective.

In these Conditions:

“Non-Viability Event” means the earlier of:

- (i) the HKMA notifying the Issuer in writing that the HKMA is of the opinion that a write-off or conversion is necessary, without which the Issuer would become non-viable; and
- (ii) the HKMA notifying the Issuer in writing that a decision has been made by the government body, a government officer or other relevant regulatory body with the authority to make such a decision, that a public sector injection of capital or equivalent support is necessary, without which the Issuer would become non-viable.

“Non-Viability Event Notice” means the notice referred to in this Condition 6(i), which shall be given by the Issuer not more than two Hong Kong Business Days after the occurrence of a Non-Viability Event, to the holders of the Notes in accordance with Condition 16, and to the Trustee and the Paying Agents, and which shall state in reasonable detail the nature of the relevant Non-Viability Event and the Non-Viability Event Write-off Amount per Dated Subordinated Note.

“Non-Viability Event Write-off Amount” means the amount of interest and/or principal to be Written-off as the HKMA may direct or, in the absence of such a direction, as the Issuer shall (in consultation with the HKMA) determine to be necessary to satisfy the HKMA that the Non-Viability Event will cease to continue. For the avoidance of doubt:

- (i) the Write-off will be effected in full in the event that the amount Written-off is not sufficient for the Non-Viability Event to cease to continue; and

- (ii) in the case of an event falling within paragraph (ii) of the definition of Non-Viability Event, the Write-off will be effected in full before any public sector injection of capital or equivalent support.

(j) ***Redemption for Dated Subordinated Notes upon occurrence of a Regulatory Redemption Event:***

- (i) Subject to Condition 6(i), the Dated Subordinated Notes, may be redeemed at the option of the Issuer in whole, but not in part, at any time on giving not less than 30 nor more than 60 days' notice to the Noteholders (which notice shall be irrevocable) if, for the purposes of the Banking Ordinance, or any successor legislation or regulations made thereunder, the Dated Subordinated Notes, after having qualified as such in whole, and not in part, will no longer qualify as Tier 2 Capital Instruments (or equivalent) of the Issuer (other than (x) non-qualification solely by virtue of the Issuer already having on issue securities with an aggregate principal amount up to or in excess of the limit of Tier 2 Capital Instruments permitted from time to time by the HKMA or (y) solely as a result of any discounting or amortisation requirements as to the eligibility of the Dated Subordinated Notes for such inclusion pursuant to the relevant legislation and statutory guidelines in force as at the Issue Date) (a "**Regulatory Redemption Event**"), provided, however, that no such notice of Redemption shall be given earlier than 90 days prior to the earliest date on which it is determined that a Regulatory Redemption Event has occurred.
- (ii) Prior to giving any notice of redemption pursuant to this Condition 6(j), the Issuer shall deliver to the Trustee:
 - (A) a certificate signed by two Directors of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer to redeem have occurred;
 - (B) an opinion of independent legal advisers of recognised standing in a form and content satisfactory to the Trustee and to the effect that a Regulatory Redemption Event has occurred; and
 - (C) a copy of the written consent of the HKMA,and the Trustee shall be entitled to accept the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above in this Condition 6(j), in which event it shall be conclusive and binding on the Noteholders, Receiptholders and the Couponholders.
- (iii) Notes redeemed pursuant to this Condition 6(j) will be redeemed at the Early Redemption Amount specified in, or determined in the manner specified in, the applicable Pricing Supplement together, if appropriate, with interest accrued to (but excluding) the date fixed for redemption.

7 Payments and Talons

- (a) ***Bearer Notes not held in the CMU:*** Payments of principal and interest in respect of Bearer Notes not held in the CMU shall, subject as mentioned below, be made against presentation and surrender of the relevant Receipts (in the case of payments of Instalment Amounts other than on the due date for redemption and provided that the Receipt is presented for payment together with its relative Note), Notes (in the case of all other payments of principal and,

in the case of interest, as specified in Condition 7(g)(vi)) or Coupons (in the case of interest, save as specified in Condition 7(g)(ii)), as the case may be:

- (i) in the case of a currency other than Renminbi, at the specified office of any Paying Agent outside the United States by a cheque payable in the relevant currency drawn on, or, at the option of the holder, by transfer to an account denominated in such currency with, a Bank; and
- (ii) in the case of Renminbi, by transfer to a relevant account (as defined below in this Condition 7(a)) maintained by or on behalf of the Noteholder. If a holder does not maintain a relevant account in respect of a payment to be made under the Notes, the Issuer reserves the right, in its sole discretion and upon such terms as it may determine, to make arrangements to pay such amount to that holder by another means, provided that the Issuer shall not have any obligation to make any such arrangements.

In this Condition 7(a) and in Condition 7(c):

“**Bank**” means a bank in the principal financial centre for such currency or, in the case of euro, in a city in which banks have access to the TARGET System; and

“**relevant account**” means the Renminbi account maintained by or on behalf of the Noteholder with, in the case of Notes cleared through the CMU, a bank in Hong Kong.

- (b) ***Bearer Notes held in the CMU:*** Payments of principal and interest in respect of Bearer Notes held in the CMU will be made to the person(s) for whose account(s) interests in the relevant Bearer Note are credited as being held with the CMU in accordance with the CMU Rules (as defined in the Agency Agreement) at the relevant time as notified to the CMU Lodging and Paying Agent by the CMU in a relevant CMU Instrument Position Report (as defined in the Rules of the CMU) or any other relevant notification by the CMU, which notification shall be conclusive evidence of the records of the CMU (save in the case of manifest error) and payment made in accordance thereof shall discharge the obligations of the Issuer in respect of that payment.

- (c) ***Registered Notes not held in the CMU:***

- (i) Payments of principal (which for the purposes of this Condition 7(c) shall include final Instalment Amounts but not other Instalment Amounts) in respect of Registered Notes shall be made against presentation and surrender of the relevant Certificates at the specified office of any of the Transfer Agents or of the relevant Registrar and in the manner provided in Condition 7(c)(ii).
- (ii) Interest (which for the purpose of this Condition 7(c) shall include all Instalment Amounts other than final Instalment Amounts) on Registered Notes shall be paid to the person shown on the Register at the close of business on the fifth (in the case of Renminbi) and fifteenth (in the case of a currency other than Renminbi) day before the due date for payment thereof (the “**Record Date**”). Payments of interest on each Registered Note shall be made:
 - (x) in the case of a currency other than Renminbi, in the relevant currency by cheque drawn on a Bank and mailed to the holder (or to the first named of joint holders) of such Note at its address appearing in the Register. Upon application by the holder to the specified office of the relevant Registrar or any Transfer Agent before the Record Date, such payment of interest may be made by transfer to an account in the relevant currency maintained by the payee with a Bank; and
 - (y) in the case of Renminbi, by transfer to the registered account of the Noteholder.

In this Condition 7(c)(ii), “**registered account**” means the Renminbi account maintained by or on behalf of the Noteholder with a bank in Hong Kong, details of which appear on the Register at the close of business on the fifth business day before the due date for payment.

- (iii) Noteholders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due on a Note if the due date is not a relevant business day, if the Noteholder is late in surrendering or cannot surrender its Certificate (if required to do so) or if a cheque mailed in accordance with Condition 7(c)(ii) arrives after the due date for payment.
- (d) **Registered Notes held in the CMU:** Payments of principal and interest in respect of Registered Notes held in the CMU will be made to the person(s) for whose account(s) interests in the relevant Registered Note are credited as being held with the CMU in accordance with the CMU Rules (as defined in the Agency Agreement) at the relevant time as notified to the CMU Lodging and Paying Agent by the CMU in a relevant CMU Instrument Position Report (as defined in the Agency Agreement) or any other relevant notification by the CMU, which notification shall be conclusive evidence of the records of the CMU (save in the case of manifest error) and payment made in accordance thereof shall discharge the obligations of the Issuer in respect of that payment.

For so long as any of the Notes that are cleared through the CMU are represented by a Global Note or a Global Certificate, payments of interest or principal will be made to the persons for whose account a relevant interest in that Global Note or, as the case may be, that Global Certificate is credited as being held by the operator of the CMU at the relevant time, as notified to the CMU Lodging and Paying Agent by the operator of the CMU in a relevant CMU Instrument Position Report (as defined in the rules of the CMU) or in any other relevant notification by the operator of the CMU. Such payment will discharge the Issuer’s obligations in respect of that payment. Any payments by the CMU participants to indirect participants will be governed by arrangements agreed between the CMU participants and the indirect participants and will continue to depend on the inter-bank clearing system and traditional payment methods. Such payments will be the sole responsibility of such CMU participants.

- (e) **Payments in the United States:** Notwithstanding the foregoing, if any Bearer Notes are denominated in U.S. dollars, payments in respect thereof may be made at the specified office of any Paying Agent in New York City in the same manner as aforesaid if (i) the Issuer shall have appointed Paying Agents with specified offices outside the United States with the reasonable expectation that such Paying Agents would be able to make payment of the amounts on the Notes in the manner provided above when due, (ii) payment in full of such amounts at all such offices is illegal or effectively precluded by exchange controls or other similar restrictions on payment or receipt of such amounts and (iii) such payment is then permitted by United States law, without involving, in the opinion of the Issuer, any adverse tax consequence to the Issuer.
- (f) **Payments subject to Fiscal Laws:** Save as provided in Condition 8, payments will be subject in all cases to any other applicable fiscal or other laws and regulations in the place of payment or other laws and regulations to which the Issuer agrees to be subject and the Issuer will not be liable for any taxes or duties of whatever nature imposed or levied by such laws, regulations or agreements. No commission or expenses shall be charged to the Noteholders or Couponholders in respect of such payments.
- (g) **Appointment of Agents:** The Issuing and Paying Agent, the CMU Lodging and Paying Agent, the Paying Agents, the Registrars and the Transfer Agents initially appointed by the Issuer and their respective specified offices are listed below. The Issuing and Paying Agent, the CMU Lodging and Paying Agent, the Paying Agents, the Registrars and the Transfer

Agents appointed under the Agency Agreement and any Calculation Agents appointed in respect of any Notes act solely as agents of the Issuer and do not assume any obligation or relationship of agency or trust for or with any Noteholder or Couponholder. The Issuer reserves the right at any time with the approval of the Trustee to vary or terminate the appointment of the Issuing and Paying Agent, the CMU Lodging and Paying Agent, any other Paying Agent, any Registrar, any Transfer Agent or any Calculation Agent and to appoint additional or other Paying Agents or Transfer Agents, in each case in accordance with the Agency Agreement, provided that the Issuer shall at all times maintain (i) an Issuing and Paying Agent, (ii) a Registrar in relation to Registered Notes, (iii) a Transfer Agent in relation to Registered Notes, (iv) a CMU Lodging and Paying Agent in relation to Notes accepted for clearance through the CMU, (v) one or more Calculation Agent(s) where the Conditions so require, (vi) such other agents as may be required by any other stock exchange on which the Notes may be listed in each case, as approved by the Trustee and (vii) a Paying Agent with a specified office in a European Union member state that will not be obliged to withhold or deduct tax pursuant to any law implementing European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000.

In addition, the Issuer shall forthwith appoint a Paying Agent in New York City in respect of any Bearer Notes denominated in U.S. dollars in the circumstances described in Condition 7(e) above.

Notice of any such change or any change of any specified office shall promptly be given to the Noteholders.

(h) ***Unmatured Coupons and Receipts and unexchanged Talons:***

- (i) Upon the due date for redemption of Bearer Notes which comprise Fixed Rate Notes (other than Dual Currency Notes or Index linked Notes), the Notes should be surrendered for payment together with all unexpired Coupons (if any) relating thereto, failing which an amount equal to the face value of each missing unexpired Coupon (or, in the case of payment not being made in full, that proportion of the amount of such missing unexpired Coupon that the sum of principal so paid bears to the total principal due) shall be deducted from the Final Redemption Amount, Early Redemption Amount or Optional Redemption Amount, as the case may be, due for payment. Any amount so deducted shall be paid in the manner mentioned above against surrender of such missing Coupon within a period of 10 years from the Relevant Date for the payment of such principal (whether or not such Coupon has become void pursuant to Condition 9).
- (ii) Upon the due date for redemption of any Bearer Note comprising a Floating Rate Note, Dual Currency Note or Index Linked Note, unexpired Coupons relating to such Note (whether or not attached) shall become void and no payment shall be made in respect of them.
- (iii) Upon the due date for redemption of any Bearer Note, any unexchanged Talon relating to such Note (whether or not attached) shall become void and no Coupon shall be delivered in respect of such Talon.
- (iv) Upon the due date for redemption of any Bearer Note that is redeemable in instalments, all Receipts relating to such Note having an Instalment Date falling on or after such due date (whether or not attached) shall become void and no payment shall be made in respect of them.

- (v) Where any Bearer Note that provides that the relative unmatured Coupons are to become void upon the due date for redemption of those Notes is presented for redemption without all unmatured Coupons, and where any Bearer Note is presented for redemption without any unexchanged Talon relating to it, redemption shall be made only against the provision of such indemnity as the Issuer may require.
- (vi) If the due date for redemption of any Note is not a due date for payment of interest, interest accrued from the preceding due date for payment of interest or the Interest Commencement Date, as the case may be, shall only be payable against presentation (and surrender if appropriate) of the relevant Bearer Note or Certificate representing it, as the case may be. Interest accrued on a Note that only bears interest after its Maturity Date shall be payable on redemption of such Note against presentation of the relevant Note or Certificate representing it, as the case may be.
- (i) **Talons:** On or after the Interest Payment Date for the final Coupon forming part of a Coupon sheet issued in respect of any Bearer Note, the Talon forming part of such Coupon sheet may be surrendered at the specified office of the Issuing and Paying Agent in exchange for a further Coupon sheet (and if necessary another Talon for a further Coupon sheet) (but excluding any Coupons that may have become void pursuant to Condition 9).
- (j) **Non-Business Days:** If any date for payment in respect of any Note, Receipt or Coupon is not a business day, the holder shall not be entitled to payment until the next following business day nor to any interest or other sum in respect of such postponed payment. In this Condition 7, “**business day**” means a day (other than a Saturday or a Sunday) on which banks and foreign exchange markets are open for business in the relevant place of presentation (if presentation and/or surrender of such Note, Receipt or Coupon is required) in such jurisdictions as shall be specified as “**Financial Centres**” hereon and:
 - (i) (in the case of a payment in a currency other than euro and Renminbi) where payment is to be made by transfer to an account maintained with a bank in the relevant currency, on which foreign exchange transactions may be carried on in the relevant currency in the principal financial centre of the country of such currency; or
 - (ii) (in the case of a payment in euro) which is a TARGET Business Day; or
 - (iii) (in the case of a payment in Renminbi where the Notes are cleared through the CMU) on which banks and foreign exchange markets are open for business and settlement of Renminbi payments in Hong Kong; or
 - (iv) (in the case of a payment in Renminbi where the Notes are not cleared through the CMU) on which banks and foreign exchange markets are open for business and settlement of Renminbi payments in the place or places specified in the applicable Pricing Supplement.

8 Taxation

All payments of principal and interest by or on behalf of the Issuer in respect of the Notes, the Receipts and the Coupons shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or within Hong Kong or any authority therein or thereof having power to tax, unless such withholding or deduction is required by law. If the Issuer is required to make a deduction or withholding by or within Hong Kong, the Issuer shall pay such additional amounts as shall result in receipt by the Noteholders and Couponholders of such amounts as would have been received by them had no such withholding or deduction been

required, except that no such additional amounts shall be payable with respect to any Note, Receipt or Coupon:

- (a) **Other connection:** to, or to a third party on behalf of, a holder who is liable to such taxes, duties, assessments or governmental charges in respect of such Note, Receipt or Coupon by reason of his having some connection with Hong Kong other than the mere holding of the Note, Receipt or Coupon; or
- (b) **Presentation more than 30 days after the Relevant Date:** presented (or in respect of which the Certificate representing it is presented) for payment more than 30 days after the Relevant Date except to the extent that the holder of it would have been entitled to such additional amounts on presenting it for payment on the thirtieth day; or
- (c) **Payment to individuals:** where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (d) **Payment by another Paying Agent:** (except in the case of Registered Notes) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note, Receipt or Coupon to another Paying Agent in a Member State of the European Union.

As used in these Conditions, “**Relevant Date**” in respect of any Note, Receipt or Coupon means the date on which payment in respect of it first becomes due or (if any amount of the money payable is improperly withheld or refused) the date on which payment in full of the amount outstanding is made or (if earlier) the date seven days after that on which notice is duly given to the Noteholders that, upon further presentation of the Note (or relative Certificate), Receipt or Coupon being made in accordance with these Conditions, such payment will be made, provided that payment is in fact made upon such presentation. References in these Conditions to (i) “**principal**” shall be deemed to include any premium payable in respect of the Notes, all Instalment Amounts, Final Redemption Amounts, Early Redemption Amounts, Optional Redemption Amounts, Amortised Face Amounts and all other amounts in the nature of principal payable pursuant to Condition 6 or any amendment or supplement to it, (ii) “**interest**” shall be deemed to include all Interest Amounts and all other amounts payable pursuant to Condition 5 or any amendment or supplement to it and (iii) “**principal**” and/or “**interest**” shall be deemed to include any additional amounts that may be payable under this Condition 8 or any undertaking given in addition to or in substitution for it under the Trust Deed.

9 Prescription

Claims against the Issuer for payment in respect of the Notes, Receipts and Coupons (which, for this purpose, shall not include Talons) shall be prescribed and become void unless made within 10 years (in the case of principal) or five years (in the case of interest) from the appropriate Relevant Date in respect of them.

10 Events of Default

- (a) **Dated Subordinated Notes:**
 - (i) If default is made in the payment of principal or interest due in respect of any of the Dated Subordinated Notes and the default continues for a period of five business days in Hong Kong (in the case of principal) or 10 business days in Hong Kong (in the case of interest) (in relation to Dated Subordinated Notes, each such event, an “**Event of**

Default”), then the Trustee at its discretion may, subject as provided in Condition 12(b), in order to enforce payment, without further notice, institute Winding-Up Proceedings in Hong Kong against the Issuer, but may take no further action in respect of such default (but without prejudice to Condition 10(a)(iii) below).

- (ii) If a Write-off has occurred pursuant to, or otherwise in accordance with, Condition 6, such event will not constitute an Event of Default under these Conditions.
- (iii) If an order is made or an effective resolution is passed for the Winding-Up of the Issuer in Hong Kong (except for the purposes of reconstruction, amalgamation or reorganisation the terms of which have previously been approved by an Extraordinary Resolution of the Dated Subordinated Noteholders) (in relation to Dated Subordinated Notes, such event also, an **“Event of Default”**), then the Trustee at its discretion may, subject as provided in Condition 12(b), give written notice to the Issuer that the Dated Subordinated Notes are, and they shall forthwith thereupon become, immediately due and repayable at their nominal amount together with accrued interest without further action or formality.
- (iv) In these Conditions:

“Winding-Up” shall mean, with respect to the Issuer, final and effective order or resolution for the bankruptcy, winding-up, liquidation, administrative receivership or similar proceeding in respect of the Issuer (as applicable); and

“Winding-Up Proceedings” shall mean, with respect to the Issuer, proceedings in Hong Kong for the bankruptcy, liquidation, winding-up, administrative receivership, or other similar proceeding of the Issuer (as applicable).

- (b) **Senior Notes:** If any of the following events (in relation to Senior Notes, each such event an **“Event of Default”**) occurs, the Trustee at its discretion may, and if so requested in writing by holders of at least 25 per cent. in nominal amount of the Senior Notes then outstanding or if so directed by an Extraordinary Resolution shall, subject in each case to first being indemnified and/or secured and/or pre-funded to its satisfaction, give notice to the Issuer that the Senior Notes are, and they shall immediately become, due and payable at their Early Redemption Amount together (if applicable) with accrued interest:
 - (i) **Non-Payment:** default is made for more than 14 days (in the case of interest) or five days (in the case of principal) in the payment on the due date of interest or principal in respect of any of the Senior Notes; or
 - (ii) **Breach of Other Obligations:** the Issuer does not perform or comply with any one or more of its other obligations in the Senior Notes or the Trust Deed which default is incapable of remedy or, if capable of remedy, is not remedied within 21 days after notice of such default shall have been given to the Issuer by the Trustee; or
 - (iii) **Cross-Default:** (A) any other present or future indebtedness for monies borrowed or raised by the Issuer or any of its Subsidiaries for or in respect of moneys borrowed or raised becomes (or becomes capable of being declared) due and payable prior to its stated maturity by reason of any actual or potential default, event of default or the like (howsoever described), or (B) any such indebtedness is not paid when due or, as the case may be, within any originally applicable grace period, or (C) the Issuer or any of its Subsidiaries fails to pay when due any amount payable by it under any present or future guarantee for, or indemnity in respect of, any moneys borrowed or raised

provided that the aggregate amount of the relevant indebtedness, guarantees and indemnities in respect of which one or more of the events mentioned above in this Condition 10(b)(iii) have occurred equals or exceeds U.S.\$15,000,000 or its equivalent in any other currency; or

- (iv) **Enforcement Proceedings:** a distress, attachment, execution or other legal process is levied, enforced or sued out on or against any part of the property, assets or revenues of the Issuer or any of its Subsidiaries and is not discharged or stayed within 45 days; or
- (v) **Security Enforced:** any mortgage, charge, pledge, lien or other encumbrance, present or future, created or assumed by the Issuer or any of its Subsidiaries becomes enforceable and any step is taken to enforce it (including the taking of possession or the appointment of a receiver, administrative receiver, administrator, manager or other similar person); or
- (vi) **Insolvency:** the Issuer or any of its Subsidiaries is (or is, or could be, deemed by law or a court to be) insolvent or bankrupt or unable to pay its debts, stops, suspends or threatens to stop or suspend payment of all or a material part of (or of a particular type of) its debts, proposes or makes any agreement for the deferral, rescheduling or other readjustment of all of (or all of a particular type of) its debts (or of any part which it will or might otherwise be unable to pay when due), proposes or makes a general assignment or an arrangement or composition with or for the benefit of the relevant creditors in respect of any of such debts or a moratorium is agreed or declared in respect of or affecting all or any part of (or of a particular type of) the debts of the Issuer or any of its Subsidiaries; or
- (vii) **Winding-up:** an order is made or an effective resolution passed for the winding-up or dissolution of the Issuer or any of its Subsidiaries, or the Issuer or any of its Subsidiaries shall apply or petition for a winding-up or administration order in respect of itself or ceases or threatens to cease to carry on all or substantially all of its business or operations, in each case except for the purpose of and followed by a reconstruction, amalgamation, reorganisation, merger or consolidation (i) on terms approved by the Trustee or by an Extraordinary Resolution (as defined in the Trust Deed) of the Noteholders or (ii) in the case of a Subsidiary, whereby the undertaking and assets of the Subsidiary are transferred to or otherwise vested in the Issuer or another of its Subsidiaries; or
- (viii) **Authorisation and Consents:** any action, condition or thing (including the obtaining or effecting of any necessary consent, approval, authorisation, exemption, filing, licence, order, recording or registration) at any time required to be taken, fulfilled or done in order (I) to enable the Issuer lawfully to enter into, exercise its rights and perform and comply with its obligations under the Senior Notes and the Trust Deed, (II) to ensure that those obligations are legally binding and enforceable and (III) to make the Senior Notes and the Trust Deed admissible in evidence in the courts of England is not taken, fulfilled or done; or
- (ix) **Illegality:** it is or will become unlawful for the Issuer to perform or comply with any one or more of its obligations under any of the Senior Notes or the Trust Deed; or
- (x) **Analogous Events:** any event occurs that under the laws of any relevant jurisdiction has an analogous effect to any of the events referred to in any of the Conditions 10(b)(i) to 10(b)(ix) (both inclusive),

provided that in the case of Conditions 10(b)(ii) and 10(b)(viii) and, in relation to Subsidiaries only, Conditions 10(b)(iv), 10(b)(v), 10(b)(vi) and 10(b)(x), the Trustee shall have certified that in its opinion such event is materially prejudicial to the interests of the Noteholders.

11 Meetings of Noteholders, Modification, Waiver and Substitution

- (a) **Meetings of Noteholders:** The Trust Deed contains provisions for convening meetings of Noteholders to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution (as defined in the Trust Deed) of a modification of any of these Conditions or any provisions of the Trust Deed. Such a meeting may be convened by Noteholders holding not less than 10 per cent. in nominal amount of the Notes for the time being outstanding. The quorum for any meeting convened to consider an Extraordinary Resolution shall be two or more persons holding or representing a clear majority in nominal amount of the Notes for the time being outstanding, or at any adjourned meeting two or more persons being or representing Noteholders whatever the nominal amount of the Notes held or represented, unless the business of such meeting includes consideration of proposals, inter alia, (i) to amend the dates of maturity or redemption of the Notes, any Instalment Date or any date for payment of interest or Interest Amounts on the Notes, (ii) to reduce or cancel the nominal amount of, or any Instalment Amount of, or any premium payable on redemption of, the Notes, (iii) to reduce the rate or rates of interest in respect of the Notes or to vary the method or basis of calculating the rate or rates or amount of interest or the basis for calculating any Interest Amount in respect of the Notes, (iv) if a Minimum Rate of Interest and/or a Maximum Rate of Interest, Instalment Amount or Redemption Amount is shown hereon, to reduce any such Minimum Rate of Interest and/or Maximum Rate of Interest, (v) to vary any method of, or basis for, calculating the Final Redemption Amount, the Early Redemption Amount or the Optional Redemption Amount, including the method of calculating the Amortised Face Amount, (vi) to vary the currency or currencies of payment or denomination of the Notes, or (vii) to modify the provisions concerning the quorum required at any meeting of Noteholders or the majority required to pass an Extraordinary Resolution, in which case the necessary quorum shall be two or more persons holding or representing not less than 75 per cent., or at any adjourned meeting not less than 25 per cent., in nominal amount of the Notes for the time being outstanding. Any Extraordinary Resolution duly passed shall be binding on Noteholders (whether or not they were present at the meeting at which such resolution was passed) and on all Couponholders.

The Trust Deed provides that a resolution in writing signed by or on behalf of the Noteholders of not less than 90 per cent. in nominal amount of the Notes for the time being outstanding shall for all purposes be as valid and effective as an Extraordinary Resolution passed at a meeting of Noteholders duly convened and held. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders.

These Conditions may be amended, modified or varied in relation to any Series of Notes by the terms of the relevant Pricing Supplement in relation to such Series.

- (b) **Modification of the Trust Deed:** The Trustee may agree, without the consent of the Noteholders or Couponholders, to (i) any modification of any of the provisions of the Trust Deed or these Conditions that is of a formal, minor or technical nature or is made to correct a manifest error or to comply with any mandatory provision of law, and (ii) any other modification (except as mentioned in the Trust Deed), and any waiver or authorisation of any breach or proposed breach, of any of the provisions of the Trust Deed and/or these Conditions that is in the opinion of the Trustee not materially prejudicial to the interests of

the Noteholders. Any such modification, authorisation or waiver shall be binding on the Noteholders and the Couponholders and, unless the Trustee otherwise requires, such modification, authorisation or waiver shall be notified to the Noteholders as soon as practicable.

- (c) ***Substitution:*** The Trust Deed contains provisions permitting the Trustee to agree, subject to such amendment of the Trust Deed and such other conditions as the Trustee may require, but without the consent of the Noteholders or the Couponholders, to the substitution of the Issuer's successor in business or any Subsidiary of the Issuer or its successor in business or any holding company of the Issuer or any other subsidiary of any such holding company or their respective successor in business in place of the Issuer, or of any previous substituted company, as principal debtor under the Trust Deed and the Notes. In the case of such a substitution the Trustee may agree, without the consent of the Noteholders or the Couponholders, to a change of the law governing the Notes, the Receipts, the Coupons, the Talons and/or the Trust Deed provided that such change would not in the opinion of the Trustee be materially prejudicial to the interests of the Noteholders.
- (d) ***Entitlement of the Trustee:*** In connection with the exercise of its functions, powers, rights and discretions (including but not limited to those referred to in this Condition 11), the Trustee shall have regard to the interests of the Noteholders as a class and shall not have regard to the consequences of such exercise for individual Noteholders or Couponholders and the Trustee, acting for and on behalf of Noteholders, shall not be entitled to require, nor shall any Noteholder or Couponholder be entitled to claim, from the Issuer any indemnification or payment in each case in respect of any tax consequence of any such exercise upon individual Noteholders or Couponholders.

12 Enforcement

- (a) Without prejudice to Condition 10, the Trustee may, subject as provided below, at its discretion and without further notice, institute such proceedings as it may think fit against the Issuer if the Issuer fails to perform, observe or comply with any obligation, condition or provision binding on the Issuer under the Notes, the Receipts, the Coupons or the Trust Deed (other than any obligation for the payment of any principal or interest in respect of Dated Subordinated Notes), provided that the Issuer shall not as consequence of such proceedings be obliged to pay any sum or sums representing or measured by reference to principal or interest in respect of the Notes sooner than the same would otherwise have been payable by it.
- (b) The Trustee shall not be bound to take action as referred to in these Conditions or any other action under the Trust Deed unless (i) it shall have been so requested in writing by Noteholders holding at least 25 per cent. of the nominal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution of the Noteholders and (ii) it shall have been indemnified and/or secured and/or pre-funded to its satisfaction.
- (c) No Noteholder, Receiptholder or Couponholder shall be entitled to proceed directly against the Issuer unless the Trustee, having become bound so to proceed, fails to do so within reasonable period and such failure is continuing. In respect of Dated Subordinated Notes only, subject to applicable laws, no remedy (including the exercise of any right of set-off or analogous event) other than those provided for in Condition 10 and Conditions 12(a) and 12(b) or submitting claims in the Winding-Up of the Issuer will be available to the Trustee or the Dated Subordinated Noteholders. No Dated Subordinated Noteholder shall be entitled to institute Winding-Up Proceedings in Hong Kong (or elsewhere) against the Issuer or to submit claim in such Winding-Up except that, if the Trustee, having become bound to institute such proceedings as aforesaid, fails to do so, or, being able and bound to submit a claim in such Winding-Up, fails to do so, in each case within reasonable period

and such failure is continuing, then any such holder may, himself institute Winding-Up Proceedings against the Issuer in Hong Kong (but not elsewhere) and/or submit a claim in such Winding-Up to the same extent (but not further or otherwise) that the Trustee would have been entitled to do.

13 Indemnification of the Trustee

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility. The Trustee is entitled to enter into business transactions with the Issuer and any entity related to the Issuer without accounting for any profit.

The Trustee may rely without liability to Noteholders or Couponholders on a report, confirmation or certificate or any advice of any accountants, financial advisers, financial institution or any other expert, whether or not addressed to it and whether their liability in relation thereto is limited (by its terms or by any engagement letter relating thereto entered into by the Trustee or in any other manner) by reference to a monetary cap, methodology or otherwise. The Trustee may accept and shall be entitled to rely on any such report, confirmation or certificate or advice and such report, confirmation or certificate or advice shall be binding on the Issuer, the Trustee and the Noteholders.

14 Replacement of Notes, Certificates, Receipts, Coupons and Talons

If a Note, Certificate, Receipt, Coupon or Talon is lost, stolen, mutilated, defaced or destroyed, it may be replaced, subject to applicable laws, regulations and stock exchange or other relevant authority regulations, at the specified office of the Issuing and Paying Agent or the CMU Lodging and Paying Agent, as the case may be, (in the case of Bearer Notes, Receipts, Coupons or Talons) and of the relevant Registrar (in the case of Certificates), in each case on payment by the claimant of the fees and costs incurred in connection therewith and on such terms as to evidence, security and indemnity (which may provide, inter alia, that if the allegedly lost, stolen or destroyed Note, Certificate, Receipt, Coupon or Talon is subsequently presented for payment or, as the case may be, for exchange for further Coupons, there shall be paid to the Issuer on demand the amount payable by the Issuer in respect of such Notes, Certificates, Receipts, Coupons or further Coupons) and otherwise as the Issuer may require. Mutilated or defaced Notes, Certificates, Receipts, Coupons or Talons must be surrendered before replacements will be issued.

15 Further Issues

The Issuer may from time to time without the consent of the Noteholders or Couponholders create and issue further securities either having the same terms and conditions as the Notes in all respects (or in all respects except for the first payment of interest on them) and so that such further issue shall be consolidated and form a single series with the outstanding securities of any series (including the Notes) or upon such terms as the Issuer may determine at the time of their issue. References in these Conditions to the Notes include (unless the context requires otherwise) any other securities issued pursuant to this Condition 15 and forming a single series with the Notes. Any further securities forming a single series with the outstanding securities of any series (including the Notes) constituted by the Trust Deed or any deed supplemental to it shall, and any other securities may (with the consent of the Trustee), be constituted by the Trust Deed. The Trust Deed contains provisions for convening a single meeting of the Noteholders and the holders of securities of other series where the Trustee so decides.

16 Notices

Notices to the holders of Registered Notes shall be mailed to them at their respective addresses in the Register and deemed to have been given on the fourth weekday (being a day other than a Saturday or a Sunday) after the date of mailing and, so long as the Notes are listed on the Singapore Exchange Securities Limited (the “SGX-ST”) and the rules of the SGX-ST so require, published in a leading newspaper having general circulation in Singapore (which is expected to be the Asian Wall Street Journal). Notices to the holders of Bearer Notes shall be valid if published in a daily newspaper of general circulation in Hong Kong and, so long as the Notes are listed on the SGX-ST and the rules of the SGX-ST so require, published in a leading newspaper having general circulation in Singapore (which is expected to be the Asian Wall Street Journal). If any such publication is not practicable, notice shall be validly given if published in another leading daily English language newspaper with general circulation in Asia. Any such notice shall be deemed to have been given on the date of such publication or, if published more than once or on different dates, on the first date on which publication is made, as provided above.

Couponholders shall be deemed for all purposes to have notice of the contents of any notice given to the holders of Bearer Notes in accordance with this Condition 16.

So long as the Notes are represented by a Global Note or a Global Certificate and such Global Note or Global Certificate is held on behalf of (i) Euroclear or Clearstream, Luxembourg or any other clearing system (except as provided in (ii) below), notices to the holders of Notes of that Series may be given by delivery of the relevant notice to that clearing system for communication by it to entitled accountholders in substitution for publication as required by the Conditions or by delivery of the relevant notice to the holder of the Global Note or (ii) the CMU, notices to the holders of Notes of that Series may be given by delivery of the relevant notice to the persons shown in a CMU Instrument Position Report issued by the CMU on the second business day preceding the date of despatch of such notice as holding interests in the relevant Global Note or Global Certificate.

A Non-Viability Event Notice to the holders of the relevant Dated Subordinated Notes shall be deemed to have been validly given on the date on which such notice is published in a daily newspaper of general circulation in Singapore (which is expected to be the Asian Wall Street Journal) or, so long as Notes are listed on the SGX-ST, published on the website of the SGX-ST. If any such publication is not practicable, notice shall be validly given if published in another leading daily English language newspaper with general circulation in Singapore. Any such notice shall be deemed to have been given on the date of such publication or, if published more than once or on different dates, on the first date on which publication is made, as provided above.

17 Contracts (Rights of Third Parties) Act 1999

No person shall have any right to enforce any term or condition of the Notes under the Contracts (Rights of Third Parties) Act 1999.

18 Governing Law and Jurisdiction

- (a) **Governing Law:** The Trust Deed, the Notes, the Receipts, the Coupons and the Talons and any non-contractual obligations arising out of or in connection with them are governed by, and shall be construed in accordance with, English law save that the provisions of Condition 3 (and related provisions of the Trust Deed) relating to subordination of the Dated Subordinated Notes are governed by, and shall be construed in accordance with, Hong Kong law.

- (b) ***Jurisdiction***: The Courts of England are to have jurisdiction to settle any disputes that may arise out of or in connection with any Notes, Receipts, Coupons or Talons and accordingly any legal action or proceedings arising out of or in connection with any Notes, Receipts, Coupons or Talons (“**Proceedings**”) may be brought in such courts. The Issuer has in the Trust Deed irrevocably submitted to the jurisdiction of such courts.
- (c) ***Service of Process***: The Issuer has in the Trust Deed irrevocably appointed an agent in England to receive, for it and on its behalf, service of process in any Proceedings in England.

19 Headings

Headings are for convenience only and do not affect the interpretation of these Conditions.

SUMMARY OF PROVISIONS RELATING TO THE NOTES WHILE IN GLOBAL FORM

1 INITIAL ISSUE OF NOTES

Global Notes and Global Certificates may be delivered on or prior to the original issue date of the Tranche to a common depository for Euroclear and Clearstream, Luxembourg (the “**Common Depository**”) or a sub-custodian for the HKMA as operator of the CMU.

Upon the initial deposit of a Global Note with the Common Depository or with a sub-custodian for the HKMA as operator of the CMU or registration of Registered Notes in the name of (i) any nominee for Euroclear and Clearstream, Luxembourg or (ii) the HKMA and delivery of the relative Global Certificate to the Common Depository or the sub-custodian for the HKMA as operator of the CMU (as the case may be), Euroclear or Clearstream, Luxembourg or the CMU (as the case may be) will credit each subscriber with a nominal amount of Notes equal to the nominal amount thereof for which it has subscribed and paid.

Notes that are initially deposited with the Common Depository may also be credited to the accounts of subscribers with (if indicated in the relevant Pricing Supplement) other clearing systems through direct or indirect accounts with Euroclear and Clearstream, Luxembourg held by such other clearing systems. Conversely, Notes that are initially deposited with any other clearing system may similarly be credited to the accounts of subscribers with Euroclear, Clearstream, Luxembourg or other clearing systems.

2 RELATIONSHIP OF ACCOUNTHOLDERS WITH CLEARING SYSTEMS

Save as provided in the following paragraph, each of the persons shown in the records of Euroclear, Clearstream, Luxembourg or any other clearing system as the holder of a Note represented by a Global Note or a Global Certificate must look solely to Euroclear, Clearstream, Luxembourg or such clearing system (as the case may be) for his share of each payment made by the Issuer to the bearer of such Global Note or the holder of the underlying Registered Notes, as the case may be, and in relation to all other rights arising under the Global Notes or Global Certificates, subject to and in accordance with the respective rules and procedures of Euroclear, Clearstream, Luxembourg or such clearing system (as the case may be). Such persons shall have no claim directly against the Issuer in respect of payments due on the Notes for so long as the Notes are represented by such Global Note or Global Certificate and such obligations of the Issuer will be discharged by payment to the bearer of such Global Note or the holder of the underlying Registered Notes, as the case may be, in respect of each amount so paid.

If a Global Note or a Global Certificate is lodged with the CMU, the person(s) for whose account(s) interests in such Global Note or Global Certificate are credited as being held in the CMU in accordance with the CMU Rules as notified by the CMU to the CMU Lodging and Paying Agent in a relevant CMU Instrument Position Report or any other relevant notification by the CMU (which notification, in either case, shall be conclusive evidence of the records of the CMU save in the case of manifest error) shall be the only person(s) entitled (in the case of Registered Notes, directed or deemed by the CMU as entitled) to receive payments in respect of Notes represented by such Global Note or Global Certificate and the Issuer will be discharged by payment to, or to the order of, such person(s) for whose account(s) interests in such Global Note or Global Certificate are credited as being held in the CMU in respect of each amount so paid. Each of the persons shown in the records of the CMU, as the beneficial holder of a particular nominal amount of Notes represented by such Global Note or Global Certificate must look solely to the Issuing and Paying Agent for his share of each payment so made by the Issuer in respect of such Global Note or Global Certificate.

3 EXCHANGE

3.1 Temporary Global Notes

Each temporary Global Note will be exchangeable, free of charge to the holder, on or after its Exchange Date:

- (i) if the relevant Pricing Supplement indicates that such Global Note is issued in compliance with the C Rules or in a transaction to which TEFRA is not applicable (as to which, see “*Summary of the Programme — Selling Restrictions*”), in whole, but not in part, for the Definitive Notes defined and described below; and
- (ii) otherwise, in whole or in part upon certification as to non-U.S. beneficial ownership in the form set out in the Agency Agreement for interests in a permanent Global Note or, if so provided in the relevant Pricing Supplement, for Definitive Notes.

The CMU may require that any such exchange for a permanent Global Note is made in whole and not in part and in such event, no such exchange will be effected until all relevant account holders (as set out in a CMU Instrument Position Report (as defined in the rules of the CMU) or any other relevant notification supplied to the CMU Lodging and Paying Agent by the CMU) have so certified.

Each temporary Global Note that is also an Exchangeable Bearer Note will be exchangeable for Registered Notes in accordance with the Conditions in addition to any permanent Global Note or Definitive Notes for which it may be exchangeable and, before its Exchange Date, will also be exchangeable in whole or in part for Registered Notes only.

3.2 Permanent Global Notes

Each permanent Global Note will be exchangeable, free of charge to the holder, on or after its Exchange Date in whole but not, except as provided under “Partial Exchange of Permanent Global Notes” below, in part for Definitive Notes or, in the case of (i) below, Registered Notes:

- (i) if the permanent Global Note is an Exchangeable Bearer Note, by the holder giving notice to the Issuing and Paying Agent of its election to exchange the whole or a part of such Global Note for Registered Notes represented by a corresponding interest in a Global Certificate; and
- (ii) (a) if the permanent Global Note is held on behalf of Euroclear or Clearstream, Luxembourg or the CMU or any other clearing system (an “**Alternative Clearing System**”) and any such clearing system is closed for business for a continuous period of 14 days (other than by reason of holidays, statutory or otherwise) or announces an intention permanently to cease business or in fact does so or (b) if principal in respect of any Notes is not paid when due, by the holder giving notice to the Issuing and Paying Agent (or, in the case of Notes lodged with the CMU, the CMU Lodging and Paying Agent) of its election for such exchange.

In the event that a Global Note is exchanged for Definitive Notes, such Definitive Notes shall be issued in Specified Denomination(s) only. A Noteholder who holds a principal amount of less than the minimum Specified Denomination will not receive a Definitive Note in respect of such holding and would need to purchase a principal amount of Notes such that it holds an amount equal to one or more Specified Denominations.

3.3 Global Certificates

If the relevant Pricing Supplement states that the Notes are to be represented by a Global Certificate on issue, the following will apply in respect of transfers of Notes held in Euroclear or Clearstream, Luxembourg or the CMU or an Alternative Clearing System. These provisions will not prevent the trading of interests in the Notes within a clearing system whilst they are held on behalf of such clearing system, but will limit the circumstances in which the Notes may be withdrawn from the relevant clearing system.

Transfers of the holding of Notes represented by any Global Certificate pursuant to Condition 2 may only be made in part:

- (i) if the relevant clearing system is closed for business for a continuous period of 14 days (other than by reason of holidays, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so;
- (ii) if principal in respect of any Notes is not paid when due; or
- (iii) with the prior consent of the Issuer,

provided that, in the case of the first transfer of part of a holding pursuant to (i) or (ii) above, the Registered Holder has given the Registrar not less than 30 days' notice at its specified office of the Registered Holder's intention to effect such transfer.

3.4 Partial Exchange of Permanent Global Notes

For so long as a permanent Global Note is held on behalf of a clearing system and the rules of that clearing system permit, such permanent Global Note will be exchangeable in part on one or more occasions (1) for Registered Notes if the permanent Global Note is an Exchangeable Bearer Note and the part submitted for exchange is to be exchanged for Registered Notes, or (2) for Definitive Notes (i) if principal in respect of any Notes is not paid when due or (ii) if so provided in, and in accordance with, the Conditions (which will be set out in the relevant Pricing Supplement) relating to Partly Paid Notes.

3.5 Delivery of Notes

On or after any due date for exchange the holder of a Global Note may surrender such Global Note or, in the case of a partial exchange, present it for endorsement to or to the order of the Issuing and Paying Agent (or, in the case of Notes lodged with the CMU, the CMU Lodging and Paying Agent). In exchange for any Global Note, or the part thereof to be exchanged, the Issuer will (i) in the case of a temporary Global Note exchangeable for a permanent Global Note, deliver, or procure the delivery of, a permanent Global Note in an aggregate nominal amount equal to that of the whole or that part of a temporary Global Note that is being exchanged or, in the case of a subsequent exchange, endorse, or procure the endorsement of, a permanent Global Note to reflect such exchange or (ii) in the case of a Global Note exchangeable for Definitive Notes or Registered Notes, deliver, or procure the delivery of, an equal aggregate nominal amount of duly executed and authenticated Definitive Notes and/or Certificates, as the case may be. Global Notes and Definitive Notes will be delivered outside the United States and its possessions. In this Offering Circular, “**Definitive Notes**” means, in relation to any Global Note, the definitive Bearer Notes for which such Global Note may be exchanged (if appropriate, having attached to them all Coupons and Receipts in respect of interest or Installment Amounts that have not already been paid on the Global Note and a Talon). Definitive Notes will be security printed and Certificates will be printed in accordance with any applicable legal and stock exchange requirements in or substantially in the form set out in the Schedules to the Trust Deed. On exchange in full of each permanent Global Note, the Issuer will, if the holder so requests, procure that it is cancelled and returned to the holder together with the relevant Definitive Notes.

3.6 Exchange Date

“**Exchange Date**” means (i) in relation to an exchange of a temporary Global Note to a permanent Global Note, the day falling after the expiry of 40 days after its issue date; (ii) in relation to an exchange of a permanent Global Note to a Definitive Note, a day falling not more than 45 days after the date of receipt of the first relevant notice by the Issuing and Paying Agent; (iii) in relation to an exchange of a permanent Global Note to a Registered Note, a day falling not more than five days after the date of receipt of the first relevant notice by the Issuing and Paying Agent; or (iv) in the case of failure to pay principal in respect of any Notes when due or an Event of Default has occurred and is continuing, a day falling 30 days after the date of receipt of the first relevant notice by the Issuing and Paying Agent, provided if such date is not a day on which banks are open for business in the city in which the specified office of the Issuing and Paying Agent is located and in the city in which the relevant clearing system is located, the immediately following day.

4 AMENDMENT TO CONDITIONS

The temporary Global Notes, permanent Global Notes and Global Notes contain provisions that apply to the Notes that they represent, some of which modify the effect of the Conditions set out in this Offering Circular. The following is a summary of certain of those provisions:

4.1 Payments

No payment falling due after the Exchange Date will be made on any Global Note unless exchange for an interest in a permanent Global Note or for Definitive Notes or Registered Notes is improperly withheld or refused. Payments on any temporary Global Note issued in compliance with the D Rules before the Exchange Date will only be made against presentation of certification as to non-U.S. beneficial ownership in the form set out in the Agency Agreement. All payments in respect of Notes represented by a Global Note (except with respect to Global Note held through the CMU) will be made against presentation for endorsement and, if no further payment falls to be made in respect of the Notes, surrender of that Global Note to or to the order of the Issuing and Paying Agent as shall have been notified to the Noteholders for such purpose. A record of each payment so made will be endorsed on each Global Note, which endorsement will be prima facie evidence that such payment has been made in respect of the Notes. Condition 7(g)(vii) and Condition 8(d) will apply to the Definitive Notes only.

All payments in respect of Notes represented by a Global Certificate will be made to, or to the order of, the person whose name is entered on the Register at the close of business on the record date which shall be on the Clearing System Business Day immediately prior to the date for payment, where “**Clearing System Business Day**” means Monday to Friday inclusive except 25 December and 1 January.

In respect of a Global Note or Global Certificate held through the CMU, any payments of principal, interest (if any) or any other amounts shall be made to the person(s) for whose account(s) interests in the relevant Global Note are credited (as set out in a CMU Instrument Position Report or any other relevant notification supplied to the CMU Lodging and Paying Agent by the CMU) and, save in the case of final payment, no presentation of the relevant bearer Global Note or Global Certificate shall be required for such purpose.

4.2 Prescription

Claims against the Issuer in respect of Notes that are represented by a permanent Global Note will become void unless it is presented for payment within a period of 10 years (in the case of principal) and five years (in the case of interest) from the appropriate Relevant Date (as defined in Condition 8).

4.3 Meetings

The holder of a permanent Global Note or of the Notes represented by a Global Certificate shall (unless such permanent Global Note or Global Certificate represents only one Note) be treated as being two persons for the purposes of any quorum requirements of a meeting of Noteholders and, at any such meeting, the holder of a permanent Global Note or a Global Certificate shall be treated as having one vote in respect of each integral currency unit of the Specified Currency of the Notes. (All holders of Registered Notes are entitled to one vote in respect of each integral currency unit of the Specified Currency of the Notes comprising such Noteholder's holding, whether or not represented by a Global Certificate.)

4.4 Cancellation

Cancellation of any Note represented by a permanent Global Note or Global Certificate that is required by the Conditions to be cancelled (other than upon its redemption) will be effected by reduction in the nominal amount of the relevant permanent Global Note or Global Certificate.

4.5 Purchase

Notes represented by a permanent Global Note may only be purchased by the Issuer or any of its respective subsidiaries if they are purchased together with the rights to receive all future payments of interest and Installment Amounts (if any) thereon.

4.6 The Option of the Issuer

Any option of the Issuer provided for in the Conditions of any Notes while such Notes are represented by a permanent Global Note shall be exercised by the Issuer giving notice to the Noteholders within the time limits set out in and containing the information required by the Conditions, except that the notice shall not be required to contain, in the case of Bearer Notes, the certificate numbers of Notes drawn or, in the case of Registered Notes, the holder of the Notes in respect of a partial exercise of an option and accordingly no drawing of Notes shall be required. In the event that any option of the Issuer is exercised in respect of some but not all of the Notes of any Series, the rights of accountholders with a clearing system in respect of the Notes will be governed by the standard procedures of Euroclear, Clearstream, Luxembourg, the CMU or any other clearing system (as the case may be).

4.7 Noteholders' Options

Any option of the Noteholders provided for in the Conditions of any Notes while such Notes are represented by a permanent Global Note may be exercised by the holder of the permanent Global Note giving notice to the Issuing and Paying Agent or (in respect of Notes represented by a Global Certificate) the Registrar or Transfer Agent or (in respect of Notes lodged with the CMU) the CMU Lodging and Paying Agent within the time limits relating to the deposit of Notes with a Paying Agent set out in the Conditions substantially in the form of the notice available from any Paying Agent, except that the notice shall not be required to contain the serial numbers of the Notes in respect of which the option has been exercised, and stating the nominal amount of Notes in respect of which the option is exercised and at the same time presenting the permanent Global Note or Global Certificate to the Issuing and Paying Agent, the relevant Registrar, a Transfer Agent or the CMU Lodging and Paying Agent (or, in each case, to a Paying Agent acting on their behalf), as the case may be, for notation.

4.8 Trustee's Powers

In considering the interests of Noteholders while any Global Note is held by or on behalf of, or Registered Notes are registered in the name of, or in the name of any nominee for, a clearing system, the Trustee may have regard to any information provided to it by such clearing system or its operator as to the identity (either individually or by category) of its accountholders with entitlements to such Global Note or Registered Notes and may consider such interests as if such accountholders were the holders of the Notes represented by such Global Note or Global Certificate.

4.9 Notices

So long as any Notes are represented by a Global Note or Global Certificate and such Global Note or Global Certificate is held on behalf of (i) Euroclear and/or Clearstream, Luxembourg or any other clearing system (except as provided in (ii) below), notices to the holders of Notes of that Series may be given by delivery of the relevant notice to that clearing system for communication by it to entitled accountholders in substitution for publication as required by the Conditions or by delivery of the relevant notice to the holder of the Global Note or Global Certificate or (ii) the CMU, notices to the holders of Notes of that Series may be given by delivery of the relevant notice to the persons shown in a CMU Instrument Position Report issued by the CMU on the second business day preceding the date of dispatch of such notice as holding interests in the relevant Global Note or Global Certificate.

5 PARTLY PAID NOTES

The provisions relating to Partly Paid Notes are not set out in this Offering Circular, but will be contained in the relevant Pricing Supplement and thereby in the Global Notes or Global Certificates. While any installments of the subscription moneys due from the holder of Partly Paid Notes are overdue, no interest in a Global Note representing such Notes may be exchanged for an interest in a permanent Global Note or for Definitive Notes (as the case may be). If any Noteholder fails to pay any installment due on any Partly Paid Notes within the time specified, the Issuer may forfeit such Notes and shall have no further obligation to their holder in respect of them.

FORM OF PRICING SUPPLEMENT

The form of Pricing Supplement that will be issued in respect of each Tranche, subject only to the deletion of non-applicable provisions, is set out below:

Pricing Supplement dated [●]

The Bank of East Asia, Limited 東亞銀行有限公司

Issue of [Aggregate Nominal Amount of Tranche] [Title of Notes]
under the U.S.\$6,000,000,000 Medium Term Note Programme

This document constitutes the Pricing Supplement relating to the issue of Notes described herein.

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions set forth in the Offering Circular dated 16 June 2014 [and the supplementary Offering Circular dated [●]]. This Pricing Supplement contains the final terms of the Notes and must be read in conjunction with such Offering Circular [as so supplemented]. Full information on the Issuer and the offer of the Notes is only available on the basis of the combination of the Offering Circular[, the supplementary Offering Circular dated [●]] and this Pricing Supplement.

[The following alternative language applies if the first tranche of an issue which is being increased was issued under an Offering Circular with an earlier date.]

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions (the “**Conditions**”) set forth in the Offering Circular dated [original date]. This Pricing Supplement contains the final terms of the Notes and must be read in conjunction with the Offering Circular dated 16 June 2014 [and the supplementary Offering Circular dated [●], save in respect of the Conditions which are extracted from the Offering Circular dated [original date] and are attached hereto. Full information on the Issuer and the offer of the Notes is only available on the basis of the combination of the Offering Circular[, the supplementary Offering Circular dated [●]] and this Pricing Supplement.]

[Include whichever of the following apply or specify as “Not Applicable” (N/A). Note that the numbering should remain as set out below, even if “Not Applicable” is indicated for individual paragraphs or sub-paragraphs. Italics denote directions for completing the Pricing Supplement.]

- | | | |
|----------|--|--|
| 1 | Issuer: | The Bank of East Asia, Limited
東亞銀行有限公司 |
| 2 | [(i)] Series Number: | [●] |
| | [(ii) Tranche Number:
<i>(If fungible with an existing Series,
details of that Series, including the
date on which the Notes become
fungible).]</i> | [●] |
| 3 | Specified Currency or Currencies: | [●] |
| 4 | Aggregate Nominal Amount: | [●] |
| | [(i)] Series: | [●] |
| | [(ii) Tranche: | [●] |

	[(iii) Date on which the Notes become fungible	[Not applicable/The Notes shall be consolidated, form a single series and be interchangeable for trading purposes with the <i>[insert description of series]</i> on <i>[insert date]</i> /the Issue Date/exchange of the Temporary Global Note for interests in the Permanent Global Note, as referred to in paragraph 26 below [which is expected to occur on or about <i>[insert date]</i>]]
5	(i) Issue Price:	[●] per cent. of the Aggregate Nominal Amount [plus accrued interest from <i>[insert date]</i> (in the case of fungible issues only, if applicable)]
	(ii) Net proceeds:	[●]
	(iii) Use of proceeds:	<i>[specify if different from that in the Offering Circular]</i>
6	(i) Specified Denominations:	[●] ^{1 2}
	(ii) Calculation Amount	[●]
7	(i) Issue Date:	[●]
	(ii) Interest Commencement Date	[Specify/Issue date/Not Applicable]
8	Maturity Date:	<i>[specify date or (for Floating Rate Notes) Interest Payment Date falling in or nearest to the relevant month and year]</i> ³
9	Interest Basis:	[[●] per cent. Fixed Rate] [[LIBOR/EURIBOR/HIBOR/CNH HIBOR/SHIBOR] +/- [●] per cent. Floating Rate] [Zero Coupon] [Index Linked Interest] [Other (<i>specify</i>)] (further particulars specified below)

¹ Notes (including Notes denominated in sterling) in respect of which the issue proceeds are to be accepted by the Issuer in the United Kingdom or whose issue otherwise constitutes a contravention of Section 19 FSMA and which have a maturity of less than one year must have a minimum redemption value of £100,000 (or its equivalent in other currencies). Add appropriate provisions to terms and conditions if included.

² If the specified denomination is expressed to be €50,000 or its equivalent and multiples of a lower principal amount (for example €1,000), insert the additional wording set out in the Guidance Note published by ICMA in November 2006 (or its replacement from time to time) as follows: “€50,000 and integral multiples of €1,000 in excess thereof up to and including €99,000. No notes in definitive form will be issued with a denomination above €99,000”.

³ Note that Renminbi or HK dollar denominated Fixed Rate Notes where the Interest Payment Dates are subject to modification it will be necessary to use the second option here.

- 10** Redemption/Payment Basis: [Redemption at par]
[Index Linked Redemption]
[Dual Currency]
[Partly Paid]
[Instalment]
[Other (*specify*)]
- 11** Change of Interest or Redemption/ Payment Basis: [*Specify details of any provision for convertibility of Notes into another interest or redemption/ payment basis/Not Applicable*]
- 12** Put/Call Options: [Investor Put]
[Issuer Call]
[(further particulars specified below)]
- 13** Status of the Notes: [Senior/Dated Subordinated]
- 14** Listing and admission to trading: [[●] (*specify*)/None]
- 15** Method of distribution: [Syndicated/Non-syndicated]

PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE

- 16 Fixed Rate Note Provisions** [Applicable/Not Applicable]
(If not applicable, delete the remaining subparagraphs of this paragraph)
- (i) Rate[(s)] of Interest: [●] per cent. per annum [payable
[annually/semi-annually/quarterly/monthly]
in arrear]
- (ii) Interest Payment Date(s): [●] in each year⁴ [adjusted in accordance
with [*specify Business Day Convention and any applicable Business Centre(s) for the definition of “Business Day”*]/[not adjusted]
with the first Interest Payment Date being
[●]
- (iii) Fixed Coupon Amount[(s)]: [●] per Calculation Amount⁵

⁴ Note that for certain Renminbi and HK dollar denominated Fixed Rate Notes the Interest Payment Dates are subject to modification and the following words should be added: “provided that if any Interest Payment Date falls on a day which is not a Business Day, the Interest Payment Date will be the next succeeding Business Day unless it would thereby fall in the next calendar month in which event the Interest Payment Date shall be brought forward to the immediately preceding Business Day”.

⁵ For Renminbi or HK dollar denominated Fixed Rate Notes where the Interest Payment Dates are subject to modification the following alternative wording is appropriate: “Each Fixed Coupon Amount shall be calculated by multiplying the product of the Rate of Interest and the Calculation Amount by the Day Count Fraction and rounding the resultant figure to the nearest RMB0.01, RMB0.005 for the case of Renminbi denominated Fixed Rate Notes to the nearest HK\$0.01, HK\$0.005 for the case of HK dollar denominated Fixed Rate Notes, being rounded upwards”.

(iv) Broken Amount(s):	[●] per Calculation Amount, payable on the Interest Payment Date falling [in/on] [●] <i>[insert particulars of any initial or final broken interest amounts which do not correspond with the Fixed Coupon Amount(s) and Interest Payment Date(s) to which they relate]</i>
(v) Day Count Fraction:	[30/360 / Actual/Actual (ICMA/ISDA) / other]
(vi) [Determination Dates:	[●] in each year <i>[insert regular interest payment dates, ignoring issue date or maturity date in the case of a long or short first or last coupon. N.B. only relevant where Day Count Fraction is Actual/Actual (ICMA)]</i>
(vii) Other terms relating to the method of calculating interest for Fixed Rate Notes:	[Not Applicable/give details]
17 Floating Rate Note Provisions	[Applicable/Not Applicable] <i>(If not applicable, delete the remaining subparagraphs of this paragraph)</i>
(i) Interest Period(s):	[●][, subject to adjustment in accordance with the Business Day Convention set out in (iv) below/, not subject to any adjustment [, as the Business Day Convention in (iv) below is specified to be Not Applicable]]
(ii) Specified Interest Payment Dates:	[●] in each year [adjusted in accordance with <i>[specify Business Day Convention and any Applicable Business Centre(s) for the definition of "Business Day"]</i>]/[not adjusted] with the first Interest Payment Date being [●]
(iii) Interest Period Date:	[●] <i>(Not applicable unless different from Interest Payment Date)</i>
(iv) Business Day Convention:	[Floating Rate Convention/Following Business Day Convention/ Modified Following Business Day Convention/ Preceding Business Day Convention/ other <i>(give details)</i>]
(v) Business Centre(s) (Condition 5(k)):	[●]
(vi) Manner in which the Rate(s) of Interest is/are to be determined:	[Screen Rate Determination/ISDA Determination/other <i>(give details)</i>]

- (vii) Party responsible for calculating the Rate(s) of Interest and Interest Amount(s) (if not the Calculation Agent): [●]
- (viii) Screen Rate Determination:
- Reference Rate: [●]
(Either LIBOR, EURIBOR, HIBOR, CNH HIBOR, SHIBOR or other, although additional information is required if other)
 - Interest Determination Date(s): [●]
(Second London business day prior to the start of each Interest Period if LIBOR (other than Sterling, Hong Kong dollar or euro LIBOR), second Hong Kong business day prior to the start of each Interest Period if CNH LIBOR, first day of each Interest Period if Sterling LIBOR or Hong Kong dollar LIBOR or HIBOR or SHIBOR or the second day on which the TARGET2 System is open prior to the start of each Interest Period if EURIBOR or euro LIBOR)
 - Relevant Screen Page: [●]
(In the case of EURIBOR, if not Reuters EURIBOR 01 ensure it is a page which shows a composite rate or amend the fallback provisions appropriately)
- (ix) ISDA Determination:
- Floating Rate Option: [●]
 - Designated Maturity: [●]
 - Reset Date: [●]
 - ISDA Definitions: 2006 (if different to those set out in the Conditions, please specify)
- (x) Margin(s): [●] per cent. per annum
- (xi) Minimum Rate of Interest: [●] per cent. per annum
- (xii) Maximum Rate of Interest: [●] per cent. per annum
- (xiii) Day Count Fraction: [●]
- (xiv) Fall back provisions, rounding provisions, denominator and any other terms relating to the method of calculating interest on Floating Rate Notes, if different from those set out in the Conditions: [●]

18	Zero Coupon Note Provisions	[Applicable/Not Applicable] <i>(If not applicable, delete the remaining subparagraphs of this paragraph)</i>
	(i) Amortization Yield:	[●] per cent. per annum
	(ii) Any other formula/basis of determining amount payable:	[●]
19	Index-Linked Interest Note Provisions	[Applicable/Not Applicable] <i>(If not applicable, delete the remaining subparagraphs of this paragraph)</i>
	(i) Index/Formula:	<i>[give or annex details]</i>
	(ii) Party responsible for calculating the Rate(s) of Interest and/or Interest Amount(s) (if not the Calculation Agent):	[●]
	(iii) Provisions for determining Coupon where calculation by reference to Index and/or Formula is impossible or impracticable or otherwise disrupted:	[●]
	(iv) Interest Period(s):	[●]
	(v) Specified Interest Payment Dates:	[●]
	(vi) Business Day Convention:	[Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/other <i>(give details)</i>]
	(vii) Business Centre(s):	[●]
	(viii) Minimum Rate of Interest:	[●] per cent. per annum
	(ix) Maximum Rate of Interest:	[●] per cent. per annum
	(x) Day Count Fraction:	[●]
20	Dual Currency Note Provisions	[Applicable/Not Applicable] <i>(If not applicable, delete the remaining subparagraphs of this paragraph)</i>
	(i) Rate of Exchange/method of calculating Rate of Exchange:	<i>[give details]</i>
	(ii) Party, if any, responsible for calculating the Rate(s) of Interest and Interest Amount(s) (if not the Calculation Agent):	[●]

- (iii) Provisions applicable where calculation by reference to Rate of Exchange impossible or impracticable: [●]
- (iv) Person at whose option Specified Currency(ies) is/ are payable: [●]

PROVISIONS RELATING TO REDEMPTION

21 Call Option [Applicable/Not Applicable]
(If not applicable, delete the remaining subparagraphs of this paragraph)

- (i) Optional Redemption Date(s): [●]
- (ii) Optional Redemption Amount(s) of each Note and specified denomination method, if any, of calculation of such amount(s): [●] per Calculation Amount
- (iii) If redeemable in part:
 - (a) Minimum Redemption Amount: [●] per Calculation Amount
 - (b) Maximum Redemption Amount: [●] per Calculation Amount
- (iv) Notice period [●]

22 Put Option [Applicable/Not Applicable]
(If not applicable, delete the remaining subparagraphs of this paragraph)

- (i) Optional Redemption Date(s): [●]
- (ii) Optional Redemption Amount(s) of each Note and method, if any, of calculation of such amount(s): [●] per Calculation Amount
- (iii) Notice period [●]

23 Final Redemption Amount of each Note [●] per Calculation Amount

24 Early Redemption Amount

Early Redemption Amount(s) per Calculation Amount payable on redemption for taxation reasons or on event of default and/or the method of calculating the same (if required or if different from that set out in the Conditions): [●]

PROVISIONS RELATING TO LOSS ABSORPTION

25 Loss Absorption Option [Applicable/Not Applicable] *(only relevant for Dated Subordinated Notes)*

GENERAL PROVISIONS APPLICABLE TO THE NOTES

<p>26 Form of Notes:</p>	<p>[Bearer Notes/Registered Notes] [Temporary Global Note exchangeable for a permanent Global Note which is exchangeable for Definitive Notes in the limited circumstances specified in the permanent Global Note]</p> <p>[Temporary Global Note exchangeable for Definitive Notes on [●] days' notice]⁶ <i>(For this option to be available, such Notes shall only be issued in denominations that are equal to, or greater than, €100,000 (or its equivalent in other currencies) and integral multiples thereof)</i></p> <p>[Permanent Global Note exchangeable for Definitive Notes in the limited circumstances specified in the permanent Global Note]</p> <p><i>(N.B. The exchange upon notice/at any time options should not be expressed to be applicable if the Specified Denomination of the Notes in paragraph 6 includes language substantially to the following effect: "€100,000 plus integral multiples of €1,000 in excess thereof up to and including €199,000". Furthermore, such Specified Denomination construction is not permitted in relation to any issue of Notes which is to be represented on issue by a temporary Global Note exchangeable for Definitive Notes)</i></p>
<p>27 Financial Centre(s) or other special provisions relating to Payment Dates:</p>	<p>[Not Applicable/give details. Note that this paragraph relates to the date and place of payment, and not the end dates of interest periods for the purposes of calculating the amount of interest, to which sub-paragraphs 16(ii), 17(iii) and 19(v) relate]</p>
<p>28 Talons for future Coupons or Receipts to be attached to Definitive Notes (and dates on which such Talons mature):</p>	<p>[Yes/No. If yes, give details. As the Notes have more than 27 coupon payments, talons may be required if, on exchange into definitive form, more than 27 coupon payments are still to be made]</p>

⁶ If the temporary Global Note is exchangeable for definitives at the option of the holder, the Notes shall be tradeable only in amounts of at least the Specified Denomination (or if more than one Specified Denomination, the lowest Specified Denomination) provided in paragraph 6 and multiples thereof.

- 29 Details relating to Partly Paid Notes: amount of each payment comprising the Issue Price and date on which each payment is to be made and consequences (if any) of failure to pay, including any right of the Issuer to forfeit the Notes and interest due on late payment: [Not Applicable/*give details*]
- 30 Details relating to Instalment Notes: amount of each instalment, date on which each payment is to be made: [Not Applicable/*give details*]
- 31 Redenomination, renominialization and reconventioning provisions: [Not Applicable/The provisions [in Condition [●]] [annexed to this Pricing Supplement] apply]
- 32 Consolidation provisions: [Not Applicable/The provisions [in Condition [●]] [annexed to this Pricing Supplement] apply]
- 33 Other terms or special conditions: [Not Applicable/*give details*]
[*Include any additional place(s) for the purposes of Condition 7(j)(iv)*]

DISTRIBUTION

- 34 (i) If syndicated, names of Managers: [Not Applicable/*give names*]
(ii) Stabilizing Manager (if any): [Not Applicable/*give name*]
- 35 If non-syndicated, name of Dealer: [Not Applicable/*give name*]
- 36 U.S. selling restrictions: Reg. S Category [1] / [2]; [TEFRA D/ TEFRA C/ TEFRA/Not Applicable]
- 37 Additional selling restrictions: [Not Applicable/*give details*]

OPERATIONAL INFORMATION

- 38 ISIN Code: [●]
- 39 Common Code: [●]
- 40 CMU Instrument Number: [●]/[Not Applicable]
- 41 CUSIP Number: [●]/[Not Applicable]
- 42 Any clearing system(s) other than Euroclear Bank, Clearstream, Luxembourg and the CMU and the relevant identification number(s): [Not Applicable/*give name(s) and number(s)*]
- 43 Delivery: Delivery [against/free of] payment
- 44 Names and addresses of additional Paying Agent(s) (if any): [●]

GENERAL

- 45 The aggregate principal amount of Notes issued has been translated into U.S. dollars at the rate of [●], producing a sum of (for Notes not denominated in U.S. dollars): [Not applicable/U.S.\$][●]
- 46 In the case of Registered Notes, specify the location of the office of the Registrar if other than Luxembourg: [●]
- 47 In the case of Bearer Notes, specify the location of the office of the Issuing and Paying Agent if other than Dublin, Ireland: [●]
- 48 Ratings: The Notes to be issued have been rated:
[Moody's Investor Service, Inc.: [●]]
[Standard & Poor's Rating Services, a division of the McGraw-Hill Companies: [●]]
[[Other: [●]]
(The above disclosure should reflect the rating allocated to Notes of the type being issued under the Programme generally or, where the issue has been specifically rated, that rating.)

PURPOSE OF PRICING SUPPLEMENT

This Pricing Supplement comprises the final terms required for issue and admission to trading on the *[specify relevant stock exchange/market]* of the Notes described herein pursuant to the U.S.\$6,000,000,000 Medium Term Note Programme.

STABILISING

In connection with this issue, [●] (the “**Stabilising Manager**”) (or persons acting on behalf of any Stabilising Manager) may over-allot Notes or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager (or persons acting on behalf of a Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the Notes and 60 days after the date of the allotment of the Notes. Any stabilisation action or overallotment must be conducted by the relevant Stabilising Manager (or persons acting on behalf of any Stabilising Manager) in accordance with all applicable laws and rules.

INVESTMENT CONSIDERATIONS

There are significant risks associated with the Notes including, but not limited to, counterparty risk, country risk, price risk and liquidity risk. Investors should contact their own financial, legal, accounting and tax advisers about the risks associated with an investment in these Notes, the appropriate tools to analyse that investment, and the suitability of the investment in each investor's particular circumstances. No investor should purchase the Notes unless that investor understands and has sufficient financial resources to bear the price, market liquidity, structure and other risks associated with an investment in these Notes.

Before entering into any transaction, investors should ensure that they fully understand the potential risks and rewards of that transaction and independently determine that the transaction is appropriate given their objectives, experience, financial and operational resources and other relevant circumstances. Investors should consider consulting with such advisers as they deem necessary to assist them in making these determinations.

RESPONSIBILITY

The Issuer accepts responsibility for the information contained in this Pricing Supplement.

Signed on behalf of The Bank of East Asia, Limited 東亞銀行有限公司:

By:
Duly authorised

REGULATION AND SUPERVISION

REGULATION AND SUPERVISION IN HONG KONG

The banking sector in Hong Kong is regulated by and subject to the provisions of the Banking Ordinance and to the powers and functions ascribed by the Banking Ordinance to the HKMA. The Banking Ordinance provides that only banks (that is, a bank which has been granted a banking licence (“**licence**”) by the HKMA) may carry on banking business (as defined in the Banking Ordinance) in Hong Kong and contains controls and restrictions on such banks (“**licensed banks**”).

Supervision of Licensed Banks in Hong Kong

The provisions of the Banking Ordinance are implemented by the HKMA, the principal function of which is to promote the general stability and effectiveness of the banking system, especially in the area of supervising compliance with the provisions of the Banking Ordinance. The HKMA supervises licensed banks through, *inter alia*, a regular information gathering process, the main features of which are as follows:

- (1) each licensed bank must submit a monthly return to the HKMA setting out the assets and liabilities of its operations in Hong Kong and a further comprehensive quarterly return relating to its principal place of business in Hong Kong and all local branches, although the HKMA has the right to allow returns to be made at less frequent intervals;
- (2) the HKMA may order a licensed bank, any of its subsidiaries, its holding company or any subsidiaries of its holding company to provide such further information (either specifically or periodically) as it may reasonably require for the exercise of its functions under the Banking Ordinance or as it may consider necessary to be submitted in the interests of the depositors or potential depositors of the licensed bank concerned. Such information shall be submitted within such period and in such manner as the HKMA may require. The HKMA may in certain circumstances also require such information or any return submitted to it to be accompanied by a certificate of the licensed bank’s auditors (approved by the HKMA for the purpose of preparing the report) confirming compliance with certain matters;
- (3) licensed banks may be required to provide information to the HKMA regarding companies in which they have an aggregate 20% or more direct or indirect shareholding or with which they have common directors or managers (as defined in the Banking Ordinance), the same controller, a common name or a concert party arrangement to promote the licensed bank’s business;
- (4) in addition, licensed banks are obliged to report to the HKMA immediately of their likelihood of becoming unable to meet their obligations or of the commencement of material civil proceedings applicable only to licensed banks incorporated in Hong Kong;
- (5) the HKMA may direct a licensed bank to appoint an auditor to report to the HKMA on the state of affairs and/or profit and loss of the licensed bank or the adequacy of the systems of control of the licensed bank or other matters as the HKMA may reasonably require;
- (6) the HKMA may, at any time, with or without prior notice, examine the books, accounts and transactions of any licensed bank, and in the case of a licensed bank incorporated in Hong Kong, any local branch, overseas branch, overseas representative office or subsidiary, whether local or overseas, of such institution. Such inspections are carried out by the HKMA on a regular basis; and
- (7) licensed banks are required to give written notice to the HKMA immediately of any proposal to remove an auditor before the expiration of his term of office or replace an auditor at the expiration of his term of office.

Exercise of Powers over Licensed Banks

The HKMA may, after consultation with the Financial Secretary, exercise certain powers over the conduct of licensed banks in any of the following circumstances:

- (1) when a licensed bank informs the HKMA that it is likely to become unable to meet its obligations, that it is insolvent, or that it is about to suspend payment;
- (2) when a licensed bank becomes unable to meet its obligations or suspends payment;
- (3) if, after an examination or investigation, the HKMA is of the opinion that a licensed bank:
 - (a) is carrying on its business in a manner detrimental to the interests of its depositors or potential depositors or of its creditors or of holders or potential holders of multi-purpose cards issued by it or the issue of which is facilitated by it;
 - (b) is insolvent or is likely to become unable to meet its obligations or is about to suspend payment;
 - (c) has contravened or failed to comply with any of the provisions of the Banking Ordinance; or
 - (d) has contravened or failed to comply with any condition attached to its licence or certain conditions in the Banking Ordinance;
- (4) where the HKMA's power under section 22(1) of the Banking Ordinance to revoke the authorisation of a licensed bank is exercisable (as discussed below); and
- (5) where the Financial Secretary advises the HKMA that he considers it in the public interest to do so.

In any of the circumstances described above, the HKMA, after consultation with the Financial Secretary, may exercise any of the following powers:

- (1) to require the licensed bank, by notice in writing served on it, forthwith to take any action or to do any act or thing whatsoever in relation to its business and property as the HKMA may consider necessary;
- (2) to direct the licensed bank to seek advice on the management of its affairs, business and property from an adviser approved by the HKMA;
- (3) to assume control of and carry on the business of the licensed bank, or direct some other person to assume control of and carry on the business of the licensed bank; or
- (4) to report to the Chief Executive in Council in certain circumstances (in which case the Chief Executive in Council may exercise a number of powers including directing the Financial Secretary to present a petition to the Court of First Instance for the winding-up of the licensed bank).

Revocation and Suspension of Banking Licence

The HKMA also has powers to recommend the revocation or suspension of a licence. Both powers are exercisable after consultation with the Financial Secretary and with a right of appeal of the licensed bank concerned except in the event of temporary suspension in urgent cases. The grounds for suspension or revocation include the following:

- (1) the licensed bank no longer fulfils the criteria for authorisation and the requirements for registration;
- (2) the licensed bank is likely to be unable to meet its obligations or proposes to make, or has made, any arrangement with its creditors or is insolvent;
- (3) the licensed bank has failed to provide material information required under the Banking Ordinance or has provided false information;
- (4) the licensed bank has breached a condition attached to its licence;
- (5) a person has become or continues to be a controller or chief executive or director of the licensed bank after the HKMA has made an objection;
- (6) the interests of the depositors require that the licence be revoked; or
- (7) the licensed bank is engaging in practices likely to prejudice Hong Kong as an international financial centre or in practices (specified in the HKMA guidelines) that should not be engaged in.

Revocation or suspension of a licence means that the licensed bank can no longer conduct banking business (for the specified period in the case of a suspension).

Principal Obligations of Licensed Banks

The obligations of a licensed bank under the Banking Ordinance, which are enforced by the HKMA through the system described above, include, but are not limited to, the following:

Capital Adequacy

A licensed bank incorporated in Hong Kong must at all times maintain a CAR of at least 8.0 per cent., calculated as the ratio (expressed as a percentage) of its capital base to its risk-weighted exposure as more fully described below. In relation to a licensed bank with subsidiaries, the HKMA may require the ratio to be calculated on a consolidated basis, or on both a consolidated and an unconsolidated basis, or on a consolidated basis only in respect of such subsidiaries of the licensed bank as may be specified by the HKMA. The HKMA may, after consultation with the licensed bank concerned, increase the ratio for any particular licensed bank. A licensed bank is under a duty to inform the HKMA immediately of a failure to maintain the required capital adequacy ratio and to provide the HKMA with such particulars as it may require. It is an indictable offence not to do so, and the HKMA is entitled to prescribe remedial action.

The capital base of a licensed bank is, broadly speaking but not limited to, all its paid-up capital and reserves, its profit and loss account including its current year's profit or loss, together with perpetual and term subordinated debt meeting prescribed conditions, general provisions against doubtful debts subject to certain limitations and a portion of its latent reserves arising from the revaluation of long-term holdings of specified equity securities or its reserves on the revaluation of real property.

Investments in, advances to and guarantees of liabilities of certain connected companies, shareholdings in subsidiaries or holding companies and in other companies in which more than 20 per cent. of voting power is held and investments in other banks (except for those which are not subject to a cross-holding arrangement or not otherwise a strategic investment) must be deducted.

The risk-weighted exposure is determined by:

- (1) multiplying risk-weight factors to the book value of various categories of assets (including but not limited to notes and coins, Hong Kong government certificates of indebtedness and cash items in the course of collection);
- (2) multiplying the credit conversion factors to various off balance sheet items (including but not limited to direct credit substitutes, transaction-related contingencies, repurchase contracts, note issuance facilities and exchange rate contracts) to determine their credit equivalent amount;
- (3) aggregating the amounts determined pursuant to (1) and (2); and
- (4) subtracting from the amount determined pursuant to (3) the value of general provisions not included in the capital base of the licensed bank and the amount by which the book value of reserves on revaluation of real property exceeds the book value of such reserves as at the period-end.

The capital adequacy standards described above (commonly known as “**Basel I**”) were promulgated by the Basel Committee and have been applied in Hong Kong since 1989. The Banking (Amendment) Ordinance 2005, enacted on 6 July 2005, put in place a legislative framework for the implementation in Hong Kong of Basel II. In line with the timetable set by the Basel Committee for its members, implementation of Basel II commenced in Hong Kong in January 2007.

In December 2010 and January 2011, the Basel Committee issued further capital requirements designed to raise the quality, consistency and transparency of banks’ capital base and new global liquidity standards. These requirements are collectively known as “**Basel III**”. Among other things, Basel III will increase the minimum capital adequacy ratio requirements in relation to risk-weighted assets, with the common equity requirement rising from 2 per cent. to 4.5 per cent. and the Tier 1 capital requirements rising from 4 per cent. to 6 per cent. The total minimum capital requirement remains unchanged at 8 per cent.

The Basel Committee’s press release dated 13 January 2011 entitled “Minimum requirements to ensure loss absorbency at the point of non-viability” included the following statements:

“The terms and conditions of all non-common Tier 1 and Tier 2 instruments issued by an internationally active bank must have a provision that requires such instruments, at the option of the relevant authority, to either be written off or converted into common equity upon the occurrence of the trigger event unless:

- (a) the governing jurisdiction of the bank has in place laws that (i) require such Tier 1 and Tier 2 instruments to be written off upon such event, or (ii) otherwise require such instruments to fully absorb losses before tax payers are exposed to loss;*
- (b) a peer group review confirms that the jurisdiction conforms with clause (a); and*
- (c) it is disclosed by the relevant regulator and by the issuing bank, in issuance documents going forward, that such instruments are subject to loss under clause (a) in this paragraph.”*

The release also states as follows:

“The trigger event is the earlier of: (1) a decision that a write-off, without which the firm would become non-viable, is necessary, as determined by the relevant authority; and (2) the decision to make a public sector injection of capital, or equivalent support, without which the firm would have become non-viable, as determined by the relevant authority”

(for the purposes of this Offering Circular, each a “**Non-Viability Event**”).

The initial stage of these proposed Basel III reforms has been implemented by the government of Hong Kong since the beginning of 2013, and the full implementation of the reforms is expected to be completed by 2019.

The Banking Ordinance was amended in 2012 to facilitate the implementation of the Basel III capital and disclosure requirements in Hong Kong. More specifically, the amendments made to the Banking Ordinance empowered the HKMA to:

- (a) prescribe capital requirements for authorised institutions incorporated in Hong Kong for authorised institutions incorporated in Hong Kong or elsewhere; and
- (b) issue and approve codes of practice for the purpose of providing guidance in respect of the requirements.

The Banking (Capital) (Amendment) Rules 2012 came into effect on 1 January 2013, with the requirements being phased in over six years to achieve full implementation by 1 January 2019. These include:

- the imposition of three minimum risk-weighted capital ratios, namely CET1 capital ratio, Tier 1 capital ratio and total capital ratio, with gradual phasing in of the minimum capital requirements over three years commencing 1 January 2013;
- the introduction of two capital buffers, namely the capital conservation buffers and countercyclical capital buffer, to be phased in sequentially from 1 January 2016 to 1 January 2019;
- the introduction of capital requirement for counterparty risk effect from 1 January 2013; and
- capital instruments issued on or after 1 January 2013 must meet all of the Basel III criteria to qualify as regulatory capital. Capital instruments prior to this date that no longer qualify for inclusion in capital base will be phased out during the 10-year period commencing 1 January 2013.

With effect from 30 June 2013, the Banking (Disclosure) Rules have been amended to implement Basel III capital and disclosure standards. The HKMA is currently conducting further consultation on implementing the Basel III liquidity standards.

Liquidity

Authorised institutions must maintain at all times a liquidity ratio of not less than 25 per cent. in each calendar month, calculated as the ratio (expressed as a percentage) of the sum of the net weighted amount of its liquefiable assets to the sum of its qualifying liabilities for each working day of the calendar month concerned as calculated in accordance with the Fourth Schedule to the Banking Ordinance. In relation to a licensed bank with subsidiaries, the HKMA may require that ratio to be calculated on a consolidated basis, or both on a consolidated basis and an unconsolidated basis, or on a consolidated basis only in respect of such subsidiaries of the licensed bank as may be specified by the HKMA. The ratio may be varied by the HKMA. A licensed bank has a duty to inform the HKMA

if the ratio requirement is not fulfilled and provide it with such particulars of that contravention as it may require, and it is an indictable offence not to do so; the HKMA is entitled to prescribe remedial action. For the purpose of the liquidity ratio, in the case of a licensed bank which has places of business in Hong Kong and elsewhere, its places of business in Hong Kong are collectively treated as a separate licensed bank to which the liquidity ratio provisions would apply.

Liquefiable assets are, broadly speaking, assets held in the form of currency notes and coins, gold, loans due within one month from other banks (after deducting amounts payable to other banks within one month), certain export bills payable within one month, certain kinds of marketable debt securities or prescribed instruments (in some cases subject to a discount) and certain types of loan repayments due on fixed dates within one month on performing loans (subject to a discount).

Qualifying liabilities are, broadly speaking, liabilities which will or could or, in the case of contingent liabilities, in the opinion of the HKMA, may, fall due within one month, except that liabilities to other banks are treated on a net basis.

Financial Exposure to Any One Customer

The financial exposure of a licensed bank incorporated in Hong Kong to any one person or group of connected persons must not (subject to certain exceptions) exceed 25 per cent. of the capital base of the licensed bank. Subject to certain exclusions, the licensed bank's financial exposure to any one person or group of connected persons is taken to be the aggregate of:

- (1) all advances, loans and credit facilities granted to that person or group;
- (2) the value of the licensed bank's holdings of shares, debentures and other debt securities issued by that person or group; and
- (3) the principal amount, multiplied by a factor to be specified by the HKMA, for off-balance sheet items resulting from transactions between the licensed bank and that person or group.

For these purposes, persons shall be treated as connected if one company is the subsidiary of another, they have a common holding company, they have a common controller (not being a company) or if one (not being a company) is a controller of another (being a company).

The calculation of financial exposure does not include financial exposure to the Hong Kong government or authorised institutions or financial exposure generally to the extent it is secured by a cash deposit, a guarantee, an undertaking, certain specified securities or a letter of comfort accepted by the HKMA.

If a person or a company to whom an authorised institution is financially exposed is a trustee of more than one trust, the HKMA may by notice in writing extend the limit of the institution's financial exposure to that person or company.

Other Restrictions on Lending

The Banking Ordinance also provides that:

- (1) licensed banks may not grant any loan, advance or credit facility (including letters of credit) or give any guarantee or incur any other liability against the security of their own shares (or, except with the approval of the HKMA, that of their respective holding companies, subsidiaries or fellow subsidiaries of such holding companies);
- (2) the amount of the facilities which a Hong Kong incorporated licensed bank may make available on an unsecured basis to its controllers, its directors, their relatives or certain of its employees and persons associated with any of them shall be subject to the restrictions set out therein; and

- (3) licensed banks may not, except with the written consent of the HKMA, provide to any one of their employees any unsecured facility of an amount in excess of that employee's salary for one year.

Restrictions on Investments in Land

A licensed bank incorporated in Hong Kong cannot purchase or hold any interest in land, whether situated in or outside Hong Kong, of a value or to an aggregate value in excess of 25 per cent. of its capital base. There are exceptions for land held that in the opinion of the HKMA is necessary for the operation of the business or for providing housing or amenities for staff.

Shareholding in Other Companies

A licensed bank incorporated in Hong Kong may not acquire or hold any part of the share capital of any other company or companies to an aggregate value which exceeds 25 per cent. of the licensed bank's capital base except for shares held by way of security for facilities and by virtue of acquisitions in satisfaction of debts due to it (which must, however, be disposed of at the earliest suitable opportunity and not later than 18 months after their acquisition unless the HKMA agrees to a longer period). Shares held by virtue of underwriting and sub-underwriting commitments are, nevertheless, permitted provided the relevant shares are disposed of within seven working days or such longer period as the HKMA may agree.

There are other exemptions for any holding of share capital approved by the HKMA in other banks and companies carrying on nominee, executor, trustee or other functions related to banking business, the business of deposit taking, insurance, investments or other financial services.

Other Restrictions on Investment

The aggregate of the outstanding amounts of all facilities granted to or on behalf of a licensed bank's controllers, directors, their relatives, certain of its employees and their associates; the value of all holdings of share capital in other companies; and the value of all holdings of interests in land (including land purchased or held which is necessary for the conduct of business or the provision of housing or amenities for the staff of the institution) must not exceed 80 per cent. of its capital base.

Charges

A licensed bank incorporated in Hong Kong is not permitted to create any charges over its assets if either the aggregate value of all charges existing over its total assets is 5 per cent. or more of the value of those total assets or creating that charge would cause the aggregate value of all charges over its total assets to be more than 5 per cent. of the value of those total assets.

Restrictions on Overseas Activities

A licensed bank which is incorporated in Hong Kong is subject to a condition that it shall not establish or maintain any overseas branch or overseas representative office without the approval of the HKMA. The HKMA is empowered by the Banking Ordinance to require financial and other information regarding any such overseas branch to be supplied to it.

Further, a licensed bank incorporated in Hong Kong or its Hong Kong incorporated holding company may not without the consent of the HKMA own a company incorporated outside Hong Kong which may (whether or not in or outside Hong Kong) lawfully take deposits from the public. The HKMA may at any time attach in respect of any such approved overseas companies any conditions as the HKMA may think proper.

Shareholders, Chief Executives and Directors

Limitations on Shareholders

The HKMA has the power to object, on certain specified grounds, to persons becoming or being “controllers” of licensed banks incorporated in Hong Kong. “**Controller**” in this context means:

- (1) a person who, either alone or with any associate(s), is entitled to exercise, or control the exercise of, 10 per cent. or more, but not more than 50 per cent., of the voting power at any general meeting of the licensed bank or of another company of which it is a subsidiary; or
- (2) a person who, either alone or with any associate(s), is entitled to exercise, or control the exercise of, more than 50 per cent. of the voting power at any general meeting of the licensed bank or of another company of which it is a subsidiary; or
- (3) a person in accordance with whose directions or instructions the directors of the licensed bank or of another company of which it is a subsidiary are accustomed to act (but does not include any professional advisers or managers appointed by the HKMA to manage the licensed bank).

A person may not become a controller of a licensed bank incorporated in Hong Kong unless he has served a written notice on the HKMA of his proposal to that effect and the HKMA consents to his becoming such a controller or does not object within three months.

Within the three-month period, the HKMA may object to the applicant’s proposal, unless it is satisfied that the applicant is a fit and proper person to become a controller; that depositors’ or potential depositors’ interests will not be threatened by that person being such a controller; and having regard to the applicant’s likely influence on that institution as a controller, the licensed bank is likely to continue to conduct its business prudently or that the applicant is likely to undertake adequate remedial action to ensure that the licensed bank will conduct its business prudently.

The HKMA may also object to the continuation of a person as a controller on similar grounds as in respect of new controllers.

Where a person becomes a controller (by virtue of being able to exercise or control the exercise of certain voting power in a licensed bank) after a notice of objection has been served on him or otherwise in the contravention of the procedure prescribed by the Banking Ordinance, the HKMA may notify the controller that until further notice any specified shares are subject to one or more of the following restrictions:

- (1) any transfer of the shares or, in the case of unissued shares, any transfer of the right to be issued with them, and any issue of such shares, shall be void;
- (2) voting rights in respect of those shares shall not be exercisable;
- (3) no further shares in right or pursuant to any offer made to the shareholder shall be issued; or
- (4) except in a liquidation, no payments of any sums due from the licensed bank on the shares shall be paid.

In addition, the HKMA may apply to court for an order that the shares be sold. Once the shares are sold, the proceeds (less the costs of sale) shall be paid into court and held for the benefit of the persons beneficially interested in them.

In the case of an indirect controller who does not have the approval of the HKMA, the person concerned is prohibited from giving directions or instructions to the directors of the licensed bank or of another company of which it is a subsidiary.

All licensed banks must have a chief executive ordinarily resident in Hong Kong. A person requires the consent of the HKMA before becoming a chief executive or alternate chief executive.

The consent of the HKMA is also required for a person to become a director of a Hong Kong incorporated licensed bank.

Supervision of Securities Business

The Securities and Futures Ordinance (Cap. 571) of Hong Kong (the “SFO”), which came into operation in April 2003, introduced a substantial change to the conduct of securities business by banks. Banks are no longer exempted from the relevant regulations when they engage in securities business. Instead they are required to apply for registration with the SFC, which means they will have to meet the Fit and Proper Criteria set by the SFC. Likewise, staff engaged by banks in securities business will have to meet the Fit and Proper Criteria applicable to staff of brokerage firms. It is a statutory condition of registration for banks that each member of staff engaged by them in securities business is a fit and proper person. Banks will also have to comply with the various regulatory requirements set by the SFC in relation to their securities business, including the subsidiary legislation and the business conduct codes. Under the SFO, banks and their securities staff will be subject to the same range of disciplinary actions that are applicable to brokers and their staff in case they are guilty of misconduct or otherwise not fit and proper.

With the introduction of a new licensing regime under the SFO, corresponding changes have been made to the Banking Ordinance by way of the introduction of the Banking (Amendment) Ordinance 2002. Such ordinance came into operation simultaneously with the SFO and has enabled the HKMA to enhance their regulatory functions in relation to securities businesses of banks and other Authorised Institutions that are registered under the SFO.

REGULATION AND SUPERVISION IN THE PRC

The banking industry is heavily regulated in the PRC, with CBRC and PBOC acting as the principal regulatory authorities. CBRC is responsible for supervising and regulating banking institutions, and PBOC, as the central bank of the PRC, is responsible for formulating and implementing monetary policies. The applicable laws and regulations governing activities in the PRC’s banking industry consist principally of the PRC PBOC Law, the PRC Commercial Banking Law, PRC Banking Regulation and Supervision Law, and the rules and regulations promulgated thereunder.

Principal Regulators

Prior to April 2003, PBOC acted as both the PRC’s central bank and the principal supervisor and regulator of the banking industry in the PRC. In April 2003, CBRC was established to serve as the primary banking industry regulator and it assumed the majority of bank regulatory functions from PBOC. PBOC retained its role as the central bank but now has a smaller role in the regulation of banking institutions.

CBRC

Functions and Powers

CBRC is the primary supervisory authority responsible for the regulation of banking institutions operating in the PRC, including branches and representative offices established by foreign financial institutions in the PRC.

According to the PRC Banking Regulations and Supervision Law, the main responsibilities of CBRC include:

- (1) setting and promulgating rules and regulations governing banking institutions and their business activities;
- (2) regulating the establishment, change, dissolution and business scope of banking institutions, as well as granting banking licences for commercial banks and their branches;
- (3) regulating the establishment, change, dissolution and business scope of foreign bank branches;
- (4) regulating the business activities of banking institutions, including the products and services they offer;
- (5) setting qualification requirements for, and approving or overseeing the nomination of, directors and senior management personnel of banking institutions;
- (6) setting guidelines and standards for internal controls, risk exposure and corporate governance of, and disclosure requirements for, banking institutions;
- (7) conducting on-site inspection and off-site surveillance of the business activities and risk exposure status of banking institutions;
- (8) monitoring the financial condition of banking institutions, including establishing standards or requirements for capital adequacy, asset quality and other financial metrics;
- (9) imposing corrective and punitive measures for violations of applicable banking regulations;
- (10) working with authorities (including PBOC and the Ministry of Finance of the PRC);
- (11) to establish emergency disposal mechanisms and to deal with any emergencies in the banking sector;
- (12) guiding and conducting surveillance on the activities of banking self-disciplinary organisations; and
- (13) carrying out international communication and cooperation activities related to supervisions of the banking sector.

Examination and Supervision

CBRC, through its head office in Beijing and offices in each province, provincial-level municipality and autonomous region, monitors the operations of commercial banks and their branches through on-site inspections and off-site surveillance. On-site inspections generally include visiting the banks' premises, interviewing bank employees and, for significant issues relating to banks' operations or risk management, senior management and directors, as well as reviewing documents and materials maintained by the banks. CBRC also conducts off-site surveillance by reviewing financial and other reports regularly submitted by the banks. Off-site surveillance generally includes the surveillance of banks' business activities and risk exposure status to evaluate and analyse the operational risk of the banks. If a banking institution is not in compliance with a regulation, CBRC has the power to issue corrective and punitive measures, including imposition of fines, suspension of certain business activities, restrictions on distributions of dividends and other income and asset transfers, closure of the institution and other penalties.

PBOC

As the central bank of the PRC, PBOC is responsible for formulating and implementing monetary policies and maintaining the stability of the financial markets. According to the PRC PBOC Law, PBOC is empowered to:

- (1) formulate and implement monetary policies by establishing benchmark interest rates, setting the deposit reserve ratios for commercial banks, extending loans to commercial banks, accepting discounted bills and conducting open market operations;
- (2) issue PRC treasury bills and other government bonds to financial institutions, as the agent of the MOF;
- (3) issue the currency of Renminbi and regulate the flow of Renminbi;
- (4) regulate the inter-bank lending market, inter-bank bond market and inter-bank foreign exchange market;
- (5) set foreign exchange rate policies and manage the PRC's foreign exchange reserves and gold reserves;
- (6) manage the state treasury;
- (7) maintain the normal operation of payment and settlement systems;
- (8) regulate and examine foreign exchange activities;
- (9) establish anti-money laundering guidelines and monitor fund transfers to ensure that such transfers are in compliance with anti-money laundering regulations;
- (10) act as the central bank of the PRC to conduct relevant international financial activities; and
- (11) collect statistics of, investigate, analyse and forecast the financial industry.

Other Regulatory Authorities

In addition to CBRC and PBOC, commercial banks in the PRC are also subject to the supervision and regulation by other regulatory authorities including, among others, SAFE, CSRC and China Insurance Regulatory Commission the (“CIRC”). For example, in conducting foreign exchange business, banks are subject to the regulation of SAFE; in dealing with securities-related matters such as distributing securities investment funds or acting as the custodians of investment assets of securities institutional investors, banks are subject to the regulation of CSRC; and in conducting bancassurance business, banks are subject to the regulation of the CIRC.

Licensing Requirements for a foreign bank to incorporate in PRC

Basic Requirements

Under the Regulations, for a foreign bank to offer a full range of banking services, including Renminbi retail business, it has to be incorporated in PRC. To incorporate a banking subsidiary in the PRC, foreign banks must at least satisfy the following main criteria:

- (1) provide proof of international track record;
- (2) provide evidence of continual profit-making ability;
- (3) show effective internal policies and procedures, including anti-money laundering measures;

- (4) have approvals from home country regulators;
- (5) the registered capital of the proposed subsidiary must meet the minimum requirement of Renminbi 1.0 billion;
- (6) the principal persons-in-charge of the proposed subsidiary must possess the requisite qualifications;
- (7) execution of the power of attorney to the proposed principal persons-in-charge of the bank;
- (8) guarantee letter issued by the foreign bank establishing a subsidiary, stating that it shall be responsible for all the taxes and other indebtedness that the subsidiary may incur; and
- (9) the foreign banks' (as the controlling or major shareholders of their PRC subsidiaries) total assets at the end of the most recent year prior to the application for establishment of their PRC subsidiaries must meet the minimum requirement of U.S.\$10 billion.

Branches

A wholly-owned foreign bank intending to set up branches in the PRC should allocate a working capital of no less than Renminbi 100 million per branch. The total capital used for setting up these branches should not exceed 60% of the wholly-owned foreign bank registered capital.

Regulations Regarding Capital Adequacy

Capital Adequacy Guidelines

In March 2004, CBRC implemented capital adequacy guidelines applicable to all commercial banks in the PRC. The guidelines, the Measures for the Management of Capital Adequacy Ratios of Commercial Banks (the “**Capital Adequacy Measures**”), provided for a phase-in period whereby all domestic banks must have met minimum CAR by 1 January 2007. On 3 July 2007, CBRC amended the Capital Adequacy Measures issued in March 2004 to set forth new and more stringent capital adequacy guidelines which must be complied with from 3 July 2007.

In June 2012, CBRC issued the Administrative Measures on the Capital of Commercial Banks (Trial) (the “**2012 Administrative Measures**”) regulating CAR of PRC commercial banks. The 2012 Administrative Measures, which are intended to reflect the Basel III regulatory capital requirements, set out minimum CAR requirements for commercial banks and provide detailed guidelines on the calculation of “capital” and “risk-weighted assets”. The overall CAR requirements are 11.5 per cent. for systematically important commercial banks and 10.5 per cent. for other commercial banks. Commercial banks in the PRC are required to have a CAR of not less than 8 per cent., Tier 1 CAR of not less than 6 per cent. and Core Tier 1 CAR of not less than 5 per cent. The CARs are calculated in accordance with the 2012 Administrative Measure as follows:

$$\text{Capital Adequacy Ratio} = \frac{\text{Total Capital - deductions from corresponding capital instruments}}{\text{Risk-weighted Assets}} \times 100\%$$

$$\text{Tier 1 Capital Adequacy Ratio} = \frac{\text{Tier 1 Capital - deductions from corresponding capital instruments}}{\text{Risk-weighted Assets}} \times 100\%$$

$$\text{Core Tier 1 Capital Adequacy Ratio} = \frac{\text{Core Tier 1 Capital - deductions from corresponding capital instruments}}{\text{Risk-weighted Assets}} \times 100\%$$

In December 2012, CBRC further released the Guiding Opinion on Commercial Banks' Innovation on Capital Instruments, setting out the general principles of the innovation of capital instruments of commercial banks and criteria of qualified capital instruments.

TAXATION

The statements herein regarding taxation are based on the laws and practice in force as at the date of this Offering Circular and are subject to any changes in law or practice occurring after such date, which changes could be made on a retroactive basis. The following summary does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase, own or dispose of the Notes and does not purport to deal with the tax consequences applicable to all categories of investors, some of which (such as dealers in securities or commodities) may be subject to special rules. Investors should consult their own tax advisers regarding the tax consequences of an investment in the Notes.

HONG KONG

Withholding Tax

No withholding tax is payable in Hong Kong in respect of payments of principal or interest on the Notes or in respect of any capital gains arising from the sale of the Notes.

Profits Tax

Hong Kong profits tax is chargeable on every person (including an individual, a corporation and other unincorporated bodies such as partnership and trust) carrying on a trade, profession or business in Hong Kong in respect of profits arising in or derived from Hong Kong from such trade, profession or business (excluding profits arising from the sale of capital assets).

Interest on the Notes may be deemed to be profits arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong in the following circumstances (which are not exhaustive):

- (i) interest on the Notes is received by or accrues to a company, other than a financial institution, carrying on a trade, profession or business in Hong Kong and such interest is of a Hong Kong source; or
- (ii) interest on the Notes is received by or accrues to a person, other than a company, carrying on a trade, profession or business in Hong Kong and is in respect of the funds of that trade, profession or business and such interest is of a Hong Kong source; or
- (iii) interest on the Notes is received by or accrues to a financial institution (as defined in the Inland Revenue Ordinance (Cap. 112) of Hong Kong) and arises through or from the carrying on by the financial institution of its business in Hong Kong, notwithstanding that the moneys in respect of which the interest is received or accrues are made available outside Hong Kong.

Pursuant to the Exemption from Profits Tax (Interest Income) Order, interest income accruing to a person other than a financial institution on deposits (denominated in any currency and whether or not the deposit is evidenced by a certificate of deposit) placed with, *inter alia*, a financial institution in Hong Kong (within the meaning of section 2 of the Banking Ordinance) is exempt from the payment of Hong Kong profits tax. This exemption does not apply, however, to deposits that are used to secure or guarantee money borrowed in certain circumstances. Provided no prospectus in relation to the issue of the Notes is registered under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) of Hong Kong, the issue of the Notes is expected to constitute a deposit to which the above exemption will apply.

Sums received by or accrued to a financial institution by way of gains or profits arising through or from the carrying on by the financial institution of its business in Hong Kong from the sale, disposal and redemption of Notes will be subject to profits tax.

Sums derived from the sale, disposal or redemption of Notes will be subject to Hong Kong profits tax where received by or accrued to a person, other than a financial institution, who carries on a trade, profession or business in Hong Kong and the sum has a Hong Kong source. However, where the sum is considered to be a capital gain in the hands of the investor who is not a financial institution, such capital gain will not be subject to Hong Kong profits tax.

Stamp Duty

No Hong Kong stamp duty is payable on the issue of a note not in bearer form. If the transfer of a non-bearer note is required to be registered in Hong Kong, stamp duty will be payable unless:

- (i) the note is denominated in a currency other than the currency of Hong Kong and is not repayable in any circumstance in the currency of Hong Kong; or
- (ii) the note constitutes loan capital (as defined in the Stamp Duty Ordinance (Cap. 117) of Hong Kong).

No Hong Kong stamp duty will be chargeable upon the issue or subsequent transfer of the Notes.

Estate Duty

No estate duty will be payable in respect of the Notes.

EUROPEAN UNION

EU Savings Directive

The Savings Directive requires EU Member States to provide to the tax authorities of other EU Member States details of payments of interest and other similar income paid by a person established within its jurisdiction to (or for the benefit of) an individual resident, or certain other types of entity established, in that other EU Member State, except that Austria and Luxembourg will instead impose a withholding system for a transitional period (subject to a procedure whereby, on meeting certain conditions, the beneficial owner of the interest or other income may request that no tax be withheld) unless during such period they elect otherwise. The Luxembourg government has announced its intention to elect out of the withholding system in favour of an automatic exchange of information with effect from 1 January 2015.

The Council of the European Union has adopted the Amending Directive which will, when implemented, amend and broaden the scope of the requirements described above. The Amending Directive will expand the range of payments covered by the Savings Directive, in particular to include additional types of income payable on securities, and the circumstances in which payments must be reported or paid subject to withholding. For example, payments made to (or for the benefit of) (i) an entity or legal arrangement effectively managed in an EU Member State that is not subject to effective taxation, or (ii) a person, entity or legal arrangement established or effectively managed outside of the EU (and outside any third country or territory that has adopted similar measures to the Savings Directive) which indirectly benefit an individual resident in an EU Member State, may fall within the scope of the Savings Directive, as amended. The Amending Directive requires EU Member States to adopt national legislation necessary to comply with it by 1 January 2016, which legislation must apply from 1 January 2017.

The Proposed Financial Transactions Tax (“FTT”)

On 14 February 2013, the European Commission published a proposal (the “**Commission’s Proposal**”) for a Directive for a common FTT in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the “**Participating Member States**”).

The Commission's Proposal has very broad scope and could, if introduced, apply to certain dealings in Notes (including secondary market transactions) in certain circumstances.

Under the Commission's Proposal the FTT could apply in certain circumstances to persons both within and outside of the Participating Member States. Generally, it would apply to certain dealings in Notes where at least one party is a financial institution, and at least one party is established in a Participating Member State. A financial institution may be, or be deemed to be, "established" in a Participating Member State in a broad range of circumstances, including (a) by transacting with a person established in a Participating Member State or (b) where the financial instrument which is subject to the dealings is issued in a Participating Member State.

A joint statement issued in May 2014 by ten of the eleven participating Member States indicated an intention to implement the FTT progressively, such that it would initially apply to shares and certain derivatives, with this initial implementation occurring by 1 January 2016. The FTT, as initially implemented on this basis, may not apply to dealings in the Notes.

The FTT proposal remains subject to negotiation between the Participating Member States. It may therefore be altered prior to any implementation. Additional EU Member States may decide to participate. Prospective holders of Notes are advised to seek their own professional advice in relation to the FTT.

FATCA WITHHOLDING

TO ENSURE COMPLIANCE WITH TREASURY DEPARTMENT CIRCULAR 230, PROSPECTIVE PURCHASERS ARE HEREBY NOTIFIED THAT: (A) ANY DISCUSSION OF U.S. FEDERAL TAX ISSUES IN THIS OFFERING CIRCULAR IS NOT INTENDED OR WRITTEN TO BE RELIED UPON, AND CANNOT BE RELIED UPON, BY ANY PERSON FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON SUCH PERSON UNDER THE INTERNAL REVENUE CODE; (B) SUCH DISCUSSION IS INCLUDED HEREIN BY THE ISSUER IN CONNECTION WITH THE PROMOTION OR MARKETING (WITHIN THE MEANING OF CIRCULAR 230) BY THE ISSUER OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) PROSPECTIVE PURCHASERS SHOULD SEEK ADVICE BASED ON THEIR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.

Certain provisions of U.S. law, commonly known as "FATCA", generally require certain non-U.S. financial institutions to report certain information on their account holders to the government of the United States and require such institutions to withhold 30 per cent. from all, or a portion of, certain payments made to persons that fail to provide the financial institution information, consents and forms or other documentation that may be necessary for such financial institution to determine whether such person is compliant with FATCA or otherwise exempt from FATCA withholding.

This new withholding regime will be phased in beginning 1 July 2014 for payments from sources within the United States and will apply to "**foreign passthru payments**" (a term not yet defined) no earlier than 1 January 2017. This withholding would potentially apply to payments in respect of (i) any Notes characterized as debt (or which are not otherwise characterized as equity and have a fixed term) for U.S. federal tax purposes that are issued on or after the "**grandfathering date**", which is the date that is six months after the date on which final U.S. Treasury regulations defining the term foreign passthru payment are filed with the Federal Register, or which are materially modified on or after the grandfathering date and (ii) any Notes characterised as equity or which do not have a fixed term for U.S. federal tax purposes, whenever issued. If Notes are issued before the grandfathering date, and additional Notes of the same series are issued on or after that date, the additional Notes may not be treated as grandfathered, which may have negative consequences for the existing Notes, including a negative impact on market price.

The application of FATCA to interest, principal or other amounts paid with respect to the Notes and the information reporting obligations of the Issuer and other entities in the payment chain is still developing. In particular, a number of jurisdictions (including Hong Kong) have entered into, or have announced their intention to enter into, intergovernmental agreements (or similar mutual understandings) with the United States (“IGAs”), which modify the way in which FATCA applies in their jurisdictions. The full impact of such agreements (and the laws implementing such agreements in such jurisdictions) on reporting and withholding responsibilities under FATCA is unclear. The Issuer and other entities in the payment chain may be required to report certain information on their U.S. account holders to government authorities in their respective jurisdictions or the United States in order (i) to obtain an exemption from FATCA withholding on payments they receive and/or (ii) to comply with applicable law in their jurisdictions. It is not yet certain how the United States and the jurisdictions which enter into IGAs will address withholding on “foreign passthru payments” (which may include payments on the Notes) or if such withholding will be required at all.

Whilst the Notes are in global form and held within the Clearing Systems, it is expected that FATCA will not affect the amount of any payments made under, or in respect of, the Notes by the Issuer, any paying agent and the Common Depositary, given that each of the entities in the payment chain beginning with the payment agent and ending with the Clearing Systems is a major financial institution whose business is dependent on compliance with FATCA and that any alternative approach introduced under an IGA will be unlikely to affect the Notes. The documentation expressly contemplates the possibility that the Notes may go into definitive form and therefore that they may be taken out of the Clearing Systems. If this were to happen, then a non-FATCA compliant holder could be subject to withholding pursuant to FATCA. However, definitive notes will only be printed in remote circumstances.

FATCA is particularly complex and its application is uncertain at this time. The above description is based in part on regulations, official guidance and IGAs, all of which are subject to change, possibly with retroactive effect. Investors should consult their own tax advisers regarding how FATCA may affect them based on their particular circumstances.

CLEARANCE AND SETTLEMENT

The information set out below is subject to any change in or reinterpretation of the rules, regulations and procedures of Euroclear, Clearstream, Luxembourg or the CMU (together, the “**Clearing Systems**”) currently in effect. The information in this section concerning the Clearing Systems has been obtained from sources that the Issuer believes to be reliable, but neither the Issuer nor any Dealer or the Sole Arranger takes any responsibility for the accuracy thereof. Investors wishing to use the facilities of any of the Clearing Systems are advised to confirm the continued applicability of the rules, regulations and procedures of the relevant Clearing System. Neither the Issuer nor any other party to the Agency Agreement will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the Notes held through the facilities of any Clearing System or for maintaining, supervising or reviewing any records relating to, or payments made on account of, such beneficial ownership interests.

The relevant Pricing Supplement will specify the Clearing System(s) applicable for each Series.

THE CLEARING SYSTEMS

Euroclear and Clearstream, Luxembourg

Euroclear and Clearstream, Luxembourg each holds securities for participating organisations and facilitates the clearance and settlement of securities transactions between their respective participants through electronic book-entry changes in accounts of such participants. Euroclear and Clearstream, Luxembourg provide to their respective participants, among other things, services for safekeeping, administration, clearance and settlement of internationally-traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg participants are financial institutions throughout the world, including underwriters, securities brokers and dealers, banks, trust companies, clearing corporations and certain other organisations. Indirect access to Euroclear or Clearstream, Luxembourg is also available to others, such as banks, brokers, dealers and trust companies which clear through or maintain a custodial relationship with a Euroclear or Clearstream, Luxembourg participant, either directly or indirectly.

Distributions of principal with respect to book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg will be credited, to the extent received by the Paying Agent, to the cash accounts of Euroclear or Clearstream, Luxembourg participants in accordance with the relevant system’s rules and procedures.

CMU

The CMU is a central depository service provided by the Central Moneymarkets Unit of the HKMA for the safe custody and electronic trading between the members of this service (“**CMU Members**”) of capital markets instruments (“**CMU Instruments**”) which are specified in the CMU Reference Manual as capable of being held within the CMU.

The CMU is only available to CMU Instruments issued by a CMU Member or by a person for whom a CMU Member acts as agent for the purposes of lodging instruments issued by such persons. Membership of the CMU is open to all members of the Hong Kong Capital Markets Association and “authorised institutions” under the Banking Ordinance.

Compared to clearing services provided by Euroclear and Clearstream, Luxembourg, the standard custody and clearing service provided by the CMU is limited. In particular (and unlike the European Clearing Systems), the HKMA does not as part of this service provide any facilities for the dissemination to the relevant CMU Members of payments (of interest or principal) under, or notices pursuant to the notice provisions of, the CMU Instruments. Instead, the HKMA advises the lodging CMU Member (or a designated paying agent) of the identities of the CMU Members to whose accounts payments in respect of the relevant CMU Instruments are credited, whereupon the lodging CMU

Member (or the designated paying agent) will make the necessary payments of interest or principal or send notices directly to the relevant CMU Members. Similarly, the HKMA will not obtain certificates of non-US beneficial ownership from CMU Members or provide any such certificates on behalf of CMU Members. The CMU Lodging and Paying Agent will collect such certificates from the relevant CMU Members identified from an instrument position report obtained by request from the HKMA for this purpose.

An investor holding an interest through an account with either Euroclear or Clearstream, Luxembourg in any Notes held in the CMU will hold that interest through the respective accounts which Euroclear and Clearstream, Luxembourg each have with the CMU.

BOOK-ENTRY OWNERSHIP

Bearer Notes

The Issuer has made applications to Euroclear and Clearstream, Luxembourg for acceptance in their respective book-entry systems in respect of any Series of Bearer Notes. The Issuer may also apply to have Bearer Notes accepted for clearance through the CMU. In respect of Bearer Notes, a temporary Global Note and/or a permanent Global Note will be deposited with a common depositary for Euroclear and Clearstream, Luxembourg or a sub-custodian for the CMU. Transfers of interests in a temporary Global Note or a permanent Global Note will be made in accordance with the normal market debt securities operating procedures of the CMU, Euroclear and Clearstream, Luxembourg.

Registered Notes

The Issuer may make applications to Euroclear and Clearstream, Luxembourg for acceptance in their respective book-entry systems in respect of the Notes to be represented by a Global Certificate. The Issuer may also apply to have Notes to be represented by a Global Certificate accepted for clearance through the CMU. Each Global Certificate will have an International Securities Identification Number (“ISIN”) and a Common Code. Investors in Notes of such Series may hold their interests in a Global Certificate through Euroclear, Clearstream, Luxembourg or the CMU (if applicable).

Each Global Certificate will be subject to restrictions on transfer contained in a legend appearing on the front of such Global Certificate, as set out under “*Subscription and Sale*”.

All Registered Notes will initially be in the form of a Global Certificate. Individual Certificates will be available, in the case of Notes initially represented by a Global Certificate, in amounts specified in the applicable Pricing Supplement.

SUBSCRIPTION AND SALE

DEALER AGREEMENT

Subject to the terms and on the conditions contained in a Dealer Agreement dated 16 June 2014 (the “**Dealer Agreement**”) between the Issuer, the Permanent Dealers and the Sole Arranger, the Notes will be offered on a continuous basis by the Issuer to the Permanent Dealers. However, the Issuer has reserved the right to sell Notes directly on its own behalf to institutions that are not Dealers. The Notes may be resold at prevailing market prices, or at prices related thereto, at the time of such resale, as determined by the relevant Dealer. The Notes may also be sold by the Issuer through the Dealers, acting as agents of the Issuer. The Dealer Agreement also provides for Notes to be issued in syndicated Tranches that are severally underwritten by two or more Dealers.

The Issuer will pay each relevant Dealer a commission as agreed between them in respect of Notes subscribed by it. The commissions in respect of an issue of Notes on a syndicated basis will be stated in the relevant Pricing Supplement.

The Issuer has agreed to indemnify the Sole Arranger and the Dealers against certain liabilities in connection with the offer and sale of the Notes. The Dealer Agreement entitles the Dealers to terminate any agreement that they make to subscribe Notes in certain circumstances prior to payment for such Notes being made to the Issuer.

The Sole Arranger, the Dealers or any of their respective affiliates may have performed certain banking and advisory services for the Issuer and/or its affiliates from time to time for which they have received customary fees and expenses and may, from time to time, engage in transactions with and perform services for the Issuer and/or its affiliates in the ordinary course of the Issuer’s or their business. The Dealers or certain of their respective affiliates may purchase the Notes and be allocated the Notes for asset management and/or proprietary purposes but not with a view to distribution.

The Sole Arranger, the Dealers or any of their respective affiliates may purchase the Notes for its or their own account and enter into transactions, including credit derivatives, such as asset swaps, repackaging and credit default swaps relating to the Notes and/or other securities of the Issuer or its associates at the same time as the offer and sale of the Notes or in secondary market transactions. Such transactions would be carried out as bilateral trades with selected counterparties and separately from any existing sale or resale of the Notes to which this Offering Circular relates (notwithstanding that such selected counterparties may also be purchasers of the Notes).

Application has been made for permission to deal in, and for the listing and quotation of, any Notes which are agreed at the time of issue to be so listed on the SGX-ST. Such permission will be granted when such Notes have been admitted to the Official List of the SGX-ST. There can be no assurance that the application will be approved. In connection with the offer and sale of each Series of Notes, the relevant Pricing Supplement will indicate whether or not and, if so, on which stock exchange(s) the Notes will be listed. No assurances can be given that the Programme will qualify for listing on a stock exchange. In addition, no assurances can be given that if the Programme qualifies for listing on a stock exchange and the relevant Pricing Supplement indicates that such Series of Notes will be listed on a stock exchange, that such Notes will trade from their date of issuance until maturity (or early redemption) and that such listing will be maintained.

SELLING RESTRICTIONS

General

The distribution of this Offering Circular or any offering material and the offering, sale or delivery of the Notes is restricted by law in certain jurisdictions. Therefore, persons who may come into possession of this Offering Circular or any offering material are advised to consult with their own legal advisers as to what restrictions may be applicable to them and to observe such restrictions. This Offering Circular may not be used for the purpose of an offer or invitation in any circumstances in which such offer or invitation is not authorised.

If a jurisdiction requires that the offering be made by a licensed broker or dealer and the Dealers or any affiliate of the Dealers are a licensed broker or dealer in that jurisdiction, the offering shall be deemed to be made by the Dealers or such affiliate on behalf of The Bank of East Asia, Limited 東亞銀行有限公司 in such jurisdiction.

United States

The following sub-paragraphs shall apply in respect of any Notes the Pricing Supplement for which specifies that “Regulation S Category 1” applies.

The Notes have not been and will not be registered under the Securities Act, and may not be offered or sold within the United States except in accordance with Regulation S or pursuant to any other exemption from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S.

The Notes are being offered and sold outside of the United States in reliance on Regulation S. In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of Notes within the United States by a dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act.

The following sub-paragraphs shall apply in respect of any Notes the Pricing Supplement for which specifies that “Regulation S Category 2” applies.

The Notes have not been and will not be registered under the Securities Act, and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in accordance with Regulation S or pursuant to any other exemption from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S.

Each Dealer has agreed that it will offer, and sell the Notes (i) as part of its distribution at any time and (ii) otherwise until 40 days after the later of the commencement of the offering and the Closing Date, only in accordance with Rule 903 of Regulation S under the Securities Act, and it will have sent to each dealer to which it sells Notes during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meanings given to them by Regulation S.

The Notes are being offered and sold outside of the United States to non-U.S. persons in reliance on Regulation S. In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of Notes within the United States by a dealer that is not participating in the offering may violate the registration requirements of the Securities Act.

European Economic Area

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a “**Relevant Member State**”), each Dealer has represented and agreed and each further Dealer appointed under the Programme will be required to represent and agree that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the “**Relevant Implementation Date**”) it has not made and will not make an offer of Notes which are the subject of the offering contemplated by this Offering Circular as completed by the final terms in relation thereto to the public in that Relevant Member State except that it may, with effect from and including the Relevant Implementation Date, make an offer of such Notes to the public in that Relevant Member State:

- (i) if the final terms in relation to the Notes specify that an offer of those Notes may be made other than pursuant to Article 3(2) of the Prospectus Directive in that Relevant Member State (a “**Non-exempt Offer**”), following the date of publication of a prospectus in relation to such Notes which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, provided that any such prospectus has subsequently been completed by the final terms contemplating such Non-exempt Offer, in accordance with the Prospectus Directive, in the period beginning and ending on the dates specified in such prospectus or final terms, as applicable and the Issuer has consented in writing to its use for the purpose of that Non-exempt Offer;
- (ii) at any time to any legal entity which is a qualified investor as defined in the Prospectus Directive;
- (iii) at any time to fewer than 100 or, if the Relevant Member State has implemented the relevant provision of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive) subject to obtaining the prior consent of the relevant Dealer or Dealers nominated by the Issuer for any such offer; or
- (iv) at any time in any other circumstances falling within Article 3(2) of the Prospectus Directive, provided that no such offer of Notes referred to in (i) to (iii) above shall require the Issuer or any Dealer to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression an “offer of Notes to the public” in relation to any Notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Notes to be offered so as to enable an investor to decide to purchase or subscribe the Notes, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State, the expression “Prospectus Directive” means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member State) and includes any relevant implementing measure in each Relevant Member State and the expression “2010 PD Amending Directive” means Directive 2010/73/EU.

United Kingdom

Each Dealer has represented, warranted and agreed, and each further Dealer appointed under the Programme will be required to represent, warrant and agree, that:

- (1) in relation to any Notes which have a maturity of less than one year, (a) it is a person whose ordinary activities involve it in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of its business and (b) it has not offered or sold and will not offer or sell any Notes other than to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their

businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses where the issue of the Notes would otherwise constitute a contravention of section 19 of the Financial Services and Markets Act 2000 (the “**FSMA**”) by the Issuer;

- (2) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA, received by it in connection with the issue or sale of any Notes in circumstances in which section 21(1) of the FSMA does not apply to the Issuer; and
- (3) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

Hong Kong

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent, warrant and agree, that:

- (1) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any Notes other than (a) to “professional investors” as defined in the SFO and any rules made under that Ordinance; or (b) in other circumstances which do not result in the document being a “prospectus” as defined in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) of Hong Kong or which do not constitute an offer to the public within the meaning of that Ordinance; and
- (2) it has not issued or had in its possession for the purposes of issue, and will not issue or have in its possession for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the Notes, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to Notes which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” as defined in the SFO and any rules made under that Ordinance.

Singapore

Each Dealer has acknowledged that this Offering Circular has not been registered as a prospectus with the Monetary Authority of Singapore (the “**MAS**”). Accordingly, each Dealer has represented, warranted and agreed, and each further Dealer appointed under the Programme will be required to represent, warrant and agree, that it has not offered or sold any Notes or caused such Notes to be made the subject of an invitation for subscription or purchase and will not offer or sell such Notes or cause such Notes to be made the subject of an invitation for subscription or purchase, and has not circulated or distributed, nor will it circulate or distribute, this Offering Circular or any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of such Notes, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor under Section 274 of the Securities and Futures Act, Chapter 289 of Singapore (the “**SFA**”), (ii) to a relevant person pursuant to Section 275(1), or any person pursuant to Section 275(1A), and in accordance with the conditions specified in Section 275, of the SFA, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

This Offering Circular has not been registered as a prospectus with the MAS. Accordingly, this Offering Circular and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of Notes may not be circulated or distributed, nor may Notes be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor under Section 274 of the

SFA, Chapter 289 of Singapore, (ii) to a relevant person pursuant to Section 275(1), or any person pursuant to Section 275(1A), and in accordance with the conditions specified in Section 275, of the SFA, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

Where the Notes are subscribed or purchased under Section 275 of the SFA by a relevant person which is:

- (a) a corporation (which is not an accredited investor (as defined in Section 4A of the SFA)) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or
- (b) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor,

securities (as defined in Section 239(1) of the SFA) of that corporation or the beneficiaries' rights and interest (howsoever described) in that trust shall not be transferred within six months after that corporation or that trust has acquired the Notes pursuant to an offer made under Section 275 of the SFA except:

- (i) to an institutional investor or to a relevant person defined in Section 275(2) of the SFA, or to any person arising from an offer referred to in Section 275(1A) or Section 276(4)(i)(B) of the SFA;
- (ii) where no consideration is or will be given for the transfer;
- (iii) where the transfer is by operation of law;
- (iv) as specified in Section 276(7) of the SFA or;
- (v) as specified in Regulation 32 of the Securities and Futures (Offer of Investments) (Shares and Debentures) Regulations 2005 of Singapore.

Japan

The Notes have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (Act No. 25 of 1948, as amended, the “**Financial Instruments and Exchange Act**”). Accordingly, each Dealer has represented and agreed and each further Dealer appointed under the Programme will be required to represent and agree that it has not, directly or indirectly, offered or sold and will not, directly or indirectly, offer or sell any Notes in Japan to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan) or to others for re-offering or re-sale, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Financial Instruments and Exchange Act and other relevant laws and regulations of Japan.

PRC

Each Dealer has represented, warranted and agreed, and each further Dealer appointed under the Programme will be required to represent, warrant and agree, that the Notes are not being offered or sold and may not be offered or sold, directly or indirectly, in the PRC (for such purposes, not including the Hong Kong and Macau Special Administrative Regions or Taiwan), except as permitted by the securities laws of the PRC.

Taiwan

The Notes have not been and will not be registered or filed with, or approved by, the Financial Supervisory Commission of Taiwan and/or other regulatory authority pursuant to relevant securities

laws and regulations and may not be offered or sold in Taiwan through a public offering or in circumstances which constitute an offer within the meaning of the Securities and Exchange Act of Taiwan or relevant laws and regulations that requires a registration, filing or approval of the Financial Supervisory Commission and/or other regulatory authority of Taiwan.

GENERAL INFORMATION

1. **Clearing Systems:** The Notes have been accepted for clearance through the Euroclear and Clearstream, Luxembourg systems (which are the entities in charge of keeping the records). The Issuer may also apply to have Notes accepted for clearance through the CMU. The relevant CMU instrument number will be set out in the relevant Pricing Supplement. The relevant ISIN, the Common Code and (where applicable) the identification number for any other relevant clearing system for each series of Notes will be specified in the applicable Pricing Supplement. If the Notes are to clear through an additional or alternative clearing system the appropriate information will be set out in the relevant Pricing Supplement.

The address of Euroclear is 1 Boulevard du Roi Albert II, B-1210 Brussels, Belgium and the address of Clearstream, Luxembourg is 42 Avenue JF Kennedy, L-1855 Luxembourg. The address of any alternative clearing system will be specified in the relevant Pricing Supplement.

2. **Listing:** Application has been made to the SGX-ST for permission to deal in, and for the listing and quotation of, any Notes which are agreed at the time of issue to be so listed on the SGX-ST. Such permission will be granted when such Notes have been admitted to the Official List of the SGX-ST. There can be no assurance that the application will be approved.
3. **Litigation:** None of the Issuer nor any of its subsidiaries is involved in any litigation or arbitration proceedings relating to claims or amounts which are material in the context of the issue of the Notes, nor is the Issuer or any of its subsidiaries aware that any such proceedings are pending or threatened.
4. **Authorisations:** The Issuer has obtained all necessary consents, approvals and authorisations as may be required in connection with the establishment of the Programme, including, but not limited to, approval by the HKMA. The establishment of the Programme and the issue of Notes thereunder have been duly authorised by resolutions of the Board of Directors of the Issuer, dated 4 April 2014. The Issuer has obtained and has agreed to obtain from time to time all necessary internal consents, approvals and authorisations for the issue of Notes under the Programme. The issue of this Offering Circular has been duly authorised by resolutions of the Board of Directors of the Issuer dated 4 April 2014.
5. **No Material Adverse Change:** Except as disclosed in this Offering Circular, there has been no significant change in the financial or trading position of the Issuer or of the Group since 31 December 2013 and no material adverse change in the financial position or prospects of the Issuer or of the Group since 31 December 2013.
6. **Available Documents:** For so long as Notes may be issued pursuant to this Offering Circular, the following documents will be available, during usual business hours on any weekday (Saturdays and public holidays excepted), for inspection at the offices of (i) the Trustee (in the case of the documents referred to in sub-paragraph (d) below; or (ii) the Issuer and/or the Paying Agents (in the case of the documents referred to in respect of all the sub-paragraphs below):
 - (a) the Articles of Association of the Issuer;
 - (b) a copy of the auditors' reports of KPMG, the Issuer's external auditors, and the audited consolidated financial statements of the Issuer as at and for the years ended 31 December 2012 and 2013;
 - (c) copies of the most recent annual and interim reports (including the financial statements) published by the Issuer;
 - (d) the Trust Deed (which includes the form of the Global Notes, the definitive Bearer Notes, the Certificates, the Coupons, the Receipts and the Talons) and the Agency Agreement;

- (e) the Dealer Agreement;
 - (f) a copy of this Offering Circular together with any Supplement to this Offering Circular or further Offering Circular;
 - (g) a copy of the subscription agreement for Notes issued on a syndicated basis that are listed on any stock exchange, where the rules of such stock exchange so require; and
 - (h) each Pricing Supplement (save that Pricing Supplement relating to a Note which is neither admitted to trading on a regulated market within the European Economic Area nor offered in the European Economic Area in circumstances where a prospectus is required to be published under the Prospectus Directive will only be available for inspection by a holder of such Note and such holder must produce evidence satisfactory to the Issuer and the Issuing and Paying Agent as to its holding of Notes and identity).
7. **Auditors:** The consolidated financial statements of the Issuer as at and for the years ended 31 December 2012 and 2013 included in this Offering Circular have been audited by KPMG, Certified Public Accountants, as stated in the auditors' report appearing in this Offering Circular in relation to such consolidated financial statements.
8. For so long as any Notes are listed on the SGX-ST and the rules of the SGX-ST so require, in the event that a Global Certificate is exchanged for definitive Certificates, the Issuer will appoint and maintain a paying agent in Singapore, where such Notes may be presented or surrendered for payment or redemption. In addition, in the event that a Global Certificate is exchanged for definitive Certificates, an announcement of such exchange shall be made by or on behalf of the Issuer through the SGX-ST and such announcement will include all material information with respect to the delivery of the definitive Certificates, including details of the paying agent in Singapore.
9. Each Bearer Note having a maturity of more than one year, Receipt, Coupon and Talon will bear the following legend: "Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in Sections 165(j) and 1287(a) of the Internal Revenue Code".
10. The issue price and the amount of the relevant Notes will be determined, before filing of the relevant Pricing Supplement of each Tranche, based on the prevailing market conditions. The Issuer does not intend to provide any post-issuance information in relation to any issues of Notes.

The independent auditor's reports on BEA's consolidated financial statements for the years ended 31 December 2012 and 2013 set out herein are reproduced from the independent auditor's reports for the years ended 31 December 2012 and 2013, respectively. Page references referred to in the reports named above refer to pages set out such independent auditor's reports.

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Independent Auditors' Report and Audited Financial Statements of BEA as at and for the Year Ended 31 December 2013

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THE BANK OF EAST ASIA, LIMITED**INDEPENDENT AUDITOR'S REPORT**
TO THE SHAREHOLDERS OF THE BANK OF EAST ASIA, LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the consolidated financial statements of The Bank of East Asia, Limited ("the Bank") and its subsidiaries (together "the Group") set out on pages 16 to 137, which comprise the consolidated and the Bank's statements of financial position as at 31st December 2012, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information.

DIRECTORS' RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

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

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. This report is made solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

THE BANK OF EAST ASIA, LIMITED

OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Bank and of the Group as at 31st December, 2012 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

Certified Public Accountants

8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

Hong Kong, 26th February, 2013

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER, 2012

	Notes	2012 HK\$ Mn	2011 Restated HK\$ Mn
Interest income	4	22,635	20,868
Interest expense	5	(12,911)	(11,605)
Net interest income		9,724	9,263
Fee and commission income	6	4,159	3,813
Fee and commission expense		(780)	(763)
Net fee and commission income		3,379	3,050
Net trading profits	7	765	175
Net result from financial instruments designated at fair value through profit or loss	8	664	(354)
Net hedging loss	9	(15)	(5)
Other operating income	10	592	586
Non-interest income		5,385	3,452
Operating income		15,109	12,715
Operating expenses	11	(8,725)	(7,992)
Operating profit before impairment losses		6,384	4,723
Impairment losses on loans and advances	12	(213)	(75)
Write back of/(Charge for) impairment losses on held-to-maturity investments	30	11	(11)
Impairment losses on available-for-sale financial assets		(63)	(49)
Impairment losses		(265)	(135)
Operating profit after impairment losses		6,119	4,588
Net profit on sale of available-for-sale financial assets	13	82	59
Net profit on sale of loans and receivables		35	3
Net profit on sale of subsidiaries/associates		203	122
Net profit on sale of fixed assets	14	139	140
Valuation gains on properties	15,34	451	404
Share of profits less losses of associates		536	435
Profit for the year before taxation		7,565	5,751
Income tax	16	(1,411)	(1,300)
Profit for the year after taxation		6,154	4,451
Attributable to:			
Owners of the parent		6,056	4,358
Non-controlling interests	42	98	93
Profit after taxation		6,154	4,451
Earnings per share		HK\$	HK\$
Basic	19	2.72	1.96
Diluted	19	2.72	1.96

The notes on pages 23 to 137 form part of these accounts. Details of dividends payable to equity shareholders of the Bank attributable to the profit for the year are set out in Note 18.

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31ST DECEMBER, 2012

		2012	2011
	Notes	HK\$ Mn	HK\$ Mn
Net profit		<u>6,154</u>	<u>4,451</u>
Other comprehensive income for the year (after taxation and reclassification adjustments):			
Premises:			
- unrealised surplus on revaluation of premises	41(c)	-	16
- deferred taxes	41(c)	1	3
- exchange differences	41(c)	1	(3)
Available-for-sale investment revaluation reserve:			
- fair value changes recognised (from)/ to equity	41(h)	1,121	(326)
- fair value changes reclassified from/(to) income statement:			
- on impairment and amortisation	41(h)	98	55
- on disposal	41(h)	(113)	5
- deferred taxes	41(h)	(120)	35
- exchange differences	41(h)	(1)	-
Share of changes in equity of associates	41 (i)	4	7
Exchange differences on other reserves	41(d)	15	82
Exchange differences on translation of:			
- accounts of overseas branches, subsidiaries and associates	41(f)	<u>379</u>	<u>452</u>
Other comprehensive income		<u>1,385</u>	<u>326</u>
Total comprehensive income		<u><u>7,539</u></u>	<u><u>4,777</u></u>
Total comprehensive income attributable to:			
Owners of the parent		7,441	4,684
Non-controlling interests	42	<u>98</u>	<u>93</u>
		<u><u>7,539</u></u>	<u><u>4,777</u></u>

The notes on pages 23 to 137 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31ST DECEMBER, 2012

		2012	2011 Restated
	Notes	HK\$ Mn	HK\$ Mn
ASSETS			
Cash and balances with banks and other financial institutions	23	85,512	71,761
Placements with banks and other financial institutions	24	50,618	58,598
Trade bills	25	55,740	46,891
Trading assets	26	7,338	5,600
Financial assets designated at fair value through profit or loss	27	15,169	16,663
Advances to customers and other accounts	28	387,273	341,341
Available-for-sale financial assets	29	64,731	44,910
Held-to-maturity investments	30	4,320	4,587
Investments in associates	32	4,677	3,820
Fixed assets	34	12,552	12,639
- Investment properties		3,100	2,940
- Other property and equipment		9,452	9,699
Goodwill and intangible assets	33	4,041	4,215
Deferred tax assets	36(b)	143	377
Total Assets		692,114	611,402
EQUITY AND LIABILITIES			
Deposits and balances of banks and other financial institutions		30,597	15,923
Deposits from customers		498,770	467,354
Trading liabilities	37(a)	3,827	4,548
Certificates of deposit issued		27,370	11,483
- At fair value through profit or loss		6,095	5,272
- At amortised cost		21,275	6,211
Current taxation	36(a)	988	473
Debt securities issued		8,657	6,393
- At fair value through profit or loss		698	-
- At amortised cost		7,959	6,393
Deferred tax liabilities	36(b)	626	461
Other accounts and provisions	37(b)	45,377	35,982
Loan capital	38	14,263	16,741
- At fair value through profit or loss		-	3,178
- At amortised cost		14,263	13,563
Total Liabilities		630,475	559,358
Share capital	40	5,568	5,190
Reserves	41	51,585	42,426
Total equity attributable to owners of the parent		57,153	47,616
Non-controlling interests	42	4,486	4,428
Total Equity		61,639	52,044
Total Equity and Liabilities		692,114	611,402

Approved and authorised for issue by the Board of Directors on 26th February, 2013.

Chairman and Chief Executive

Directors

The notes on pages 23 to 137 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 31ST DECEMBER, 2012

	Notes	2012 HK\$ Mn	2011 HK\$ Mn
ASSETS			
Cash and balances with banks and other financial institutions	23	19,756	22,570
Placements with banks and other financial institutions	24	19,335	33,370
Trade bills	25	47,931	35,876
Trading assets	26	3,993	4,159
Financial assets designated at fair value through profit or loss	27	14,870	16,453
Advances to customers and other accounts	28	228,226	203,593
Amounts due from subsidiaries	35	15,566	11,498
Available-for-sale financial assets	29	45,016	28,629
Held-to-maturity investments	30	3,219	2,880
Investments in subsidiaries	31	13,958	13,754
Investments in associates	32	2,565	2,466
Fixed assets	34	6,836	6,878
- Investment properties		2,428	2,433
- Other property and equipment		4,408	4,445
Goodwill and intangible assets	33	1,460	1,460
Deferred tax assets	36(b)	130	153
Total Assets		422,861	383,739
EQUITY AND LIABILITIES			
Deposits and balances of banks and other financial institutions		10,607	10,064
Deposits from customers		306,653	290,445
Trading liabilities	37(a)	3,080	3,827
Certificates of deposit issued		29,570	13,683
- At fair value through profit or loss		6,095	5,272
- At amortised cost		23,475	8,411
Amounts due to subsidiaries	35	3,105	2,416
Current taxation	36(a)	872	297
Debt securities issued		1,200	241
- At fair value through profit or loss		698	-
- At amortised cost		502	241
Deferred tax liabilities	36(b)	600	454
Other accounts and provisions	37(b)	7,033	6,221
Loan capital	38	18,673	20,766
- At fair value through profit or loss		4,410	7,203
- At amortised cost		14,263	13,563
Total Liabilities		381,393	348,414
Share capital	40	5,568	5,190
Reserves	41	35,900	30,135
Total equity attributable to owners of the Bank		41,468	35,325
Total Equity and Liabilities		422,861	383,739

Approved and authorised for issue by the Board of Directors on 26th February, 2013.

Chairman and Chief Executive

Directors

The notes on pages 23 to 137 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31ST DECEMBER, 2012

	Share capital	Share premium	Capital reserve – staff share options issued	Exchange revaluation reserve	Investment revaluation reserve	Revaluation reserve of bank premises	Capital reserve	General reserve	Other reserves*	Retained profits	Total	Non-controlling interests	Total equity
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1 st January, 2012	5,190	12,037	140	2,390	27	1,032	86	13,744	2,202	10,768	47,616	4,428	52,044
Changes in equity													
Profit for the year	-	-	-	-	-	-	-	-	-	6,056	6,056	98	6,154
Other comprehensive income	-	-	-	379	985	2	-	-	19	-	1,385	-	1,385
Total comprehensive income	-	-	-	379	985	2	-	-	19	6,056	7,441	98	7,539
Shares issued in lieu of dividend	97	1,002	-	-	-	-	-	-	-	-	1,099	-	1,099
Subscription of new shares	279	3,022	-	-	-	-	-	-	-	-	3,301	-	3,301
Shares issued under Staff Share Option Schemes	2	16	-	-	-	-	-	-	-	-	18	-	18
Equity settled share-based transaction	-	-	22	-	-	-	-	-	-	-	22	-	22
Transfer	-	6	(27)	-	-	(58)	48	79	390	(485)	(47)	47	-
Dividends declared or approved during the year	-	-	-	-	-	-	-	-	-	(2,293)	(2,293)	(68)	(2,361)
Reversal due to disposal of a subsidiary	-	-	-	-	-	-	(4)	-	-	-	(4)	-	(4)
Exchange adjustments	-	-	-	-	-	-	-	-	-	-	-	(19)	(19)
At 31 st December, 2012	5,568	16,083	135	2,769	1,012	976	130	13,823	2,611	14,046	57,153	4,486	61,639
At 1 st January, 2011	5,105	9,331	165	1,938	258	1,023	86	15,453	2,043	8,841	44,243	4,400	48,643
- As previously reported	-	2,181	-	-	-	-	-	(2,181)	-	-	-	-	-
- Reclassification from general reserve to share premium	5,105	11,512	165	1,938	258	1,023	86	13,272	2,043	8,841	44,243	4,400	48,643
- As restated													
Changes in equity													
Profit for the year	-	-	-	-	-	-	-	-	-	4,358	4,358	93	4,451
Other comprehensive income	-	-	-	452	(231)	16	-	-	89	-	326	-	326
Total comprehensive income	-	-	-	452	(231)	16	-	-	89	4,358	4,684	93	4,777
Shares issued in lieu of dividend	77	416	-	-	-	-	-	441	-	-	934	-	934
Shares issued under Staff Share Option Schemes	8	85	-	-	-	-	-	-	-	-	93	-	93
Equity settled share-based transaction	-	-	20	-	-	-	-	-	-	-	20	-	20
Transfer	-	24	(45)	-	-	(7)	-	31	70	(73)	-	-	-
Dividends declared or approved during the year	-	-	-	-	-	-	-	-	-	(2,358)	(2,358)	(61)	(2,419)
Purchase of interests in businesses from non-controlling interests investors	-	-	-	-	-	-	-	-	-	-	-	2	2
Exchange adjustments	-	-	-	-	-	-	-	-	-	-	-	(6)	(6)
At 31 st December, 2011	5,190	12,037	140	2,390	27	1,032	86	13,744	2,202	10,768	47,616	4,428	52,044

* Other reserves include statutory reserve and other reserves.

The notes on pages 23 to 137 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER, 2012

	Notes	2012 HK\$ Mn	2011 Restated HK\$ Mn
OPERATING ACTIVITIES			
Profit for the year before taxation		7,565	5,751
Adjustments for:			
Charge for impairment losses on loans and advances	12	213	75
Charge for impairment allowances on held-to-maturity investments, available-for-sale financial assets and associates		52	60
Share of profits less losses of associates		(536)	(435)
Net profit on sale of available-for-sale financial assets		(82)	(59)
Net profit on sale of subsidiaries and associates		(203)	(122)
Net profit on sale of fixed assets		(139)	(140)
Interest expense on loan capital and certificates of deposit		1,534	978
Depreciation on fixed assets	11,34	657	636
Dividend income from available-for-sale financial assets		(42)	(89)
Amortisation of intangible assets	11	33	33
Amortisation of premium/discount on certificates of deposit and loan capital issued		110	60
Revaluation losses on certificates of deposit and loan capital issued		298	711
Valuation gains on investment properties	34	(454)	(404)
Revaluation loss on bank premises		3	-
Equity-settled share-based payment expenses		22	20
OPERATING PROFIT BEFORE CHANGES IN WORKING CAPITAL		9,031	7,075
(Increase)/decrease in operating assets:			
Cash and balances with banks with original maturity beyond three months		(811)	(10,076)
Placements with banks and other financial institutions with original maturity beyond three months		8,715	(25,165)
Trade bills		(8,849)	(28,353)
Trading assets		(1,738)	245
Financial assets designated at fair value through profit or loss		1,494	(471)
Advances to customers		(40,074)	(18,383)
Advances to banks and other financial institutions		47	1,127
Held-to-maturity debt securities		379	1,276
Available-for-sale financial assets		(12,256)	259
Other accounts and accrued interest		(10,578)	(4,364)
Increase/(decrease) in operating liabilities:			
Deposits and balances of banks and other financial institutions		14,715	5,929
Deposits from customers		35,710	47,521
Trading liabilities		(607)	1,447
Other accounts and provisions		9,382	7,296
Exchange adjustments		368	619
NET CASH INFLOW/(OUTFLOW) FROM OPERATIONS		4,928	(14,018)
Income tax paid			
Hong Kong profits tax paid		(50)	(69)
Outside Hong Kong profits tax paid		(746)	(817)
NET CASH GENERATED FROM/(USED IN) OPERATING ACTIVITIES		4,132	(14,904)

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED CASH FLOW STATEMENT (Continued)
FOR THE YEAR ENDED 31ST DECEMBER, 2012

	Notes	2012 HK\$ Mn	2011 Restated HK\$ Mn
INVESTING ACTIVITIES			
Dividends received from associates		140	117
Dividends received from available-for-sale equity securities		42	89
Purchase of equity securities		(777)	(606)
Proceeds from sale of equity securities		745	988
Purchase of fixed assets	34	(436)	(577)
Purchase of investment properties		(38)	(8)
Proceeds from disposal of fixed assets		505	519
(Purchase)/disposal of shareholding in associates		(99)	116
Purchase of subsidiaries	46(a)	(11)	(75)
Proceeds from sale of interest in a subsidiary	46(b)	584	-
Purchase of interests in business from non-controlling interests investors		-	2
NET CASH GENERATED FROM INVESTING ACTIVITIES		655	565
FINANCING ACTIVITIES			
Ordinary dividends paid		(932)	(1,157)
Distribution to Hybrid Tier 1 issue holders		(331)	(328)
Issue of ordinary share capital	40	18	93
Subscription of new shares		3,301	-
Issue of certificates of deposit		40,875	19,380
Issue of debt securities		4,910	6,148
Issue of loan capital		5,066	3,867
Redemption of certificates of deposit issued		(25,070)	(13,608)
Redemption of debt securities issued		(2,710)	(4,929)
Redemption of loan capital		(7,920)	(449)
Interest paid on loan capital		(768)	(572)
Interest paid on certificates of deposit issued		(324)	(129)
Interest paid on debt securities issued		(345)	(162)
NET CASH GENERATED FROM FINANCING ACTIVITIES		15,770	8,154
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		20,557	(6,185)
CASH AND CASH EQUIVALENTS AT 1ST JANUARY	46(c)	79,181	85,366
CASH AND CASH EQUIVALENTS AT 31ST DECEMBER	46(c)	99,738	79,181
Cash flows from operating activities included:			
Interest received		23,083	19,938
Interest paid		12,896	9,718
Dividend received		74	129

The notes on pages 23 to 137 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
NOTES ON THE ACCOUNTS

1. Principal Activities

The Bank and its subsidiaries (the “Group”) are engaged in the provision of banking and related financial services, and business, corporate and investor services.

2. Significant Accounting Policies

(a) Statement of Compliance

These accounts have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (“HKFRSs”), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (“HKASs”), and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. These accounts also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. A summary of the significant accounting policies adopted by the Group is set out below.

The HKICPA has issued certain new and revised HKFRSs that are first effective or available for early adoption for the current accounting period of the Group and the Bank. Note 3 provides information on the changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these accounts.

(b) Basis of Preparation of the Accounts

The accounts for the year ended 31st December, 2012 comprise the Group and the Group’s interest in associates.

The measurement basis used in the preparation of the accounts is historical cost except that the following assets and liabilities are stated at their fair value as explained in the accounting policies set out below:

- financial instruments classified as trading, designated at fair value through profit or loss and available-for-sale (Note 2(f)(ii)); and
- investment properties (Note 2(h)(ii)).

The preparation of accounts in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Details of judgements made by management in the application of HKFRSs that have significant effect on the accounts and major sources of estimation uncertainty are discussed in Note 52.

(c) Basis of Consolidation

These consolidated accounts cover the consolidated position of the Bank and all subsidiaries unless otherwise stated and the Group's interest in associates. For information required to be reported in accordance with the Banking (Disclosures) Rules, the basis of consolidation is set out in the Notes (1) and (2) in the Unaudited Supplementary Financial Information.

(i) Subsidiaries and Non-controlling interests

The consolidated accounts include the accounts of the Bank and all its subsidiaries made up to 31st December each year. Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

An investment in a subsidiary is consolidated into the consolidated accounts from the date that control commences until the date that control ceases. Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated accounts. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Non-controlling interests (previously known as "minority interests") represent the equity in a subsidiary not attributable directly or indirectly to the Bank, and in respect of which the Group has not agreed any additional terms with the holders of these interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meets the definition of a financial liability. For each business combination, the Group can elect to measure any non-controlling interests either at fair value or at their proportionate share of the subsidiary's net identifiable assets.

Non-controlling interests are presented in the consolidated statement of financial position and consolidated statement of changes in equity within equity, separately from equity attributable to equity shareholders of the Group. Non-controlling interests in the results of the Group are presented on the face of the consolidated income statement and the consolidated statement of comprehensive income as an allocation of the net profit and total comprehensive income for the year between non-controlling interests and equity shareholders of the Bank.

Changes in the Group's interests in a subsidiary that do not result in a loss of control are accounted for as equity transactions, whereby adjustments are made to the amounts of controlling and non-controlling interests within consolidated equity to reflect the change in relative interests, but no adjustments are made to goodwill and no gain or loss is recognised.

When the Group loses control of a subsidiary, it is accounted for as a disposal of the entire interest in that subsidiary, with a resulting gain or loss being recognised in profit or loss. Any interest retained in that former subsidiary at the date when

control is lost is recognised at fair value and this amount is regarded as the fair value on initial recognition of a financial asset (Note 2(f)) or, when appropriate, the cost on initial recognition of an investment in an associate (Note 2(c)(ii)).

In the Bank's statement of financial position, its investments in subsidiaries are stated at cost less any impairment losses (Note 2(k)).

(ii) Associates

An associate is a company in which the Group or the Bank has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

An investment in an associate is accounted for in the consolidated accounts under the equity method unless it is classified as held-for-sale, and is initially recorded at cost, adjusted for any excess of the Group's share of the acquisition-date fair values of the associate's identifiable net assets over the cost of the investment (if any). Thereafter, the investment is adjusted for the post acquisition change in the Group's share of the associate's net assets and any impairment loss relating to the investment (Note 2(j) and 2(k)). Any acquisition-date excess over cost, the Group's share of the post-acquisition, post-tax results of the associates and any impairment losses for the year are recognised in the consolidated income statement, whereas the Group's share of the post-acquisition post-tax items of the associate's other comprehensive income is recognised in the consolidated statement of comprehensive income.

When the Group's share of losses exceeds its interest in the associates, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. For these purposes, the Group's interest in the associate is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associate.

Unrealised profits and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates, except when unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

When the Group ceases to have significant influence over an associate, it is accounted for as a disposal of the entire interest in that associate, with a resulting gain or loss being recognised in profit or loss. Any interest retained in that former associate at the date when significant influence is lost is recognised at fair value and this amount is regarded as the fair value on initial recognition of a financial asset (Note 2(f)) or, when appropriate, the cost on initial recognition of an investment in an associate.

The Bank accounts for the results of associates to the extent of dividends received. Investments in associates are stated at cost less any impairment losses (Note 2(k)).

(d) Translation of Foreign Currencies

Transactions in foreign currencies are translated into Hong Kong dollars at the rates of exchange ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the rates of exchange

ruling at the end of the reporting period. Exchange differences are dealt with in the income statement.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into Hong Kong dollars using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was determined.

Exchange differences relating to investments at fair value through profit or loss and derivative financial instruments are included in gains less losses from trading securities or financial instruments designated at fair value through profit or loss. All other exchange differences relating to monetary items are presented as gains less losses from dealing in foreign currencies in the income statement. Differences arising on translation of available-for-sale equity instruments are recognised in other comprehensive income and accumulated separately in equity.

The results of foreign operations are translated into Hong Kong dollars at the exchange rates approximating the foreign exchange rates ruling at the dates of the transactions. Balance sheet items, including goodwill arising on consolidation of foreign operations acquired on or after 1st January, 2005, are translated into Hong Kong dollars at the foreign exchange rates ruling at the end of the reporting period. The resulting exchange differences are recognised directly in other comprehensive income and accumulated separately in equity in the exchange reserve. Goodwill arising on consolidation of a foreign operation acquired before 1st January, 2005 is translated at the foreign exchange rate that applied at the date of acquisition of the foreign operation.

On disposal of a foreign enterprise, the cumulative amount of the exchange differences which relate to that foreign enterprise is included in the calculation of the profit or loss on disposal.

(e) Revenue Recognition

Revenue is measured at the fair value of the consideration received or receivable. Provided it is probable that economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in the income statement as follows:

Interest income for all interest-bearing financial instruments, except those classified as held for trading or designated at fair value through profit or loss, is recognised as interest income in the income statement on an accruals basis using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating the interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

For impaired loans, the accrual of interest income based on the original terms of the loan is discontinued, but any increase in the present value of impaired loans due to the passage of time is reported as interest income.

Net income from financial instruments designated at fair value through profit or loss and net trading income comprises all gains and losses from changes in fair value (net of accrued coupon) of such financial assets and financial liabilities, together with dividend income attributable to those financial instruments.

Fee and commission income is recognised in the income statement when the corresponding service is provided, except where the fee is charged to cover the costs of a continuing service to, or risk borne for, the customer, or is interest in nature. In these cases, the fee is recognised as income in the accounting period in which the costs or risk is incurred and is accounted for as interest income.

Origination or commitment fees received/paid by the Group which result in the creation or acquisition of a financial asset are deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the Group making a loan, the fee is recognised as revenue on a straight-line basis over the commitment period.

Finance income implicit in finance leases is recognised as interest income over the period of the lease so as to produce an approximately constant periodic rate of return of the outstanding net investment in the leases for each accounting period.

Rental income received under operating leases is recognised as other operating income in equal instalments over the periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives granted are recognised in the income statement as an integral part of the aggregate net lease payments receivable. Contingent rentals receivable are recognised as income in the accounting period in which they are earned.

Dividend income from unlisted investments is recognised when the shareholder's right to receive payment is established. Dividend income from listed investments is recognised when the share price of the investment is quoted ex-dividend.

(f) Financial Instruments

(i) Initial recognition

The Group classifies its financial instruments into different categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are: fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets and other financial liabilities.

Financial instruments are measured initially at fair value, which normally will be equal to the transaction price plus, in case of a financial asset or financial liability not held at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset or issue of the financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately.

The Group recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument. A regular way purchase or sale of financial assets is recognised using trade date accounting.

From this date, any gains and losses arising from changes in fair value of the financial assets or financial liabilities at fair value through profit or loss are recorded.

(ii) Categorisation

Fair value through profit or loss

This category comprises financial assets and financial liabilities held for trading, and those designated at fair value through profit or loss upon initial recognition, but excludes those investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured.

Trading financial instruments are financial assets or financial liabilities which are acquired or incurred principally for the purpose of trading, or are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Non-hedging derivatives are accounted for as trading instruments.

Financial instruments are designated at fair value through profit or loss upon initial recognition when:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise;
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract; or
- the separation of the embedded derivatives from the financial instrument is not prohibited.

Financial assets and financial liabilities under this category are carried at fair value. Changes in the fair value are included in the income statement in the period in which they arise. Upon disposal or repurchase, the difference between the net sales proceeds or the net payment and the carrying value is included in the income statement.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (a) those that the Group intends to sell immediately or in the near term, which will be classified as held for trading; (b) those that the Group, upon initial recognition, designates as at fair value through profit or loss or as available-for-sale; or (c) those where the Group may not recover substantially all of its initial investment, other than because of credit deterioration, which will be classified as available-for-sale. Loans and receivables mainly comprise placements with banks and other financial institutions, trade bills and loans and advances to customers.

Securities classified as loans and receivables typically comprise securities issued by the same customers with whom the Group has a lending relationship in its wholesale banking business. Investment decisions for credit substitute securities are subject to the same credit approval processes as loans, and the Group bears the same customer risk as it does for loans extended to those customers.

Additionally the yield and maturity terms are generally directly negotiated by the Group with the issuer. These securities include commercial paper, short term debentures and preference shares issued by the borrower.

Loans and receivables and securities classified as loans and receivables are carried at amortised cost using the effective interest method, less impairment losses, if any (Note 2(k)).

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity which the Group has the positive intention and ability to hold to maturity, other than (a) those that the Group, upon initial recognition, designates as at fair value through profit or loss or available-for-sale; and (b) those that meet the definition of loans and receivables.

Held-to-maturity investments are carried at amortised cost using the effective interest method less impairment losses, if any (Note 2(k)).

If, as a result of a change in intention or ability, it is no longer appropriate to classify an investment as held-to-maturity, it shall be reclassified as available-for-sale and remeasured at fair value.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any of the other three categories above. They include financial assets intended to be held for an indefinite period of time, but which may be sold in response to needs for liquidity or changes in the market environment.

Available-for-sale financial assets are carried at fair value. Unrealised gains and losses arising from changes in the fair value are recognised in other comprehensive income and accumulated separately in equity, except for impairment losses and foreign exchange gains and losses on monetary items such as debt securities which are recognised in the income statement.

Investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be measured reliably, and derivatives that are linked to and must be settled by delivery of such unquoted equity securities are carried at cost less impairment losses, if any (Note 2(k)).

When the available-for-sale financial assets are sold, gains or losses on disposal include the difference between the net sale proceeds and the carrying value, and the accumulated fair value adjustments which are previously recognised in other comprehensive income shall be reclassified from equity to the income statement.

Other financial liabilities

Financial liabilities, other than trading liabilities and those designated at fair value through profit or loss, are measured at amortised cost using the effective interest method.

(iii) Fair value measurement principles

The fair value of financial instruments is based on their quoted market prices at the end of the reporting period without any deduction for estimated future selling costs.

If there is no publicly available latest traded price nor a quoted market price on a recognised stock exchange or a price from a broker/dealer for non-exchange-traded financial instruments or if the market for it is not active, the fair value of the instrument is estimated using valuation techniques that provide a reliable estimate of prices which could be obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the end of the reporting period applicable for an instrument with similar terms and conditions. Where other pricing models are used, inputs are based on market data at the end of the reporting period.

(iv) Derecognition

The Group derecognises a financial asset when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset, together with substantially all the risks and rewards of ownership, have been transferred.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

The Group uses the weighted average method to determine realised gains and losses to be recognised in the income statement on derecognition.

(v) Offsetting

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position only where there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(vi) Embedded derivatives

An embedded derivative is a component of a hybrid (combined) instrument that includes both the derivative and a host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. The embedded derivatives are separated from the host contract and accounted for as a derivative when (a) the economic characteristics and risks of the embedded derivative are not closely related to the host contract; and (b) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in the income statement.

When the embedded derivative is separated, the host contract is accounted for in accordance with note (ii) above.

(g) Hedging

Hedge accounting recognizes the offsetting effects on profit or loss of changes in the fair values of the hedging instrument and the hedged item. The Group assesses and documents whether the financial instruments that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items

attributable to the hedged risks both at hedge inception and on an ongoing basis. The Group discontinues prospectively hedge accounting when (a) the hedging instrument expires or is sold, terminated or exercised; (b) the hedge no longer meets the criteria for hedge accounting; or (c) the Group revokes the designation.

(i) Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, or the foreign currency risk of a committed future transaction, the effective part of any gain or loss on remeasurement of the derivative financial instrument to fair value is recognised in other comprehensive income and accumulated separately in equity in the hedging reserve. The ineffective portion of any gain or loss is recognised immediately in the income statement.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the cumulative gain or loss at that point remains in equity until the transaction occurs and is recognised in the income statement. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss is reclassified from equity to the income statement immediately.

(ii) Fair value hedge

A fair value hedge seeks to offset risks of changes in the fair value of recognised asset or liability that will give rise to a gain or loss being recognised in the income statement.

The hedging instrument is measured at fair value, with fair value changes recognised in the income statement. The carrying amount of the hedged item is adjusted by the amount of the changes in fair value of hedging instrument attributable to the risk being hedged. This adjustment is recognised in the income statement to offset the effect of the gain or loss on the hedging instrument.

When a hedging instrument expires or is sold, terminated or exercised, the hedge no longer meets the criteria for hedge accounting, or the Group revokes designation of the hedge relationship, any adjustment up to that point, to a hedged item for which the effective interest method is used, is amortised to the income statement as part of the recalculated effective interest rate of the item over its remaining life.

(iii) Hedge effectiveness testing

In order to qualify for hedge accounting, the Group carries out prospective effectiveness testing to demonstrate that it expects the hedge to be highly effective at the inception of the hedge and throughout its life. Actual effectiveness (retrospective effectiveness) is also demonstrated on an ongoing basis.

The documentation of each hedge relationship sets out how the effectiveness of the hedge is assessed. The method which the Group adopts for assessing hedge effectiveness will depend on its risk management strategy.

For fair value hedge relationships, the Group utilises the cumulative dollar offset method or regressive analysis as effectiveness testing methodologies. For cash flow hedge relationship, the Group utilises the change in variable cash flow method

or the cumulative dollar offset method using the hypothetical derivative approach.

For prospective effectiveness, the hedging instrument must be expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness, the changes in fair value or cash flows must offset each other in the range of 80 per cent to 125 per cent for the hedge to be deemed effective.

(h) Properties

- (i) Bank premises are stated in the statement of financial position at cost or at Directors' valuation, by reference to an independent professional valuation, less accumulated depreciation and accumulated impairment loss (Note 2(k)).

When a deficit arises on revaluation, it will be charged to the income statement, to the extent that it exceeds the amount held in the bank premises revaluation reserve in respect of that same asset immediately prior to the revaluation; and when a surplus arises on revaluation, it will be credited to the income statement, to the extent that a deficit on revaluation in respect of that same asset had previously been charged to the income statement.

In preparing these accounts, advantage has been taken of the transitional provisions set out in paragraph 80A of HKAS 16 "Property, Plant and Equipment" issued by the HKICPA, with the effect that bank premises have not been revalued to fair value at the end of the reporting period.

- (ii) Investment properties are properties which are held either to earn rental income or for capital appreciation or for both. Investment properties are stated at fair value. Investment properties are valued annually by external independent valuation companies, having an appropriate recognised professional qualification and recent experience in the location and category of property being valued. The fair values are based on market values, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. No allowance has been made in the valuations for any charges, mortgages or amounts owing on the properties nor any expenses or taxation which may be incurred in effecting a sale.

Any gain or loss arising from a change in fair value is recognised in the income statement. Rental income from investment property is accounted for as described in Note 2(e).

When a bank property is transferred to investment property following a change in its use, any differences arising at the date of transfer between the carrying amount of the bank property immediately prior to transfer and its fair value is recognised as a revaluation of bank premises as described in Note 2(h)(i).

If an investment property becomes owner-occupied, it is reclassified as bank premises and its fair value at the date of reclassification becomes its cost for subsequent accounting purposes.

A property interest under an operating lease is classified and accounted for as an investment property when the Group holds it to earn rentals or for capital

appreciation or both. Any such property interest under an operating lease classified as an investment property is carried at fair value. Lease payments are accounted for as described in Note 2(l).

- (iii) Profit or loss on disposal of bank premises and investment properties is determined as the difference between the net sales proceeds and the carrying amount of the asset and is recognised in the income statement upon disposal. Any surplus that is included in the bank premises revaluation reserve related to the bank premises disposed is transferred to the general reserve.

(i) Amortisation and Depreciation

(i) Bank premises

Freehold land is not amortised. Leasehold land held for own use under an operating lease, the fair value of which cannot be measured separately from the fair value of a building situated thereon at the inception of the lease, is accounted for as being held under a finance lease. Leasehold land is amortised on a straight line basis over the remaining term of the lease. Buildings are depreciated on a straight line basis at rates calculated to write off the cost or valuation of each building over its estimated useful life of 50 years or the remaining lease period of the land on which it is situated, whichever is the shorter.

Investment properties are not depreciated.

(ii) Other fixed assets

Other fixed assets are stated in the statement of financial position at cost less accumulated depreciation and impairment losses, which is calculated on a straight line basis to write off the assets over their estimated useful lives from 4 to 20 years.

(j) Goodwill

Goodwill represents the excess of

- (i) the aggregate of the fair value of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the Group's previously held equity interest in the acquiree; over
- (ii) the Group's interest in the net fair value of the acquiree's identifiable assets and liabilities measured as at the acquisition date.

When (ii) is greater than (i), then this excess is recognised immediately in profit or loss as a gain on a bargain purchase.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill arising on a business combination is allocated to each cash-generating unit, or groups of cash generating units, that is expected to benefit from the synergies of the combination and is tested annually for impairment (Note 2(k)).

On disposal of a cash generating unit, or an associate during the year, any attributable amount of purchased goodwill is included in the calculation of the profit and loss on disposal.

Expenditure on internally generated goodwill and brands is recognised as an expense

in the period in which it is incurred.

(k) Impairment of Assets

At each end of the reporting period, the carrying amount of the Group's assets are reviewed to determine whether there is objective evidence of impairment. If internal and external sources of information indicate such evidence exists, the carrying amount is reduced to the estimated recoverable amount and an impairment loss is recognised in the income statement.

(i) Loans and receivables

The impairment losses of loans and receivables are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets). Receivables with a short duration are not discounted if the effect of discounting is immaterial.

The total allowance for impairment losses consists of two components: individual impairment allowances, and collective impairment allowances.

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

The individual impairment allowance is based upon management's best estimate of the present value of the cash flows which are expected to be received discounted at the original effective interest rate. In estimating these cash flows, management makes judgements about the borrower's financial situation and the net realisable value of any underlying collateral or guarantees in favour of the Group. Each impaired asset is assessed on its own merits.

In assessing the need for collective loan loss allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required allowance, the Group makes assumptions both to define the way the Group models inherent losses and to determine the required input parameters, based on historical experience and current economic conditions.

The accuracy of the impairment allowances the Group makes depends on how well the Group can estimate future cash flows for individually assessed impairment allowances and the model assumptions and parameters used in determining collective impairment allowances. While this necessarily involves judgment, the Group believes that the impairment allowances on loans and advances to customers are reasonable and supportable.

All loans and receivables are reviewed and analysed periodically. Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates that can be linked objectively to an event occurring after the write-down, will result in a change in the impairment allowances on loans and

receivables and will be charged or credited to the income statement. A reversal of impairment losses is limited to the loans and receivables' carrying amount that would have been determined had no impairment loss been recognised in prior years.

Where there is no reasonable prospect of recovery, the loan and the related interest receivables are written off.

Loans and receivables with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Group has made concessions that it would not otherwise consider. Renegotiated loans and receivables are subject to ongoing monitoring to determine whether they remain impaired or past due.

(ii) Held-to-maturity investments

Impairment on held-to-maturity investments is considered at both an individual and collective level. The individual impairment allowance is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at asset's original effective interest rate, where the effect of discounting is material.

All significant assets found not to be individually impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets with similar risk characteristics.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement. A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

(iii) Available-for-sale financial assets

When there is objective evidence that an available-for-sale financial asset is impaired, the cumulative loss that had been recognised in the fair value reserve is reclassified to the income statement. The amount of the cumulative loss that is recognised in the income statement is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in the income statement.

For unquoted available-for-sale equity securities that are carried at cost, the impairment loss is measured as the difference between the carrying amount of the equity securities and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset, where the effect of discounting is material.

Impairment losses recognised in the income statement in respect of available-for-sale equity securities are not reversed through the income statement. Any subsequent increase in the fair value of such assets is recognised directly in other comprehensive income.

Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring

after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in the income statement.

(iv) Other assets

Internal and external sources of information are reviewed at each end of the reporting period to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

- property and equipment (other than properties carried at revalued amounts);
- investments in subsidiaries and associates;
- goodwill; and
- intangible assets

If any such indication exists, the asset's recoverable amount is estimated. In addition, for goodwill, the recoverable amount is estimated annually whether or not there is any indication of impairment.

Calculation of recoverable amount

The recoverable amount of an asset is the greater of its fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

Recognition of impairment losses

An impairment loss is recognised in the income statement whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

Reversals of impairment losses

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

Reversals of impairment losses are credited to the income statement in the year in which the reversals are recognised.

(v) Interim financial reporting and impairment

Under the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, the Group is required to prepare an interim financial report in compliance with HKAS 34, Interim financial reporting, in respect of the first six months of the year. At the end of the interim period, the Group applies the same impairment testing, recognition, and reversal criteria as it would at the end of the year (Note 2(k)(i) to (iv)).

Impairment losses recognised in an interim period in respect of goodwill, available-for-sale equity securities and unquoted equity securities carried at cost are not reversed in a subsequent period. This is the case even if no loss, or a smaller loss, would have been recognised had the impairment been assessed only at the end of the year to which the interim period relates. Consequently, if the fair value of an available-for-sale equity security increases in the remainder of the annual period, or in any other period subsequently, the increase is recognised in other comprehensive income and not the income statement.

(l) Leased Assets

Leases of assets under which the lessee assumes substantially all the risks and benefits of ownership are classified as finance leases. Leases of assets under which the lessor has not transferred all the risks and benefits of ownership are classified as operating leases.

(i) Assets held under finance leases

The amounts due from lessees in respect of finance leases are recorded in the statement of financial position as advances to customers at the amounts of net investment which represent the total rentals receivable under finance leases less unearned income. Revenue arising from finance leases is recognised in accordance with the Group's revenue recognition policies, as set out in Note 2(e).

(ii) Assets held for use in operating leases

Where the Group leases out assets under operating leases, the leased assets are included in the statement of financial position according to their nature and, where applicable, are depreciated in accordance with the Group's depreciation policies, as set out in Note 2(i). Impairment losses are accounted for in accordance with the accounting policy as set out in Note 2(k). Revenue arising from operating leases is recognised in accordance with the Group's revenue recognition policies, as set out in Note 2(e).

(iii) Operating lease charges

Where the Group has the use of assets under operating leases, payments made under the leases are charged to the income statement in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in the income statement as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the income statement in the accounting period in which they are incurred.

(m) Repossession of Assets

In the recovery of impaired loans and advances, the Group may take possession of the collateral assets through court proceedings or voluntary delivery of possession by the borrowers. In accordance with the Group's accounting policy set out in Note 2(k), impairment allowances for impaired loans and advances are maintained after taking into account the net realisable value of the collateral assets, usually resulting in a partial write-off of the loans and advances against impairment allowances. Repossessed assets are reported under other assets if it is highly probable that their carrying amount will be recovered through a sale transaction rather than through continuing use and the assets are available for sale in their present condition. Related loans and advances are then written off.

Repossessed assets are recorded at the lower of the amount of the related loans and advances and fair value less costs to sell at the date of exchange. They are not depreciated or amortised.

Impairment losses on initial classification and on subsequent remeasurement are recognised in the income statement.

(n) Income Tax

- (i) Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the income statement except to the extent that they relate to items recognised in other comprehensive income or directly in equity, in which case the relevant amounts of tax are recognised in other comprehensive income or directly in equity, respectively.
- (ii) Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the end of the reporting period, and any adjustment to tax payable in respect of previous years.
- (iii) Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same

taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing deductible temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination), and temporary differences relating to investments in subsidiaries to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

Where investment properties are carried at their fair value in accordance with the accounting policy set out in Note 2 (h)(ii), the amount of deferred tax recognised is measured using the tax rates that would apply on sale of those assets at their carrying value at the reporting date unless the property is depreciable and is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the property over time, rather than through sale. In all other cases, the amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the reporting date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each end of the reporting period and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

- (iv) Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if the Bank or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:
- in the case of current tax assets and liabilities, the Bank or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
 - in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
 - the same taxable entity; or
 - different taxable entities, which in each future period in which significant

amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

(o) Insurance Reserves and Provisions for Outstanding Claims

Insurance reserves, except those attributable to long term business, represent the proportion of retained premiums written in the year relating to the period of risk from 1st January in the following year to the subsequent date of expiry of policies which is carried forward as a provision for unearned premiums and calculated on a daily basis.

The insurance reserve for long term business is ascertained by actuarial valuation.

Full provision is made for the estimated cost of claims notified but not settled at the end of the reporting period and for the estimated cost of claims incurred but not reported by that date, after deducting the amounts due from reinsurers. Provision has also been made for the estimated cost of servicing claims notified but not settled at the end of the reporting period and to meet expenses on claims incurred but not reported at the end of the reporting period.

These reserves and provisions are classified as other accounts and provisions.

(p) Provisions and Contingent Liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Bank has a legal or constructive obligation arising as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditures expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events, are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(q) Employee Benefits

(i) Salaries, bonuses and leave benefits

Employee entitlements to salaries, annual bonuses, paid annual leave, leave passage and the cost to the Group of non-monetary benefits are recognised when they accrue to employees. An accrual is made for the estimated liability for annual leave as a result of services rendered by employees up to the end of the reporting period.

Employee entitlements to sick leave and maternity leave are recognised when the absences occur.

(ii) Performance-related bonus plan

Liabilities for performance-related bonus plan, which are due wholly within twelve

months after the end of the reporting period, are recognised when the Group has a present legal or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made.

(iii) Retirement benefits

Retirement benefits are provided to eligible staff of the Group. Hong Kong employees enjoy retirement benefits under either the Mandatory Provident Fund Exempted ORSO Scheme (“MPFEOS”) or the Mandatory Provident Fund Scheme (“MPFS”). Both are defined contribution schemes. The employer’s monthly contributions to both schemes are at a maximum of 10% of each employee’s monthly salary.

The pension schemes covering all the Group’s PRC and overseas employees are defined contribution schemes at various funding rates, and are in accordance with local practices and regulations.

The cost of all these schemes is charged to the income statement for the period concerned and the assets of all these schemes are held separately from those of the Group. Under the MPFEOS, the employer’s contribution is not reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions. Under the MPFS, the employer’s contribution is reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions.

(iv) Share based payments

The option exercise price is equal to the higher of:

- (a) the closing price of the Bank’s shares in the Stock Exchange’s daily quotation sheet on the date of grant of the relevant options;
- (b) an amount equivalent to the average closing price of the Bank’s shares as stated in the Stock Exchange’s daily quotation sheets for the 5 business days immediately preceding the date of grant of the relevant options; and
- (c) the nominal value of the Bank’s shares.

When the options are exercised, equity is increased by the amount of the proceeds received. The fair value of share options granted to employees is recognised as an expense in the income statement with a corresponding increase in a capital reserve within equity. The fair value is measured at the grant date using the trinomial model, taking into account the terms and conditions upon which the options were granted. Where the employees have to meet vesting conditions before becoming unconditionally entitled to those share options, the total estimated fair value of the share options is spread over the vesting period, taking into account the probability that the options will vest.

During the vesting period, the number of share options that is expected to vest is reviewed. Any resulting adjustment to the cumulative fair value recognised in prior years is charged or credited to the income statement for the year of the review unless the original expenses qualify for recognition as an asset, with a corresponding adjustment to the capital reserve. On vesting date, the amount recognised as an expense is adjusted to reflect the actual number of share options that vest (with a corresponding adjustment to capital reserve) except where forfeiture is only due to not achieving vesting conditions that relate to the market price of the Bank's shares.

The equity amount is recognised in capital reserve until either the option is exercised (when it is transferred to share premium) or the option expires (when it is released directly to retained profits).

(r) Related Parties

For the purposes of these accounts, a party is considered to be related to the Group if:

- (a) A person, or a close member of that person's family, is related to the Group if that person:
 - (i) has control or joint control over the Group;
 - (ii) has significant influence over the Group; or
 - (iii) is a member of the key management personnel of the Group or the Group's parent.
- (b) An entity is related to the Group if any of the following conditions applies:
 - (i) The entity and the Group are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
 - (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a Group of which the other entity is a member).
 - (iii) Both entities are joint venture of the same third party.
 - (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
 - (v) The entity is a post-employment benefit plan for the benefit of employees of either the Group or an entity related to the Group.
 - (vi) The entity is controlled or jointly controlled by a person identified in (a).
 - (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity.

(s) Segment Reporting

Operating segments, and the amounts of each segment item reported in the accounts, are identified from the financial information provided regularly to the Group's most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

Individually material operating segments are not aggregated for financial reporting purposes unless the segments have similar economic characteristics and are similar in respect of the nature of products and services, the nature of production processes, the type or class of customers, the methods used to distribute the products or provide the services, and the nature of the regulatory environment. Operating segments which are not individually material may be aggregated if they share a majority of these criteria.

(t) Cash and Cash Equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition including cash, balances with banks and other financial institutions, treasury bills, other eligible bills and certificates of deposit that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

(u) Deposits, debt securities issued and subordinated liabilities

Deposits, debt securities issued and subordinated liabilities are the Group's sources of debt funding.

The Group classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. The Group's redeemable preference shares bear non-discretionary coupons and are redeemable by the holder, and are therefore included within subordinated liabilities.

Subsequent to initial recognition deposits, debt securities issued and subordinated liabilities are measured at their amortised cost using the effective interest method, except where the Group designates liabilities at fair value through profit or loss.

3. Changes in Accounting Policies

The HKICPA has issued several amendments to HKFRSs that are first effective for the current accounting period of the Group and the Bank. Of these, the following developments are relevant to the Group's accounts:

- Amendments to HKFRS 7, *Financial instruments: Disclosures – transfers of financial assets*

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period. The impact of the above developments is as follows:

Amendments to HKFRS 7, *Financial instruments: Disclosures*

The amendments to HKFRS 7 require certain disclosures to be included in the annual financial statements in respect of all transferred financial assets that are not derecognized and for any continuing involvement in a transferred asset existing at the reporting date, irrespective of when the related transfer transaction occurred. However, an entity needs not to provide the disclosures for the comparative period in the first year of adoption.

4. Interest Income

	2012 HK\$ Mn	2011 HK\$ Mn
Listed securities classified as held-to-maturity or available-for-sale	464	388
Trading assets		
- listed	18	27
- unlisted	218	73
Interest rate swaps	1,576	3,327
Financial assets designated at fair value through profit or loss		
- listed	433	473
- unlisted	220	229
Loans, deposits with banks and financial institutions, trade bills, and other unlisted securities that are not at fair value through profit or loss	19,706	16,351
Total interest income	<u>22,635</u>	<u>20,868</u>

Included above is interest income accrued on impaired financial assets of HK\$85 million (2011: HK\$62 million) which includes interest income on unwinding of discount on loan impairment losses of HK\$20 million (2011: HK\$17 million) (Note 28(b)) for the year ended 31st December, 2012.

5. Interest Expense

	2012 HK\$ Mn	2011 Restated HK\$ Mn
Customer deposits, deposits of banks and other financial institutions and certificates of deposit issued which are stated at amortised cost	9,754	7,225
Debt securities issued	360	209
Subordinated notes carried at amortised cost	730	373
Interest rate swaps	1,877	3,439
Financial instruments designated at fair value through profit or loss	170	341
Other borrowings	20	18
Total interest expense	<u>12,911</u>	<u>11,605</u>

6. Fee and Commission Income

Fee and commission income arises from the following services:

	2012 HK\$ Mn	2011 Restated HK\$ Mn
Corporate services	1,041	979
Credit cards	860	793
Loans, overdrafts and guarantees	599	502
Trade Finance	400	409
Other retail banking services	369	273
Securities and brokerage	279	385
Trust and other fiduciary activities	152	122
Others	459	350
Total fee and commission income	<u>4,159</u>	<u>3,813</u>

of which:

Net fee income, other than amounts included in determining the effective interest rate, arising from financial assets or financial liabilities that are not held for trading nor designated at fair value through profit or loss

Fee income	3,396	3,061
Fee expenses	<u>4,159</u> (763)	<u>3,813</u> (752)

7. Net Trading Profits

	2012 HK\$ Mn	2011 Restated HK\$ Mn
(Loss)/Profit on dealing in foreign currencies	(68)	326
Profit/(Loss) on trading securities	275	(290)
Net gain on derivatives	526	99
Dividend income from listed trading securities	32	40
Total net trading profits	<u>765</u>	<u>175</u>

8. Net Result from Financial Instruments Designated at Fair Value through Profit or Loss

	2012 HK\$ Mn	2011 HK\$ Mn
Revaluation gain/(loss) on debts issued	17	(158)
Net loss on sale of other financial instruments designated at fair value through profit or loss	(113)	(103)
Profit/(Loss) on redemption of subordinated notes issued	24	(4)
Revaluation gain/(loss) on other financial assets designated at fair value through profit or loss	736	(94)
Dividend income from financial assets designated at fair value through profit or loss	-	5
Total net result from financial instruments designated at fair value through profit or loss	<u>664</u>	<u>(354)</u>

9. Net Hedging Loss

	2012 HK\$ Mn	2011 HK\$ Mn
Fair value hedges		
- Net loss on hedged items attributable to the hedged risk	(229)	(553)
- Net gain on hedging instruments	214	548
	<u>(15)</u>	<u>(5)</u>

There was insignificant ineffectiveness recognised in the Group's income statement arising from cash flow hedge for the year 2012 (2011: Nil).

10. Other Operating Income

	2012 HK\$ Mn	2011 HK\$ Mn
Dividend income from available-for-sale financial assets		
- listed	8	36
- unlisted	34	53
Rental from safe deposit boxes	78	80
Net revenue from insurance activities	241	199
Rental income on properties	142	129
Others	89	89
Total other operating income	<u>592</u>	<u>586</u>

11. Operating Expenses

	2012 HK\$ Mn	2011 HK\$ Mn
Contributions to defined contribution plan*		
- Hong Kong	142	120
- Outside Hong Kong	264	198
Equity-settled share-based payment expenses	22	21
Salaries and other staff costs	4,372	4,045
Total staff costs	<u>4,800</u>	<u>4,384</u>
Premises and equipment expenses excluding depreciation		
- Rental of premises	573	549
- Maintenance, repairs and others	561	549
Total premises and equipment expenses excluding depreciation	<u>1,134</u>	<u>1,098</u>
Depreciation on fixed assets (Note 34)	<u>657</u>	<u>636</u>
Amortisation of intangible assets (Note 33(b))	<u>33</u>	<u>33</u>
Other operating expenses		
- Stamp duty, overseas and PRC** business taxes, and value added taxes	580	491
- Communications, stationery and printing	325	299
- Advertising expenses	272	252
- Legal and professional fees	252	251
- Business promotions and business travel	176	158
- Card related expenses	160	69
- Insurance expenses	32	35
- Audit fee	15	15
- Administration expenses of corporate services	14	14
- Donations	14	8
- Membership fees	12	12
- Bank charges	12	11
- Bank licence	4	4
- Others	233	222
Total other operating expenses	<u>2,101</u>	<u>1,841</u>
Total operating expenses***	<u>8,725</u>	<u>7,992</u>

* Forfeited contributions totalling HK\$8 million (2011: HK\$18 million) were utilised to reduce the Group's contribution during the year. There were no forfeited contributions available for reducing future contributions at the year end (2011: Nil).

** PRC denotes the People's Republic of China.

*** Included in operating expenses are direct operating expenses of HK\$22 million (2011: HK\$19 million) in respect of investment properties which generated rental income during the year.

12. Impairment Losses on Loans and Advances

	2012 HK\$ Mn	2011 HK\$ Mn
Net charge for impairment losses on loans and advances		
Individual impairment loss		
- new provisions	398	247
- releases	(111)	(125)
- recoveries	(112)	(74)
	<u>175</u>	<u>48</u>
Collective impairment loss		
- new provisions (Note 28(b))	38	27
Net charge to income statement	<u>213</u>	<u>75</u>

13. Net Profit on Sale of Available-for-sale Financial Assets

	2012 HK\$ Mn	2011 HK\$ Mn
Net revaluation gain/(loss) transferred from reserves (Note 41(h))	113	(5)
(Loss)/Profit arising in current year	<u>(31)</u>	<u>64</u>
	<u>82</u>	<u>59</u>

14. Net Profit on Sale of Fixed Assets

	2012 HK\$ Mn	2011 HK\$ Mn
Net profit on sale of investment properties	137	6
Net profit on sale of bank premises, furniture, fixtures and equipment	<u>2</u>	<u>134</u>
	<u>139</u>	<u>140</u>

15. Valuation Gains on Properties

	2012 HK\$ Mn	2011 HK\$ Mn
Investment properties	454	404
Bank premises	<u>(3)</u>	<u>-</u>
	<u>451</u>	<u>404</u>

16. Income Tax

(a) Taxation in the consolidated income statement represents:

	2012 HK\$ Mn	2011 HK\$ Mn
Current tax – Hong Kong (Note 36(a))		
Tax for the year	533	250
Under-provision/(Write back of over-provision) in respect of prior years	<u>35</u>	<u>(122)</u>
	<u>568</u>	<u>128</u>
Current tax – outside Hong Kong		
Tax for the year	752	744
(Write back of over-provision)/Under-provision in respect of prior years	<u>(22)</u>	<u>111</u>
	<u>730</u>	<u>855</u>
Deferred tax (Note 36(b))		
Origination and reversal of temporary differences	<u>113</u>	<u>317</u>
	<u>1,411</u>	<u>1,300</u>

The provision for Hong Kong profits tax is calculated at 16.5% (2011: 16.5%) of the estimated assessable profits for the year.

Taxation for overseas branches and subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

16. Income Tax (continued)

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2012 HK\$ Mn	2011 HK\$ Mn
Profit before tax	<u>7,565</u>	<u>5,751</u>
Notional tax on profit before tax, calculated at the rates applicable to profits in the tax jurisdictions concerned	1,373	1,168
Tax effect of non-deductible expenses	306	317
Tax effect of non-taxable revenue	(307)	(305)
Tax effect of tax losses not recognised	23	15
Recognition of deferred tax assets on prior year tax losses	(2)	(4)
Under-provision/(Write back of over-provision) in respect of prior years	13	(11)
Others	<u>5</u>	<u>120</u>
Actual tax expense	<u>1,411</u>	<u>1,300</u>

17. Profit Attributable to Owners of the Parent

The consolidated profit attributable to owners of the parent includes a profit of HK\$2,894 million (2011: HK\$1,881 million) which has been dealt with in the accounts of the Bank.

Reconciliation of the above amount to the Bank's profit for the year

	2012 HK\$ Mn	2011 HK\$ Mn
Amount of consolidated profit attributable to equity holders dealt with in the Bank's accounts	2,894	1,881
Final dividends from subsidiaries and associates attributable to the profits of the previous financial year and general reserves, approved and paid during the year	103	93
Bank's profit for the year	<u>2,997</u>	<u>1,974</u>

18. Dividends

(a) Dividends attributable to the year

	2012 HK\$ Mn	2011 HK\$ Mn
Interim dividend declared and paid of HK\$0.43 per share on 2,100 million shares (2011: HK\$0.43 per share on 2,059 million shares) (Note 41(j))	903	885
Final dividend paid in respect of the previous financial year on shares issued under the share option schemes subsequent to the end of the reporting period and before the close of the Register of Members of the Bank, of HK\$0.56 per share	-	1
Second interim dividend in lieu of the final dividend of HK\$0.63 per share on 2,227 million shares (2011: HK\$0.51 per share on 2,076 million shares)	<u>1,403</u>	<u>1,059</u>
	<u>2,306</u>	<u>1,945</u>

The second interim dividend in lieu of the final dividend has not been recognised as a liability at the end of the reporting period.

18. Dividends (continued)

(b) Dividends attributable to the previous financial year, approved and paid during the year

	2012 HK\$ Mn	2011 HK\$ Mn
Second interim dividend in respect of the previous financial year, approved and paid during the year, of HK\$0.51 per share on 2,076 million shares	<u>1,059</u>	<u>-</u>
Final dividend in respect of the previous financial year, approved and paid during the year, of HK\$0.56 per share on 2,042 million shares	<u>-</u>	<u>1,144</u>

(c) Distribution to holders of Hybrid Tier 1 capital instruments

	2012 HK\$ Mn	2011 HK\$ Mn
Interest payable on the Hybrid Tier 1 capital instruments, the details of which are disclosed in Note 38 and Note 41(j)	<u>331</u>	<u>328</u>

19. Earnings Per Share

(a) Basic earnings per share

The calculation of basic earnings per share is based on earnings of HK\$5,725 million (2011: HK\$4,030 million) after the distribution of HK\$331 million (2011: HK\$328 million) to Hybrid Tier 1 issue holders and on the weighted average of 2,105 million (2011: 2,059 million) ordinary shares outstanding during the year, calculated as follows:

Weighted average number of ordinary shares

	2012 Number of shares million	2011 Number of shares million
Issued ordinary shares at 1 st January	2,076	2,042
Effect of share options exercised and shares issued in lieu of dividends	<u>29</u>	<u>17</u>
Weighted average number of ordinary shares at 31 st December	<u>2,105</u>	<u>2,059</u>

(b) Diluted earnings per share

The calculation of diluted earnings per share is based on earnings of HK\$5,725 million (2011: HK\$4,030 million) after the distribution of HK\$331 million (2011: HK\$328 million) to Hybrid Tier 1 issue holders and on 2,106 million (2011: 2,060 million) ordinary shares, being the weighted average number of ordinary shares outstanding during the year, adjusted for the effects of all dilutive potential shares.

Weighted average number of ordinary shares (diluted)

	2012 Number of shares million	2011 Number of shares million
Weighted average number of ordinary shares at 31 st December	2,105	2,059
Effect of deemed issue of ordinary shares under the Bank's share option schemes for nil consideration	<u>1</u>	<u>1</u>
Weighted average number of ordinary shares (diluted) at 31 st December	<u>2,106</u>	<u>2,060</u>

20. Directors' Remuneration

Directors' remuneration disclosed pursuant to Section 161 of the Hong Kong Companies Ordinance is as follows:

	Directors' fees HK\$ Mn	Salaries, allowances and benefits in kind HK\$ Mn	Discretionary bonuses HK\$ Mn	Share options HK\$ Mn	Retirement scheme contributions HK\$ Mn	2012 Total HK\$ Mn
Chairman and Chief Executive						
Dr. the Hon. Sir David LI Kwok-po	0.4	9.4	20.9	7.4	0.9	39.0
Non-executive Directors						
Prof. Arthur LI Kwok-cheung	0.2	-	-	-	-	0.2
Mr. Aubrey LI Kwok-sing	0.3	-	-	-	-	0.3
Tan Sri Dr. KHOO Kay-peng	0.2	-	-	-	-	0.2
Mr. Richard LI Tzar-kai	0.2	-	-	-	-	0.2
Mr. Eric LI Fook-chuen	0.3	-	-	-	-	0.3
Mr. Stephen Charles LI Kwok-sze	0.2	-	-	-	-	0.2
Dr. Isidro FAINÉ CASAS	0.3	-	-	-	-	0.3
Independent Non-executive Directors						
Dr. Allan WONG Chi-yun	0.4	-	-	-	-	0.4
Mr. WONG Chung-hin	0.3	-	-	-	-	0.3
Dr. LEE Shau-kee	0.3	-	-	-	-	0.3
Mr. Winston LO Yau-lai	0.4	-	-	-	-	0.4
Dr. Thomas KWOK Ping-kwong	0.3	-	-	-	-	0.3
Mr. Kenneth LO Chin-ming	0.3	-	-	-	-	0.3
Mr. William DOO Wai-hoi	0.3	-	-	-	-	0.3
Mr. KUOK Khooon-ean	0.3	-	-	-	-	0.3
Mr. Valiant CHEUNG Kin-piu	0.5	-	-	-	-	0.5
	<u>5.2</u>	<u>9.4</u>	<u>20.9</u>	<u>7.4</u>	<u>0.9</u>	<u>43.8</u>

20. Directors' Remuneration (continued)

	Directors' fees HK\$ Mn	Salaries, allowances and benefits in kind HK\$ Mn	Discretionary bonuses HK\$ Mn	Share options HK\$ Mn	Retirement scheme contributions HK\$ Mn	2011 Total HK\$ Mn
Chairman and Chief Executive						
Dr. the Hon. Sir David LI Kwok-po	0.4	9.0	15.0	7.0	0.8	32.2
Non-executive Directors						
Prof. Arthur LI Kwok-cheung	0.2	-	-	-	-	0.2
Mr. Aubrey LI Kwok-sing	0.3	-	-	-	-	0.3
Tan Sri Dr. KHOO Kay-peng	0.2	-	-	-	-	0.2
Mr. Richard LI Tzar-kai	0.2	-	-	-	-	0.2
Mr. Eric LI Fook-chuen	0.3	-	-	-	-	0.3
Mr. Stephen Charles LI Kwok-sze	0.2	-	-	-	-	0.2
Dr. Isidro FAINÉ CASAS	0.3	-	-	-	-	0.3
Independent Non-executive Directors						
Dr. Allan WONG Chi-yun	0.4	-	-	-	-	0.4
Mr. WONG Chung-hin	0.3	-	-	-	-	0.3
Dr. LEE Shau-kee	0.3	-	-	-	-	0.3
Mr. Winston LO Yau-lai	0.4	-	-	-	-	0.4
Dr. Thomas KWOK Ping-kwong	0.3	-	-	-	-	0.3
Mr. Kenneth LO Chin-ming	0.3	-	-	-	-	0.3
Mr. William DOO Wai-hoi	0.3	-	-	-	-	0.3
Mr. KUOK Khoo-eon	0.3	-	-	-	-	0.3
Mr. Valiant CHEUNG Kin-piu	0.5	-	-	-	-	0.5
	<u>5.2</u>	<u>9.0</u>	<u>15.0</u>	<u>7.0</u>	<u>0.8</u>	<u>37.0</u>

Included in the above remuneration were share options granted to Executive Directors under the Bank's Staff Share Option Schemes. The details of these benefits in kind are disclosed under the paragraph "Information on Share Options" in the Report of the Directors and Note 39.

21. Five Top-paid Employees

	2012 HK\$ Mn	2011 HK\$ Mn
Salaries and other emoluments	24	23
Performance-related bonuses	39	28
Share options	17	16
Pension contributions	2	2
	<u>82</u>	<u>69</u>

The remuneration of the five top-paid employees is within the following bands:

HK\$	2012 Number of employees	2011 Number of employees
9,000,001 - 9,500,000	-	4
10,500,001 - 11,000,000	3	-
11,000,001 - 11,500,000	1	-
32,000,001 - 32,500,000	-	1
38,500,001 - 39,000,000	1	-

Included in the emoluments of the five top-paid employees were the emoluments of 1 (2011: 1) Director and all senior management members (2011 and 2012). His director's emoluments have been included in Note 20 above.

22. Segment Reporting

The Group manages its businesses by divisions, which are organised by a mixture of both business lines and geography. In a manner consistent with the way in which information is reported internally to the Group's most senior management for the purposes of resource allocation and performance assessment, the Group has presented the following nine reportable segments. No operating segments have been aggregated to form the following reportable segments.

(a) Business segments

The Group has identified the following nine reportable segments.

Personal banking, which includes branch operations, personal internet banking, consumer finance, property loans and credit card business in Hong Kong.

Corporate banking, which includes corporate lending and loan syndication, asset based lending, commercial lending and securities lending in Hong Kong.

Treasury markets, which include treasury operations and securities dealing in Hong Kong.

Wealth management, which includes private banking business and related assets in Hong Kong.

Financial institutions, which includes trade financing activities with correspondent banks in Hong Kong.

Other Hong Kong banking operations, which include insurance business, trust business, securities & futures broking, money lender activities and corporate financial advisory in Hong Kong.

China operations include the back office unit for China operations in Hong Kong, all branches, subsidiaries and associates operated in China, except those subsidiaries carrying out corporate services, data processing and other back office operations in China.

22. Segment Reporting (continued)

(a) Business segments (continued)

Overseas operations include the back office unit for overseas banking operations in Hong Kong, all branches, subsidiaries and associates operated in overseas, except those subsidiaries carrying out corporate services in overseas.

Corporate services include company secretarial services, share registration and business services, and offshore corporate and trust services.

Other businesses include property-related business, supporting units of Hong Kong operations, investment properties, bank premises, the net results of other subsidiaries in Hong Kong except for those subsidiaries which are included in other Hong Kong banking operations.

For the purposes of assessing segment performance and allocating resources between segments, the Group's senior executive management monitors the results, assets and liabilities attributable to each reportable segment on the following bases:

Segment assets include all tangible assets, intangible assets and financial assets with the exception of interests in associates, deferred tax assets and other corporate assets. Segment liabilities include deposits, financial liabilities and other liabilities attributable to the individual segments.

Revenue and expenses are allocated to the reportable segments with reference to interest and fee and commission income generated by those segments and the expenses incurred by those segments or which otherwise arise from the depreciation or amortisation of assets attributable to those segments. Segment revenue and expenses do not include the Group's share of revenue and expenses arising from the activities of the Group's associates. Other than reporting inter-segment income, assistance provided by one segment to another, including sharing of assets, is not measured.

In addition to receiving segment information concerning profit before taxation, management is provided with segment information concerning revenue (including inter segment lending), interest expense, depreciation, amortisation and impairment losses and additions to non-current segment assets used by the segments in their operations.

22. Segment Reporting (continued)

2012

	Hong Kong banking operations									Total reportable segments	Inter-segment elimination		Total
	Personal banking	Corporate banking	Treasury markets	Wealth management	Financial institutions	Others	China operations	Overseas operations	Corporate services		Others	Inter-segment elimination	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Net interest income/(expense)	2,095	2,364	(1,271)	342	172	174	4,865	1,042	4	9,787	(43)	(20)	9,724
Non-interest income/(expense)	643	551	756	289	18	510	966	396	1,049	5,178	549	(342)	5,385
Operating income/(expense)	2,738	2,915	(515)	631	190	684	5,831	1,438	1,053	14,965	506	(362)	15,109
Operating expenses	(1,536)	(179)	(122)	(157)	(12)	(484)	(3,594)	(536)	(729)	(7,349)	(1,706)	330	(8,725)
Operating profit/(loss) before impairment losses	1,202	2,736	(637)	474	178	200	2,237	902	324	7,616	(1,200)	(32)	6,384
(Charge for)/Write back of impairment losses on loans and advances and other accounts	(51)	(79)	60	13	-	(4)	(159)	58	(8)	(170)	51	(94)	(213)
(Charge for)/Write back of impairment losses on available-for-sale financial assets and held-to-maturity investments	-	-	(61)	-	-	(1)	-	10	-	(52)	-	-	(52)
Operating profit/(loss) after impairment losses	1,151	2,657	(638)	487	178	195	2,078	970	316	7,394	(1,149)	(126)	6,119
Profit/(Loss) on sale of fixed assets, available-for-sale financial assets and loans and receivables	(7)	3	70	-	-	7	11	-	-	84	172	-	256
Profit on sale of subsidiaries	-	-	-	-	-	-	-	203	(4)	199	4	-	203
Valuation gains on properties	-	-	-	-	-	-	50	38	-	88	429	(66)	451
Share of profits less losses of associates	-	-	-	-	-	9	107	420	-	536	-	-	536
Profit/(Loss) before taxation	1,144	2,660	(568)	487	178	211	2,246	1,631	312	8,301	(544)	(192)	7,565
Depreciation for the year	(71)	(2)	(5)	(3)	(1)	(17)	(354)	(22)	(22)	(497)	(160)	-	(657)
Segment assets	46,544	143,869	121,226	21,989	7,372	13,268	329,605	70,989	2,897	757,759	27,659	(97,981)	687,437
Investments in associates	-	-	-	-	-	59	513	4,105	-	4,677	-	-	4,677
Total assets	46,544	143,869	121,226	21,989	7,372	13,327	330,118	75,094	2,897	762,436	27,659	(97,981)	692,114
Total liabilities	252,630	1,606	55,176	17,427	-	9,837	305,303	60,201	715	702,895	2,514	(74,934)	630,475
Capital expenditure incurred during the year	69	-	2	1	-	24	201	33	28	358	71	-	429

22. Segment Reporting (continued)

	2011 (Restated)										Total reportable segments HK\$ Mn	Others HK\$ Mn	Inter-segment elimination HK\$ Mn	Total HK\$ Mn
	Hong Kong banking operations													
	Personal banking HK\$ Mn	Corporate banking HK\$ Mn	Treasury markets HK\$ Mn	Wealth management HK\$ Mn	Financial institutions HK\$ Mn	Others HK\$ Mn	China operations HK\$ Mn	Overseas operations HK\$ Mn	Corporate services HK\$ Mn					
Net interest income/(expense)	1,762	2,033	(796)	279	111	217	4,812	921	3	9,342	(57)	(22)	9,263	
Non-interest income/(expense)	603	429	(704)	276	12	525	830	388	981	3,340	438	(326)	3,452	
Operating income/(expense)	2,365	2,462	(1,500)	555	123	742	5,642	1,309	984	12,682	381	(348)	12,715	
Operating expenses	(1,321)	(165)	(113)	(153)	(12)	(457)	(3,306)	(589)	(664)	(6,780)	(1,538)	326	(7,992)	
Operating profit/(loss) before impairment losses	1,044	2,297	(1,613)	402	111	285	2,336	720	320	5,902	(1,157)	(22)	4,723	
(Charge for)/Write back of impairment losses on loans and advance and other accounts	(63)	33	4	15	-	(6)	(161)	51	(7)	(134)	-	59	(75)	
Impairment losses on available-for-sale financial assets and held-to-maturity investments	-	-	-	-	-	(43)	-	(11)	-	(54)	(6)	-	(60)	
Operating profit/(loss) after impairment losses	981	2,330	(1,609)	417	111	236	2,175	760	313	5,714	(1,163)	37	4,588	
Profit/(Loss) on sale of fixed assets, available-for-sale financial assets and loans and receivables	1	-	39	-	-	45	112	4	(2)	199	3	-	202	
Profit on sale of associates	-	-	-	-	-	-	-	122	-	122	-	-	122	
Valuation gains on properties	-	-	-	-	-	-	48	2	-	50	388	(34)	404	
Share of profits less losses of associates	-	-	-	-	-	(3)	38	400	-	435	-	-	435	
Profit/(Loss) before taxation	982	2,330	(1,570)	417	111	278	2,373	1,288	311	6,520	(772)	3	5,751	
Depreciation for the year	(68)	(1)	(5)	(2)	(1)	(18)	(325)	(28)	(19)	(467)	(171)	2	(636)	
Segment assets	47,797	124,066	113,094	19,133	12,345	10,917	278,991	60,684	2,881	669,908	13,676	(76,002)	607,582	
Investments in associates	-	-	-	-	-	49	313	3,458	-	3,820	-	-	3,820	
Total assets	47,797	124,066	113,094	19,133	12,345	10,966	279,304	64,142	2,881	673,728	13,676	(76,002)	611,402	
Total liabilities	245,027	1,026	44,395	17,199	-	8,154	256,521	50,275	762	623,359	2,342	(66,343)	559,358	
Capital expenditure incurred during the year	66	8	8	6	1	18	313	2	89	511	124	-	635	

22. Segment Reporting (continued)**(b) Geographical segments**

The information concerning geographical analysis has been classified by the location of the principal operations of the subsidiaries, or in the case of the Bank itself, by the location of the branches of the Bank responsible for reporting the results or booking the assets.

	2012					
	Hong Kong HK\$ Mn	People's Republic of China HK\$ Mn	Other Asian Countries HK\$ Mn	Others HK\$ Mn	Inter- segment elimination HK\$ Mn	Consolidated HK\$ Mn
The Group						
Operating income	7,799	5,921	907	888	(406)	15,109
Profit before taxation	3,767	2,328	852	810	(192)	7,565
Total assets	384,001	329,794	48,072	37,412	(107,165)	692,114
Total liabilities	339,368	305,644	42,635	29,916	(87,088)	630,475
Contingent liabilities and commitments	67,258	133,508	4,863	4,151	-	209,780
Capital expenditure during the year	192	201	13	23	-	429
	2011 (Restated)					
	Hong Kong HK\$ Mn	People's Republic of China HK\$ Mn	Other Asian Countries HK\$ Mn	Others HK\$ Mn	Inter- segment elimination HK\$ Mn	Consolidated HK\$ Mn
The Group						
Operating income	5,595	5,821	745	906	(352)	12,715
Profit before taxation	1,961	2,538	728	521	3	5,751
Total assets	356,493	278,610	33,413	37,031	(94,145)	611,402
Total liabilities	318,241	256,494	28,707	29,214	(73,298)	559,358
Contingent liabilities and commitments	56,617	84,176	4,554	3,134	-	148,481
Capital expenditure during the year	253	313	69	-	-	635

23. Cash and Balances with Banks and Other Financial Institutions (Note 46(c))

	The Group		The Bank	
	2012	2011	2012	2011
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Cash in hand	1,420	1,828	910	1,237
Balances with central banks	69,139	45,315	6,874	984
Balances with banks and other financial institutions	14,953	24,618	11,972	20,349
	<u>85,512</u>	<u>71,761</u>	<u>19,756</u>	<u>22,570</u>

24. Placements with Banks and Other Financial Institutions (Note 46(c))

	The Group		The Bank	
	2012	2011 Restated	2012	2011
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Placements with banks and authorised institutions	50,381	57,371	19,098	32,570
Placements with central banks	237	1,227	237	800
	<u>50,618</u>	<u>58,598</u>	<u>19,335</u>	<u>33,370</u>
Maturing				
- within one month	25,409	17,956	12,698	13,603
- between one month and one year	25,209	40,642	6,637	19,767
	<u>50,618</u>	<u>58,598</u>	<u>19,335</u>	<u>33,370</u>

25. Trade Bills

	The Group		The Bank	
	2012	2011 Restated	2012	2011
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Gross trade bills	55,744	46,903	47,935	35,880
Less: Individual impairment allowances	(4)	(12)	(4)	(4)
	<u>55,740</u>	<u>46,891</u>	<u>47,931</u>	<u>35,876</u>

Movement of individual impairment allowances

	The Group		The Bank	
	2012	2011	2012	2011
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1 st January	12	-	4	-
New provisions charged to income statement	1	12	1	4
Net provisions released back to income statement	(1)	(2)	(1)	(2)
Amounts written off	(8)	-	-	-
Recoveries	-	2	-	2
At 31 st December	<u>4</u>	<u>12</u>	<u>4</u>	<u>4</u>

26. Trading Assets

	The Group		The Bank	
	2012	2011	2012	2011
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Treasury bills (including Exchange Fund Bills) (Note 46(c))	9	-	9	-
Debt securities (Note 46(c))	3,048	1,317	561	715
Equity securities	1,138	1,051	1,138	1,051
Investment funds	18	17	18	17
Trading securities	4,213	2,385	1,726	1,783
Positive fair values of derivatives (Note 45(b)(ii))	3,125	3,215	2,267	2,376
	<u>7,338</u>	<u>5,600</u>	<u>3,993</u>	<u>4,159</u>
Issued by:				
Central governments and central banks	26	551	26	11
Public sector entities	336	10	12	10
Banks and other financial institutions	681	374	323	374
Corporate entities	3,152	1,433	1,347	1,371
Other entities	18	17	18	17
	<u>4,213</u>	<u>2,385</u>	<u>1,726</u>	<u>1,783</u>
Analysed by place of listing:				
Debt securities				
Listed in Hong Kong	15	54	15	54
Listed outside Hong Kong	342	449	342	449
	357	503	357	503
Unlisted	2,700	814	213	212
	<u>3,057</u>	<u>1,317</u>	<u>570</u>	<u>715</u>
Equity securities				
Listed in Hong Kong	904	793	904	793
Listed outside Hong Kong	234	258	234	258
	<u>1,138</u>	<u>1,051</u>	<u>1,138</u>	<u>1,051</u>
Investment funds				
Listed in Hong Kong	8	7	8	7
Listed outside Hong Kong	10	10	10	10
	<u>18</u>	<u>17</u>	<u>18</u>	<u>17</u>
	<u>4,213</u>	<u>2,385</u>	<u>1,726</u>	<u>1,783</u>

27. Financial Assets Designated at Fair Value through Profit or Loss

	The Group		The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn	2012 HK\$ Mn	2011 HK\$ Mn
Debt securities (Note 46(c))	14,751	16,330	14,751	16,330
Equity securities	412	329	119	123
Investment funds	6	4	-	-
	<u>15,169</u>	<u>16,663</u>	<u>14,870</u>	<u>16,453</u>
Issued by:				
Central governments and central banks	450	452	450	452
Banks and other financial institutions	6,794	8,036	6,775	8,020
Corporate entities	7,920	8,171	7,645	7,981
Other entities	5	4	-	-
	<u>15,169</u>	<u>16,663</u>	<u>14,870</u>	<u>16,453</u>
Analysed by place of listing:				
Debt securities				
Listed in Hong Kong	3,330	3,495	3,330	3,495
Listed outside Hong Kong	6,792	7,437	6,792	7,438
	<u>10,122</u>	<u>10,932</u>	<u>10,122</u>	<u>10,933</u>
Unlisted	4,629	5,398	4,629	5,397
	<u>14,751</u>	<u>16,330</u>	<u>14,751</u>	<u>16,330</u>
Equity securities				
Listed in Hong Kong	224	194	119	123
Listed outside Hong Kong	188	135	-	-
	<u>412</u>	<u>329</u>	<u>119</u>	<u>123</u>
Investment funds				
Unlisted	6	4	-	-
	<u>15,169</u>	<u>16,663</u>	<u>14,870</u>	<u>16,453</u>

28. Advances to Customers and Other Accounts

(a) Advances to customers and other accounts

	The Group		The Bank	
	2012	2011 Restated	2012	2011
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
(i) Advances to customers	350,720	315,281	221,572	197,923
Less: Impairment allowances				
- Individual	(238)	(205)	(128)	(130)
- Collective	(681)	(763)	(474)	(535)
	<u>349,801</u>	<u>314,313</u>	<u>220,970</u>	<u>197,258</u>
(ii) Other accounts				
Advances to banks and other financial institutions *	146	193	146	192
Less: Impairment allowances - Individual	(4)	(3)	(4)	(3)
	<u>142</u>	<u>190</u>	<u>142</u>	<u>189</u>
Notes and bonds (Note 46(c))	1	-	-	-
Certificates of deposit held (Note 46(c))	77	39	77	39
Accrued interest	2,688	3,136	1,292	1,790
Bankers acceptances	24,633	18,381	296	219
Other accounts	9,962	5,374	5,452	4,101
	<u>37,361</u>	<u>26,930</u>	<u>7,117</u>	<u>6,149</u>
Less: Impairment allowances				
- Individual	(28)	(88)	(3)	(3)
- Collective	(3)	(4)	-	-
	<u>37,330</u>	<u>26,838</u>	<u>7,114</u>	<u>6,146</u>
	<u>387,273</u>	<u>341,341</u>	<u>228,226</u>	<u>203,593</u>

* The above advances to banks and other financial institutions include:

Receivables from reverse repurchase agreements under which the Group obtains securities on terms which permit it to re-pledge or resell securities to others in the absence of default. At 31st December, 2012, the fair value of financial assets accepted as collateral that the Group is permitted to sell or re-pledge under such terms is Nil (2011: NIL).

28. Advances to Customers and Other Accounts (continued)**(b) Impairment allowances against advances and other accounts for 2012**

	The Group							
	<u>Advances to customers</u>		<u>Advances to banks</u>		<u>Other accounts</u>		<u>Total</u>	
	Individual	Collective	Individual	Collective	Individual	Collective	Individual	Collective
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1 st January	205	763	3	-	88	4	296	767
New provisions charged to income statement	346	38	1	-	50	-	397	38
Net provisions released back to income statement	(178)	-	-	-	(24)	-	(202)	-
Amounts written off	(288)	(101)	-	-	(12)	(1)	(300)	(102)
Recoveries	112	-	-	-	-	-	112	-
Effect of discounting (Note 4)	(20)	-	-	-	-	-	(20)	-
Transfer	75	-	-	-	(75)	-	-	-
Reversal due to disposal of a subsidiary	(17)	(30)	-	-	-	-	(17)	(30)
Exchange adjustments	3	11	-	-	1	-	4	11
At 31 st December	<u>238</u>	<u>681</u>	<u>4</u>	<u>-</u>	<u>28</u>	<u>3</u>	<u>270</u>	<u>684</u>

	The Bank							
	<u>Advances to customers</u>		<u>Advances to banks</u>		<u>Other accounts</u>		<u>Total</u>	
	Individual	Collective	Individual	Collective	Individual	Collective	Individual	Collective
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1 st January	130	535	3	-	3	-	136	535
New provisions charged to income statement	172	23	1	-	6	-	179	23
Net provisions released back to income statement	(118)	-	-	-	-	-	(118)	-
Amounts written off	(136)	(93)	-	-	(6)	-	(142)	(93)
Recoveries	92	-	-	-	-	-	92	-
Effect of discounting	(14)	-	-	-	-	-	(14)	-
Exchange adjustments	2	9	-	-	-	-	2	9
At 31 st December	<u>128</u>	<u>474</u>	<u>4</u>	<u>-</u>	<u>3</u>	<u>-</u>	<u>135</u>	<u>474</u>

28. Advances to Customers and Other Accounts (continued)**(b) Impairment allowances against advances and other accounts for 2011**

	The Group							
	<u>Advances to customers</u>		<u>Advances to banks</u>		<u>Other accounts</u>		<u>Total</u>	
	Individual	Collective	Individual	Collective	Individual	Collective	Individual	Collective
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1 st January	282	819	-	-	38	3	320	822
New provisions charged to income statement	171	26	3	-	61	1	235	27
Net provisions released back to income statement	(172)	-	-	-	(8)	-	(180)	-
Amounts written off	(131)	(87)	-	-	(3)	-	(134)	(87)
Recoveries	72	-	-	-	-	-	72	-
Effect of discounting (Note 4)	(17)	-	-	-	-	-	(17)	-
Exchange adjustments	-	5	-	-	-	-	-	5
At 31 st December	<u>205</u>	<u>763</u>	<u>3</u>	<u>-</u>	<u>88</u>	<u>4</u>	<u>296</u>	<u>767</u>

	The Bank							
	<u>Advances to customers</u>		<u>Advances to banks</u>		<u>Other accounts</u>		<u>Total</u>	
	Individual	Collective	Individual	Collective	Individual	Collective	Individual	Collective
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1 st January	226	654	-	-	3	-	229	654
New provisions charged to income statement	78	-	3	-	-	-	81	-
Net provisions released back to income statement	(129)	(39)	-	-	-	-	(129)	(39)
Amounts written off	(95)	(79)	-	-	-	-	(95)	(79)
Recoveries	60	-	-	-	-	-	60	-
Effect of discounting	(9)	-	-	-	-	-	(9)	-
Exchange adjustments	(1)	(1)	-	-	-	-	(1)	(1)
At 31 st December	<u>130</u>	<u>535</u>	<u>3</u>	<u>-</u>	<u>3</u>	<u>-</u>	<u>136</u>	<u>535</u>

28. Advances to Customers and Other Accounts (continued)

(c) Advances to customers - by industry sectors

The analysis of gross advances to customers and the percentage of secured advances by industry sector is based on the categories and definitions used by the Hong Kong Monetary Authority.

	2012		2011 (Restated)	
	Gross advances HK\$ Mn	% of secured advances %	Gross advances HK\$ Mn	% of secured advances %
The Group				
Loans for use in Hong Kong				
Industrial, commercial and financial				
- Property development	13,460	71.28	10,946	69.03
- Property investment	39,522	90.10	41,747	89.63
- Financial concerns	11,557	86.79	9,430	78.35
- Stockbrokers	804	85.26	422	85.95
- Wholesale and retail trade	10,232	41.50	7,790	33.58
- Manufacturing	6,331	34.07	5,392	42.40
- Transport and transport equipment	5,414	64.01	4,642	76.38
- Recreational activities	215	44.22	272	26.60
- Information technology	1,170	8.28	589	60.57
- Others	7,580	47.25	5,758	44.02
- Sub-total	96,285	72.25	86,988	73.73
Individuals				
- Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	1,171	100.00	1,379	100.00
- Loans for the purchase of other residential properties	25,337	99.98	27,246	99.97
- Credit card advances	3,802	0.00	3,649	0.00
- Others	16,297	75.17	14,457	70.71
- Sub-total	46,607	83.15	46,731	83.11
Total loans for use in Hong Kong	142,892	75.80	133,719	77.01
Trade finance	5,156	41.08	5,948	43.44
Loans for use outside Hong Kong *	202,672	70.42	175,614	71.22
Total advances to customers	350,720	72.18	315,281	73.15

* Loans for use outside Hong Kong include the following loans for use in the PRC.

	2012		2011 (Restated)	
	Gross advances HK\$ Mn	% of secured advances %	Gross advances HK\$ Mn	% of secured advances %
Property development	27,835	55.35	26,038	50.83
Property investment	29,895	98.45	23,123	92.69
Wholesale and retail trade	26,872	74.89	22,492	81.35
Manufacturing	10,116	46.81	10,712	60.34
Others	57,015	63.41	48,870	68.31
	151,733	69.76	131,235	70.72

28. Advances to Customers and Other Accounts (continued)

(c) Advances to customers - by industry sectors (continued)

	2012		2011	
	Gross advances	% of secured advances	Gross advances	% of secured advances
	HK\$ Mn	%	HK\$ Mn	%
The Bank				
Loans for use in Hong Kong				
Industrial, commercial and financial				
- Property development	13,450	71.33	10,933	69.11
- Property investment	39,437	90.08	41,640	89.61
- Financial concerns	11,557	86.80	9,429	78.35
- Stockbrokers	804	85.26	422	85.95
- Wholesale and retail trade	9,875	39.39	7,701	32.82
- Manufacturing	6,288	33.63	5,341	41.85
- Transport and transport equipment	5,386	63.82	4,642	76.38
- Recreational activities	215	44.22	272	26.60
- Information technology	1,170	8.28	586	60.35
- Others	7,061	43.37	5,327	39.48
- Sub-total	95,243	71.95	86,293	73.54
Individuals				
- Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	1,171	100.00	1,379	100.00
- Loans for the purchase of other residential properties	25,331	99.98	27,190	99.97
- Credit card advances	3,802	0.00	3,649	0.00
- Others	14,944	75.11	13,134	70.53
- Sub-total	45,248	83.36	45,352	83.40
Total loans for use in Hong Kong	140,491	75.63	131,645	76.94
Trade finance	4,606	36.28	5,352	39.07
Loans for use outside Hong Kong *	76,475	56.59	60,926	53.96
Total advances to customers	221,572	68.24	197,923	68.84

* Loans for use outside Hong Kong include the following loans for use in the PRC.

	2012		2011	
	Gross advances	% of secured advances	Gross advances	% of secured advances
	HK\$ Mn	%	HK\$ Mn	%
Property development	11,905	4.82	11,064	6.87
Property investment	805	96.85	1,193	67.46
Wholesale and retail trade	3,640	78.27	2,187	63.26
Manufacturing	3,415	52.47	2,889	51.72
Others	5,932	12.81	3,748	15.73
	25,697	26.28	21,081	23.87

28. Advances to Customers and Other Accounts (continued)

(c) Advances to customers - by industry sectors (continued)

Individually impaired loans, as well as relevant information, in respect of industry sectors which constitute 10% or more of total advances to customers are as follows:

	The Group		The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn	2012 HK\$ Mn	2011 HK\$ Mn
(i) Property development				
a. Individually impaired loans	166	274	156	264
b. Individual impairment allowance	21	39	11	29
c. Collective impairment allowance	59	61	35	38
d. Provision charged to income statement				
- individual impairment loss	7	11	7	10
- collective impairment loss	18	16	8	7
e. Written off	8	7	8	5
(ii) Property investment				
a. Individually impaired loans	174	388	131	181
b. Individual impairment allowance	7	35	7	21
c. Collective impairment allowance	177	226	133	156
d. Provision charged to income statement				
- individual impairment loss	12	29	7	21
- collective impairment loss	56	87	42	74
e. Written off	19	18	14	12
(iii) Loans for purchase of residential properties				
a. Individually impaired loans	102	238	83	232
b. Individual impairment allowance	1	-	-	-
c. Collective impairment allowance	54	56	31	37
d. Provision charged to income statement				
- individual impairment loss	5	1	1	1
- collective impairment loss	8	20	3	7
e. Written off	1	1	1	1
(iv) Wholesale and retail trade				
a. Individually impaired loans	264	170	61	78
b. Individual impairment allowance	77	73	33	42
c. Collective impairment allowance	94	89	58	54
d. Provision charged to income statement				
- individual impairment loss	170	63	40	26
- collective impairment loss	24	30	11	12
e. Written off	120	30	15	29

28. Advances to Customers and Other Accounts (continued)

(d) Advances to customers – by geographical areas

The information concerning the breakdown of the gross amount of advances to customers by countries or geographical areas is derived according to the location of the counterparties after taking into account any transfer of risk. In general, such transfer of risk takes place if the claims are guaranteed by a party in a country which is different from that of the counterparty or if the claims are on an overseas branch of a bank whose head office is located in another country.

The Group 2012					
	Total advances to customers	Advances overdue for over three months	Impaired advances to customers	Individual impairment allowance	Collective impairment allowance
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Hong Kong	159,038	171	338	84	208
People's Republic of China	151,588	375	453	119	232
Other Asian Countries	19,446	29	43	17	118
Others	20,648	81	304	18	123
Total	350,720	656	1,138	238	681

% of total advances to
customers

0.32%

Market value of security
held against impaired
advances to customers

2,947

The Group 2011 (Restated)					
	Total advances to customers	Advances overdue for over three months	Impaired advances to customers	Individual impairment allowance	Collective impairment allowance
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Hong Kong	149,309	179	558	66	254
People's Republic of China	129,757	21	216	24	204
Other Asian Countries	15,625	20	33	24	131
Others	20,590	31	668	91	174
Total	315,281	251	1,475	205	763

% of total advances to
customers

0.47%

Market value of security
held against impaired
advances to customers

3,267

28. Advances to Customers and Other Accounts (continued)

(d) Advances to customers – by geographical areas (continued)

The Bank 2012					
	Total advances to customers	Advances overdue for over three months	Impaired advances to customers	Individual impairment allowance	Collective impairment allowance
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Hong Kong	143,354	149	304	74	182
People's Republic of China	39,563	98	127	19	53
Other Asian Countries	18,863	29	43	17	117
Others	19,792	80	303	18	122
Total	<u>221,572</u>	<u>356</u>	<u>777</u>	<u>128</u>	<u>474</u>
% of total advances to customers			<u>0.35%</u>		
Market value of security held against impaired advances to customers			<u>2,262</u>		

The Bank 2011					
	Total advances to customers	Advances overdue for over three months	Impaired advances to customers	Individual impairment allowance	Collective impairment allowance
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Hong Kong	133,412	158	526	56	226
People's Republic of China	34,724	5	129	1	48
Other Asian Countries	14,432	20	32	24	129
Others	15,355	14	447	49	132
Total	<u>197,923</u>	<u>197</u>	<u>1,134</u>	<u>130</u>	<u>535</u>
% of total advances to customers			<u>0.57%</u>		
Market value of security held against impaired advances to customers			<u>2,694</u>		

Impaired loans and advances are individually assessed loans with objective evidence of impairment on an individual basis. The above information by countries or geographical areas is derived according to the location of the counterparties after taking into account any transfer of risk.

28. Advances to Customers and Other Accounts (continued)

(e) Advances to customers – net investment in finance leases

Advances to customers include net investment in equipment leased under finance leases. The total minimum lease payments receivable under finance leases and their present values at the year end are as follows:

	The Group and the Bank					
	2012			2011		
	Present value of the minimum lease payments HK\$ Mn	Interest income relating to future periods HK\$ Mn	Total minimum lease payments HK\$ Mn	Present value of the minimum lease payments HK\$ Mn	Interest income relating to future periods HK\$ Mn	Total minimum lease payments HK\$ Mn
Amounts receivable:						
Within one year	1,298	167	1,465	1,157	155	1,312
After one year but within five years	1,576	215	1,791	1,506	206	1,712
After five years	1,857	261	2,118	2,023	262	2,285
	4,731	643	5,374	4,686	623	5,309
Less: Individual impairment allowances	(8)			(1)		
Net investment in finance leases	4,723			4,685		

The net investment in finance leases is carried on the statement of financial position as a receivable. No accrual is made for the interest income relating to future periods.

29. Available-For-Sale Financial Assets

	The Group		The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn	2012 HK\$ Mn	2011 HK\$ Mn
Treasury bills (including Exchange Fund Bills) (Note 46(c))	22,873	14,106	22,873	14,095
Certificates of deposit held (Note 46(c))	2,914	3,120	1,609	1,931
Debt securities (Note 46(c))	36,546	25,671	19,330	11,641
Equity securities	2,307	1,910	1,132	878
Investment funds	91	103	72	84
	<u>64,731</u>	<u>44,910</u>	<u>45,016</u>	<u>28,629</u>
Issued by:				
Central governments and central banks	23,087	17,751	22,363	15,184
Public sector entities	2,198	1,917	66	-
Banks and other financial institutions	20,855	14,202	11,121	8,419
Corporate entities	18,462	10,900	11,394	4,942
Other entities	129	140	72	84
	<u>64,731</u>	<u>44,910</u>	<u>45,016</u>	<u>28,629</u>
Analysed by place of listing:				
Debt securities				
Listed in Hong Kong	5,450	1,291	4,303	975
Listed outside Hong Kong	12,519	5,482	10,108	3,515
	17,969	6,773	14,411	4,490
Unlisted	44,364	36,124	29,401	23,177
	<u>62,333</u>	<u>42,897</u>	<u>43,812</u>	<u>27,667</u>
Equity securities				
Listed in Hong Kong	553	470	142	139
Listed outside Hong Kong	978	783	282	190
	1,531	1,253	424	329
Unlisted	776	657	708	549
	<u>2,307</u>	<u>1,910</u>	<u>1,132</u>	<u>878</u>
Investment funds				
Listed outside Hong Kong	19	19	-	-
Unlisted	72	84	72	84
	<u>91</u>	<u>103</u>	<u>72</u>	<u>84</u>
	<u>64,731</u>	<u>44,910</u>	<u>45,016</u>	<u>28,629</u>

30. Held-To-Maturity Investments (Note 46 (c))

	The Group		The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn	2012 HK\$ Mn	2011 HK\$ Mn
Treasury bills (including Exchange Fund Bills)	615	445	615	445
Certificates of deposit held	1,070	1,165	1,039	1,107
Debt securities	2,635	2,988	1,565	1,339
	4,320	4,598	3,219	2,891
Less: Impairment allowances	-	(11)	-	(11)
	<u>4,320</u>	<u>4,587</u>	<u>3,219</u>	<u>2,880</u>
Issued by:				
Central governments and central banks	1,552	1,372	1,548	1,368
Public sector entities	316	428	168	169
Banks and other financial institutions	1,108	2,335	390	1,243
Corporate entities	1,344	452	1,113	100
	<u>4,320</u>	<u>4,587</u>	<u>3,219</u>	<u>2,880</u>
Analysed by place of listing:				
Debt securities				
Listed in Hong Kong	627	289	570	216
Listed outside Hong Kong	1,527	2,192	1,096	1,522
	2,154	2,481	1,666	1,738
Unlisted	2,166	2,106	1,553	1,142
	<u>4,320</u>	<u>4,587</u>	<u>3,219</u>	<u>2,880</u>
Fair value:				
Listed securities	2,295	2,549	1,783	1,778
Unlisted securities	2,179	2,109	1,553	1,144
	<u>4,474</u>	<u>4,658</u>	<u>3,336</u>	<u>2,922</u>
Movement of impairment allowances				
	The Group		The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn	2012 HK\$ Mn	2011 HK\$ Mn
At 1 st January	11	-	11	-
Charge for the year	-	11	-	11
Written back	(11)	-	(11)	-
At 31 st December	<u>-</u>	<u>11</u>	<u>-</u>	<u>11</u>

31. Investments in Subsidiaries

	The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn
Unlisted shares, at cost	14,093	13,987
Less: Impairment allowances	(135)	(233)
	<u>13,958</u>	<u>13,754</u>

The following list contains only the particulars of subsidiaries which principally affected the results, assets or liabilities of the Group. The class of shares held is ordinary.

Details of these companies are as follows:

Name of company	Place of incorporation and operation	Issued and paid-up capital	% Held by The Bank The Group		Nature of business
Ample Delight Limited	Hong Kong	HK\$450,000,000		100%	Investment holding
Bank of East Asia (Trustees) Limited	Hong Kong	HK\$150,000,000	100%		Trustee
BEA Life Limited	Hong Kong	HK\$500,000,000	100%		Life insurance
Blue Cross (Asia-Pacific) Insurance Limited	Hong Kong	HK\$625,000,000	100%		Insurance
BEA Union Investment Management Limited	Hong Kong	HK\$374,580,000	51%		Asset management
BEA Wealth Management Services (Taiwan) Limited	Taiwan, Republic of China	NTD273,200,000		100%	Wealth management services
Central Town Limited	Hong Kong	HK\$2	100%		Property investment
Century Able Limited	Hong Kong	HK\$929,752,849		100%	Investment holding
Corona Light Limited	BVI	HK\$929,752,849		100%	Investment holding
Credit Gain Finance Company Limited	Hong Kong	HK\$370,000,000	100%		Money lenders
Crystal Gleaming Limited	BVI	HK\$929,752,849	100%		Investment holding
East Asia Electronic Data Processing (Guangzhou) Limited	PRC	US\$3,000,000		100%	Servicing
* East Asia Holding Company, Inc.	U.S.A.	US\$5	100%		Bank holding company
East Asia International Trustees Limited	BVI	US\$1,301,000	100%		Trustees services
East Asia Investments Holdings (BVI) Ltd.	BVI	HK\$186,038,725	100%		Investment holding
East Asia Property Holdings (Jersey) Limited	BVI	GBP9	100%		Property Holding

31. Investments in Subsidiaries (continued)

Name of company	Place of incorporation and operation	Issued and paid-up capital	% Held by		Nature of business
			The Bank	The Group	
East Asia Secretaries (BVI) Limited	BVI	HK\$300,000,000		75.61%	Investment holding
East Asia Securities Company Limited	Hong Kong	HK\$25,000,000	100%		Securities broking
East Asia Strategic Holdings Limited	BVI	US\$50,000,000	100%		Investment holding
Innovate Holdings Limited	BVI	US\$1(Ordinary) US\$500,000,000 (with a liquidation preference of US\$1,000 per share)	100%		Special purpose vehicle company
Keen Sight Development Limited	BVI	US\$26,200,000	100%		Investment holding
Powerhouse Worldwide Limited	BVI	US\$26,200,000		100%	Investment holding
Skyray Holdings Limited	BVI	HK\$450,000,000	100%		Investment holding
Shaanxi Fuping BEA Rural Bank Corporation	PRC	CNY20,000,000	100%		Banking and other financial businesses
Speedfull Limited	BVI	HK\$450,000,000		100%	Investment holding
The Bank of East Asia (China) Limited (Note 1)	PRC	CNY8,000,000,000	100%		Banking and related financial services
Tricor Consultancy (Beijing) Limited (Note 1)	PRC	US\$1,850,000		75.61%	Business consultancy in China
Tricor Holdings Limited	BVI	US\$7,001		75.61%	Investment holding
Tricor Holdings Pte. Ltd.	Singapore	S\$5,000,002		75.61%	Investment holding
Tricor Investor Services Limited	Hong Kong	HK\$2		75.61%	Investor services
Tricor Services Limited	Hong Kong	HK\$2		75.61%	Business, corporate and investor services
Tricor Services (Malaysia) Sdn. Bhd.	Malaysia	RM5,672,484		68.05%	Investment holding
Tung Shing Holdings Company Limited	BVI	US\$20,000,000	100%		Investment holding

Notes: 1. Represents a wholly foreign owned enterprise.
2. BVI denotes the British Virgin Islands and PRC denotes the People's Republic of China.
* Company not audited by KPMG. The accounts of the subsidiaries not audited by KPMG reflect total net assets and total income constituting approximately 0.2% and 0.1% respectively of the related consolidated totals.

32. Investments in Associates

	The Group		The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn	2012 HK\$ Mn	2011 HK\$ Mn
Listed shares, at cost	-	-	2,040	2,040
Unlisted shares, at cost	-	-	525	426
Share of net assets	4,322	3,569	-	-
Goodwill	355	251	-	-
	<u>4,677</u>	<u>3,820</u>	<u>2,565</u>	<u>2,466</u>
Less: Impairment allowances	-	-	-	-
	<u>4,677</u>	<u>3,820</u>	<u>2,565</u>	<u>2,466</u>

Loans to associates amounting to HK\$233 million (2011: HK\$233 million) are included under placements with banks and other financial institutions.

Share of associates' taxation for the year amounted to HK\$173 million (2011: HK\$148 million).

Shareholdings in associates held by the Bank include listed investments of HK\$2,040 million (2011: HK\$2,040 million). As at the end of the reporting period, the fair value of these investments held by the Group, based on quoted market prices, was HK\$3,063 million (2011: HK\$2,652 million).

The following list contains only the particulars of associates which principally affected the results or assets of the Group:

Name of company	Place of incorporation and operation	% of ordinary shares held by		Nature of business
		The Bank	The Group	
Listed				
AFFIN Holdings Berhad	Malaysia	23.52%		Investment holding
Unlisted				
Dolford Property Holdings Limited	BVI		30%	Investment holding
Founder BEA Trust Company Limited	PRC	19.99%		Trust and other financial businesses
Industrial and Commercial Bank of China (Canada)	Canada	20%		Banking services
Industrial and Commercial Bank of China (USA) N.A.	U.S.A.		20%	Banking services
Platinum Holdings Company Limited	Cayman Islands	29.99%		Investment holding
PT. Bank Resona Perdania	Indonesia		30%	Banking and related financial services
TCL Finance Co., Ltd	PRC	20%		Financial services and cash management

Notes: BVI denotes the British Virgin Islands and PRC denotes the People's Republic of China.

32. Investments in Associates (continued)

Summary financial information on associates

	Assets HK\$ Mn	Liabilities HK\$ Mn	Equity HK\$ Mn	Revenue HK\$ Mn	Profit HK\$ Mn
2012					
100 per cent	166,760	145,836	20,924	5,550	2,315
Group's effective interest	<u>38,621</u>	<u>34,300</u>	<u>4,321</u>	<u>1,293</u>	<u>536</u>
2011					
100 per cent	143,878	126,984	16,894	4,482	1,765
Group's effective interest	<u>33,621</u>	<u>30,052</u>	<u>3,569</u>	<u>1,074</u>	<u>435</u>

33. Goodwill and Intangible Assets

Goodwill and intangible assets include goodwill arising on business combinations and acquired intangible assets. Acquired intangible assets include core deposits which are amortised over their estimated economic useful life of ten years, and naming rights.

	The Group		The Bank	
	2012	2011	2012	2011
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Goodwill	2,743	2,882	1,460	1,460
Acquired intangible assets	<u>1,298</u>	<u>1,333</u>	<u>-</u>	<u>-</u>
	<u>4,041</u>	<u>4,215</u>	<u>1,460</u>	<u>1,460</u>

(a) Goodwill

	The Group		The Bank	
	2012	2011	2012	2011
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1 st January	2,882	2,822	1,460	1,460
Additions through acquisition of subsidiaries	11	68	-	-
Reversal due to disposal of a subsidiary	(172)	-	-	-
Exchange adjustments	<u>22</u>	<u>(8)</u>	<u>-</u>	<u>-</u>
At 31 st December	<u>2,743</u>	<u>2,882</u>	<u>1,460</u>	<u>1,460</u>

Impairment tests for cash-generating units containing goodwill

Goodwill is allocated to the Group's cash-generating units (CGU) identified according to business segments as follows:

	2012 HK\$ Mn	2011 HK\$ Mn
Personal banking	849	849
Corporate banking	453	453
Treasury markets	158	158
Corporate services	1,235	1,210
Others	<u>48</u>	<u>212</u>
	<u>2,743</u>	<u>2,882</u>

33. Goodwill and Intangible Assets (continued)

The recoverable amount of the CGU is determined based on value-in-use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimated rates stated below. The growth rate does not exceed the long-term average growth rate for the business in which the CGU operates.

The pre-tax discount rate used for value-in-use calculations is 11.39%-12.5% (2011: 10%-12.28%) and the long-term growth rate is 4%-10% (2011: 2% - 10%).

Management determined the budgeted net profit based on past performance and its expectation for market development. The weighted average growth rates used are consistent with the internal forecasts.

(b) Intangible assets (other than goodwill)

Intangible assets include acquired core deposits. Intangible assets are stated at cost less accumulated amortisation and impairment loss (Note 2(k)(iv)).

Amortisation of intangible assets with finite useful lives is charged to the income statement over the assets' estimated useful lives. The following intangible assets with finite useful lives are amortised from the date they are available to use and their estimated useful lives are as follows:

Acquired core deposits	10 years
Naming rights	Over the shorter of the lease period of building or land

Both the period and method of amortisation are reviewed annually.

	The Group		The Bank	
	2012	2011	2012	2011
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Cost				
At 1 st January	1,433	1,433	-	-
Reversal due to disposal of a subsidiary	(14)	-	-	-
At 31 st December	<u>1,419</u>	<u>1,433</u>	<u>-</u>	<u>-</u>
Accumulated amortisation				
At 1 st January	(100)	(67)	-	-
Amortisation charge for the year (Note 11)	(33)	(33)	-	-
Reversal due to disposal of a subsidiary	12	-	-	-
At 31 st December	<u>(121)</u>	<u>(100)</u>	<u>-</u>	<u>-</u>
Carrying amount at 31st December	<u>1,298</u>	<u>1,333</u>	<u>-</u>	<u>-</u>

34. Fixed Assets

2012					
The Group					
	Investment properties HK\$ Mn	Bank premises HK\$ Mn	Furniture, fixtures and equipment HK\$ Mn	Sub-total HK\$ Mn	Total HK\$ Mn
Cost or valuation					
At 1 st January, 2012	2,940	8,991	4,563	13,554	16,494
Additions	17	22	386	408	425
Revaluation surplus (Note 15)	454	-	-	-	454
Revaluation of bank premises transferred to investment properties	36	(36)	-	(36)	-
Revaluation loss on bank premises (Note 15)	-	(3)	-	(3)	(3)
Redevelopment cost	21	28	-	28	49
Reversal due to disposal of a subsidiary	-	-	(116)	(116)	(116)
Disposals	(375)	(25)	(183)	(208)	(583)
Exchange adjustments	7	77	21	98	105
At 31 st December, 2012	<u>3,100</u>	<u>9,054</u>	<u>4,671</u>	<u>13,725</u>	<u>16,825</u>
Accumulated depreciation and amortisation					
At 1 st January, 2012	-	1,012	2,843	3,855	3,855
Charge for the year (Note 11)	-	168	489	657	657
Reversal due to disposal of a subsidiary	-	-	(78)	(78)	(78)
Write back on disposals	-	(16)	(163)	(179)	(179)
Exchange adjustments	-	6	12	18	18
At 31 st December, 2012	<u>-</u>	<u>1,170</u>	<u>3,103</u>	<u>4,273</u>	<u>4,273</u>
Net book value at 31 st December, 2012	<u>3,100</u>	<u>7,884</u>	<u>1,568</u>	<u>9,452</u>	<u>12,552</u>
The gross amounts of the above assets are stated:					
At cost	-	8,242	4,671	12,913	12,913
At Directors' valuation - 1989	-	812	-	812	812
At professional valuation - 2012	3,100	-	-	-	3,100
	<u>3,100</u>	<u>9,054</u>	<u>4,671</u>	<u>13,725</u>	<u>16,825</u>

34. Fixed Assets (continued)

	2012				
	The Bank				
	Investment properties HK\$ Mn	Bank premises HK\$ Mn	Furniture, fixtures and equipment HK\$ Mn	Sub-total HK\$ Mn	Total HK\$ Mn
Cost or valuation					
At 1 st January, 2012	2,433	4,071	2,576	6,647	9,080
Additions	-	-	168	168	168
Revaluation surplus	361	-	-	-	361
Redevelopment cost	9	28	-	28	37
Disposals	(375)	-	(134)	(134)	(509)
Exchange adjustments	-	39	7	46	46
At 31 st December, 2012	<u>2,428</u>	<u>4,138</u>	<u>2,617</u>	<u>6,755</u>	<u>9,183</u>
Accumulated depreciation and amortisation					
At 1 st January, 2012	-	444	1,758	2,202	2,202
Charge for the year	-	48	217	265	265
Write back on disposals	-	-	(122)	(122)	(122)
Exchange adjustments	-	1	1	2	2
At 31 st December, 2012	<u>-</u>	<u>493</u>	<u>1,854</u>	<u>2,347</u>	<u>2,347</u>
Net book value at 31 st December, 2012	<u>2,428</u>	<u>3,645</u>	<u>763</u>	<u>4,408</u>	<u>6,836</u>
The gross amounts of the above assets are stated:					
At cost	-	3,326	2,617	5,943	5,943
At Directors' valuation					
- 1989	-	812	-	812	812
At professional valuation					
- 2012	<u>2,428</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,428</u>
	<u>2,428</u>	<u>4,138</u>	<u>2,617</u>	<u>6,755</u>	<u>9,183</u>

34. Fixed Assets (continued)

	2011				
	The Group				
	Investment properties HK\$ Mn	Bank premises HK\$ Mn	Furniture, fixtures and equipment HK\$ Mn	Sub-total HK\$ Mn	Total HK\$ Mn
Cost or valuation					
At 1 st January, 2011	2,574	9,031	4,160	13,191	15,765
Additions	-	61	506	567	567
Additions through acquisition	-	-	3	3	3
Revaluation surplus (Note 15)	404	-	-	-	404
Revaluation of bank premises transferred to investment properties	-	14	-	14	14
Transfer from bank premises to investment properties	25	(25)	-	(25)	-
Redevelopment cost	8	10	-	10	18
Disposals	(94)	(306)	(161)	(467)	(561)
Exchange adjustments	23	206	55	261	284
At 31 st December, 2011	<u>2,940</u>	<u>8,991</u>	<u>4,563</u>	<u>13,554</u>	<u>16,494</u>
Accumulated depreciation and amortisation					
At 1 st January, 2011	-	877	2,474	3,351	3,351
Additions through acquisition	-	-	2	2	2
Charge for the year (Note 11)	-	164	472	636	636
Revaluation of bank premises transferred to investment properties	-	(2)	-	(2)	(2)
Write back on disposals	-	(45)	(137)	(182)	(182)
Exchange adjustments	-	18	32	50	50
At 31 st December, 2011	<u>-</u>	<u>1,012</u>	<u>2,843</u>	<u>3,855</u>	<u>3,855</u>
Net book value at 31st December, 2011	<u>2,940</u>	<u>7,979</u>	<u>1,720</u>	<u>9,699</u>	<u>12,639</u>
The gross amounts of the above assets are stated:					
At cost	-	8,178	4,563	12,741	12,741
At Directors' valuation - 1989	-	813	-	813	813
At professional valuation - 2011	<u>2,940</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,940</u>
	<u>2,940</u>	<u>8,991</u>	<u>4,563</u>	<u>13,554</u>	<u>16,494</u>

34. Fixed Assets (continued)

2011					
The Bank					
	Investment properties HK\$ Mn	Bank premises HK\$ Mn	Furniture, fixtures and equipment HK\$ Mn	Sub-total HK\$ Mn	Total HK\$ Mn
Cost or valuation					
At 1 st January, 2011	2,173	4,081	2,430	6,511	8,684
Additions	-	-	219	219	219
Revaluation surplus	338	-	-	-	338
Revaluation of bank premises transferred to investment properties	-	9	-	9	9
Transfer from bank premises to investment properties	13	(13)	-	(13)	-
Redevelopment cost	3	10	-	10	13
Disposals	(94)	(8)	(72)	(80)	(174)
Exchange adjustments	-	(8)	(1)	(9)	(9)
At 31 st December, 2011	<u>2,433</u>	<u>4,071</u>	<u>2,576</u>	<u>6,647</u>	<u>9,080</u>
Accumulated depreciation and amortisation					
At 1 st January, 2011	-	398	1,595	1,993	1,993
Charge for the year	-	49	221	270	270
Revaluation of bank premises transferred to investment properties	-	(2)	-	(2)	(2)
Write back on disposals	-	(1)	(57)	(58)	(58)
Exchange adjustments	-	-	(1)	(1)	(1)
At 31 st December, 2011	<u>-</u>	<u>444</u>	<u>1,758</u>	<u>2,202</u>	<u>2,202</u>
Net book value at 31 st December, 2011	<u>2,433</u>	<u>3,627</u>	<u>818</u>	<u>4,445</u>	<u>6,878</u>
The gross amounts of the above assets are stated:					
At cost	-	3,258	2,576	5,834	5,834
At Directors' valuation					
- 1989	-	813	-	813	813
At professional valuation					
- 2011	2,433	-	-	-	2,433
	<u>2,433</u>	<u>4,071</u>	<u>2,576</u>	<u>6,647</u>	<u>9,080</u>

34. Fixed Assets (continued)

The net book value of bank premises and investment properties comprises:

	The Group			
	2012		2011(Restated)	
	Investment properties HK\$ Mn	Bank premises HK\$ Mn	Investment properties HK\$ Mn	Bank premises HK\$ Mn
Freeholds – Held outside Hong Kong	195	742	97	750
Leaseholds				
Held in Hong Kong				
On long lease (over 50 years)	2,083	1,664	2,127	1,646
On medium-term lease (10 - 50 years)	365	1,300	313	1,335
Held outside Hong Kong				
On long lease (over 50 years)	-	40	-	40
On medium-term lease (10 - 50 years)	457	4,138	403	4,208
	<u>3,100</u>	<u>7,884</u>	<u>2,940</u>	<u>7,979</u>
The Bank				
	2012		2011(Restated)	
	Investment properties HK\$ Mn	Bank premises HK\$ Mn	Investment properties HK\$ Mn	Bank premises HK\$ Mn
Freeholds – Held outside Hong Kong	-	707	-	674
Leaseholds				
Held in Hong Kong				
On long lease (over 50 years)	1,771	1,637	1,877	1,618
On medium-term lease (10 - 50 years)	657	1,194	556	1,225
Held outside Hong Kong				
On medium-term lease (10 - 50 years)	-	107	-	110
	<u>2,428</u>	<u>3,645</u>	<u>2,433</u>	<u>3,627</u>

The carrying amount of the bank premises of the Group and the Bank would have been HK\$6,217 million (2011(restated) :HK\$6,268 million) and HK\$2,040 million (2011 (restated): HK\$2,017 million) respectively had they been stated at cost less accumulated depreciation.

Investment properties were valued by independent valuers. Investment properties in Hong Kong were valued at HK\$2,448 million as at 31st December, 2012 by an independent valuer, Savills Valuation and Professional Services Limited, Chartered Surveyors, who has among their staff Fellows of the Hong Kong Institute of Surveyors with recent experience in the location and category of property being valued. The valuation has been incorporated in the accounts as at 31st December, 2012 and it was performed on an open market value basis.

The Group leases out investment properties under operating leases. The leases typically run for an initial period from 1 to 10 years, with an option to renew the leases after that date at which time all terms are renegotiated. None of the leases includes contingent rentals.

Rental income receivable from investment properties held for use under operating leases amounted to HK\$142 million in 2012 (2011: HK\$129 million). There was no contingent rental recognised during the year 2012 (2011: Nil).

34. Fixed Assets (continued)

The total future minimum lease payments of bank premises and investment properties held for use under non-cancellable operating leases are receivable as follows:

	The Group		The Bank	
	2012	2011	2012	2011
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Within one year	122	128	57	63
After one year but within five years	82	123	21	33
After five years	-	-	-	-
	<u>204</u>	<u>251</u>	<u>78</u>	<u>96</u>

35. Amounts Due from and Due to Subsidiaries

During the year, the Bank entered into transactions with certain subsidiaries in the ordinary course of its banking business. Details of the amounts due from and due to subsidiaries are as follows:

	The Bank	
	2012	2011
	HK\$ Mn	HK\$ Mn
Amounts due from subsidiaries	15,566	11,498
Amounts due to subsidiaries	<u>3,105</u>	<u>2,416</u>
	<u>12,461</u>	<u>9,082</u>

	The Bank	
	2012	2011
	HK\$ Mn	HK\$ Mn
Assets:		
Cash and balances with banks and other financial institutions	5,809	545
Placements with banks and other financial institutions	2,319	1,582
Trading assets	166	248
Other assets	<u>8,790</u>	<u>10,292</u>
	<u>17,084</u>	<u>12,667</u>
Liabilities:		
Deposits and balances of banks and other financial institutions	1,825	824
Deposits from customers	2,508	2,312
Trading liabilities	113	162
Other liabilities	<u>177</u>	<u>287</u>
	<u>4,623</u>	<u>3,585</u>
	<u>12,461</u>	<u>9,082</u>

36. Income Tax in the Statement of Financial Position

(a) Current taxation in the statement of financial position represents:

	The Group		The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn	2012 HK\$ Mn	2011 HK\$ Mn
Provision for Hong Kong profits tax for the year (Note 16(a))	533	250	484	189
Impact of leasing partnerships	(19)	(189)	(19)	(189)
	514	61	465	-
Provisional profits tax paid	(52)	(58)	-	-
	462	3	465	-
Balance of profits tax provision relating to prior years	206	202	189	156
Taxation outside Hong Kong	320	268	218	141
	<u>988</u>	<u>473</u>	<u>872</u>	<u>297</u>

(b) Deferred tax assets and liabilities recognised

The components of deferred tax (assets) / liabilities recognised in the consolidated statement of financial position and the movements during the year are as follows:

	The Group						
	Depreciation allowances in excess of related depreciation HK\$ Mn	Revaluation of properties HK\$ Mn	Impairment losses on financial assets HK\$ Mn	Revaluation of available-for-sale securities HK\$ Mn	Tax losses HK\$ Mn	Others HK\$ Mn	Total HK\$ Mn
Deferred tax arising from:							
At 1 st January, 2012	366	150	(94)	(57)	(25)	(256)	84
Charged to income statement (Note 16(a))	26	13	21	-	15	38	113
(Credited)/charged to reserves (Notes 41(c) and (h))	-	(1)	-	120	-	-	119
Reversal due to disposal of a subsidiary	-	-	31	-	-	134	165
Exchange and other adjustments	-	1	-	-	-	1	2
At 31 st December, 2012	<u>392</u>	<u>163</u>	<u>(42)</u>	<u>63</u>	<u>(10)</u>	<u>(83)</u>	<u>483</u>

36. Income Tax in the Statement of Financial Position (continued)**(b) Deferred tax assets and liabilities recognised (continued)**

Deferred tax arising from:	The Group						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Impairment losses on financial assets	Revaluation of available- for-sale securities	Tax losses	Others	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1 st January, 2011	322	145	(131)	(19)	(147)	(366)	(196)
Charged to income statement (Note 16(a))	44	6	34	-	123	110	317
Credited to reserves (Notes 41(c) and (h))	-	(3)	-	(35)	-	-	(38)
Exchange and other adjustments	-	2	3	(3)	(1)	-	1
At 31 st December, 2011	<u>366</u>	<u>150</u>	<u>(94)</u>	<u>(57)</u>	<u>(25)</u>	<u>(256)</u>	<u>84</u>

Deferred tax arising from:	The Bank						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Impairment losses on financial assets	Revaluation of available- for-sale securities	Tax losses	Others	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1 st January, 2012	354	90	(129)	(12)	(13)	11	301
Charged to income statement	22	-	14	-	14	18	68
(Credited)/charged to reserves (Notes 41(c) and (h))	-	(1)	-	99	-	-	98
Exchange and other adjustments	-	-	-	-	-	3	3
At 31 st December, 2012	<u>376</u>	<u>89</u>	<u>(115)</u>	<u>87</u>	<u>1</u>	<u>32</u>	<u>470</u>

36. Income Tax in the Statement of Financial Position (continued)**(b) Deferred tax assets and liabilities recognised (continued)**

Deferred tax arising from:	The Bank						Total HK\$ Mn
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Impairment losses on financial assets	Revaluation of available- for-sale securities	Tax losses	Others	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
At 1 st January, 2011	314	91	(177)	43	(61)	(208)	2
Charged to income statement	40	-	49	-	48	215	352
Credited to reserves (Notes 41(c) and (h))	-	(1)	-	(54)	-	-	(55)
Exchange and other adjustments	-	-	(1)	(1)	-	4	2
At 31 st December, 2011	<u>354</u>	<u>90</u>	<u>(129)</u>	<u>(12)</u>	<u>(13)</u>	<u>11</u>	<u>301</u>

	The Group		The Bank	
	2012	2011	2012	2011
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Net deferred tax assets recognised on the statement of financial position	(143)	(377)	(130)	(153)
Net deferred tax liabilities recognised on the statement of financial position	626	461	600	454
	<u>483</u>	<u>84</u>	<u>470</u>	<u>301</u>

(c) Deferred tax assets not recognised

The Group has not recognised deferred tax assets in respect of cumulative tax losses of HK\$965 million (2011: HK\$842 million) as it is not probable that future taxable profits against which the losses can be utilized will be available in the relevant tax jurisdiction and entity. Under the current tax legislation, the expiry dates of the tax losses were as follows:

	2012 HK\$ Mn	2011 HK\$ Mn
Expiring within 5 years	29	30
Expiring more than 5 years	122	101
No expiry date	814	711
	<u>965</u>	<u>842</u>

37. Other Liabilities

	The Group		The Bank	
	2012	2011	2012	2011
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
(a) Trading liabilities				
Shares sold	21	10	21	10
Negative fair value of derivatives (Note 45(b)(ii))	3,806	4,538	3,059	3,817
	<u>3,827</u>	<u>4,548</u>	<u>3,080</u>	<u>3,827</u>
(b) Other accounts and provisions				
Accrued interest payable	3,912	3,897	1,399	1,716
Acceptance draft payable	24,633	18,381	296	219
Other accounts	16,832	13,704	5,338	4,286
	<u>45,377</u>	<u>35,982</u>	<u>7,033</u>	<u>6,221</u>

38. Loan Capital

	The Group		The Bank	
	2012	2011	2012	2011
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
GBP262 million step-up perpetual subordinated notes, measured at fair value through profit or loss	-	3,178	-	3,178
USD600 million floating rate step-up subordinated notes, measured at amortised cost	-	4,659	-	4,659
USD500 million Hybrid Tier 1	-	-	4,410	4,025
USD600 million subordinated notes, measured at amortised cost	5,139	5,031	5,139	5,031
USD500 million subordinated notes (under the Euro Medium Term Note Programme), measured at amortised cost	3,976	3,873	3,976	3,873
SGD800 million subordinated notes (under the Euro Medium Term Note Programme), measured at amortised cost	5,148	-	5,148	-
	<u>14,263</u>	<u>16,741</u>	<u>18,673</u>	<u>20,766</u>

The carrying amount of financial liabilities designated at fair value through profit or loss for the Group as at 31st December, 2012 was Nil (2011: HK\$15 million higher than the contractual amount at maturity) and for the Bank was HK\$534 million (2011: HK\$156 million) higher than the contractual amount at maturity. The difference in the accumulated amount of the changes in fair value attributable to changes in credit risk for the Group was Nil (2011: HK\$853 million) and for the Bank were HK\$67 million (2011: HK\$1,521 million). The change for the year ended 31st December, 2012 for the Group was HK\$853 million (2011: HK\$202 million) and for the Bank was HK\$1,588 million (2011: HK\$555 million).

Hybrid Tier 1 capital instruments comprising step-up subordinated notes ("Notes") of face value HK\$3,876 million (USD500 million) and carrying amount of HK\$4,410 million and HK\$3,876 million (USD500 million) non-cumulative preference shares ("Innovate Preference Shares") were issued respectively by the Bank and by Innovate Holdings Limited, a wholly owned subsidiary of the Bank, on 5th November, 2009. The Notes bear a fixed interest rate of 8.5% per annum and will mature on 5th November, 2059. The Innovate Preference Shares are perpetual securities on which no dividend is payable. The Notes and the Innovate Preference Shares are listed, and traded together as units, on the Singapore Stock Exchange. The Hybrid Tier 1 capital instruments are qualified as tier 1 capital of the Bank and the Group. In the consolidated accounts, the Notes are eliminated and the Innovate Preference Shares are classified as non-controlling interests.

38. Loan Capital (continued)

Two tranches of loan capital of face value totalling HK\$4,651 million (USD600 million) and carrying amount totalling HK\$5,139 million (2011: HK\$5,031 million) were issued on 16th July, 2010 (USD450 million) and on 23rd July, 2010 (USD150 million) by the Bank. These subordinated notes carrying a coupon rate of 6.125% qualifying as supplementary capital are listed on the Singapore Stock Exchange and will mature on 16th July, 2020. Hedge ineffectiveness of HK\$0.3 million loss in 2012 (2011: HK\$3 million loss) was recorded under fair value hedge accounting.

Loan capital of face value of HK\$3,876 million (USD500 million) and carrying amount of HK\$3,976 million (2011: HK\$3,873 million) represents 6.375% subordinated notes (under the Euro Medium Term Note Programme) qualifying as supplementary capital issued on 4th November, 2011 by the Bank. The notes are listed on the Singapore Stock Exchange and will mature on 4th May, 2022. Hedge ineffectiveness of HK\$8 million profit in 2012 (2011: HK\$2 million loss) was recorded under the fair value hedge accounting for the USD400 million subordinated notes. The fair value as of 31st December, 2012 for the USD100 million subordinated notes was HK\$772 million (USD99.6 million).

Loan capital of face value of HK\$5,073 million (SGD800 million) and carrying amount of HK\$5,148 million represents two tranches of 4.25% subordinated notes (under the Euro Medium Term Note Programme) qualifying as supplementary capital issued on 13th March, 2012 (SGD600 million) and on 27th April, 2012 (SGD200 million) by the Bank. The notes are listed on the Singapore Stock Exchange and will mature on 13th September, 2022. Hedge ineffectiveness of approximately HK\$18 million loss in 2012 was recorded under the fair value hedge accounting.

On 21st March, 2012, the Bank redeemed the HK\$3,230 million (GBP262 million) 6.125% step-up perpetual subordinated notes which were issued on 20th March, 2007 and which qualified as supplementary capital.

On 22nd June, 2012, the Bank redeemed the HK\$4,656 million (USD600 million) floating rate step-up subordinated notes which were issued on 21st June, 2007 and which qualified as supplementary capital.

39. Equity Settled Share-based Transactions

The Bank has adopted Staff Share Option Schemes whereby the Board of the Bank may at its discretion grant to any employees, including Executive Director and Chief Executive, of the Group options to subscribe for ordinary shares of the Bank. Except as provided otherwise in the rules of the relevant Schemes, share options granted under Staff Share Option Schemes 2002 and 2007, may be exercised during the period beginning on the first anniversary of the Date of Grant and ending on the fifth anniversary of the Date of Grant while share options granted under the Staff Share Option Scheme 2011 and after may be exercised beginning on the Vesting Date and ending on the fifth anniversary of the Vesting Date. All options were granted for nil consideration.

(a) Particulars of share options:

(i) Share options granted under Staff Share Option Schemes 2002 and 2007:

<u>Date of grant</u>	<u>Vesting period</u>	<u>Exercise period</u>	<u>Exercise price per share</u>
			HK\$
10/5/2007	10/5/2007 – 09/5/2008	10/5/2008 – 10/5/2012	42.84
05/5/2008	05/5/2008 – 04/5/2009	05/5/2009 – 05/5/2013	40.09
05/5/2009	05/5/2009 – 04/5/2010	05/5/2010 – 05/5/2014	21.25
06/7/2010	06/7/2010 – 05/7/2011	06/7/2011 – 06/7/2015	28.49

(ii) Share options granted under Staff Share Option Scheme 2011:

<u>Date of grant</u>	<u>Tranche</u>	<u>Vesting period</u>	<u>Exercise period</u>	<u>Exercise price per share</u>
				HK\$
05/5/2011	T1	05/5/2011 – 04/5/2012	05/5/2012 – 05/5/2017	32.00
05/5/2011	T2	05/5/2011 – 04/5/2013	05/5/2013 – 05/5/2018	32.00
05/5/2011	T3	05/5/2011 – 04/5/2014	05/5/2014 – 05/5/2019	32.00

39. Equity Settled Share-based Transactions (continued)

(a) Particulars of share options: (continued)

(iii) Share options granted under Staff Share Option Scheme 2012:

<u>Date of grant</u>	<u>Tranche</u>	<u>Vesting period</u>	<u>Exercise period</u>	<u>Exercise price per share</u> HK\$
10/5/2012	T1	10/5/2012 – 09/5/2013	10/5/2013 – 10/5/2018	28.99
10/5/2012	T2	10/5/2012 – 09/5/2014	10/5/2014 – 10/5/2019	28.99
10/5/2012	T3	10/5/2012 – 09/5/2015	10/5/2015 – 10/5/2020	28.99

(b) The number and weighted average exercise prices of share options are as follows:

	2012		2011	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
	HK\$	Mn	HK\$	Mn
Outstanding at the beginning of the year	31.83	22	31.81	21
Exercised during the year	23.07	(1)	27.53	(3)
Granted during the year	28.99	6	32.00	6
Lapsed during the year	42.84	(2)	41.01	(2)
Outstanding at the end of the year	30.49	<u>25</u>	31.83	<u>22</u>
Exercisable at the end of the year	30.73	15	31.76	16

The weighted average share price at the date of exercise for share options exercised during the year was HK\$28.71 (2011: HK\$30.61).

The options outstanding at 31st December, 2012 had an exercise price from HK\$21.25 to HK\$42.84 (2011: from HK\$21.25 to HK\$42.84) and a weighted average remaining contractual life of 3.61 years (2011: 3.38 years).

(c) Fair value of share options and assumptions

The fair value of services received in return for share options granted is measured by reference to the fair value of share options granted. The estimate of the fair value of the share options granted is measured based on a trinomial lattice model. The contractual life of the option is used as an input into this model.

	2012	2011
Fair value at measurement date		
- Tranche 1	HK\$3.95	HK\$5.12
- Tranche 2	HK\$4.02	HK\$5.34
- Tranche 3	HK\$3.99	HK\$5.48
Share price	HK\$28.90	HK\$31.60
Exercise price	HK\$28.99	HK\$32.00
Expected volatility (expressed as weighted average volatility used in the modelling under trinomial lattice model)	22.08%	21.78%
Option life		
- Tranche 1	6 years	6 years
- Tranche 2	7 years	7 years
- Tranche 3	8 years	8 years
Expected dividends	3.87%-3.94%	2.98%
Risk-free interest rate (based on Exchange Fund Notes)	0.45%	1.66%

39. Equity Settled Share-based Transactions (continued)**(c) Fair value of share options and assumptions (continued)**

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility based on publicly available information. Expected dividends are based on historical dividends. Changes in the subjective input assumptions could materially affect the fair value estimate.

Share options were granted under a service condition. This condition has not been taken into account in the grant date fair value measurement of the services received. There were no market conditions associated with the share option grants.

40. Share Capital

	2012		2011	
	No. of shares million	Nominal value	No. of shares million	Nominal value
Authorised:				
Ordinary shares of HK\$2.50 each	<u>4,000</u>	<u>HK\$10,000Mn</u>	<u>4,000</u>	<u>HK\$10,000Mn</u>
Substitute preference shares of US\$1,000 each	<u>0.5</u>	<u>US\$500Mn</u>	<u>0.5</u>	<u>US\$500Mn</u>
		HK\$ Mn		HK\$ Mn
Issued and fully paid:				
At 1 st January	2,076	5,190	2,042	5,105
Shares issued under Staff Share Option Schemes	1	2	3	8
Subscription for new shares	111	279	-	-
Shares issued in lieu of dividends	<u>39</u>	<u>97</u>	<u>31</u>	<u>77</u>
At 31 st December	<u>2,227</u>	<u>5,568</u>	<u>2,076</u>	<u>5,190</u>

Pursuant to the approved Staff Share Option Schemes (the "Schemes"), options to purchase ordinary shares in the Bank were granted to eligible employees. The option price of the Schemes equals the fair value of the underlying shares at the date of grant. Except as provided otherwise in the rules of the relevant Schemes, the share options granted under the Schemes 2002 & 2007 will be exercisable between the first and the fifth anniversaries of the date of grant while share options granted under Scheme 2011 and after will be exercisable on the Vesting Date and ending on the fifth anniversary of the Vesting Date.

(a) Shares issued under Staff Share Option Scheme

During the year, options were exercised to subscribe for 1 million ordinary shares in the Bank at a consideration of HK\$18 million of which HK\$2 million was credited to share capital and the balance of HK\$16 million was credited to the share premium account (Note 41). HK\$6 million has been transferred from the capital reserve to the share premium account in accordance with policy set out in Note 2(q)(iv).

40. Share Capital (continued)

(b) Terms of unexpired and unexercised share options at the end of the reporting period

Date of options granted	Option price	2012 No. of shares	2011 No. of shares
10/5/2007	HK\$42.84	-	2,035,000
05/5/2008	HK\$40.09	4,070,000	4,070,000
05/5/2009	HK\$21.25	2,920,000	3,515,000
06/7/2010	HK\$28.49	5,750,000	5,950,000
05/5/2011 (T1)	HK\$32.00	1,980,000	1,980,000
05/5/2011 (T2)	HK\$32.00	1,980,000	1,980,000
05/5/2011 (T3)	HK\$32.00	1,990,000	1,990,000
10/5/2012 (T1)	HK\$28.99	1,980,000	-
10/5/2012 (T2)	HK\$28.99	1,980,000	-
10/5/2012 (T3)	HK\$28.99	1,990,000	-
		<u>24,640,000</u>	<u>21,520,000</u>

41. Reserves

	2012	
	The Group HK\$ Mn	The Bank HK\$ Mn
(a) Share premium		
At 1 st January	12,037	12,037
Net premium on shares issued under Staff Share Option Schemes	16	16
Transfer of the fair value of options from capital reserve – share options issued	6	6
Subscription of new shares	3,022	3,022
Shares issued in lieu of dividends	1,002	1,002
At 31 st December	<u>16,083</u>	<u>16,083</u>
(b) General reserve		
At 1 st January	13,744	13,376
Transfer from retained profits	21	-
Realised surplus on disposals transferred from property revaluation reserve	58	58
At 31 st December	<u>13,823</u>	<u>13,434</u>
(c) Revaluation reserve on bank premises		
At 1 st January	1,032	971
Recognition of deferred tax liabilities (Note 36(b))	1	1
Realised surplus on disposals transferred to general reserve	(58)	(58)
Exchange adjustments	1	-
At 31 st December	<u>976</u>	<u>914</u>
(d) Statutory reserves		
At 1 st January	2,142	2
Transfer from/(to) retained profits	390	(2)
Exchange adjustments	15	-
At 31 st December	<u>2,547</u>	<u>-</u>

41. Reserves (continued)

	2012	
	The Group HK\$ Mn	The Bank HK\$ Mn
(e) Capital reserve		
At 1 st January	86	-
Transfer from retained profits	48	-
Disposal of a subsidiary	(4)	-
At 31 st December	<u>130</u>	<u>-</u>
(f) Exchange revaluation reserve		
At 1 st January	2,390	22
Exchange adjustments	379	82
At 31 st December	<u>2,769</u>	<u>104</u>
(g) Capital reserve – staff share options issued		
At 1 st January	140	140
Transfer of the fair value of options to share premium	(6)	(6)
Forfeited options transferred to retained profits	(21)	(21)
Additions	22	22
At 31 st December	<u>135</u>	<u>135</u>
(h) Investment revaluation reserve		
At 1 st January	27	67
Changes in fair value of securities	1,121	635
Reversal upon disposal (Note 13)	(113)	(15)
Recognition of deferred tax liabilities (Note 36(b))	(120)	(99)
Impairment loss and amortisation	98	61
Exchange adjustments	(1)	3
At 31 st December	<u>1,012</u>	<u>652</u>
(i) Other reserves		
At 1 st January	60	-
Share of changes in equity of associates	4	-
At 31 st December	<u>64</u>	<u>-</u>
(j) Retained profits		
At 1 st January	10,768	3,520
Net profit for the year	6,056	2,997
Transfer to general reserve	(21)	-
Transfer (to)/from statutory reserve	(390)	2
Transfer to capital reserve	(48)	-
Forfeited options transferred to retained profits	21	21
Transfer to non-controlling interests	(47)	-
Dividends (Note 18)		
- Interim dividend	(903)	(903)
- Second interim dividend	(1,059)	(1,059)
- Hybrid Tier 1 USD500M	(331)	-
At 31 st December	<u>14,046</u>	<u>4,578</u>
(k) Total reserves	<u>51,585</u>	<u>35,900</u>

41. Reserves (continued)

	2011	
	The Group	The Bank
	HK\$ Mn	HK\$ Mn
(a) Share premium		
At 1 st January		
- As previously reported	9,331	9,331
- Reclassification from general reserve to share premium	2,181	2,181
- As restated	11,512	11,512
Net premium on shares issued under Staff Share Option Schemes	85	85
Transfer of the fair value of options from capital reserve – share options issued	24	24
Shares issued in lieu of dividends	416	416
At 31 st December	<u>12,037</u>	<u>12,037</u>
(b) General reserve		
At 1 st January		
- As previously reported	15,453	15,109
- Reclassification from general reserve to share premium	(2,181)	(2,181)
- As restated	13,272	12,928
Transfer from retained profits	24	-
Shares issued in lieu of dividends	441	441
Realised surplus on disposals transferred from property revaluation reserve	7	7
At 31 st December	<u>13,744</u>	<u>13,376</u>
(c) Revaluation reserve on bank premises		
At 1 st January	1,023	965
Recognition of deferred tax liabilities (Note 36(b))	3	1
Revaluation surplus on bank premises transferred to investment properties	16	12
Realised surplus on disposals transferred to general reserve	(7)	(7)
Exchange adjustments	(3)	-
At 31 st December	<u>1,032</u>	<u>971</u>
(d) Statutory reserves		
At 1 st January	1,990	7
Transfer from retained profits	70	(5)
Exchange adjustments	82	-
At 31 st December	<u>2,142</u>	<u>2</u>
(e) Capital reserve		
At 1 st January and 31 st December	<u>86</u>	<u>-</u>
(f) Exchange revaluation reserve		
At 1 st January	1,938	96
Exchange adjustments	452	(74)
At 31 st December	<u>2,390</u>	<u>22</u>

41. Reserves (continued)

	2011	
	The Group HK\$ Mn	The Bank HK\$ Mn
(g) Capital reserve – staff share options issued		
At 1 st January	165	165
Transfer of the fair value of options to share premium	(24)	(24)
Forfeited options transferred to retained profits	(21)	(21)
Additions	20	20
At 31 st December	<u>140</u>	<u>140</u>
(h) Investment revaluation reserve		
At 1 st January	258	141
Changes in fair value of securities	(326)	(123)
Reversal upon disposal (Note 13)	5	(5)
Recognition of deferred tax liabilities (Note 36(b))	35	54
Impairment loss and amortisation	55	-
At 31 st December	<u>27</u>	<u>67</u>
(i) Other reserves		
At 1 st January	53	-
Share of changes in equity of associates	7	-
At 31 st December	<u>60</u>	<u>-</u>
(j) Retained profits		
At 1 st January	8,841	3,550
Net profit for the year	4,358	1,974
Transfer to general reserve	(24)	-
Transfer to statutory reserve	(70)	5
Forfeited options transferred to retained profits	21	21
Dividends (Note 18)		
- Interim dividend	(885)	(885)
- Final dividend in respect of previous year	(1,145)	(1,145)
- Hybrid Tier 1 USD500M	(328)	-
At 31 st December	<u>10,768</u>	<u>3,520</u>
(k) Total reserves	<u>42,426</u>	<u>30,135</u>

41. Reserves (continued)

The application of the share premium account is governed by Section 48B of the Hong Kong Companies Ordinance.

General reserve was set up from the transfer of retained earnings and the realized revaluation surplus on disposal of properties.

Revaluation reserve on bank premises and exchange revaluation reserve have been set up and are dealt with in accordance with the accounting policies adopted for the revaluation of bank premises and foreign currency translation.

Statutory reserves are set up to supplement the paid-up capital until the sum of paid-up capital and the statutory reserves are equal to the registered capital for a branch, subsidiary and certain associates.

Capital reserve represents the capitalisation of subsidiaries' reserves.

Capital reserve - staff share options issued comprises the fair value of the actual or estimated number of unexercised share options granted to employees of the Bank recognised in accordance with the accounting policy adopted for share based payment in Note 2(q)(iv).

Investment revaluation reserve comprises the cumulative net change in the fair value of available-for-sale securities held until the securities are derecognised and is dealt with in accordance with the accounting policies in Notes 2(f) and (k).

Other reserves represent share of changes in equity of associates of investment revaluation reserve and revaluation reserve of bank premises.

A regulatory reserve is maintained to satisfy the provisions of the Hong Kong Banking Ordinance for prudential supervision purposes by earmarking amounts in respect of losses which the Bank will or may incur on loans and advances and investments in addition to impairment losses recognised. Movements in the reserve are earmarked directly through retained earnings and in consultation with the Hong Kong Monetary Authority. As at 31st December, 2012, HK\$4,580 million (2011: HK\$4,065 million) was included in the retained profits in this respect which was distributable to equity holders of the Group subject to consultation with the Hong Kong Monetary Authority.

At 31st December, 2012 the aggregate amount of reserves available for distribution to equity holders of the Bank was HK\$12,473 million (2011: HK\$11,427 million). After the end of the reporting period the directors declared a second interim dividend of HK\$0.63 per ordinary share (2011: HK\$0.51 per share), amounting to HK\$1,403 million (2011: HK\$1,059 million). The dividend has not been recognised as a liability at the end of the reporting period.

42. Non-controlling interests

	2012 HK\$ Mn	2011 HK\$ Mn
At 1 st January	4,428	4,400
- sale of interests in businesses to non-controlling interests investors	-	2
- final dividend in respect of previous year	(68)	(61)
- transfer from retained profits	47	-
- exchange adjustments	(19)	(6)
Profit for the year	98	93
At 31 st December	<u>4,486</u>	<u>4,428</u>

43. Financial Risk Management

This section presents information on the Group's management of principal risks.

The Group has in place a risk management system to identify, measure, monitor, control and report on the various types of risk that the Group faces and, where appropriate, to set strategy and allocate capital to cover those risks.

The risk mechanisms are built around a centralised framework and include the Risk Management Committee, specialised risk management committees and the Risk Management Division.

The Risk Management Committee comprises the Group's Chairman and Chief Executive, Senior Advisors, Deputy Chief Executives and the Group Chief Risk Officer.

The specialised risk management committees include Credit Committee, Asset and Liability Management Committee and Operational Risk Management Committee. These committees comprise the Group's Senior Advisors, Deputy Chief Executives, the Group Chief Risk Officer and where appropriate division heads from the relevant areas.

An independent centralised risk management unit, Risk Management Division, is responsible for monitoring the activities relating to the principal risks. The internal auditors also perform regular audits on business units to check compliance with policies and procedures.

In particular, the Risk Management Committee regularly reviews the Bank's risk appetite statement, risk management policies, and risk control limits and submits them to the Board of Directors for approval.

The risk appetite statement covers the major risks faced by the Group including credit risk, market risk, interest rate risk, liquidity risk, operational risk, legal risk, reputation risk and strategic risk. The related risk levels, where appropriate, are laid down in the risk management policies.

Each new product launch has to go through an evaluation process including business and financial analysis and risk assessment. Approval on launching such new products will be obtained from the New Product Development Working Group chaired by the Bank's Group Chief Risk Officer, with other members being heads of support and control units.

(a) Credit risk management

Credit risk arises from the possibility that a customer or counterparty in a transaction may default. Such risk may arise from counterparty risks from loans and advances, issuer risks from the securities business and counterparty risks from trading activities.

The Board of Directors has delegated authority to the Credit Committee to oversee management of the Group's credit risk, independent of the business units. The Credit Committee reports to the Board of Directors via the Risk Management Committee, which deals with all risk management related issues of the Group. Credit risk control limits are set at different levels and dimensions. The Board of Directors approves the core control limits and delegates the Credit Committee to approve the detailed control limits. Risk, return and market situations are considered when setting all limits. Active limit monitoring process is undertaken.

The Credit Committee is responsible for all credit risk related issues of the Group. The Group identifies and manages credit risk through defining target market segment, formulation of credit policies, credit assessment process and monitoring of asset quality.

In evaluating the credit risk associated with an individual customer or counterparty, financial strength and repayment ability are always the primary considerations. Credit risk may be mitigated by obtaining collateral from the customer or counterparty.

The Group has established policies, procedures and rating systems to identify, measure, monitor, control and report on credit risk. In this connection, guidelines for management of credit risk have been laid down in the Group's Credit Risk Management Manual. These guidelines stipulate delegated lending authorities, credit extension criteria, credit monitoring process, internal rating structure, credit recovery and provisioning policy. They are reviewed and enhanced on an on-going basis to cater for the market change, statutory requirement and best practice risk management processes.

43. Financial Risk and Management (continued)

(a) Credit risk management (continued)

Stress tests on the Group's credit risk are conducted regularly. The results are reviewed by the Credit Committee and reported to the Risk Management Committee and to the Board of Directors regularly. If necessary, remedial actions will be taken.

The Credit Risk Management Department under the Risk Management Division of the Group is responsible for monitoring activities relating to credit risk.

The Group's credit risk management for the major types of credit risk is depicted as follows:

(i) Corporate and bank credit risk

The Group has laid down policies and procedures to evaluate the potential credit risk of a particular counterparty or transaction and to approve the transaction. For corporate and bank customers, the Group has different internal rating systems that are applied to each counterparty. For exposure classified as Specialised Lending in particular, supervisory slotting criteria are used. To monitor concentration risk, the Group has preset limits for exposures to individual industries and for borrowers and groups of borrowers. The Group also has a review process to ensure that the level of review and approval is proper and will depend on the size of the facility and rating of the credit.

The Group undertakes on-going credit analysis and monitoring at several levels. The policies are designed to promote early detection of counterparty, industry or product exposures that require special monitoring. The overall portfolio risk as well as individual impaired loans and potential impaired loans are monitored on a regular basis.

(ii) Retail credit risk

The Group's retail credit policy and approval process are designed for the fact that there are high volumes of relatively homogeneous and small value transactions in each retail loan category. The design of internal rating system and formulation of credit policies are primarily based on the demographic factors and the loss experience of the loan portfolios. The Group monitors its own and industry experience to determine and periodically revise product terms and desired customer profiles.

(iii) Credit for treasury transactions

The credit risk of the Group's treasury transactions is managed in the same way as the Group manages its corporate and bank lending risk. The Group applies an internal rating system to its counterparties and sets individual counterparty limits.

(iv) Credit-related commitment

The risks involved in credit-related commitments and contingencies are essentially the same as the credit risk involved in extending loan facilities to customers. These transactions are subject to the same credit application, portfolio maintenance and collateral requirements as for customers applying for loans.

(v) Concentrations of credit risk

Concentration of credit risk exists when changes in geographic, economic or industry factors similarly affect groups of counterparties whose aggregate credit exposure is material in relation to the Group's total exposures. The Group's credit portfolio is diversified along geographic, industry and product sectors.

The Group monitors its concentration risk by adopting appropriate risk control measures, such as setting limits on exposures to different industries and loan portfolios.

43. Financial Risk Management (continued)

(a) Credit risk management (continued)

(vi) Maximum exposure

The maximum exposure to credit risk at the end of the reporting period without taking into consideration of any collateral held or other credit enhancements is represented by the carrying amount of each financial assets in the statement of financial position after deducting any impairment allowance. A summary of the maximum exposure is as follows:

	The Group		The Bank	
	2012	2011	2012	2011
		Restated		
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Cash and balances with banks, central banks and other financial institutions	84,092	69,933	18,846	21,333
Placements with banks, central banks and other financial institutions	50,618	58,598	19,335	33,370
Trade bills	55,740	46,891	47,931	35,876
Trading assets	6,182	4,532	2,837	3,091
Financial assets designated at fair value through profit or loss	14,751	16,330	14,751	16,330
Loans and advances to customers	349,801	314,313	220,970	197,258
Available-for-sale financial assets	62,333	42,897	43,812	27,667
Held-to-maturity investments	4,320	4,587	3,219	2,880
Other assets	36,502	25,979	6,518	5,538
Financial guarantees and other credit related contingent liabilities	17,597	13,936	7,239	9,017
Loan commitments and other credit related commitments	192,183	134,545	74,479	59,489
	<u>874,119</u>	<u>732,541</u>	<u>459,937</u>	<u>411,849</u>

(vii) Credit quality of loans and advances

Loans and advances to banks are only made to banks with good credit standing. The credit quality of loans and advances to customers can be analysed as follows:

	The Group		The Bank	
	2012	2011	2012	2011
		Restated		
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Gross loans and advances to customers				
- neither past due nor impaired	349,294	313,645	220,696	196,675
- past due but not impaired	288	161	99	114
- impaired	1,138	1,475	777	1,134
	<u>350,720</u>	<u>315,281</u>	<u>221,572</u>	<u>197,923</u>

Of which:

	The Group		The Bank	
	2012	2011	2012	2011
		Restated		
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Gross loans and advances to customers that are neither past due nor impaired				
- pass	348,019	311,890	219,706	195,622
- special mention	1,275	1,755	990	1,053
	<u>349,294</u>	<u>313,645</u>	<u>220,696</u>	<u>196,675</u>

43. Financial Risk Management (continued)

(a) Credit risk management (continued)

(vii) Credit quality of loans and advances (continued)

The Group classifies the loans and advances in accordance with the loan classification system required to be adopted for reporting to the Hong Kong Monetary Authority.

The ageing analysis of loans and advances to customers that are past due but not impaired is as follows:

	The Group		The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn	2012 HK\$ Mn	2011 HK\$ Mn
Gross loans and advances to customers that are past due but not impaired				
- overdue 3 months or less	<u>288</u>	<u>161</u>	<u>99</u>	<u>114</u>

Loans and advances that would be past due or impaired had the terms not been renegotiated amounted to HK\$91 million as at 31st December, 2012 (2011: HK\$392 million).

(viii) Credit quality of financial assets other than loans and advances

Credit risk of treasury transactions is managed in the same way as the Group manages its corporate and bank lending risk and risk gradings are applied to the counterparties with individual counterparty limits set.

At the end of the reporting period, the credit quality of investment in debt securities analysed by designation of external credit assessment institution, Moody's Investor Services, or equivalent, is as follows:

	The Group		The Bank	
	2012 HK\$ Mn	2011 Restated HK\$ Mn	2012 HK\$ Mn	2011 Restated HK\$ Mn
Aaa	15,637	12,632	10,243	7,636
Aa1 to Aa3	35,387	30,202	26,816	22,183
A1 to A3	13,711	11,963	11,234	10,011
P-1 (Short term)	1,280	572	-	572
Baa1 to Baa3	9,371	6,348	5,306	3,867
Below Baa3	<u>2,395</u>	<u>258</u>	<u>2,089</u>	<u>167</u>
(NB)	77,781	61,975	55,688	44,436
Unrated	<u>6,758</u>	<u>3,195</u>	<u>6,741</u>	<u>3,195</u>
Total	<u>84,539</u>	<u>65,170</u>	<u>62,429</u>	<u>47,631</u>

NB As at 31st December 2012, the Group has debt securities of HK\$7,710 million with investment grade assigned by PRC local rating agencies (2011: HK\$6,683 million).

43. Financial Risk Management (continued)**(ix) Collateral and other credit enhancements**

The Group has established guidelines on the acceptability of various classes of collateral and determined the corresponding valuation parameters. The guidelines and collateral valuation parameters are subject to regular reviews to ensure their effectiveness over credit risk management.

The extent of collateral coverage over the Group's loans and advances to customer depends on the type of customers and the product offered. Types of collateral include residential properties (in the form of mortgages over property), other properties, other registered securities over assets, cash deposits, standby letters of credit and guarantees. Collateral generally is not held over balances and placements with banks and other financial institutions, and loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity. The Group takes possession of collateral through court proceedings or voluntary delivery of possession by the borrowers during the course of the recovery of impaired loans and advances. These repossessed assets are reported in the statement of financial position within "other assets" (Note 2(m)). If the recovery from the repossessed assets exceeds the corresponding exposure, the surplus fund is made available either to repay the borrower's other secured loans with lower priority or is returned to the borrower.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured with the exception of asset-based securities and similar instruments, which are secured by pools of financial assets. However the credit risk may be implicit in the terms or reflected in the fair value of the corresponding instruments.

The Group's preferred agreement for documenting derivatives activity is the ISDA Master Agreement which covers the contractual framework within which dealing activity across a full range of over-the-counter products is conducted and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement, if either party defaults or following other pre-agreed termination events. It is also common for the Group to execute a Credit Support Annex in conjunction with the ISDA Master Agreement with the counterparty under which collateral is passed between the parties to mitigate the market contingent counterparty risk inherent in the outstanding position.

For contingent liabilities and commitments that are unconditionally cancellable (Note 45), the Group will assess the necessity to withdraw the credit line when there is a concern over the credit quality of the customers. Accordingly, the exposure to significant credit risk is considered as minimal. For commitments that are not unconditionally cancellable, the Group assesses the necessity of collateral depending on the type of customer and the product offered.

The lower of gross loan amount and the estimate of the fair value of collateral and other credit enhancements held against financial assets is as follows:

	The Group		The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn	2012 HK\$ Mn	2011 HK\$ Mn
Fair value of collateral and other credit enhancements held against financial assets that are:				
- neither past due nor impaired	251,750	233,040	150,244	134,323
- past due but not impaired	287	157	98	111
	<u>252,037</u>	<u>233,197</u>	<u>150,342</u>	<u>134,434</u>

43. Financial Risk Management (continued)**(b) Market risk management**

Market risk arises from all market risk sensitive financial instruments, including debt securities, foreign exchange contracts, equity and derivative instruments, as well as from statement of financial position or structural positions. The aim in managing market risk is to reduce the Group's exposure to the volatility inherent in financial instruments.

Management of the Group's market risk is governed by the market risk management policies which are approved by the Board of Directors or the Asset and Liability Management Committee. The Board of Directors has delegated the responsibility for day-to-day market risk management to the Asset and Liability Management Committee. The Asset and Liability Management Committee reports to the Board of Directors via the Risk Management Committee. The Asset and Liability Management Department under the Risk Management Division of the Group is responsible for monitoring activities relating to market risk.

The Asset and Liability Management Committee deals with all market risk and liquidity risk related issues of the Group. It is also responsible for conducting a regular review of interest rates trend and deciding the corresponding future business strategy.

The use of derivatives for proprietary trading and their sale to customers as risk management products is an integral part of the Group's business activities. These instruments are also used to manage the Group's own exposures to market risk, as part of its asset and liability management process. The principal derivatives instruments used by the Group are interest rate, foreign exchange and equity related contracts, in the form of both over-the-counter derivatives and exchange traded derivatives. Most of the Group's derivatives positions have been entered into to meet customer demand and to manage the risk of these and other trading positions.

In this connection, the key types of risk to manage are:

(i) Currency risk

The Group's foreign currency positions arise from foreign exchange dealing, commercial banking operations and structural foreign currency exposures. The Group's non-structural foreign currency exposures are dominated in USD and for other currencies, their currency concentrations are below 10% of the total net position in all non-structural foreign currencies of the Group. All foreign currency positions are managed within limits approved by the Board.

Structural foreign currency positions, which arise mainly from foreign currency investments in the Group's branches, subsidiaries and associated companies, are excluded from value-at-risk ("VaR") measurements, as related gains or losses are taken to reserves. Such foreign currency positions are managed with the principal objective of ensuring that the Group's reserves are protected from exchange rate fluctuations. The Group seeks to match closely its foreign currency denominated assets with corresponding liabilities in the same currencies.

The Group had the following net structural positions which were not less than 10% of the total net structural foreign currency position at the end of the reporting period:

	The Group and The Bank			
	2012		2011	
	USD	RMB	USD	RMB
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Net structural position	2,488	8,703	2,573	8,631

43. Financial Risk Management (continued)

(b) Market risk management (continued)

(ii) Interest rate risk

The Group's interest rate positions arise from treasury and commercial banking activities. Interest rate risk arises in both trading portfolios and non-trading portfolios. Interest rate risk primarily results from the timing differences in the repricing of interest-bearing assets, liabilities and commitments. It also relates to positions from non-interest bearing liabilities including shareholders' funds and current accounts, as well as from certain fixed-rate loans and liabilities. Interest rate risk is managed daily by the Treasury Markets Division within the limits approved by the Board of Directors or the Asset and Liability Management Committee. The instruments used to manage interest rate risk include interest rate swaps and other derivatives.

(iii) Equity risk

The Group's equity positions arise from equity investment and dynamic hedging of customer-driven business. Equity risk is managed daily by the Investment Department within the limits approved by the Board of Directors or the Asset and Liability Management Committee.

Market risk control limits have been set at varying levels according to the practical requirements of different units. The Board of Directors approves the core control limits and has delegated the authority to set detailed control limits to the Asset and Liability Management Committee. Risk, return and market conditions are considered when setting limits. Active limit monitoring is carried out.

In this connection, the Asset and Liability Management Committee monitors the related market risk arising from risk-taking activities of the Group, to ensure that overall and individual market risks are within the Group's risk tolerance level. Risk exposures are monitored on a frequent basis to ensure that they are within established control limits.

Stress tests on the Group's market risk are conducted regularly. The results are reviewed by the Asset and Liability Management Committee and reported to the Risk Management Committee and to the Board of Directors regularly. If necessary, remedial actions will be taken.

The Group quantifies the market risk of the underlying trading portfolio by means of VaR. VaR is a statistical estimate that measures the potential losses in market value of a portfolio as a result of unfavourable movements in market rates and prices, if positions are held unchanged over a certain horizon time period.

The Group estimates VaR for the Group's trading portfolio by the Parametric Approach, where the VaR is derived from the underlying variances and covariances of the constituents of a portfolio. This methodology uses historical movements in market rates and prices, a 99% confidence level, a one-day holding period, a one-year historical observation period with higher weights being assigned to more recent observations, and takes into account correlations between different markets and rates.

Structural foreign exchange positions arising from net investments in branches and subsidiaries are not included in the VaR for the foreign exchange trading position.

The book value of listed shares, as well as the book value of private equity funds and unlisted equities (excluding credit-related unlisted securities) (collectively the "Unlisted Securities"), are subject to limits and these are monitored by the management of the Group. The Unlisted Securities and listed non-trading equities are not included in the VaR for the equity trading position, and are managed through delegated limits. The limits are subject to regular review by the Board.

43. Financial Risk Management (continued)

(b) Market risk management (continued)

Value-at-risk statistics

	2012			
	At 31 st December	Maximum	Minimum	Mean
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
VaR for total trading activities	16	38	16	26
VaR for foreign exchange trading positions *	4	8	3	5
VaR for interest rate trading positions	1	5	1	3
VaR for equity trading positions	12	32	12	21

	2011			
	At 31 st December	Maximum	Minimum	Mean
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
VaR for total trading activities	40	75	28	46
VaR for foreign exchange trading positions *	13	13	1	4
VaR for interest rate trading positions	2	8	2	4
VaR for equity trading positions	31	70	25	41

* Including all foreign exchange positions but excluding structured foreign exchange positions.

	2012			
	At 31 st December	Maximum	Minimum	Mean
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Stressed VaR for total trading activities	68	106	65	80

A Stressed VaR measure is intended to replicate a VaR calculation that would be generated on current market risk portfolio if the relevant market factors were experiencing a period of stress.

43. Financial Risk Management (continued)

(c) Operational risk management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

The objective of operational risk management is to identify, assess, monitor and report on operational risk and to comply with the relevant regulatory requirements.

The Group has implemented a centralised operational risk management framework. All units are required to manage operational risk within the operational risk management policies which are approved by the Board of Directors or the Operational Risk Management Committee. The Board of Directors has delegated the responsibility for day-to-day operational risk management to the Operational Risk Management Committee. The Operational Risk Management Committee regularly reports the status of operational risk management to the Board of Directors via the Risk Management Committee. The Operational Risk Management Department under the Risk Management Division of the Group is responsible for monitoring activities relating to operational risk.

Operational risk management tools adopted include operational risk incidents reporting, control self-assessment, key risk indicators, operation manuals, insurance policies, business continuity planning, etc.

Moreover, stress tests on the Group's operational risk are conducted regularly. The results are reviewed by the Operational Risk Management Committee and reported to the Risk Management Committee and to the Board of Directors regularly. If necessary, remedial actions are taken.

Furthermore, the Operational Risk Management Department under the Risk Management Division of the Group has also performed self-assessment on the Group's compliance with the requirements of HKMA Supervisory Policy Manual on Operational Risk Management, with satisfactory result which had been reviewed independently by Internal Audit Department.

(d) Liquidity risk management

Liquidity pertains to the Group's ability to meet obligations as they fall due. Funding liquidity relates to the ability to meet both expected and unexpected, current and future cash flow and collateral needs without affecting daily operations or the financial position. Market liquidity concerns the ability to offset or eliminate a position at market price because of inadequate market depth or market disruption.

The purpose of liquidity risk management is to ensure sufficient cash flows to meet all financial commitments and to capitalise on opportunities for business expansion. This includes the Group's ability to meet deposit withdrawals either on demand or at contractual maturity, to repay borrowings as they mature, to comply with the statutory liquidity ratio, and to make new loans and investments as opportunities arise.

The management of the Group's liquidity risk is governed by the liquidity risk management policies and principle as approved by the Board of Directors or the Asset and Liability Management Committee. The Asset and Liability Management Committee is delegated by the Board of Directors to oversee the Group's liquidity risk management. The Asset and Liability Management Committee sets the strategy, policy and limits for managing liquidity risk and the means for ensuring that such strategy and policy are implemented. Regular meeting is held to review the compliance status of the monitoring matrix established and the needs of change in strategy and policy. Liquidity is managed daily by the Capital Markets & Liquidity Management Department under the Treasury Markets Division within the limits. The Asset and Liability Management Department under the Risk Management Division of the Group is responsible for monitoring the activities relating to liquidity risk. The Internal Audit Department performs periodic reviews to make sure the liquidity risk management functions are carried out effectively.

43. Financial Risk Management (continued)

(d) Liquidity risk management (continued)

Our strong retail customer base forms a significant portion of our funding and we strive to maintain its stability. It constitutes a broad spectrum of depositors with whom we have maintained in-depth relationship. Funding diversification is achieved by issuance of certificates of deposit, medium term notes and subordinated debts. Professional markets are accessed for the purposes of providing additional funding, maintaining a presence in local money markets and optimising asset and liability maturities. □

Internally, intra-group funding transactions are transacted at arm's length and treated in a manner in line with other third party transactions, with regular monitoring and appropriate control.

In addition to observing the statutory liquidity ratio, the Group has established different liquidity metrics, including but not limited to the liquidity ratio, loan-to-deposit ratio, cumulative mismatch ratio, funding concentration ratios, intra-group exposure threshold and cross currency funding ratio to measure and analyse our liquidity risks. As a majority of our liquidity risk arises from the maturity mismatch gap between the Group's asset and liability portfolios, the Group manages liquidity risk by conducting cash flow analysis and cash flow projection arising from on- and off- balance sheet assets and items over a set of time horizons on a regular basis to identify funding needs in specific time bucket. We also hold sufficient liquid assets (e.g. cash, short term funds and securities) of appropriate quality to ensure that short term funding requirements are covered within prudent limits. Contingent funding sources are maintained to provide strategic liquidity to meet unexpected and material cash outflows.

The Group also conducts stress testing regularly to analyse liquidity risk. In our stress test, both on- and off-balance sheet items with cash flow impact are considered, with applicable hypothetical as well as historical assumptions. Both funding and market liquidity risks are addressed. Three stress scenarios, namely the institution-specific crisis, the general market crisis and the combined crisis are adopted with minimum survival period defined according to Hong Kong Monetary Authority's latest Supervisory Policy Manual "Sound Systems and Controls for Liquidity Risk Management".

With reference to the stress-testing results, the Group identifies potential vulnerabilities within the Group, and formulates a Contingency Funding Plan that describes our strategy for dealing with any liquidity problem and the procedures for making up cash flow deficits in emergency situations.

The Contingency Funding Plan is designed to be pro-active and pre-emptive, and stipulates the following 3 stages:

In the first stage, the Group utilises early warning indicators, which cover both qualitative and quantitative measures, monitoring both internal and external factors. Should there be any early signs of significant impact on the Group's liquidity position the management would be informed for their consideration.

In the second stage, Crisis Management Committee, which is chaired by Senior Management, is formed to handle the crisis. Strategy and procedures in obtaining contingency funding, as well as roles and responsibilities of parties concerned are clearly stated.

In the final stage, review on the issues and necessary improvement would be made to avoid future incidents of nature.

Annual drill test would be conducted and the Contingency Funding Plan would be subject to regular review in order to cope with the change of business environment. Any significant changes to the Contingency Funding Plan would be approved by the Board.

43. Financial Risk Management (continued)

(d) Liquidity risk management (continued)

Analysis of assets and liabilities by remaining maturity:

The Group	2012							Total HK\$ Mn
	Repayable on demand HK\$ Mn	Within 1 month HK\$ Mn	3 months or less but over 1 month HK\$ Mn	1 year or less but over 3 months HK\$ Mn	5 years or less but over 1 year HK\$ Mn	Over 5 years HK\$ Mn	Undated or overdue HK\$ Mn	
Assets								
Cash and balances with banks and other financial institutions	55,308	46	70	91	-	-	29,997	85,512
Placements with banks and other financial institutions	-	25,409	5,581	19,628	-	-	-	50,618
Trade bills	5	7,758	9,295	38,673	-	-	9	55,740
Trading assets	-	72	400	1,327	1,165	93	4,281	7,338
Financial assets designated at fair value through profit or loss	-	-	129	1,447	10,804	2,371	418	15,169
Advances to customers and other accounts	5,791	46,793	33,877	84,085	132,032	77,479	7,216	387,273
Available-for-sale financial assets	-	14,589	7,500	5,907	29,307	5,030	2,398	64,731
Held-to-maturity investments	107	1,102	201	985	1,879	46	-	4,320
Undated assets	-	-	-	-	-	-	21,413	21,413
Total assets	61,211	95,769	57,053	152,143	175,187	85,019	65,732	692,114
Liabilities								
Deposits and balances of banks and other financial institutions	1,128	19,221	4,306	5,801	141	-	-	30,597
Deposits from customers	157,048	144,532	84,329	98,893	13,968	-	-	498,770
- Demand deposits and current accounts	68,950	-	-	-	-	-	-	68,950
- Savings deposit	86,549	-	-	-	-	-	-	86,549
- Time, call and notice deposits	1,549	144,532	84,329	98,893	13,968	-	-	343,271
Trading liabilities	-	-	-	-	-	-	3,827	3,827
Certificates of deposit issued	-	3,122	3,548	14,907	5,793	-	-	27,370
Current taxation	-	-	-	988	-	-	-	988
Debt securities issued	-	-	3,146	4,152	1,359	-	-	8,657
Loan capital	-	-	-	-	9,124	5,139	-	14,263
Other liabilities	1,090	6,373	11,122	12,347	5,150	2,174	7,747	46,003
Total liabilities	159,266	173,248	106,451	137,088	35,535	7,313	11,574	630,475
Net gap	(98,055)	(77,479)	(49,398)	15,055	139,652	77,706		

The Group	2011 (Restated)							Total HK\$ Mn
	Repayable on demand HK\$ Mn	Within 1 month HK\$ Mn	3 months or less but over 1 month HK\$ Mn	1 year or less but over 3 months HK\$ Mn	5 years or less but over 1 year HK\$ Mn	Over 5 years HK\$ Mn	Undated or overdue HK\$ Mn	
Assets								
Cash and balances with banks and other financial institutions	40,392	210	43	125	-	-	30,991	71,761
Placements with banks and other financial institutions	1,027	16,930	12,721	27,920	-	-	-	58,598
Trade bills	55	6,958	16,292	23,581	-	-	5	46,891
Trading assets	-	-	-	572	683	62	4,283	5,600
Financial assets designated at fair value through profit or loss	-	-	648	826	12,119	2,737	333	16,663
Advances to customers and other accounts	5,465	32,874	32,848	74,190	117,734	73,070	5,160	341,341
Available-for-sale financial assets	107	3,382	7,990	7,950	20,149	3,319	2,013	44,910
Held-to-maturity investments	-	1,088	339	1,307	1,622	231	-	4,587
Undated assets	-	-	-	-	-	-	21,051	21,051
Total assets	47,046	61,442	70,881	136,471	152,307	79,419	63,836	611,402
Liabilities								
Deposits and balances of banks and other financial institutions	711	4,688	1,425	8,485	423	-	191	15,923
Deposits from customers	135,783	137,548	101,956	76,692	15,375	-	-	467,354
- Demand deposits and current accounts	56,896	-	-	-	-	-	-	56,896
- Savings deposit	77,452	-	-	-	-	-	-	77,452
- Time, call and notice deposits	1,435	137,548	101,956	76,692	15,375	-	-	333,006
Trading liabilities	-	-	-	-	-	-	4,548	4,548
Certificates of deposit issued	-	1,110	1,658	5,386	3,329	-	-	11,483
Current taxation	-	-	-	473	-	-	-	473
Debt securities issued	-	-	-	241	6,152	-	-	6,393
Loan capital	-	-	3,178	4,659	-	8,904	-	16,741
Other liabilities	1,926	4,775	7,036	9,820	312	1	12,573	36,443
Total liabilities	138,420	148,121	115,253	105,756	25,591	8,905	17,312	559,358
Net gap	(91,374)	(86,679)	(44,372)	30,715	126,716	70,514		

43. Financial Risk Management (continued)

(d) Liquidity risk management (continued)

The Bank

	2012							Total HK\$ Mn
	Repayable on demand HK\$ Mn	Within 1 month HK\$ Mn	3 months or less but over 1 month HK\$ Mn	1 year or less but over 3 months HK\$ Mn	5 years or less but over 1 year HK\$ Mn	Over 5 years HK\$ Mn	Undated or overdue HK\$ Mn	
Assets								
Cash and balances with banks and other financial institutions	19,307	-	-	-	-	-	449	19,756
Placements with banks and other financial institutions	-	12,698	3,559	3,078	-	-	-	19,335
Trade bills	-	4,564	6,639	36,728	-	-	-	47,931
Trading assets	-	10	51	73	417	19	3,423	3,993
Financial assets designated at fair value through profit or loss	-	-	129	1,447	10,804	2,371	119	14,870
Advances to customers and other accounts	4,986	37,962	15,304	37,537	83,084	44,380	4,973	228,226
Available-for-sale financial assets	-	14,402	6,876	3,673	17,010	1,851	1,204	45,016
Held-to-maturity investments	107	1,058	171	747	1,136	-	-	3,219
Undated assets	-	-	-	-	-	-	40,515	40,515
Total assets	24,400	70,694	32,729	83,283	112,451	48,621	50,683	422,861
Liabilities								
Deposits and balances of banks and other financial institutions	1,123	2,259	3,645	3,580	-	-	-	10,607
Deposits from customers	107,181	117,138	46,963	34,804	567	-	-	306,653
- Demand deposits and current accounts	21,690	-	-	-	-	-	-	21,690
- Savings deposit	85,279	-	-	-	-	-	-	85,279
- Time, call and notice deposits	212	117,138	46,963	34,804	567	-	-	199,684
Trading liabilities	-	-	-	-	-	-	3,080	3,080
Certificates of deposit issued	-	3,122	3,548	14,907	5,793	2,200	-	29,570
Current taxation	-	-	-	872	-	-	-	872
Debt securities issued	-	-	661	423	116	-	-	1,200
Loan capital	-	-	-	-	9,124	9,549	-	18,673
Other liabilities	8	1,478	281	201	10	-	8,760	10,738
Total liabilities	108,312	123,997	55,098	54,787	15,610	11,749	11,840	381,393
Net gap	(83,912)	(53,303)	(22,369)	28,496	96,841	36,872		

The Bank

	2011							Total HK\$ Mn
	Repayable on demand HK\$ Mn	Within 1 month HK\$ Mn	3 months or less but over 1 month HK\$ Mn	1 year or less but over 3 months HK\$ Mn	5 years or less but over 1 year HK\$ Mn	Over 5 years HK\$ Mn	Undated or overdue HK\$ Mn	
Assets								
Cash and balances with banks and other financial institutions	20,758	172	-	-	-	-	1,640	22,570
Placements with banks and other financial institutions	1,027	12,576	9,790	9,977	-	-	-	33,370
Trade bills	55	9,006	10,506	16,304	-	-	5	35,876
Trading assets	-	-	-	31	622	62	3,444	4,159
Financial assets designated at fair value through profit or loss	-	-	648	826	12,119	2,737	123	16,453
Advances to customers and other accounts	4,747	25,888	18,890	33,869	71,368	43,778	5,053	203,593
Available-for-sale financial assets	107	3,345	7,721	6,069	9,321	1,104	962	28,629
Held-to-maturity investments	-	917	219	1,164	580	-	-	2,880
Undated assets	-	-	-	-	-	-	36,209	36,209
Total assets	26,694	51,904	47,774	68,240	94,010	47,681	47,436	383,739
Liabilities								
Deposits and balances of banks and other financial institutions	696	4,150	1,201	3,826	-	-	191	10,064
Deposits from customers	89,884	109,183	64,900	24,736	1,742	-	-	290,445
- Demand deposits and current accounts	15,844	-	-	-	-	-	-	15,844
- Savings deposit	73,317	-	-	-	-	-	-	73,317
- Time, call and notice deposits	723	109,183	64,900	24,736	1,742	-	-	201,284
Trading liabilities	-	-	-	-	-	-	3,827	3,827
Certificates of deposit issued	-	1,110	1,658	5,386	3,329	2,200	-	13,683
Current taxation	-	-	-	297	-	-	-	297
Debt securities issued	-	-	-	241	-	-	-	241
Loan capital	-	-	3,178	4,659	-	12,929	-	20,766
Other liabilities	8	1,072	308	136	22	-	7,545	9,091
Total liabilities	90,588	115,515	71,245	39,281	5,093	15,129	11,563	348,414
Net gap	(63,894)	(63,611)	(23,471)	28,959	88,917	32,552		

As the trading and available-for-sale portfolios may be sold before maturity or deposits from customers may mature without being withdrawn, the contractual maturity dates do not represent expected dates of future cash flows.

43. Financial Risk Management (continued)

(d) Liquidity risk management (continued)

The following tables provide an analysis of the undiscounted cashflow projection of the financial liabilities of the Group at the end of the reporting period based on the dates of their contractual payment obligations:

The Group	2012							
	Carrying amount HK\$ Mn	Gross cash outflow HK\$ Mn	Repayable on demand HK\$ Mn	Less than three months HK\$ Mn	Between three months and one year HK\$ Mn	Between one and five years HK\$ Mn	More than five years HK\$ Mn	Undated HK\$ Mn
Deposits and balances of banks and other financial institutions	30,597	30,626	1,128	23,540	5,817	141	-	-
Deposits from customers	498,770	504,752	157,739	230,245	101,448	15,320	-	-
- Demand deposits and current accounts	68,950	69,620	69,620	-	-	-	-	-
- Savings deposit	86,549	86,550	86,550	-	-	-	-	-
- Time, call and notice deposits	343,271	348,582	1,569	230,245	101,448	15,320	-	-
Trading liabilities	3,827	3,827	-	-	-	-	-	3,827
Certificates of deposit issued	27,370	27,896	-	6,741	15,196	5,959	-	-
Current taxation	988	988	-	-	988	-	-	-
Debt securities issued	8,657	8,966	-	3,184	4,355	1,427	-	-
Loan capital	14,263	18,847	-	249	497	12,108	5,993	-
Interest rate swaps	6,605	6,605	-	540	1,036	4,435	594	-
Other liabilities	46,003	46,003	1,090	17,495	12,347	5,150	2,174	7,747
Total	637,080	648,510	159,957	281,994	141,684	44,540	8,761	11,574

The Group	2011							
	Carrying amount HK\$ Mn	Gross cash outflow HK\$ Mn	Repayable on demand HK\$ Mn	Less than three months HK\$ Mn	Between three months and one year HK\$ Mn	Between one and five years HK\$ Mn	More than five years HK\$ Mn	Undated HK\$ Mn
Deposits and balances of banks and other financial institutions	15,923	15,957	711	6,133	8,496	426	-	191
Deposits from customers	467,354	470,311	135,853	240,178	77,864	16,416	-	-
- Demand deposits and current accounts	56,896	56,934	56,934	-	-	-	-	-
- Savings deposit	77,452	77,453	77,453	-	-	-	-	-
- Time, call and notice deposits	333,006	335,924	1,466	240,178	77,864	16,416	-	-
Trading liabilities	4,548	4,548	-	-	-	-	-	4,548
Certificates of deposit issued	11,483	11,743	-	2,812	5,453	3,478	-	-
Current taxation	473	473	-	-	473	-	-	-
Debt securities issued	6,393	6,861	-	25	398	6,438	-	-
Loan capital	16,741	23,435	-	3,431	5,392	3,452	11,160	-
Interest rate swaps	4,817	4,817	-	423	789	2,673	932	-
Other liabilities	36,443	36,443	1,926	11,811	9,820	312	1	12,573
Total	564,175	574,588	138,490	264,813	108,685	33,195	12,093	17,312

43. Financial Risk Management (continued)

(d) Liquidity risk management (continued)

The Bank

2012

	Carrying amount HK\$ Mn	Gross cash outflow HK\$ Mn	Repayable on demand HK\$ Mn	Less than three months HK\$ Mn	Between three months and one year HK\$ Mn	Between one and five years HK\$ Mn	More than five years HK\$ Mn	Undated HK\$ Mn
Deposits and balances of banks and other financial institutions	10,607	10,629	1,123	5,910	3,596	-	-	-
Deposits from customers	306,653	307,147	107,183	164,283	35,102	579	-	-
- Demand deposits and current accounts	21,690	21,692	21,692	-	-	-	-	-
- Savings deposit	85,279	85,279	85,279	-	-	-	-	-
- Time, call and notice deposits	199,684	200,176	212	164,283	35,102	579	-	-
Trading liabilities	3,080	3,080	-	-	-	-	-	3,080
Certificates of deposit issued	29,570	30,096	-	6,741	15,196	5,959	2,200	-
Current taxation	872	872	-	-	872	-	-	-
Debt securities issued	1,200	1,220	-	675	429	116	-	-
Loan capital	18,673	25,563	-	249	826	13,426	11,062	-
Interest rate swaps	6,466	6,466	-	411	1,026	4,435	594	-
Other liabilities	10,738	10,858	8	1,768	219	103	-	8,760
Total	387,859	395,931	108,314	180,037	57,266	24,618	13,856	11,840

The Bank

2011

	Carrying amount HK\$ Mn	Gross cash outflow HK\$ Mn	Repayable on demand HK\$ Mn	Less than three months HK\$ Mn	Between three months and one year HK\$ Mn	Between one and five years HK\$ Mn	More than five years HK\$ Mn	Undated HK\$ Mn
Deposits and balances of banks and other financial institutions	10,064	10,075	696	5,359	3,829	-	-	191
Deposits from customers	290,445	290,985	89,885	174,379	24,951	1,770	-	-
- Demand deposits and current accounts	15,844	15,845	15,845	-	-	-	-	-
- Savings deposit	73,317	73,317	73,317	-	-	-	-	-
- Time, call and notice deposits	201,284	201,823	723	174,379	24,951	1,770	-	-
Trading liabilities	3,827	3,827	-	-	-	-	-	3,827
Certificates of deposit issued	13,683	13,943	-	2,812	5,453	3,478	2,200	-
Current taxation	297	297	-	-	297	-	-	-
Debt securities issued	241	243	-	1	242	-	-	-
Loan capital	20,766	27,460	-	3,431	5,392	3,452	15,185	-
Interest rate swaps	4,368	4,368	-	305	627	2,514	922	-
Other liabilities	9,091	9,110	8	1,381	137	39	-	7,545
Total	352,782	360,308	90,589	187,668	40,928	11,253	18,307	11,563

43. Financial Risk Management (continued)

(e) Interest rate risk management

The management of the Group's interest rate risk is governed by the interest rate risk management policies which are approved by the Board of Directors or the Asset and Liability Management Committee. The Asset and Liability Management Committee is delegated by the Board of Directors to oversee the Group's interest rate risk management, set the strategy and policy for managing interest rate risk and the means for ensuring that such strategy and policy are implemented. Interest rate risk is daily managed by the Treasury Markets Division within the limits approved by the Board of Directors or the Asset and Liability Management Committee. The Asset and Liability Management Department under the Risk Management Division of the Group is responsible for monitoring the activities relating to interest rate risk. The Internal Audit Department performs periodic review to make sure the interest rate risk management functions are implemented effectively.

The Group manages the interest rate risk on the banking book primarily by focusing on the repricing mismatches. Gap analysis provides a static view of the maturity and repricing characteristics of the Group's financial positions. Repricing gap limits are set to control the Group's interest rate risk.

Stress tests on the Group's interest rate risk are conducted regularly. The results are reviewed by the Asset and Liability Management Committee and reported to the Risk Management Committee and to the Board of Directors regularly. If necessary, remedial actions will be taken.

Sensitivity analysis in relation to the impact of changes in interest rates on earnings and economic value is assessed through a hypothetical interest rate shock of 200 basis points across the yield curve on both sides of the balance sheet and is performed on monthly basis. Sensitivity limits are set to control the Group's interest rate risk exposure under both earnings and economic value perspectives. The results are reported to the Asset and Liability Management Committee, Risk Management Committee and the Board of Directors on a regular basis.

Sensitivity analysis on interest rate risk

The Group uses sensitivity analysis to measure the potential effect of changes in interest rates on our net interest income and economic value change:

	2012			2011		
	HKD	USD	RMB	HKD	USD	RMB
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Impact on earnings over the next 12 months if interest rates rise by 200 basis points	235	(74)	475	116	(12)	346
Impact on economic value if interest rates rise by 200 basis points	(126)	8	58	(156)	195	126

This sensitivity analysis, which is based on a static interest rate risk profile of assets and liabilities, is used for risk management purposes only. The analysis is based on the following assumptions:

- (i) there is a parallel shift in the yield curve and in interest rates;
- (ii) there are no other changes to the portfolio;
- (iii) no loan prepayment is assumed as the majority of loans is on a floating rate basis; and
- (iv) deposits without fixed maturity dates are assumed to be repriced on the next day.

Actual changes in the Group's net interest income and the economic value resulting from the increases in interest rates may differ from the results of this sensitivity analysis.

43. Financial Risk Management (continued)**(e) Interest rate risk management (continued)**

The following table indicates the expected next repricing dates (or maturity dates whichever are earlier) for the interest bearing assets and liabilities at the end of the reporting period:

The Group	2012					Total
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non- interest bearing	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
Assets						
Cash and balances with banks and other financial institutions	80,508	91	8	-	4,905	85,512
Placements with banks and other financial institutions	31,486	19,132	-	-	-	50,618
Trade bills	36,317	19,416	-	-	7	55,740
Trading assets	610	1,327	1,017	93	4,291	7,338
Financial assets designated at fair value through profit or loss	554	1,291	10,535	2,371	418	15,169
Advances to customers and other accounts	291,083	42,152	15,886	1,667	36,485	387,273
Available-for-sale financial assets	30,052	5,236	22,268	4,773	2,402	64,731
Held-to-maturity investments	1,524	985	1,765	46	-	4,320
Non-interest bearing assets	-	-	-	-	21,413	21,413
Total assets	472,134	89,630	51,479	8,950	69,921	692,114
Liabilities						
Deposits and balances of banks and other financial institutions	28,585	360	-	-	1,652	30,597
Deposits from customers	373,704	98,532	10,409	-	16,125	498,770
Trading liabilities	-	-	-	-	3,827	3,827
Certificates of deposit issued	6,818	14,760	5,792	-	-	27,370
Debt securities issued	3,146	4,152	1,359	-	-	8,657
Loan capital	-	-	9,125	5,138	-	14,263
Non-interest bearing liabilities	-	-	-	-	46,991	46,991
Total liabilities	412,253	117,804	26,685	5,138	68,595	630,475
Interest rate sensitivity gap	59,881	(28,174)	24,794	3,812		

43. Financial Risk Management (continued)**(e) Interest rate risk management (continued)**

The Group	2011 (Restated)					Total
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non- interest bearing	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
Assets						
Cash and balances with banks and other financial institutions	66,976	125	8	-	4,652	71,761
Placements with banks and other financial institutions	33,654	24,944	-	-	-	58,598
Trade bills	24,848	20,774	1,127	-	142	46,891
Trading assets	-	572	684	61	4,283	5,600
Financial assets designated at fair value through profit or loss	1,208	826	11,559	2,737	333	16,663
Advances to customers and other accounts	270,793	33,637	9,120	1,291	26,500	341,341
Available-for-sale financial assets	17,465	7,243	15,257	2,961	1,984	44,910
Held-to-maturity investments	1,907	827	1,622	231	-	4,587
Non-interest bearing assets	-	-	-	-	21,051	21,051
Total assets	416,851	88,948	39,377	7,281	58,945	611,402
Liabilities						
Deposits and balances of banks and other financial institutions	14,147	880	43	-	853	15,923
Deposits from customers	368,135	74,389	11,123	-	13,707	467,354
Trading liabilities	-	-	-	-	4,548	4,548
Certificates of deposit issued	6,242	4,195	1,046	-	-	11,483
Debt securities issued	241	-	6,152	-	-	6,393
Loan capital	7,837	-	-	8,904	-	16,741
Non-interest bearing liabilities	-	-	-	-	36,916	36,916
Total liabilities	396,602	79,464	18,364	8,904	56,024	559,358
Interest rate sensitivity gap	20,249	9,484	21,013	(1,623)		

43. Financial Risk Management (continued)**(e) Interest rate risk management (continued)**

The Bank	2012					Total
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non- interest bearing	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Assets						
Cash and balances with banks and other financial institutions	16,188	-	-	-	3,568	19,756
Placements with banks and other financial institutions	16,753	2,582	-	-	-	19,335
Trade bills	25,953	21,971	-	-	7	47,931
Trading assets	51	73	417	19	3,433	3,993
Financial assets designated at fair value through profit or loss	554	1,291	10,535	2,371	119	14,870
Advances to customers and other accounts	197,604	9,524	12,883	1,294	6,921	228,226
Available-for-sale financial assets	28,335	3,002	10,877	1,594	1,208	45,016
Held-to-maturity investments	1,450	747	1,022	-	-	3,219
Non-interest bearing assets	-	-	-	-	40,515	40,515
Total assets	286,888	39,190	35,734	5,278	55,771	422,861
Liabilities						
Deposits and balances of banks and other financial institutions	8,595	360	-	-	1,652	10,607
Deposits from customers	255,714	35,222	476	-	15,241	306,653
Trading liabilities	-	-	-	-	3,080	3,080
Certificates of deposit issued	6,818	14,760	5,792	2,200	-	29,570
Debt securities issued	661	423	116	-	-	1,200
Loan capital	-	-	9,125	9,548	-	18,673
Non-interest bearing liabilities	-	-	-	-	11,610	11,610
Total liabilities	271,788	50,765	15,509	11,748	31,583	381,393
Interest rate sensitivity gap	15,100	(11,575)	20,225	(6,470)		

43. Financial Risk Management (continued)**(e) Interest rate risk management (continued)**

The Bank	2011					Total
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non- interest bearing	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Assets						
Cash and balances with banks and other financial institutions	19,655	-	-	-	2,915	22,570
Placements with banks and other financial institutions	26,368	7,002	-	-	-	33,370
Trade bills	15,934	19,918	-	-	24	35,876
Trading assets	-	31	622	62	3,444	4,159
Financial assets designated at fair value through profit or loss	1,208	826	11,559	2,737	123	16,453
Advances to customers and other accounts	181,987	10,621	4,445	460	6,080	203,593
Available-for-sale financial assets	17,170	5,352	4,429	746	932	28,629
Held-to-maturity investments	1,616	685	579	-	-	2,880
Non-interest bearing assets	-	-	-	-	36,209	36,209
Total assets	263,938	44,435	21,634	4,005	49,727	383,739
Liabilities						
Deposits and balances of banks and other financial institutions	8,947	264	-	-	853	10,064
Deposits from customers	250,659	24,736	1,742	-	13,308	290,445
Trading liabilities	-	-	-	-	3,827	3,827
Certificates of deposit issued	6,242	4,195	1,046	2,200	-	13,683
Debt securities issued	241	-	-	-	-	241
Loan capital	7,837	-	-	12,929	-	20,766
Non-interest bearing liabilities	-	-	-	-	9,388	9,388
Total liabilities	273,926	29,195	2,788	15,129	27,376	348,414
Interest rate sensitivity gap	(9,988)	15,240	18,846	(11,124)		

43. Financial Risk Management (continued)

(e) Interest rate risk management (continued)

The following table summarises the range of effective average interest rates for the year ended 31st December for monetary financial instruments:

	The Group		The Bank	
	2012	2011	2012	2011
	%	%	%	%
Assets				
Cash and short-term funds and placements with banks and other financial institutions	0-5.92	0-5.72	0-5.08	0.01-5.43
Trade bills, advances to customers and advances to banks and other financial institutions	0.44-50.14	0.31-53.39	0.44-17.36	0.31-21.49
Securities (Note)	0.06-7.25	0.10-7.75	0.06-6.79	0.10-7.75
Liabilities				
Deposits and balances of banks and other financial institutions	0.03-5.26	0.01-7.41	0.03-4.44	0.01-7.41
Deposits from customers	0-7.18	0-8.11	0-6.25	0-6.25
Certificates of deposit issued and loan capital	0.5-8.54	0.67-8.44	0.5-8.54	0.67-8.44

Note: Securities include certificates of deposit held, trading assets, financial assets designated at fair value through profit or loss, securities measured as loans and receivables, available-for-sale financial assets and held-to-maturity investments.

(f) Strategic risk management

The objective of strategic risk management is to monitor the risk to earnings or capital arising from bad business decisions or from an improper implementation of good business decisions.

The management of the Group's strategic risk is governed by the strategic risk management policies which are approved by the Board of Directors or the Asset and Liability Management Committee. The Board of Directors has delegated the responsibility for ongoing strategic risk management to the Asset and Liability Management Committee. The Asset and Liability Management Committee reports to the Board of Directors via the Risk Management Committee. The Risk Management Division monitors the activities under the Bank's prevailing interest earning assets mix and funding strategies and regularly reports the status to the Asset and Liability Management Committee and Risk Management Committee.

(g) Legal risk and reputation risk management

Legal risk is the risk arising from the potential that unenforceable contracts, lawsuits or adverse judgements may disrupt or otherwise negatively affect the operations or financial condition of the Group.

Reputation risk is the risk that the Group's reputation is damaged by one or more than one reputation event as reflected from negative publicity about the Group's business practices, conduct or financial condition. Such negative publicity, whether true or not, may impair public confidence in the Group, result in costly litigation, or lead to a decline in the Group's customer base, business or revenue.

The objective of managing the aforesaid risks is to identify, assess, monitor and report on these risks, and to comply with the relevant regulatory requirements.

All units are required to manage legal risk and reputation risk within the legal risk management policies and reputation risk policies respectively which are approved by the Board of Directors or the Operational Risk Management Committee. The Board of Directors has delegated the responsibility for ongoing risk management of these risks to the Operational Risk Management Committee. The Operational Risk Management Committee reports to the Board of Directors via the Risk Management Committee.

43. Financial Risk Management (continued)

(h) Capital management

The Hong Kong Monetary Authority (“HKMA”) sets and monitors capital requirements for the Group as a whole. In implementing current capital requirements the HKMA requires the Group to maintain a prescribed ratio of total capital to total risk-weighted assets. The Group calculates requirements for market risk in its trading portfolios based upon the Group’s VaR models and uses its internal gradings as the basis for risk weightings for credit risk. Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

In addition to meeting the regulatory requirements, the Group’s primary objectives when managing capital are to safeguard the Group’s ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, by pricing products and services commensurately with the level of risk and by securing access to finance at a reasonable cost.

The HKMA supervises the Group on a consolidated basis, which sets capital requirements and receives information of capital adequacy on a regular basis for the Group as a whole. Individual branches are directly regulated by respective domestic banking supervisors, who set and monitor their capital adequacy requirements. In certain jurisdictions, non-banking financial subsidiaries are also subject to the supervision and capital requirements of domestic regulatory authorities.

The Group actively and regularly reviews and manages its capital structure to maintain a balance between the higher shareholder returns that might otherwise be possible with greater gearing and the advantages and security afforded by a sound capital position, and makes adjustments to the capital structure in light of changes in economic conditions.

The process of allocating capital to specific operations and activities is undertaken by Asset and Liability Management Committee and is reviewed regularly by the Board of Directors.

Consistent with industry practice, the Group monitors its capital structure on the basis of the capital adequacy ratio and there have been no material changes in the Group’s policy on the management of capital during the year, except for a change in the calculation methodology in the capital adequacy ratios.

The capital adequacy ratios as at 31st December, 2012 and 31st December, 2011 are computed on the consolidated basis of the Bank and certain of its subsidiaries as specified by the HKMA for its regulatory purposes, and are in accordance with the Banking (Capital) Rules of the Hong Kong Banking Ordinance which became effective on 1st January, 2007.

The Group and its individually regulated operations have complied with all externally imposed capital requirements throughout the year ended 31st December, 2012 and 31st December, 2011 and the Group are well above the minimum required ratio set by the HKMA.

44. Fair values of Financial Instruments

(a) Financial instruments carried at fair value

Fair value estimates are generally subjective in nature, and are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. The Group measures fair values using the following hierarchy of methods:

44. Fair values of Financial Instruments (continued)

(a) Financial instruments carried at fair value (continued)

Level 1 – Quoted market price in an active market for an identical instrument.

Level 2 – Valuation techniques based on observable input. This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

Level 3 – Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs could have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or counterparty quotations. For all other financial instruments the Group determines fair values using valuation techniques. Valuation techniques include net present value and discounted cash flow models and various market widely recognised option pricing models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, equity prices, foreign currency exchange rates, index prices, historical or implied volatilities and correlations. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date, that would have been determined by market participants acting at arm's length.

The Group uses widely recognised valuation models for determining the fair value of common and simpler financial instruments, like interest rate and currency swaps that use only observable market data and require little management judgement and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over-the-counter (OTC) derivatives like interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex instruments, the Group uses valuation models, which usually are developed from recognised valuation methodologies. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in determination of fair value. Management judgement and estimation are usually required for selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instrument being valued, determination of probability of counterparty default and prepayments and selection of appropriate discount rates.

The Group has an established control framework with respect to the measurement of fair values. This framework includes a valuation control function, namely Financial Instruments Valuation Group ("FIVG") which comprises control units independent of front office management. Procedures for price verification have been established. Any pricing models to be used would be subject to a rigorous validation and approval process.

44. Fair values of Financial Instruments (continued)**(a) Financial instruments carried at fair value (continued)**

The table below analyses financial instruments carried at fair value, by valuation method:

2012								
	The Group				The Bank			
	Level One HK\$ Mn	Level Two HK\$ Mn	Level Three HK\$ Mn	Total HK\$ Mn	Level One HK\$ Mn	Level Two HK\$ Mn	Level Three HK\$ Mn	Total HK\$ Mn
Assets								
Trading assets	4,009	2,775	554	7,338	1,522	2,077	394	3,993
Financial assets designated at fair value through profit or loss	10,416	4,753	-	15,169	10,122	4,748	-	14,870
Available-for-sale financial assets	51,988	11,978	765	64,731	34,135	10,184	697	45,016
	<u>66,413</u>	<u>19,506</u>	<u>1,319</u>	<u>87,238</u>	<u>45,779</u>	<u>17,009</u>	<u>1,091</u>	<u>63,879</u>
Liabilities								
Trading liabilities	21	3,244	562	3,827	21	2,564	495	3,080
Financial liabilities designated at fair value through profit or loss	-	6,793	-	6,793	4,410	6,793	-	11,203
	<u>21</u>	<u>10,037</u>	<u>562</u>	<u>10,620</u>	<u>4,431</u>	<u>9,357</u>	<u>495</u>	<u>14,283</u>
2011								
	The Group				The Bank			
	Level One HK\$ Mn	Level Two HK\$ Mn	Level Three HK\$ Mn	Total HK\$ Mn	Level One HK\$ Mn	Level Two HK\$ Mn	Level Three HK\$ Mn	Total HK\$ Mn
Assets								
Trading assets	2,363	2,886	351	5,600	1,761	2,260	138	4,159
Financial assets designated at fair value through profit or loss	10,784	5,879	-	16,663	10,578	5,875	-	16,453
Available-for-sale financial assets	35,860	8,374	676	44,910	21,265	6,796	568	28,629
	<u>49,007</u>	<u>17,139</u>	<u>1,027</u>	<u>67,173</u>	<u>33,604</u>	<u>14,931</u>	<u>706</u>	<u>49,241</u>
Liabilities								
Trading liabilities	18	4,197	333	4,548	18	3,489	320	3,827
Financial liabilities designated at fair value through profit or loss	3,178	5,272	-	8,450	7,203	5,272	-	12,475
	<u>3,196</u>	<u>9,469</u>	<u>333</u>	<u>12,998</u>	<u>7,221</u>	<u>8,761</u>	<u>320</u>	<u>16,302</u>

During the year there were no significant transfers of financial instruments between Level 1 and Level 2 of the fair value hierarchy.

44. Fair values of Financial Instruments (continued)**(a) Financial instruments carried at fair value (continued)****(1) Valuation of financial instruments with significant unobservable inputs**

Movements in the recognised fair values of instruments with significant unobservable inputs were as follows:

	The Group		
	Trading assets – Positive fair value of derivatives HK\$ Mn	Available-for-sale financial assets HK\$ Mn	Total HK\$ Mn
Assets			
At 1 st January, 2012	351	676	1,027
Purchases	-	136	136
Settlements	(87)	(76)	(163)
Changes in fair value recognised in the income statement	290	(62)	228
Changes in fair value recognised in the other comprehensive income	-	89	89
Exchange adjustments	-	2	2
At 31 st December, 2012	<u>554</u>	<u>765</u>	<u>1,319</u>

Total gains or losses for the year included in available-for-sale fair value reserve of the other comprehensive income for assets held at the end of the reporting period

-	89	89
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Total gains or losses for the year included in the income statement for assets held at the end of the reporting period recorded in net trading income

290	(62)	228
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	The Bank		
	Trading assets – Positive fair value of derivatives HK\$ Mn	Available-for-sale financial assets HK\$ Mn	Total HK\$ Mn
Assets			
At 1 st January, 2012	138	568	706
Purchases	-	136	136
Settlements	(14)	(34)	(48)
Changes in fair value recognised in the income statement	270	(62)	208
Changes in fair value recognised in the other comprehensive income	-	89	89
At 31 st December, 2012	<u>394</u>	<u>697</u>	<u>1,091</u>

Total gains or losses for the year included in available-for-sale fair value reserve of the other comprehensive income for assets held at the end of the reporting period

-	89	89
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Total gains or losses for the year included in the income statement for assets held at the end of the reporting period recorded in net trading income

270	(62)	208
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44. Fair values of Financial Instruments (continued)**(a) Financial instruments carried at fair value (continued)****(1) Valuation of financial instruments with significant unobservable inputs (continued)**

	The Group		
	Trading assets – Positive fair value of derivatives HK\$ Mn	Available-for- sale financial assets HK\$ Mn	Total HK\$ Mn
Assets			
At 1 st January, 2011	294	619	913
Purchases	-	94	94
Settlements	(104)	(117)	(221)
Changes in fair value recognised in the income statement	161	-	161
Changes in fair value recognised in the other comprehensive income	-	80	80
At 31 st December, 2011	<u>351</u>	<u>676</u>	<u>1,027</u>
Total gains or losses for the year included in available-for-sale fair value reserve of the other comprehensive income for assets held at the end of the reporting period	<u>-</u>	<u>80</u>	<u>80</u>
Total gains or losses for the year included in the income statement for assets held at the end of the reporting period recorded in net trading income	<u>161</u>	<u>-</u>	<u>161</u>
	The Bank		
	Trading assets – Positive fair value of derivatives HK\$ Mn	Available-for- sale financial assets HK\$ Mn	Total HK\$ Mn
Assets			
At 1 st January, 2011	204	544	748
Purchases	-	44	44
Settlements	(57)	(106)	(163)
Changes in fair value recognised in the income statement	(9)	-	(9)
Changes in fair value recognised in the other comprehensive income	-	86	86
At 31 st December, 2011	<u>138</u>	<u>568</u>	<u>706</u>
Total gains or losses for the year included in available-for-sale fair value reserve of the other comprehensive income for assets held at the end of the reporting period	<u>-</u>	<u>86</u>	<u>86</u>
Total gains or losses for the year included in the income statement for assets held at the end of the reporting period recorded in net trading income	<u>(9)</u>	<u>-</u>	<u>(9)</u>

44. Fair values of Financial Instruments (continued)

(a) Financial instruments carried at fair value (continued)

(1) Valuation of financial instruments with significant unobservable inputs (continued)

	The Group Trading liabilities – Negative fair value of derivatives HK\$ Mn	The Bank Trading liabilities – Negative fair value of derivatives HK\$ Mn
Liabilities		
At 1 st January, 2012	333	320
Settlements	(87)	(75)
Changes in fair value recognised in the income statement	316	250
At 31 st December, 2012	<u>562</u>	<u>495</u>
Total gains or losses for the year included in the income statement for liabilities held at the end of the reporting period recorded in net trading income	<u>316</u>	<u>250</u>

	The Group Trading liabilities – Negative fair value of derivatives HK\$ Mn	The Bank Trading liabilities – Negative fair value of derivatives HK\$ Mn
Liabilities		
At 1 st January, 2011	278	256
Settlements	(123)	(118)
Changes in fair value recognised in the income statement	178	182
At 31 st December, 2011	<u>333</u>	<u>320</u>
Total gains or losses for the year included in the income statement for liabilities held at the end of the reporting period recorded in net trading income	<u>178</u>	<u>182</u>

(2) Effects of changes in significant unobservable assumptions to reasonably possible alternative assumptions

	2012			
	Effect recorded in profit or loss		Effect recorded directly in equity	
	Favourable	(Unfavourable)	Favourable	(Unfavourable)
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Trading assets	46	(46)	-	-
Available-for-sale financial assets	-	-	64	(64)
	<u>46</u>	<u>(46)</u>	<u>64</u>	<u>(64)</u>
Trading liabilities	<u>47</u>	<u>(47)</u>	<u>-</u>	<u>-</u>

44. Fair values of Financial Instruments (continued)**(a) Financial instruments carried at fair value (continued)****(2) Effects of changes in significant unobservable assumptions to reasonably possible alternative assumptions (continued)**

	2011			
	Effect recorded in profit or loss		Effect recorded directly in equity	
	Favourable	(Unfavourable)	Favourable	(Unfavourable)
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Trading assets	29	(29)	-	-
Available-for-sale financial assets	-	-	56	(56)
	<u>29</u>	<u>(29)</u>	<u>56</u>	<u>(56)</u>
Trading liabilities	<u>28</u>	<u>(28)</u>	<u>-</u>	<u>-</u>

The fair values of financial instruments are in certain circumstances, measured using valuation models that incorporate assumptions that are not supported by prices from observable current market transactions in the same instrument and are not based on observable market data. The table above shows the sensitivity of fair values due to parallel movement of plus or minus 10 per cent in reasonably possible alternative assumptions.

(b) Fair values of financial instruments carried at other than fair value

The following methods and significant assumptions have been applied in determining the fair values of financial instruments presented below:

- (i) The fair value of demand deposits and savings accounts with no specific maturity is assumed to be the amount payable on demand at the end of the reporting period.
- (ii) The fair value of variable rate financial instruments is assumed to be approximated by their carrying amounts and, in the case of loans and unquoted debt securities, does not, therefore, reflect changes in their credit quality, as the impact of credit risk is recognised separately by deducting the amount of the impairment allowances from both the carrying amount and fair value.
- (iii) The fair value of fixed rate loans and mortgages carried at amortised cost is estimated by comparing market interest rates when the loans were granted with current market rates offered on similar loans. Changes in the credit quality of loans within the portfolio are not taken into account in determining gross fair values, as the impact of credit risk is recognised separately by deducting the amount of the impairment loss and allowances from both the carrying amount and fair value.
- (iv) The fair value of unquoted equity investments is estimated, if possible, using the applicable dividend discount model, or share of net asset value in the investment, or applying a discount to the market value of investments with a lock-up period.
- (v) The fair value of unlisted open-ended investment funds is estimated using the net asset value per share as reported by the managers of such funds.

44. Fair values of Financial Instruments (continued)**(b) Fair values of financial instruments carried at other than fair value (continued)**

- (vi) The fair value of financial guarantees issued is determined by reference to fees charged in an arm's length transaction for similar services, when such information is obtainable, or is otherwise estimated by reference to interest rate differentials, by comparing the actual rates charged by lenders when the guarantee is made available with the estimated rates that lenders would have charged, had the guarantees not been available, where reliable estimates of such information can be made.

The carrying amounts of the Group's and the Bank's financial instruments carried at cost or amortised cost are not materially different from their fair values as at 31st December, 2012 and 2011 except as follows:

The Group	2012		2011	
	Carrying amount HK\$ Mn	Fair value HK\$ Mn	Carrying amount HK\$ Mn	Fair value HK\$ Mn
Financial assets				
Held-to-maturity investments	4,320	4,474	4,587	4,658
Financial liabilities				
Certificates of deposits issued	21,275	21,289	6,211	6,236
Debt securities issued	7,959	8,103	6,393	6,515
Subordinated liabilities	14,263	15,105	13,563	13,559
The Bank				
	2012		2011	
	Carrying amount HK\$ Mn	Fair value HK\$ Mn	Carrying amount HK\$ Mn	Fair value HK\$ Mn
Financial assets				
Held-to-maturity investments	3,219	3,336	2,880	2,922
Financial liabilities				
Certificates of deposits issued	23,475	23,489	8,411	8,436
Debt securities issued	502	502	241	241
Subordinated liabilities	14,263	15,105	13,563	13,559

45. Off-Balance Sheet Exposures**(a) Contingent liabilities and commitments**

The following is a summary of the contractual amounts of each significant class of contingent liabilities and commitments:

	The Group		The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn	2012 HK\$ Mn	2011 HK\$ Mn
Direct credit substitutes	13,303	10,456	4,756	6,464
Transaction-related contingencies	2,364	1,159	1,224	880
Trade-related contingencies	1,930	2,321	1,259	1,673
Commitments that are unconditionally cancellable without prior notice	52,631	41,114	47,885	40,246
Other commitments with an original maturity				
- up to 1 year	103,119	76,774	7,091	4,299
- over 1 year	36,433	16,657	19,503	14,944
	<u>209,780</u>	<u>148,481</u>	<u>81,718</u>	<u>68,506</u>
Credit risk weighted amounts	<u>71,525</u>	<u>49,965</u>	<u>18,063</u>	<u>15,514</u>

45. Off-Balance Sheet Exposures (continued)

(a) Contingent liabilities and commitments (continued)

Contingent liabilities and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. Since a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the contract amounts does not represent expected future cash flows.

(b) Derivatives

(i) Notional amount of derivatives

Derivatives refer to financial contracts whose value depends on the value of one or more underlying assets or indices.

The following is a summary of the notional amounts of each significant type of derivative for the Group and the Bank:

The Group**2012**

	Trading HK\$ Mn	Qualifying for hedge accounting HK\$ Mn	Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$ Mn	Others HK\$ Mn	Non-trading Total HK\$ Mn	Total HK\$ Mn
Exchange rate contracts						
Forwards and futures	35,512	129	-	4	133	35,645
Swaps	154,871	-	-	130,756	130,756	285,627
Options purchased	2,726	-	-	39,689	39,689	42,415
Options written	3,691	-	-	39,742	39,742	43,433
Interest rate contracts						
Forwards and futures	-	-	-	860	860	860
Swaps	79,973	16,886	20,318	32,115	69,319	149,292
Equity contracts						
Swaps	61	-	-	8,748	8,748	8,809
Options purchased	266	-	-	2,417	2,417	2,683
Options written	430	-	-	1,751	1,751	2,181
Others	-	-	-	3,478	3,478	3,478
	<u>277,530</u>	<u>17,015</u>	<u>20,318</u>	<u>259,560</u>	<u>296,893</u>	<u>574,423</u>

The Group**2011 (Restated)**

	Trading HK\$ Mn	Qualifying for hedge accounting HK\$ Mn	Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$ Mn	Others HK\$ Mn	Non-trading Total HK\$ Mn	Total HK\$ Mn
Exchange rate contracts						
Forwards and futures	87,776	-	-	-	-	87,776
Swaps	75,636	-	-	98,900	98,900	174,536
Options purchased	1,707	-	-	50,120	50,120	51,827
Options written	2,383	-	-	49,974	49,974	52,357
Interest rate contracts						
Forwards and futures	-	-	-	1,689	1,689	1,689
Swaps	53,225	7,767	15,995	64,665	88,427	141,652
Equity contracts						
Swaps	-	-	-	7,089	7,089	7,089
Options purchased	168	-	-	2,558	2,558	2,726
Options written	275	-	-	1,894	1,894	2,169
Others	-	-	-	3,091	3,091	3,091
	<u>221,170</u>	<u>7,767</u>	<u>15,995</u>	<u>279,980</u>	<u>303,742</u>	<u>524,912</u>

45. Off-Balance Sheet Exposures (continued)

(b) Derivatives (continued)

(i) Notional amount of derivatives (continued)

The Bank**2012**

	Trading HK\$ Mn	Qualifying for hedge accounting HK\$ Mn	Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$ Mn	Others HK\$ Mn	Non-trading Total HK\$ Mn	Total HK\$ Mn
Exchange rate contracts						
Forwards and futures	28,912	-	-	-	-	28,912
Swaps	58,676	-	-	130,408	130,408	189,084
Options purchased	2,726	-	-	39,689	39,689	42,415
Options written	3,692	-	-	39,742	39,742	43,434
Interest rate contracts						
Forwards and futures	-	-	-	860	860	860
Swaps	15,866	16,886	20,318	32,100	69,304	85,170
Equity contracts						
Swaps	61	-	-	8,799	8,799	8,860
Options purchased	266	-	-	2,417	2,417	2,683
Options written	430	-	-	2,414	2,414	2,844
Others	-	-	-	3,475	3,475	3,475
	<u>110,629</u>	<u>16,886</u>	<u>20,318</u>	<u>259,904</u>	<u>297,108</u>	<u>407,737</u>

The Bank**2011 (Restated)**

	Trading HK\$ Mn	Qualifying for hedge accounting HK\$ Mn	Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$ Mn	Others HK\$ Mn	Non-trading Total HK\$ Mn	Total HK\$ Mn
Exchange rate contracts						
Forwards and futures	73,543	-	-	-	-	73,543
Swaps	28,324	-	-	98,142	98,142	126,466
Options purchased	1,707	-	-	50,120	50,120	51,827
Options written	2,383	-	-	49,974	49,974	52,357
Interest rate contracts						
Forwards and futures	-	-	-	1,689	1,689	1,689
Swaps	3,602	7,767	15,995	61,828	85,590	89,192
Equity contracts						
Swaps	-	-	-	6,796	6,796	6,796
Options purchased	168	-	-	2,558	2,558	2,726
Options written	275	-	-	2,558	2,558	2,833
Others	-	-	-	3,081	3,081	3,081
	<u>110,002</u>	<u>7,767</u>	<u>15,995</u>	<u>276,746</u>	<u>300,508</u>	<u>410,510</u>

Derivatives arise from futures, forward, swap and option transactions undertaken by the Group and the Bank in the foreign exchange, interest rate and equity markets. The notional amounts of these instruments indicate the volume of transactions outstanding at the end of the reporting period; they do not represent amounts at risk.

The fair value and credit risk weighted amounts of the aforesaid off-balance sheet exposures are as follows. These amounts do not take into account the effects of bilateral netting arrangements.

45. Off-Balance Sheet Exposures (continued)

(b) Derivatives (continued)

(ii) Fair value and credit risk weighted amounts of derivatives

	The Group			
	2012		2011 (Restated)	
	Assets	Liabilities	Assets	Liabilities
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Fair value (Notes 26 and 37)				
Exchange rate contracts	1,279	1,559	1,446	2,236
Interest rate contracts	1,502	1,924	1,305	1,898
Equity contracts	191	170	337	292
Others	153	153	127	112
	<u>3,125</u>	<u>3,806</u>	<u>3,215</u>	<u>4,538</u>

	The Bank			
	2012		2011 (Restated)	
	Assets	Liabilities	Assets	Liabilities
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Fair value (Notes 26 and 37)				
Exchange rate contracts	607	1,052	990	1,915
Interest rate contracts	1,349	1,751	1,087	1,502
Equity contracts	161	103	179	288
Others	150	153	120	112
	<u>2,267</u>	<u>3,059</u>	<u>2,376</u>	<u>3,817</u>

	The Group		The Bank	
	2012	2011 Restated	2012	2011 Restated
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Credit risk weighted amounts *				
Exchange rate contracts	2,878	3,168	2,101	2,854
Interest rate contracts	1,618	1,256	1,443	1,067
Equity contracts	574	328	637	383
Others	301	108	303	111
	<u>5,371</u>	<u>4,860</u>	<u>4,484</u>	<u>4,415</u>

* The Bank adopted the Foundation Internal Ratings Based ("IRB") approach according to Banking (Capital) Rules for calculating the credit risk weighted amount as at 31st December, 2012.

The tables above give the contractual or notional amounts, fair value and credit risk weighted amounts of off-balance sheet transactions. The fair value is calculated for the purposes of deriving the credit risk weighted amounts. These are assessed in accordance with the Banking (Capital) Rules. Fair value represents the cost of replacing all contracts which have a positive value when marked to market.

Fair value is a close approximation of the credit risk for these contracts as at the end of the reporting period. The credit risk weighted amount refers to the amount as computed in accordance with the Banking (Capital) Rules.

(iii) Fair values of derivatives designated as hedging instruments

The following is a summary of the fair values of derivatives held for hedging purposes by product type:

	The Group and The Bank			
	2012		2011	
	Assets	Liabilities	Assets	Liabilities
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Exchange rate contracts	-	-	-	-
Interest rate contracts	712	89	409	-
	<u>712</u>	<u>89</u>	<u>409</u>	<u>-</u>

45. Off-Balance Sheet Exposures (continued)

(b) Derivatives (continued)

(iii) Fair values of derivatives designated as hedging instruments (continued)

(a) Cash flow hedges

The Group's cash flow hedge principally consists of foreign exchange contracts that are used to hedge against the variability in cash flows of certain debt securities subject to foreign exchange rate movement.

At 31st December, 2012, the net fair value of derivatives held as cash flow hedges was insignificant (2011: Nil).

The time periods in which the hedged cash flows are expected to occur and affect the consolidated statement of comprehensive income are as follows:

The Group

	Within one year HK\$ Mn	Over one year but within five years HK\$ Mn	Over Five years HK\$ Mn
At 31 st December, 2012			
Cash inflows from assets	-	102	27
Cash inflows from liabilities	-	-	-
Net cash inflows	-	102	27
At 31 st December, 2011			
Cash inflows from assets	-	-	-
Cash inflows from liabilities	-	-	-
Net cash inflows	-	-	-

(b) Fair value hedges

The Group's fair value hedge principally consists of interest rate swaps that are used to protect against changes in the fair value of fixed rate long-term financial instruments due to movements in market interest rates.

At 31st December, 2012, the net fair value of interest rate swaps was \$623 million (2011: HK\$409 million) comprising assets of HK\$712 million (2011: HK\$409 million) and liabilities of HK\$89 million (2011: Nil).

45. Off-Balance Sheet Exposures (continued)

(b) Derivatives (continued)

(iv) Remaining life of derivatives

The following table provides an analysis of the notional amounts of derivatives of the Group by relevant maturity grouping based on the remaining periods to settlement at the end of the reporting period.

The Group								
Notional amounts with remaining life of								
	2012				2011 (Restated)			
	1 year or less	Over 1 year to 5 years	Over 5 years	Total	1 year or less	Over 1 year to 5 years	Over 5 years	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Interest rate derivatives	86,001	53,932	10,219	150,152	86,698	41,601	15,042	143,341
Currency derivatives	345,390	60,930	800	407,120	282,468	83,951	77	366,496
Other derivatives	5,690	10,945	516	17,151	6,312	8,625	138	15,075
	<u>437,081</u>	<u>125,807</u>	<u>11,535</u>	<u>574,423</u>	<u>375,478</u>	<u>134,177</u>	<u>15,257</u>	<u>524,912</u>

The Bank								
Notional amounts with remaining life of								
	2012				2011 (Restated)			
	1 year or less	Over 1 year to 5 years	Over 5 years	Total	1 year or less	Over 1 year to 5 years	Over 5 years	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Interest rate derivatives	41,776	34,035	10,219	86,030	52,020	23,827	15,034	90,881
Currency derivatives	242,613	60,432	800	303,845	221,057	83,136	-	304,193
Other derivatives	5,756	11,473	633	17,862	6,275	8,906	255	15,436
	<u>290,145</u>	<u>105,940</u>	<u>11,652</u>	<u>407,737</u>	<u>279,352</u>	<u>115,869</u>	<u>15,289</u>	<u>410,510</u>

(c) Capital commitments

Capital commitments outstanding at 31st December and not provided for in the accounts were as follows:

	The Group		The Bank	
	2012	2011	2012	2011
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Expenditure authorised and contracted for	403	171	329	117
Expenditure authorised but not contracted for	124	213	26	175
	<u>527</u>	<u>384</u>	<u>355</u>	<u>292</u>

45. Off-Balance Sheet Exposures (continued)

(d) Operating lease commitments

At 31st December, 2012, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	The Group		The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn	2012 HK\$ Mn	2011 HK\$ Mn
Properties				
Within one year	480	472	181	174
After one year but within five years	911	986	170	150
After five years	212	300	-	-
	<u>1,603</u>	<u>1,758</u>	<u>351</u>	<u>324</u>
	The Group		The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn	2012 HK\$ Mn	2011 HK\$ Mn
Equipment				
Within one year	6	6	2	2
After one year but within five years	11	11	1	2
	<u>17</u>	<u>17</u>	<u>3</u>	<u>4</u>

The Group and the Bank lease certain properties and equipment under operating leases. The leases run for an initial period of one to twenty five years, with an option to renew the lease when all terms are renegotiated. Lease payments are usually adjusted annually to reflect market rentals. None of the leases includes contingent rentals.

46. Notes on Consolidated Cash Flow Statement**(a) Purchase of subsidiaries**

	2012 HK\$ Mn	2011 HK\$ Mn
Net assets acquired		
Cash and balances with banks and other financial institutions	-	15
Advances and other accounts less provisions	1	18
Fixed assets	-	1
Current taxation	-	(2)
Other accounts and provisions	(1)	(10)
	-	22
Goodwill arising on consolidation	11	68
Total purchase price	11	90
Less: Cash and cash equivalents acquired	-	(15)
Cash flow on acquisition net of cash acquired	11	75

(b) Disposal of subsidiary

	2012 HK\$ Mn	2011 HK\$ Mn
Net assets disposed of		
Cash and balances with banks and other financial institutions	436	-
Placements with banks and other financial institutions	287	-
Advances and other accounts less provisions	4,447	-
Available-for-sale financial assets	43	-
Held-to-maturity investments	45	-
Fixed assets	38	-
Deferred tax assets	165	-
Goodwill and intangible assets	174	-
Deposits and balances of banks and other financial institutions	(41)	-
Deposits from customers	(4,294)	-
Trading liabilities	(114)	-
Other accounts and provisions	(86)	-
	1,100	-
Add: Gain on disposal	203 *	-
Less: Transferred to investment in associates	(283) *	-
Less: Cash and cash equivalents disposed	(436)	-
Cash flow on disposal of subsidiary	584	-

* Included HK\$55 million of gain that attributable to recognizing any investment retained in the former subsidiary at its fair value at the date when control is lost.

(c) Cash and cash equivalents**(i) Components of cash and cash equivalents in the consolidated cash flow statement**

	2012 HK\$ Mn	2011 HK\$ Mn
Cash and balances with banks and other financial institutions	55,981	43,041
Placements with banks and other financial institutions with original maturity within three months	26,360	25,338
Treasury bills with original maturity within three months	16,425	9,791
Certificates of deposit held with original maturity within three months	972	911
Debt securities with original maturity within three months	-	100
	99,738	79,181

46. Notes on Consolidated Cash Flow Statement (continued)**(c) Cash and cash equivalents (continued)****(ii) Reconciliation with the consolidated statement of financial position**

	2012 HK\$ Mn	2011 Restated HK\$ Mn
Cash and balances with banks and other financial institutions (Note 23)	85,512	71,761
Placements with banks and other financial institutions (Note 24)	50,618	58,598
Treasury bills, certificates of deposit held and debt securities		
- trading assets (Note 26)	3,057	1,317
- designated at fair value through profit or loss (Note 27)	14,751	16,330
- advances and other accounts (Note 28(a))	78	39
- available-for-sale (Note 29)	62,333	42,897
- held-to-maturity (Note 30)	4,320	4,598
	<u>84,539</u>	<u>65,181</u>
Amounts shown in the consolidated statement of financial position	220,669	195,540
Less: Amounts with an original maturity of beyond three months	(91,400)	(87,639)
Cash balance with central bank subject to regulatory restriction	<u>(29,531)</u>	<u>(28,720)</u>
Cash and cash equivalents in the consolidated cash flow statement	<u>99,738</u>	<u>79,181</u>

47. Assets Pledged as Security

The following assets have been pledged as collateral for own liabilities at the end of the reporting period.

	The Group		The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn	2012 HK\$ Mn	2011 HK\$ Mn
Secured liabilities	<u>9,633</u>	<u>3,631</u>	<u>2,649</u>	<u>3,621</u>
Assets pledged:				
Advances to customers and other accounts	1,599	2,976	1,450	1,631
Financial assets designated at fair value through profit or loss	1,793	2,474	1,793	2,474
Available-for-sale financial assets	6,836	138	-	127
Held-to-maturity investments	<u>792</u>	<u>1,087</u>	<u>792</u>	<u>1,087</u>
	<u>11,020</u>	<u>6,675</u>	<u>4,035</u>	<u>5,319</u>

The following balances with banks have been pledged as collateral for securities borrowings and margin deposits of derivatives.

	The Group		The Bank	
	2012 HK\$ Mn	2011 HK\$ Mn	2012 HK\$ Mn	2011 HK\$ Mn
Cash collateral for borrowed securities	-	39	-	39
Margin accounts for open futures and forward contracts	<u>1,085</u>	<u>1,464</u>	<u>1,077</u>	<u>1,431</u>
	<u>1,085</u>	<u>1,503</u>	<u>1,077</u>	<u>1,470</u>

These transactions are conducted under terms that are usual and customary to standard lending and securities borrowing and lending activities.

48. Loans to Officers

The aggregate of loans to officers of the Bank disclosed pursuant to Section 161B(4B) and (4C) of the Hong Kong Companies Ordinance is as follows:

	2012 HK\$ Mn	2011 HK\$ Mn
Aggregate amount of relevant loans outstanding at 31 st December		
By the Bank	2,368	3,427
By subsidiaries	<u>1,296</u>	<u>851</u>
	<u>3,664</u>	<u>4,278</u>
The maximum aggregate amount of relevant loans outstanding during the year		
By the Bank	5,382	6,365
By subsidiaries	<u>1,431</u>	<u>1,230</u>
	<u>6,813</u>	<u>7,595</u>

There was no interest due but unpaid nor any impairment allowance made against these loans at 31st December, 2012 and 31st December, 2011.

49. Material Related Party Transactions**(a) Key management personnel remuneration**

Remuneration for key management personnel of the Group, including amounts paid to the Bank's directors as disclosed in Note 20 and certain of the highest paid employees as disclosed in Note 21, is as follows:

	2012 HK\$ Mn	2011 HK\$ Mn
Short-term employee benefits	123	95
Post-employment benefits	5	5
Equity compensation benefits	<u>22</u>	<u>37</u>
	<u>150</u>	<u>137</u>

(b) The Group maintains certain retirement benefit schemes for its staff as per Note 2(q)(iii). In 2012, the total amount of contributions the Group made to the schemes was HK\$145 million (2011: HK\$131 million).

The Group enters into a number of transactions with the Group's related parties, including its associates, and key management personnel and their close family members and companies controlled or significantly influenced by them. The transactions include accepting deposits from and extending credit facilities to them. All interest rates in connection with the deposits taken and credit facilities extended are under terms and conditions normally applicable to customers of comparable standing.

The interest received from and interest paid to the Group's related parties for the year, outstanding balances of amounts due from and due to at the year end, and maximum outstanding balance of amounts due from and due to them during the year are aggregated as follows:

49. Material Related Party Transactions (continued)

	Key management personnel		Subsidiaries		Associates	
	2012	2011	2012	2011	2012	2011
	HK\$ Mn	Restated HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Interest income	123	84	412	253	11	19
Interest expense	54	50	125	157	-	-
Amounts due from	6,450	6,020	15,566	11,498	390	585
Amounts due to	4,616	5,285	3,105	2,416	228	203
Maximum amounts due from	9,683	9,650	17,890	18,802	503	1,018
Maximum amounts due to	9,656	10,699	3,142	3,013	485	203
Committed facilities to	4,247	3,271	1,079	835	10	10

50. Equity Compensation Plans

The Bank has adopted Staff Share Option Schemes whereby the Board of the Bank may at its discretion grant to any employees of the Group, including Executive Directors and Chief Executive, options to subscribe for ordinary shares of the Bank. All options were granted for nil consideration.

(a) Particulars of share options

<u>Date of grant</u>	<u>Vesting period</u>	<u>Exercise period</u>	<u>Exercise price per share</u> HK\$
10/5/2007	10/5/2007 – 09/5/2008	10/5/2008 – 10/5/2012	42.84 *
05/5/2008	05/5/2008 – 04/5/2009	05/5/2009 – 05/5/2013	40.09 *
05/5/2009	05/5/2009 – 04/5/2010	05/5/2010 – 05/5/2014	21.25
06/7/2010	06/7/2010 – 05/7/2011	06/7/2011 – 06/7/2015	28.49
05/5/2011(T1)	05/5/2011 – 04/5/2012	05/5/2012 – 05/5/2017	32.00
05/5/2011(T2)	05/5/2011 – 04/5/2013	05/5/2013 – 05/5/2018	32.00
05/5/2011(T3)	05/5/2011 – 04/5/2014	05/5/2014 – 05/5/2019	32.00
10/5/2012(T1)	10/5/2012 – 09/5/2013	10/5/2013 – 10/5/2018	28.99
10/5/2012(T2)	10/5/2012 – 09/5/2014	10/5/2014 – 10/5/2019	28.99
10/5/2012(T3)	10/5/2012 – 09/5/2015	10/5/2015 – 10/5/2020	28.99

(b) Movement of share options during the period

2012		Number of share options					Outstanding at 31/12/2012
<u>Date of grant</u>	<u>Tranche</u>	<u>Option price</u> HK\$	<u>Outstanding</u> <u>at 1/1/2012</u>	<u>Granted</u>	<u>Exercised</u>	<u>Lapsed</u>	
10/5/2007		42.84 *	2,035,000	-	-	2,035,000	-
05/5/2008		40.09 *	4,070,000	-	-	-	4,070,000
05/5/2009		21.25	3,515,000	-	595,000	-	2,920,000
06/7/2010		28.49	5,950,000	-	200,000	-	5,750,000
05/5/2011	T1	32.00	1,980,000	-	-	-	1,980,000
05/5/2011	T2	32.00	1,980,000	-	-	-	1,980,000
05/5/2011	T3	32.00	1,990,000	-	-	-	1,990,000
10/5/2012	T1	28.99	-	1,980,000	-	-	1,980,000
10/5/2012	T2	28.99	-	1,980,000	-	-	1,980,000
10/5/2012	T3	28.99	-	1,990,000	-	-	1,990,000
Total			21,520,000	5,950,000	795,000	2,035,000	24,640,000

* After adjusting for the bonus issue one for ten in April 2009.

50. Equity Compensation Plans (continued)

(b) Movement of share options during the period (continued)

2011		Number of share options					
Date of grant	Tranche	Option price HK\$	Outstanding at 1/1/2011	Granted	Exercised	Lapsed	Outstanding at 31/12/2011
03/5/2006		30.04 *	2,420,000	-	2,420,000	-	-
10/5/2007		42.84 *	2,585,000	-	-	550,000	2,035,000
05/5/2008		40.09 *	5,170,000	-	-	1,100,000	4,070,000
05/5/2009		21.25	4,480,000	-	965,000	-	3,515,000
06/7/2010		28.49	5,950,000	-	-	-	5,950,000
05/5/2011	T1	32.00	-	1,980,000	-	-	1,980,000
05/5/2011	T2	32.00	-	1,980,000	-	-	1,980,000
05/5/2011	T3	32.00	-	1,990,000	-	-	1,990,000
Total			20,605,000	5,950,000	3,385,000	1,650,000	21,520,000

* After adjusting for the bonus issue one for ten in April 2009.

(c) No share options were cancelled during the years ended 31st December, 2012 and 2011.

(d) Details of share options exercised

Exercise period	Date of grant	Number of share options	
		2012	2011
March	03/5/2006	-	2,255,000
	05/5/2009	60,000	765,000
April	05/5/2009	50,000	20,000
May	03/5/2006	-	165,000
June	05/5/2009	-	100,000
July	05/5/2009	135,000	-
August	05/5/2009	160,000	-
November	05/5/2009	10,000	80,000
December	05/5/2009	180,000	-
	06/7/2010	200,000	-
		<u>795,000</u>	<u>3,385,000</u>

51. Non-adjusting events after the reporting period

After the end of the reporting period the directors declared a second interim dividend. Further details are disclosed in Note 18(a).

52. Accounting Estimates and Judgements

The preparation of accounts requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of these accounts and the reported amounts of revenues and expenses for the years presented. Changes in assumptions may have a significant impact on the accounts in the periods where the assumptions are changed. The application of assumptions and estimates means that any selection of different assumptions would cause the Group's reporting to differ. The Group believes that the assumptions that have been made are appropriate and that the accounts therefore present the financial position and results fairly, in all material respects.

Management discussed with the Audit Committee the development, selection and disclosure of the Group's significant accounting policies and estimates and the application of these policies and estimates.

(a) Key sources of estimation uncertainty

Notes 33, 39 and 44 contain information about the assumptions and their risk factors relating to goodwill impairment, fair value of share options granted and fair values of financial instruments. Other key sources of estimation uncertainty are as follows:

(i) Impairment losses

Loans and advances

Loan portfolios are reviewed periodically to assess whether impairment losses exist. The Group makes judgement as to whether there is any objective evidence that a loan portfolio is impaired, i.e. whether there is a decrease in estimated future cash flows. Objective evidence for impairment includes observable data that the payment status of borrowers in a group has adversely changed. It may also include observable data that correlate with defaults on the assets in the Group. If management has determined, based on their judgement, that objective evidence for impairment exists, expected future cash flows are estimated based on historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of the current observable data. Management reviews the methodology and assumptions used in estimating future cash flows regularly to reduce any difference between loss estimates and actual loss experience.

Available-for-sale financial assets and held-to-maturity investments

The Group determines that available-for-sale financial assets and held-to-maturity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. The determination of when a decline in fair value below its cost is not recoverable within a reasonable time period is judgmental by nature, so profit and loss could be affected by differences in this judgement.

(ii) Valuation of financial instruments

The Group's accounting policy for valuation of financial instruments is included in Note 2. The fair value of the financial instruments is mainly based on the quoted market price on a recognised stock exchange or a price quoted from a broker/dealer for non-exchanged traded financial instruments. The fair value of collateralised debt obligations is based on bid prices quoted by reputable brokers and has been carefully assessed for reasonableness by management. The fair value of a SIV is based on its net asset values as provided by the SIV's manager.

52. Accounting Estimates and Judgements (continued)

(b) Critical accounting judgements in applying the Group's accounting policies

Certain critical accounting judgements in applying the Group's accounting policies are described below:

(i) Held-to-maturity investments

The Group classifies non-derivative financial assets with fixed or determinable payments and fixed maturity and where the Group has a positive intention and ability to hold to maturity as held-to-maturity investments. In making this judgement, the Group evaluates its intention and ability to hold such investments till maturity.

If the Group fails to hold these investments to maturity other than for certain specific circumstances, the Group will have to reclassify the entire portfolio of held-to-maturity investments as available-for-sale, as such class is deemed to have been tainted.

This would result in held-to-maturity investments being measured at fair value instead of at amortised cost.

(ii) Recognition of deferred tax assets

The Group recognises deferred tax assets only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Estimates and judgements are applied in determining the amount of future taxable profits and the probability that such future taxable profits are available in the foreseeable future to support recognition of the deferred tax assets. The Group uses all readily available information, including estimates based on reasonable and supportable assumptions and projections of revenue and operating costs, in determining future taxable profits. Changes in these estimates could significantly affect the timing of deferred tax asset recognition and the amount of asset recognised.

53. Comparative Figures

The 2011 figures in Note 6 and 7 – Fee and Commission Income and Net Trading Profits have been restated to better reflect upfront income and expense in respect of certain derivatives entered into in relation to structured deposit products.

The 2011 figures in Note 22 – Segment Reporting have been restated as one reportable segment has been added under Hong Kong banking operations in 2012 and certain local entities have been reported separately to the Group's most senior executive management with effect from 2012.

For other restatements, the comparative figure has been restated to conform with current year's presentation.

54. Possible Impact of Amendments, New Standards and Interpretations Issued but not Yet Effective for the Year Ended 31st December, 2012

Up to the date of issue of these accounts, the HKICPA has issued a number of amendments and five new standards which are not yet effective for the year ended 31st December, 2012 and which have not been adopted in these accounts. These include the following which may be relevant to the group.

	Effective for accounting periods beginning on or after
Amendments to HKAS 1, <i>Presentation of financial statements - Presentation of items of other comprehensive income</i>	1 st July, 2012
HKFRS 10, <i>Consolidated financial statements</i>	1 st January, 2013
HKFRS 12, <i>Disclosure of interests in other entities</i>	1 st January, 2013
HKFRS 13, <i>Fair value measurement</i>	1 st January, 2013
<i>Annual Improvements to HKFRSs 2009-2011 Cycle</i>	1 st January, 2013
Amendments to HKFRS 7, <i>Financial instruments: Disclosures - Disclosures - Offsetting financial assets and financial liabilities</i>	1 st January, 2013
Amendments to HKAS 32, <i>Financial instruments: Presentation - Offsetting financial assets and financial liabilities</i>	1 st January, 2014
HKFRS 9, <i>Financial instruments</i>	1 st January, 2015

The Group is in the process of making an assessment of what the impact of these amendments is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the consolidated financial statements except for the following:

HKFRS 13, Fair value measurement

HKFRS 13 replaces existing guidance in individual HKFRSs with a single source of fair value measurement guidance. HKFRS 13 also contains extensive disclosure requirements about fair value measurements for both financial instruments and non-financial instruments. HKFRS 13 is effective as from 1 January 2013, but retrospective adoption is not required. The Group estimates that the adoption of HKFRS 13 will not have any significant impact on the fair value measurements of its assets and liabilities, but additional disclosures may need to be made in the 2013 financial statements.

HKFRS 9, Financial Instruments

HKFRS 9 was issued in November 2009 and establishes new principles for the classification and measurement of financial assets. In December 2010, the HKICPA issued additions to HKFRS 9 dealing with financial liabilities. The main changes to the requirements of HKAS 39 are summarised below.

All financial assets are classified into two measurement categories: amortised cost or fair value on the basis of both an entity's business model for managing groups of financial assets and the contractual cash flow characteristics of the individual assets. These two categories replace the four categories under the current HKAS 39, *Financial instruments: Recognition and Measurement*.

54. Possible Impact of Amendments, New Standards and Interpretations Issued but not Yet Effective for the Year Ended 31st December, 2012 (continued)

Financial assets are measured at fair value through profit or loss, if they do not meet the criteria specified for measurement at amortised cost or if doing so significantly reduces or eliminates an accounting mismatch. An entity has the option to designate all subsequent changes in fair value of an equity instrument not held for trading at fair value through other comprehensive income with no recycling of gains or losses to the income statement. Dividend income would continue to be recognised in the income statement.

Financial assets which contain embedded derivatives are to be classified in their entirety either at fair value or amortised cost depending on whether the contracts as a whole meet the relevant criteria under HKFRS 9.

HKFRS 9 retains all the existing requirements for derecognition of financial instruments and most of the requirements for financial liabilities, except that for financial liabilities designated under the fair value option other than loan commitments and financial guarantee contracts, fair value changes attributable to changes in own credit risk are to be presented in the statement of other comprehensive income, and are not subsequently reclassified to income statement but may be transferred within equity.

HKFRS 9 is mandatory for annual periods beginning on or after 1 January 2015 with earlier application permitted. In December 2011, the amendment to HKFRS 9 and HKFRS 7 issued by HKICPA provided relief from the requirement to restate prior period comparative information and required additional disclosures on transition from HKAS39 to HKFRS 9. The Group is presently studying the implications of applying HKFRS 9 but it is impracticable to quantify its effect as at the date of publication of these consolidated financial statements.

THE BANK OF EAST ASIA, LIMITED**INDEPENDENT AUDITOR'S REPORT
TO THE SHAREHOLDERS OF THE BANK OF EAST ASIA, LIMITED**
(incorporated in Hong Kong with limited liability)

We have audited the consolidated financial statements of The Bank of East Asia, Limited ("the Bank") and its subsidiaries (together "the Group") set out on pages 16 to 145, which comprise the consolidated and the Bank's statements of financial position as at 31st December 2013, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information.

DIRECTORS' RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

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

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. This report is made solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

THE BANK OF EAST ASIA, LIMITED

OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Bank and of the Group as at 31st December, 2013 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

Certified Public Accountants

8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

Hong Kong, 18th February, 2014

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER, 2013

	Notes	2013 HK\$ Mn	2012 HK\$ Mn
Interest income	4	25,084	22,635
Interest expense	5	(12,917)	(12,911)
Net interest income		12,167	9,724
Fee and commission income	6	4,874	4,159
Fee and commission expense		(882)	(780)
Net fee and commission income		3,992	3,379
Net trading profits	7	878	765
Net result from financial instruments designated at fair value through profit or loss	8	(387)	664
Net hedging loss	9	(22)	(15)
Other operating income	10	625	592
Non-interest income		5,086	5,385
Operating income		17,253	15,109
Operating expenses	11	(9,583)	(8,725)
Operating profit before impairment losses		7,670	6,384
Impairment losses on loans and advances	12	(458)	(213)
Write back of impairment losses on held-to-maturity investments	30	-	11
Impairment losses on available-for-sale financial assets		(69)	(63)
Impairment losses		(527)	(265)
Operating profit after impairment losses		7,143	6,119
Net profit on sale of available-for-sale financial assets	13	80	82
Net profit on sale of loans and receivables		-	35
Net profit on sale of subsidiaries/associates		27	203
Net profit on sale of fixed assets	14	164	139
Valuation gains on properties	15,34	388	451
Share of profits less losses of associates		684	536
Profit for the year before taxation		8,486	7,565
Income tax	16	(1,779)	(1,411)
Profit for the year after taxation		6,707	6,154
Attributable to:			
Owners of the parent		6,613	6,056
Non-controlling interests	42	94	98
Profit after taxation		6,707	6,154
Earnings per share		HK\$	HK\$
Basic	19	2.78	2.72
Diluted	19	2.78	2.72

The notes on pages 23 to 145 form part of these accounts. Details of dividends payable to equity shareholders of the Bank attributable to the profit for the year are set out in Note 18.

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31ST DECEMBER, 2013

	Notes	2013 HK\$ Mn	2012 HK\$ Mn
Net profit		6,707	6,154
Other comprehensive income for the year (after taxation and reclassification adjustments):			
Item that will not be reclassified to income statement:			
Premises:			
- unrealised surplus on revaluation of premises	41(c)	670	-
- exchange differences	41(c)	2	1
Items that may be reclassified subsequently to income statement:			
Premises:			
- deferred taxes	41(c)	1	1
Available-for-sale investment revaluation reserve:			
- fair value changes recognised (from)/to equity	41(h)	(46)	1,121
- fair value changes reclassified from/(to) income statement:			
- on impairment and amortisation	41(h)	84	98
- on disposal	41(h)	(142)	(113)
- deferred taxes	41(h)	71	(120)
- exchange differences	41(h)	(1)	(1)
Share of changes in equity of associates	41 (i)	(18)	4
Exchange differences on other reserves	41(d)	64	15
Exchange differences on translation of:			
- accounts of overseas branches, subsidiaries and associates	41(f)	105	379
Other comprehensive income		790	1,385
Total comprehensive income		7,497	7,539
Total comprehensive income attributable to:			
Owners of the parent		7,403	7,441
Non-controlling interests	42	94	98
		7,497	7,539

The notes on pages 23 to 145 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31ST DECEMBER, 2013

	Notes	2013 HK\$ Mn	2012 HK\$ Mn
ASSETS			
Cash and balances with banks and other financial institutions	23	68,777	85,512
Placements with banks and other financial institutions	24	57,372	50,618
Trade bills	25	59,932	55,740
Trading assets	26	5,331	4,213
Financial assets designated at fair value through profit or loss	27	11,606	15,169
Positive fair value of derivatives	45(b)(ii)	3,625	3,125
Advances to customers and other accounts	28	448,255	387,273
Available-for-sale financial assets	29	71,589	64,731
Held-to-maturity investments	30	5,048	4,320
Investments in associates	32	4,779	4,677
Fixed assets	34	13,530	12,552
- Investment properties		4,400	3,100
- Other property and equipment		9,130	9,452
Goodwill and intangible assets	33	3,990	4,041
Deferred tax assets	36(b)	120	143
Total Assets		753,954	692,114
EQUITY AND LIABILITIES			
Deposits and balances of banks and other financial institutions		28,923	30,597
Deposits from customers		534,971	498,770
Trading liabilities	37(a)	11	21
Negative fair value of derivatives	45(b)(ii)	4,545	3,806
Certificates of deposit issued		42,929	27,370
- At fair value through profit or loss		8,509	6,095
- At amortised cost		34,420	21,275
Current taxation	36(a)	1,353	988
Debt securities issued		4,728	8,657
- At fair value through profit or loss		150	698
- At amortised cost		4,578	7,959
Deferred tax liabilities	36(b)	647	626
Other accounts and provisions	37(b)	53,981	45,377
Loan capital – at amortised cost	38	13,632	14,263
Total Liabilities		685,720	630,475
Share capital	40	5,724	5,568
Reserves	41	57,958	51,585
Total equity attributable to owners of the parent		63,682	57,153
Non-controlling interests	42	4,552	4,486
Total Equity		68,234	61,639
Total Equity and Liabilities		753,954	692,114

Approved and authorised for issue by the Board of Directors on 18th February, 2014.

Chairman and Chief Executive

Directors

The notes on pages 23 to 145 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 31ST DECEMBER, 2013

	Notes	2013 HK\$ Mn	2012 HK\$ Mn
ASSETS			
Cash and balances with banks and other financial institutions	23	22,212	19,756
Placements with banks and other financial institutions	24	13,399	19,335
Trade bills	25	52,739	47,931
Trading assets	26	1,925	1,726
Financial assets designated at fair value through profit or loss	27	11,199	14,870
Positive fair value of derivatives	45(b)(ii)	1,729	2,267
Advances to customers and other accounts	28	266,925	228,226
Amounts due from subsidiaries	35	24,124	15,566
Available-for-sale financial assets	29	47,330	45,016
Held-to-maturity investments	30	3,940	3,219
Investments in subsidiaries	31	15,270	13,958
Investments in associates	32	2,505	2,565
Fixed assets	34	7,609	6,836
- Investment properties		3,738	2,428
- Other property and equipment		3,871	4,408
Goodwill and intangible assets	33	1,460	1,460
Deferred tax assets	36(b)	101	130
Total Assets		472,467	422,861
EQUITY AND LIABILITIES			
Deposits and balances of banks and other financial institutions		23,507	10,607
Deposits from customers		323,114	306,653
Trading liabilities	37(a)	11	21
Negative fair value of derivatives	45(b)(ii)	2,766	3,059
Certificates of deposit issued		45,129	29,570
- At fair value through profit or loss		8,509	6,095
- At amortised cost		36,620	23,475
Amounts due to subsidiaries	35	3,108	3,105
Current taxation	36(a)	1,097	872
Debt securities issued		3,448	1,200
- At fair value through profit or loss		150	698
- At amortised cost		3,298	502
Deferred tax liabilities	36(b)	596	600
Other accounts and provisions	37(b)	6,330	7,033
Loan capital	38	18,110	18,673
- At fair value through profit or loss		4,478	4,410
- At amortised cost		13,632	14,263
Total Liabilities		427,216	381,393
Share capital	40	5,724	5,568
Reserves	41	39,527	35,900
Total equity attributable to owners of the Bank		45,251	41,468
Total Equity and Liabilities		472,467	422,861

Approved and authorised for issue by the Board of Directors on 18th February, 2014.

Chairman and Chief Executive

Directors

The notes on pages 23 to 145 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31ST DECEMBER, 2013

	Share capital	Share premium	Capital reserve – staff share options issued	Exchange revaluation reserve	Investment revaluation reserve	Revaluation reserve of bank premises	Capital reserve	General reserve	Other reserves*	Retained profits	Total	Non- controlling interests	Total equity
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1 st January, 2013	5,568	16,083	135	2,769	1,012	976	130	13,823	2,611	14,046	57,153	4,486	61,639
Changes in equity													
Profit for the year	-	-	-	-	-	-	-	-	-	6,613	6,613	94	6,707
Other comprehensive income	-	-	-	105	(34)	673	-	-	46	-	790	-	790
Total comprehensive income	-	-	-	105	(34)	673	-	-	46	6,613	7,403	94	7,497
Shares issued in lieu of dividend	144	1,550	-	-	-	-	-	-	-	-	1,694	-	1,694
Shares issued under Staff Share Option Schemes	12	106	-	-	-	-	-	-	-	-	118	-	118
Equity settled share-based transaction	-	-	21	-	-	-	-	-	-	-	21	-	21
Transfer	-	31	(87)	-	-	(7)	70	54	1,113	(1,174)	-	-	-
Dividends declared or approved during the year	-	-	-	-	-	-	-	-	-	(2,707)	(2,707)	(64)	(2,771)
Purchase of interests in businesses from non-controlling interests investors	-	-	-	-	-	-	-	-	-	-	-	33	33
Exchange adjustments	-	-	-	-	-	-	-	-	-	-	-	3	3
At 31 st December, 2013	5,724	17,770	69	2,874	978	1,642	200	13,877	3,770	16,778	63,682	4,552	68,234
At 1 st January, 2012	5,190	12,037	140	2,390	27	1,032	86	13,744	2,202	10,768	47,616	4,428	52,044
Changes in equity													
Profit for the year	-	-	-	-	-	-	-	-	-	6,056	6,056	98	6,154
Other comprehensive income	-	-	-	379	985	2	-	-	19	-	1,385	-	1,385
Total comprehensive income	-	-	-	379	985	2	-	-	19	6,056	7,441	98	7,539
Shares issued in lieu of dividend	97	1,002	-	-	-	-	-	-	-	-	1,099	-	1,099
Subscription of new shares	279	3,022	-	-	-	-	-	-	-	-	3,301	-	3,301
Shares issued under Staff Share Option Schemes	2	16	-	-	-	-	-	-	-	-	18	-	18
Equity settled share-based transaction	-	-	22	-	-	-	-	-	-	-	22	-	22
Transfer	-	6	(27)	-	-	(58)	48	79	390	(485)	(47)	47	-
Dividends declared or approved during the year	-	-	-	-	-	-	-	-	-	(2,293)	(2,293)	(68)	(2,361)
Reversal due to disposal of a subsidiary	-	-	-	-	-	-	(4)	-	-	-	(4)	-	(4)
Exchange adjustments	-	-	-	-	-	-	-	-	-	-	-	(19)	(19)
At 31 st December, 2012	5,568	16,083	135	2,769	1,012	976	130	13,823	2,611	14,046	57,153	4,486	61,639

* Other reserves include statutory reserve and other reserves.

The notes on pages 23 to 145 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER, 2013

	Notes	2013 HK\$ Mn	2012 HK\$ Mn
OPERATING ACTIVITIES			
Profit for the year before taxation		8,486	7,565
Adjustments for:			
Charge for impairment losses on loans and advances	12	458	213
Charge for impairment allowances on held-to-maturity investments and available-for-sale financial assets		69	52
Share of profits less losses of associates		(684)	(536)
Net profit on sale of available-for-sale financial assets		(80)	(82)
Net profit on sale of subsidiaries and associates		(27)	(203)
Net profit on sale of fixed assets		(164)	(139)
Interest expense on loan capital and certificates of deposit		1,579	1,534
Depreciation on fixed assets	11,34	670	657
Dividend income from available-for-sale financial assets		(43)	(42)
Amortisation of intangible assets	11	32	33
Amortisation of premium/discount on certificates of deposit and loan capital issued		132	110
Revaluation (gains)/losses on certificates of deposit and loan capital issued		(487)	298
Valuation gains on investment properties	34	(388)	(454)
Revaluation loss on bank premises		-	3
Equity-settled share-based payment expenses		21	22
OPERATING PROFIT BEFORE CHANGES IN WORKING CAPITAL		9,574	9,031
(Increase)/decrease in operating assets:			
Cash and balances with banks with original maturity beyond three months		(5,178)	(811)
Placements with banks and other financial institutions with original maturity beyond three months		10,390	8,715
Trade bills		(4,191)	(8,849)
Trading assets		(1,092)	(1,828)
Financial assets designated at fair value through profit or loss		3,563	1,494
Positive fair value of derivatives		(500)	90
Advances to customers		(55,000)	(40,074)
Advances to banks and other financial institutions		141	47
Held-to-maturity debt securities		(623)	379
Available-for-sale financial assets		(12,087)	(12,256)
Other accounts and accrued interest		(6,591)	(10,578)
Increase/(decrease) in operating liabilities:			
Deposits and balances of banks and other financial institutions		(1,674)	14,715
Deposits from customers		36,201	35,710
Trading liabilities		(10)	11
Negative fair value of derivatives		739	(618)
Other accounts and provisions		8,684	9,382
Exchange adjustments		728	368
NET CASH (OUTFLOW)/INFLOW FROM OPERATIONS		(16,926)	4,928
Income tax paid			
Hong Kong profits tax paid		(537)	(50)
Outside Hong Kong profits tax paid		(767)	(746)
NET CASH (USED IN)/GENERATED FROM OPERATING ACTIVITIES		(18,230)	4,132

THE BANK OF EAST ASIA, LIMITED
CONSOLIDATED CASH FLOW STATEMENT (Continued)
FOR THE YEAR ENDED 31ST DECEMBER, 2013

	Notes	2013 HK\$ Mn	2012 HK\$ Mn
INVESTING ACTIVITIES			
Dividends received from associates		151	140
Dividends received from available-for-sale equity securities		43	42
Purchase of equity securities		(1,293)	(777)
Proceeds from sale of equity securities		1,336	745
Purchase of fixed assets	34	(750)	(436)
Purchase of investment properties		(154)	(38)
Proceeds from disposal of fixed assets		591	505
Purchase of shareholding in associates		(71)	(99)
Proceeds from disposal of an associate		160	-
Purchase of subsidiaries	46(a)	-	(11)
Proceeds from sale of interest in a subsidiary	46(b)	-	584
Purchase of interests in business from non-controlling interests investors		33	-
NET CASH GENERATED FROM INVESTING ACTIVITIES		46	655
FINANCING ACTIVITIES			
Ordinary dividends paid		(747)	(932)
Distribution to Hybrid Tier 1 issue holders		(330)	(331)
Issue of ordinary share capital	40	118	18
Subscription of new shares		-	3,301
Issue of certificates of deposit		68,516	40,875
Issue of debt securities		4,002	4,910
Issue of loan capital		-	5,066
Redemption of certificates of deposit issued		(53,274)	(25,070)
Redemption of debt securities issued		(8,173)	(2,710)
Redemption of loan capital		-	(7,920)
Interest paid on loan capital		(752)	(768)
Interest paid on certificates of deposit issued		(537)	(324)
Interest paid on debt securities issued		(370)	(345)
NET CASH GENERATED FROM FINANCING ACTIVITIES		8,453	15,770
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS		(9,731)	20,557
CASH AND CASH EQUIVALENTS AT 1ST JANUARY	46(c)	99,738	79,181
CASH AND CASH EQUIVALENTS AT 31ST DECEMBER	46(c)	90,007	99,738
Cash flows from operating activities included:			
Interest received		25,131	23,083
Interest paid		12,698	12,896
Dividend received		78	74

The notes on pages 23 to 145 form part of these accounts.

THE BANK OF EAST ASIA, LIMITED
NOTES ON THE ACCOUNTS

1. Principal Activities

The Bank and its subsidiaries (the “Group”) are engaged in the provision of banking and related financial services, and business, corporate and investor services.

2. Significant Accounting Policies

(a) Statement of Compliance

These accounts have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (“HKFRSs”), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (“HKASs”), and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. These accounts also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. A summary of the significant accounting policies adopted by the Group is set out below.

The HKICPA has issued certain new and revised HKFRSs that are first effective or available for early adoption for the current accounting period of the Group and the Bank. Note 3 provides information on the changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these accounts.

(b) Basis of Preparation of the Accounts

The accounts for the year ended 31st December, 2013 comprise the Group and the Group’s interest in associates.

The measurement basis used in the preparation of the accounts is historical cost except that the following assets and liabilities are stated at their fair value as explained in the accounting policies set out below:

- financial instruments classified as trading, designated at fair value through profit or loss and available-for-sale (Note 2(f)(ii)); and
- investment properties (Note 2(h)(ii)).

The preparation of accounts in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Details of judgements made by management in the application of HKFRSs that have significant effect on the accounts and major sources of estimation uncertainty are discussed in Note 52.

(c) Basis of Consolidation

These consolidated accounts cover the consolidated position of the Bank and all subsidiaries unless otherwise stated and the Group's interest in associates. For information required to be reported in accordance with the Banking (Disclosures) Rules, the basis of consolidation is set out in the Notes (1) and (2) in the Unaudited Supplementary Financial Information.

(i) Subsidiaries and Non-controlling interests

The consolidated accounts include the accounts of the Bank and all its subsidiaries made up to 31st December each year. Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

An investment in a subsidiary is consolidated into the consolidated accounts from the date that control commences until the date that control ceases. Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated accounts. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Non-controlling interests (previously known as "minority interests") represent the equity in a subsidiary not attributable directly or indirectly to the Bank, and in respect of which the Group has not agreed any additional terms with the holders of these interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meets the definition of a financial liability. For each business combination, the Group can elect to measure any non-controlling interests either at fair value or at their proportionate share of the subsidiary's net identifiable assets.

Non-controlling interests are presented in the consolidated statement of financial position and consolidated statement of changes in equity within equity, separately from equity attributable to equity shareholders of the Group. Non-controlling interests in the results of the Group are presented on the face of the consolidated income statement and the consolidated statement of comprehensive income as an allocation of the net profit and total comprehensive income for the year between non-controlling interests and equity shareholders of the Bank.

Changes in the Group's interests in a subsidiary that do not result in a loss of control are accounted for as equity transactions, whereby adjustments are made to the amounts of controlling and non-controlling interests within consolidated equity to reflect the change in relative interests, but no adjustments are made to goodwill and no gain or loss is recognised.

When the Group loses control of a subsidiary, it is accounted for as a disposal of the entire interest in that subsidiary, with a resulting gain or loss being recognised in profit or loss. Any interest retained in that former subsidiary at the date when

control is lost is recognised at fair value and this amount is regarded as the fair value on initial recognition of a financial asset (Note 2(f)) or, when appropriate, the cost on initial recognition of an investment in an associate (Note 2(c)(ii)).

In the Bank's statement of financial position, its investments in subsidiaries are stated at cost less any impairment losses (Note 2(k)).

(ii) Associates

An associate is a company in which the Group or the Bank has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

An investment in an associate is accounted for in the consolidated accounts under the equity method unless it is classified as held-for-sale, and is initially recorded at cost, adjusted for any excess of the Group's share of the acquisition-date fair values of the associate's identifiable net assets over the cost of the investment (if any). Thereafter, the investment is adjusted for the post acquisition change in the Group's share of the associate's net assets and any impairment loss relating to the investment (Note 2(j) and 2(k)). Any acquisition-date excess over cost, the Group's share of the post-acquisition, post-tax results of the associates and any impairment losses for the year are recognised in the consolidated income statement, whereas the Group's share of the post-acquisition post-tax items of the associate's other comprehensive income is recognised in the consolidated statement of comprehensive income.

When the Group's share of losses exceeds its interest in the associates, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. For these purposes, the Group's interest in the associate is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associate.

Unrealised profits and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates, except when unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

When the Group ceases to have significant influence over an associate, it is accounted for as a disposal of the entire interest in that associate, with a resulting gain or loss being recognised in profit or loss. Any interest retained in that former associate at the date when significant influence is lost is recognised at fair value and this amount is regarded as the fair value on initial recognition of a financial asset (Note 2(f)).

The Bank accounts for the results of associates to the extent of dividends received. Investments in associates are stated at cost less any impairment losses (Note 2(k)).

An associate is considered material if it is material to either profit or loss or balance sheet of the Group in two consecutive years.

(d) Translation of Foreign Currencies

Transactions in foreign currencies are translated into Hong Kong dollars at the rates of exchange ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the rates of exchange ruling at the end of the reporting period. Exchange differences are dealt with in the income statement.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into Hong Kong dollars using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was determined.

Exchange differences relating to investments at fair value through profit or loss and derivative financial instruments are included in gains less losses from trading securities or financial instruments designated at fair value through profit or loss. All other exchange differences relating to monetary items are presented as gains less losses from dealing in foreign currencies in the income statement. Differences arising on translation of available-for-sale equity instruments are recognised in other comprehensive income and accumulated separately in equity.

The results of foreign operations are translated into Hong Kong dollars at the exchange rates approximating the foreign exchange rates ruling at the dates of the transactions. Balance sheet items, including goodwill arising on consolidation of foreign operations acquired on or after 1st January, 2005, are translated into Hong Kong dollars at the foreign exchange rates ruling at the end of the reporting period. The resulting exchange differences are recognised directly in other comprehensive income and accumulated separately in equity in the exchange reserve. Goodwill arising on consolidation of a foreign operation acquired before 1st January, 2005 is translated at the foreign exchange rate that applied at the date of acquisition of the foreign operation.

On disposal of a foreign enterprise, the cumulative amount of the exchange differences which relate to that foreign enterprise is included in the calculation of the profit or loss on disposal.

(e) Revenue Recognition

Revenue is measured at the fair value of the consideration received or receivable. Provided it is probable that economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in the income statement as follows:

Interest income for all interest-bearing financial instruments, except those classified as held for trading or designated at fair value through profit or loss, is recognised as interest income in the income statement on an accruals basis using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating the interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms

of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

For impaired loans, the accrual of interest income based on the original terms of the loan is discontinued, but any increase in the present value of impaired loans due to the passage of time is reported as interest income.

Net income from financial instruments designated at fair value through profit or loss and net trading income comprises all gains and losses from changes in fair value (net of accrued coupon) of such financial assets and financial liabilities, together with dividend income attributable to those financial instruments.

Fee and commission income is recognised in the income statement when the corresponding service is provided, except where the fee is charged to cover the costs of a continuing service to, or risk borne for, the customer, or is interest in nature. In these cases, the fee is recognised as income in the accounting period in which the costs or risk is incurred and is accounted for as interest income.

Origination or commitment fees received/paid by the Group which result in the creation or acquisition of a financial asset are deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the Group making a loan, the fee is recognised as revenue on a straight-line basis over the commitment period.

Finance income implicit in finance leases is recognised as interest income over the period of the lease so as to produce an approximately constant periodic rate of return of the outstanding net investment in the leases for each accounting period.

Rental income received under operating leases is recognised as other operating income in equal instalments over the periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives granted are recognised in the income statement as an integral part of the aggregate net lease payments receivable. Contingent rentals receivable are recognised as income in the accounting period in which they are earned.

Dividend income from unlisted investments is recognised when the shareholder's right to receive payment is established. Dividend income from listed investments is recognised when the share price of the investment is quoted ex-dividend.

(f) Financial Instruments

(i) Initial recognition

The Group classifies its financial instruments into different categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are: fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets and other financial liabilities.

Financial instruments are measured initially at fair value, which normally will be equal to the transaction price plus, in case of a financial asset or financial liability not held at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset or issue of the financial liability. Transaction costs on financial assets and financial liabilities at fair value through

profit or loss are expensed immediately.

The Group recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument. A regular way purchase or sale of financial assets is recognised using trade date accounting. From this date, any gains and losses arising from changes in fair value of the financial assets or financial liabilities at fair value through profit or loss are recorded.

(ii) Categorisation

Fair value through profit or loss

This category comprises financial assets and financial liabilities held for trading, and those designated at fair value through profit or loss upon initial recognition, but excludes those investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured.

Trading financial instruments are financial assets or financial liabilities which are acquired or incurred principally for the purpose of trading, or are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Non-hedging derivatives are accounted for as trading instruments.

Financial instruments are designated at fair value through profit or loss upon initial recognition when:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise;
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract; or
- the separation of the embedded derivatives from the financial instrument is not prohibited.

Financial assets and financial liabilities under this category are carried at fair value. Changes in the fair value are included in the income statement in the period in which they arise. Upon disposal or repurchase, the difference between the net sales proceeds or the net payment and the carrying value is included in the income statement.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (a) those that the Group intends to sell immediately or in the near term, which will be classified as held for trading; (b) those that the Group, upon initial recognition, designates as at fair value through profit or loss or as available-for-sale; or (c) those where the Group may not recover substantially all of its initial investment, other than because of credit deterioration, which will be classified as available-for-sale. Loans and receivables mainly comprise placements with banks and other financial institutions, trade bills and loans and advances to customers.

Securities classified as loans and receivables typically comprise securities issued by the same customers with whom the Group has a lending relationship in its wholesale banking business. Investment decisions for credit substitute securities are subject to the same credit approval processes as loans, and the Group bears the same customer risk as it does for loans extended to those customers. Additionally the yield and maturity terms are generally directly negotiated by the Group with the issuer. These securities include commercial paper, short term debentures and preference shares issued by the borrower.

Loans and receivables and securities classified as loans and receivables are carried at amortised cost using the effective interest method, less impairment losses, if any (Note 2(k)).

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity which the Group has the positive intention and ability to hold to maturity, other than (a) those that the Group, upon initial recognition, designates as at fair value through profit or loss or available-for-sale; and (b) those that meet the definition of loans and receivables.

Held-to-maturity investments are carried at amortised cost using the effective interest method less impairment losses, if any (Note 2(k)).

If, as a result of a change in intention or ability, it is no longer appropriate to classify an investment as held-to-maturity, it shall be reclassified as available-for-sale and remeasured at fair value.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any of the other three categories above. They include financial assets intended to be held for an indefinite period of time, but which may be sold in response to needs for liquidity or changes in the market environment.

Available-for-sale financial assets are carried at fair value. Unrealised gains and losses arising from changes in the fair value are recognised in other comprehensive income and accumulated separately in equity, except for impairment losses and foreign exchange gains and losses on monetary items such as debt securities which are recognised in the income statement.

Investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be measured reliably, and derivatives that are linked to and must be settled by delivery of such unquoted equity securities are carried at cost less impairment losses, if any (Note 2(k)).

When the available-for-sale financial assets are sold, gains or losses on disposal include the difference between the net sale proceeds and the carrying value, and the accumulated fair value adjustments which are previously recognised in other comprehensive income shall be reclassified from equity to the income statement.

Other financial liabilities

Financial liabilities, other than trading liabilities and those designated at fair value

through profit or loss, are measured at amortised cost using the effective interest method.

(iii) Fair value measurement principles

The fair value of financial instruments is based on their quoted market prices at the end of the reporting period without any deduction for estimated future selling costs.

If there is no publicly available latest traded price nor a quoted market price on a recognised stock exchange or a price from a broker/dealer for non-exchange-traded financial instruments or if the market for it is not active, the fair value of the instrument is estimated using valuation techniques that provide a reliable estimate of prices which could be obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the end of the reporting period applicable for an instrument with similar terms and conditions. Where other pricing models are used, inputs are based on market data at the end of the reporting period.

(iv) Derecognition

The Group derecognises a financial asset when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset, together with substantially all the risks and rewards of ownership, have been transferred.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

The Group uses the weighted average method to determine realised gains and losses to be recognised in the income statement on derecognition.

(v) Offsetting

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position only where there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(vi) Embedded derivatives

An embedded derivative is a component of a hybrid (combined) instrument that includes both the derivative and a host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. The embedded derivatives are separated from the host contract and accounted for as a derivative when (a) the economic characteristics and risks of the embedded derivative are not closely related to the host contract; and (b) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in the income statement.

When the embedded derivative is separated, the host contract is accounted for in accordance with note (ii) above.

(g) Hedging

Hedge accounting recognises the offsetting effects on profit or loss of changes in the fair values of the hedging instrument and the hedged item. The Group assesses and documents whether the financial instruments that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items attributable to the hedged risks both at hedge inception and on an ongoing basis. The Group discontinues prospectively hedge accounting when (a) the hedging instrument expires or is sold, terminated or exercised; (b) the hedge no longer meets the criteria for hedge accounting; or (c) the Group revokes the designation.

(i) Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, or the foreign currency risk of a committed future transaction, the effective part of any gain or loss on remeasurement of the derivative financial instrument to fair value is recognised in other comprehensive income and accumulated separately in equity in the hedging reserve. The ineffective portion of any gain or loss is recognised immediately in the income statement.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the cumulative gain or loss at that point remains in equity until the transaction occurs and is recognised in the income statement. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss is reclassified from equity to the income statement immediately.

(ii) Fair value hedge

A fair value hedge seeks to offset risks of changes in the fair value of recognised asset or liability that will give rise to a gain or loss being recognised in the income statement.

The hedging instrument is measured at fair value, with fair value changes recognised in the income statement. The carrying amount of the hedged item is adjusted by the amount of the changes in fair value of hedging instrument attributable to the risk being hedged. This adjustment is recognised in the income statement to offset the effect of the gain or loss on the hedging instrument.

When a hedging instrument expires or is sold, terminated or exercised, the hedge no longer meets the criteria for hedge accounting, or the Group revokes designation of the hedge relationship, any adjustment up to that point, to a hedged item for which the effective interest method is used, is amortised to the income statement as part of the recalculated effective interest rate of the item over its remaining life.

(iii) Hedge effectiveness testing

In order to qualify for hedge accounting, the Group carries out prospective effectiveness testing to demonstrate that it expects the hedge to be highly effective at the inception of the hedge and throughout its life. Actual effectiveness (retrospective effectiveness) is also demonstrated on an ongoing basis.

The documentation of each hedge relationship sets out how the effectiveness of the

hedge is assessed. The method which the Group adopts for assessing hedge effectiveness will depend on its risk management strategy.

For fair value hedge relationships, the Group utilises the cumulative dollar offset method or regressive analysis as effectiveness testing methodologies. For cash flow hedge relationship, the Group utilises the change in variable cash flow method or the cumulative dollar offset method using the hypothetical derivative approach.

For prospective effectiveness, the hedging instrument must be expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness, the changes in fair value or cash flows must offset each other in the range of 80 per cent to 125 per cent for the hedge to be deemed effective.

(h) Properties

- (i) Bank premises are stated in the statement of financial position at cost or at Directors' valuation, by reference to an independent professional valuation, less accumulated depreciation and accumulated impairment loss (Note 2(k)).

When a deficit arises on revaluation, it will be charged to the income statement, to the extent that it exceeds the amount held in the bank premises revaluation reserve in respect of that same asset immediately prior to the revaluation; and when a surplus arises on revaluation, it will be credited to the income statement, to the extent that a deficit on revaluation in respect of that same asset had previously been charged to the income statement.

In preparing these accounts, advantage has been taken of the transitional provisions set out in paragraph 80A of HKAS 16 "Property, Plant and Equipment" issued by the HKICPA, with the effect that bank premises have not been revalued to fair value at the end of the reporting period.

- (ii) Investment properties are properties which are held either to earn rental income or for capital appreciation or for both. Investment properties are stated at fair value. Investment properties are valued annually by external independent valuation companies, having an appropriate recognised professional qualification and recent experience in the location and category of property being valued. The fair values are based on market values, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. No allowance has been made in the valuations for any charges, mortgages or amounts owing on the properties nor any expenses or taxation which may be incurred in effecting a sale.

Any gain or loss arising from a change in fair value is recognised in the income statement. Rental income from investment property is accounted for as described in Note 2(e).

When a bank property is transferred to investment property following a change in its use, any differences arising at the date of transfer between the carrying amount of the bank property immediately prior to transfer and its fair value is recognised as a revaluation of bank premises as described in Note 2(h)(i).

If an investment property becomes owner-occupied, it is reclassified as bank

premises and its fair value at the date of reclassification becomes its cost for subsequent accounting purposes.

A property interest under an operating lease is classified and accounted for as an investment property when the Group holds it to earn rentals or for capital appreciation or both. Any such property interest under an operating lease classified as an investment property is carried at fair value. Lease payments are accounted for as described in Note 2(l).

- (iii) Profit or loss on disposal of bank premises and investment properties is determined as the difference between the net sales proceeds and the carrying amount of the asset and is recognised in the income statement upon disposal. Any surplus that is included in the bank premises revaluation reserve related to the bank premises disposed is transferred to the general reserve.

(i) Amortisation and Depreciation

(i) Bank premises

Freehold land is not amortised. Leasehold land held for own use under an operating lease, the fair value of which cannot be measured separately from the fair value of a building situated thereon at the inception of the lease, is accounted for as being held under a finance lease. Leasehold land is amortised on a straight line basis over the remaining term of the lease. Buildings are depreciated on a straight line basis at rates calculated to write off the cost or valuation of each building over its estimated useful life of 50 years or the remaining lease period of the land on which it is situated, whichever is the shorter.

Investment properties are not depreciated.

(ii) Other fixed assets

Other fixed assets are stated in the statement of financial position at cost less accumulated depreciation and impairment losses, which is calculated on a straight line basis to write off the assets over their estimated useful lives from 4 to 20 years.

(j) Goodwill

Goodwill represents the excess of

- (i) the aggregate of the fair value of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the Group's previously held equity interest in the acquiree; over
- (ii) the Group's interest in the net fair value of the acquiree's identifiable assets and liabilities measured as at the acquisition date.

When (ii) is greater than (i), then this excess is recognised immediately in profit or loss as a gain on a bargain purchase.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill arising on a business combination is allocated to each cash-generating unit, or groups of cash generating units, that is expected to benefit from the synergies of the combination and is tested annually for impairment (Note 2(k)).

On disposal of a cash generating unit, or an associate during the year, any attributable amount of purchased goodwill is included in the calculation of the profit and loss on disposal.

Expenditure on internally generated goodwill and brands is recognised as an expense in the period in which it is incurred.

(k) Impairment of Assets

At each end of the reporting period, the carrying amount of the Group's assets are reviewed to determine whether there is objective evidence of impairment. If internal and external sources of information indicate such evidence exists, the carrying amount is reduced to the estimated recoverable amount and an impairment loss is recognised in the income statement.

(i) Loans and receivables

The impairment losses of loans and receivables are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets). Receivables with a short duration are not discounted if the effect of discounting is immaterial.

The total allowance for impairment losses consists of two components: individual impairment allowances, and collective impairment allowances.

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

The individual impairment allowance is based upon management's best estimate of the present value of the cash flows which are expected to be received discounted at the original effective interest rate. In estimating these cash flows, management makes judgements about the borrower's financial situation and the net realisable value of any underlying collateral or guarantees in favour of the Group. Each impaired asset is assessed on its own merits.

In assessing the need for collective loan loss allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required allowance, the Group makes assumptions both to define the way the Group models inherent losses and to determine the required input parameters, based on historical experience and current economic conditions.

The accuracy of the impairment allowances the Group makes depends on how well the Group can estimate future cash flows for individually assessed impairment allowances and the model assumptions and parameters used in determining collective impairment allowances. While this necessarily involves judgement, the Group believes that the impairment allowances on loans and advances to customers are reasonable and supportable.

All loans and receivables are reviewed and analysed periodically. Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates that can be linked objectively to an event occurring after the write-down, will result in a change in the impairment allowances on loans and receivables and will be charged or credited to the income statement. A reversal of impairment losses is limited to the loans and receivables' carrying amount that would have been determined had no impairment loss been recognised in prior years.

Where there is no reasonable prospect of recovery, the loan and the related interest receivables are written off.

Loans and receivables with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Group has made concessions that it would not otherwise consider. Renegotiated loans and receivables are subject to ongoing monitoring to determine whether they remain impaired or past due.

(ii) Held-to-maturity investments

Impairment on held-to-maturity investments is considered at both an individual and collective level. The individual impairment allowance is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at asset's original effective interest rate, where the effect of discounting is material.

All significant assets found not to be individually impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets with similar risk characteristics.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement. A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

(iii) Available-for-sale financial assets

When there is objective evidence that an available-for-sale financial asset is impaired, the cumulative loss that had been recognised in the fair value reserve is reclassified to the income statement. The amount of the cumulative loss that is recognised in the income statement is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in the income statement.

For unquoted available-for-sale equity securities that are carried at cost, the impairment loss is measured as the difference between the carrying amount of the equity securities and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset, where the effect of discounting is material.

Impairment losses recognised in the income statement in respect of available-for-sale equity securities are not reversed through the income statement. Any

subsequent increase in the fair value of such assets is recognised directly in other comprehensive income.

Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in the income statement.

(iv) Other assets

Internal and external sources of information are reviewed at each end of the reporting period to identify indications that the following assets may be impaired or, except in the case of goodwill, an impairment loss previously recognised no longer exists or may have decreased:

- property and equipment (other than properties carried at revalued amounts);
- investments in subsidiaries and associates;
- goodwill; and
- intangible assets

If any such indication exists, the asset's recoverable amount is estimated. In addition, for goodwill, the recoverable amount is estimated annually whether or not there is any indication of impairment.

Calculation of recoverable amount

The recoverable amount of an asset is the greater of its fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

Recognition of impairment losses

An impairment loss is recognised in the income statement whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

Reversals of impairment losses

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

Reversals of impairment losses are credited to the income statement in the year in which the reversals are recognised.

(v) Interim financial reporting and impairment

Under the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, the Group is required to prepare an interim financial report in compliance with HKAS 34, Interim financial reporting, in respect of the first six months of the year. At the end of the interim period, the Group applies the same impairment testing, recognition, and reversal criteria as it would at the end of the year (Note 2(k)(i) to (iv)).

Impairment losses recognised in an interim period in respect of goodwill, available-for-sale equity securities and unquoted equity securities carried at cost are not reversed in a subsequent period. This is the case even if no loss, or a smaller loss, would have been recognised had the impairment been assessed only at the end of the year to which the interim period relates. Consequently, if the fair value of an available-for-sale equity security increases in the remainder of the annual period, or in any other period subsequently, the increase is recognised in other comprehensive income and not the income statement.

(l) Leased Assets

Leases of assets under which the lessee assumes substantially all the risks and benefits of ownership are classified as finance leases. Leases of assets under which the lessor has not transferred all the risks and benefits of ownership are classified as operating leases.

(i) Assets held under finance leases

The amounts due from lessees in respect of finance leases are recorded in the statement of financial position as advances to customers at the amounts of net investment which represent the total rentals receivable under finance leases less unearned income. Revenue arising from finance leases is recognised in accordance with the Group's revenue recognition policies, as set out in Note 2(e).

(ii) Assets held for use in operating leases

Where the Group leases out assets under operating leases, the leased assets are included in the statement of financial position according to their nature and, where applicable, are depreciated in accordance with the Group's depreciation policies, as set out in Note 2(i). Impairment losses are accounted for in accordance with the accounting policy as set out in Note 2(k). Revenue arising from operating leases is recognised in accordance with the Group's revenue recognition policies, as set out in Note 2(e).

(iii) Operating lease charges

Where the Group has the use of assets under operating leases, payments made under the leases are charged to the income statement in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in the income statement as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the income statement in the accounting period in which they are incurred.

(m) Repossession of Assets

In the recovery of impaired loans and advances, the Group may take possession of the collateral assets through court proceedings or voluntary delivery of possession by the borrowers. In accordance with the Group's accounting policy set out in Note 2(k), impairment allowances for impaired loans and advances are maintained after taking into account the net realisable value of the collateral assets, usually resulting in a partial write-off of the loans and advances against impairment allowances. Repossessed assets are reported under other assets if it is highly probable that their carrying amount will be recovered through a sale transaction rather than through continuing use and the assets are available for sale in their present condition. Related loans and advances are then written off.

Repossessed assets are recorded at the lower of the amount of the related loans and advances and fair value less costs to sell at the date of exchange. They are not depreciated or amortised.

Impairment losses on initial classification and on subsequent remeasurement are recognised in the income statement.

(n) Income Tax

- (i) Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the income statement except to the extent that they relate to items recognised in other comprehensive income or directly in equity, in which case the relevant amounts of tax are recognised in other comprehensive income or directly in equity, respectively.
- (ii) Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the end of the reporting period, and any adjustment to tax payable in respect of previous years.
- (iii) Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same

taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing deductible temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination), and temporary differences relating to investments in subsidiaries to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

Where investment properties are carried at their fair value in accordance with the accounting policy set out in Note 2 (h)(ii), the amount of deferred tax recognised is measured using the tax rates that would apply on sale of those assets at their carrying value at the reporting date unless the property is depreciable and is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the property over time, rather than through sale. In all other cases, the amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the reporting date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each end of the reporting period and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividends is recognised.

- (iv) Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if the Bank or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:
- in the case of current tax assets and liabilities, the Bank or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
 - in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
 - the same taxable entity; or
 - different taxable entities, which in each future period in which significant

amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

(o) Insurance Reserves and Provisions for Outstanding Claims

Insurance reserves, except those attributable to long term business, represent the proportion of retained premiums written in the year relating to the period of risk from 1st January in the following year to the subsequent date of expiry of policies which is carried forward as a provision for unearned premiums and calculated on a daily basis.

The insurance reserve for long term business is ascertained by actuarial valuation.

Full provision is made for the estimated cost of claims notified but not settled at the end of the reporting period and for the estimated cost of claims incurred but not reported by that date, after deducting the amounts due from reinsurers. Provision has also been made for the estimated cost of servicing claims notified but not settled at the end of the reporting period and to meet expenses on claims incurred but not reported at the end of the reporting period.

These reserves and provisions are classified as other accounts and provisions.

(p) Provisions and Contingent Liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Bank has a legal or constructive obligation arising as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditures expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events, are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(q) Employee Benefits

(i) Salaries, bonuses and leave benefits

Employee entitlements to salaries, annual bonuses, paid annual leave, leave passage and the cost to the Group of non-monetary benefits are recognised when they accrue to employees. An accrual is made for the estimated liability for annual leave as a result of services rendered by employees up to the end of the reporting period.

Employee entitlements to sick leave and maternity leave are recognised when the absences occur.

(ii) Performance-related bonus plan

Liabilities for performance-related bonus plan, which are due wholly within twelve

months after the end of the reporting period, are recognised when the Group has a present legal or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made.

(iii) Retirement benefits

Retirement benefits are provided to eligible staff of the Group. Hong Kong employees enjoy retirement benefits under either the Mandatory Provident Fund Exempted ORSO Scheme (“MPFEOS”) or the Mandatory Provident Fund Scheme (“MPFS”). Both are defined contribution schemes. The employer’s monthly contributions to both schemes are at a maximum of 10% of each employee’s monthly salary.

The pension schemes covering all the Group’s PRC and overseas employees are defined contribution schemes at various funding rates, and are in accordance with local practices and regulations.

The cost of all these schemes is charged to the income statement for the period concerned and the assets of all these schemes are held separately from those of the Group. Under the MPFEOS, the employer’s contribution is not reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions. Under the MPFS, the employer’s contribution is reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions.

(iv) Share based payments

The option exercise price is equal to the higher of:

- (a) the closing price of the Bank’s shares in the Stock Exchange’s daily quotation sheet on the date of grant of the relevant options;
- (b) an amount equivalent to the average closing price of the Bank’s shares as stated in the Stock Exchange’s daily quotation sheets for the 5 business days immediately preceding the date of grant of the relevant options; and
- (c) the nominal value of the Bank’s shares.

When the options are exercised, equity is increased by the amount of the proceeds received. The fair value of share options granted to employees is recognised as an expense in the income statement with a corresponding increase in a capital reserve within equity. The fair value is measured at the grant date using the trinomial model, taking into account the terms and conditions upon which the options were granted. Where the employees have to meet vesting conditions before becoming unconditionally entitled to those share options, the total estimated fair value of the share options is spread over the vesting period, taking into account the probability that the options will vest.

During the vesting period, the number of share options that is expected to vest is reviewed. Any resulting adjustment to the cumulative fair value recognised in prior years is charged or credited to the income statement for the year of the review unless the original expenses qualify for recognition as an asset, with a corresponding adjustment to the capital reserve. On vesting date, the amount recognised as an expense is adjusted to reflect the actual number of share options that vest (with a corresponding adjustment to capital reserve) except where forfeiture is only due to not achieving vesting conditions that relate to the market price of the Bank's shares.

The equity amount is recognised in capital reserve until either the option is exercised (when it is transferred to share premium) or the option expires (when it is released directly to retained profits).

(r) Related Parties

For the purposes of these accounts, a party is considered to be related to the Group if:

- (a) A person, or a close member of that person's family, is related to the Group if that person:
 - (i) has control or joint control over the Group;
 - (ii) has significant influence over the Group; or
 - (iii) is a member of the key management personnel of the Group or the Group's parent.
- (b) An entity is related to the Group if any of the following conditions applies:
 - (i) The entity and the Group are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
 - (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a Group of which the other entity is a member).
 - (iii) Both entities are joint venture of the same third party.
 - (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
 - (v) The entity is a post-employment benefit plan for the benefit of employees of either the Group or an entity related to the Group.
 - (vi) The entity is controlled or jointly controlled by a person identified in (a).
 - (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity.

(s) Segment Reporting

Operating segments, and the amounts of each segment item reported in the accounts, are identified from the financial information provided regularly to the Group's most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

Individually material operating segments are not aggregated for financial reporting purposes unless the segments have similar economic characteristics and are similar in respect of the nature of products and services, the nature of production processes, the type or class of customers, the methods used to distribute the products or provide the services, and the nature of the regulatory environment. Operating segments which are not individually material may be aggregated if they share a majority of these criteria.

(t) Cash and Cash Equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition including cash, balances with banks and other financial institutions, treasury bills, other eligible bills and certificates of deposit that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

(u) Deposits, debt securities issued and subordinated liabilities

Deposits, debt securities issued and subordinated liabilities are the Group's sources of debt funding.

The Group classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. The Group's redeemable preference shares bear non-discretionary coupons and are redeemable by the holder, and are therefore included within subordinated liabilities.

Subsequent to initial recognition deposits, debt securities issued and subordinated liabilities are measured at their amortised cost using the effective interest method, except where the Group designates liabilities at fair value through profit or loss.

3. Changes in Accounting Policies

The HKICPA has issued a number of new HKFRSs and amendments to HKFRSs that are first effective for the current accounting period of the Group and the Bank. Of these, the following developments are relevant to the Group's accounts:

- Amendments to HKAS 1, *Presentation of financial statements – Presentation of items of other comprehensive income*
- HKFRS 10, *Consolidated financial statements*
- HKFRS 12, *Disclosure of interests in other entities*
- HKFRS 13, *Fair value measurement*
- *Annual Improvements to HKFRSs 2009-2011 Cycle*

- Amendments to HKFRS 7 – *Disclosures – Offsetting financial assets and financial liabilities*

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period.

Amendments to HKAS 1, Presentation of financial statements – Presentation of items of other comprehensive income

The amendments to HKAS 1 require entities to present the items of other comprehensive income that would be reclassified to income statement in the future if certain conditions are met separately from those that would never be reclassified to income statement. The Group's presentation of other comprehensive income in these financial statements has been modified accordingly.

HKFRS 10, Consolidated financial statements

HKFRS 10 replaces the requirements in HKAS 27, Consolidated and separate financial statements relating to the preparation of consolidated financial statements and HK-SIC 12 Consolidation – Special purpose entities. It introduces a single control model to determine whether an investee should be consolidated, by focusing on whether the entity has power over the investee, exposure or rights to variable returns from its involvement with the investee and the ability to use its power to affect the amount of those returns.

As a result of the adoption of HKFRS 10, the Group has changed its accounting policy with respect to determining whether it has control over an investee. The adoption does not change any of the control conclusions reached by the Group in respect of its involvement with other entities as at 1st January, 2013.

HKFRS 12, Disclosure of interests in other entities

HKFRS 12 brings together into a single standard all the disclosure requirements relevant to an entity's interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. The disclosures required by HKFRS 12 are generally more extensive than those previously required by the respective standards. To the extent that the requirements are applicable to the Group, the Group has provided those disclosures in Notes 31 and 32.

HKFRS 13, Fair value measurement

HKFRS 13 replaces existing guidance in individual HKFRSs with a single source of fair value measurement guidance. HKFRS 13 also contains extensive disclosure requirements about fair value measurements for both financial instruments and non-financial instruments. The Group has provided those disclosures in Note 44. The adoption of HKFRS 13 does not have any material impact on the fair value measurements of the Group's assets and liabilities.

Annual Improvements to HKFRSs 2009-2011 Cycle

This cycle of annual improvements contains amendments to five standards with

consequential amendments to other standards and interpretations. Among them, HKAS 34 has been amended to clarify that total assets for a particular reportable segment are required to be disclosed only if the amounts are regularly provided to the chief operating decision maker (CODM) and only if there has been a material change in the total assets for that segment from the amount disclosed in the last annual financial statements. The amendment also requires the disclosure of segment liabilities if the amounts are regularly provided to the CODM and there has been a material change in the amounts compared with the last annual financial statements. The amendment does not have any impact on the segment disclosure of the Group because the Group does not have any reportable segments with total assets or total liabilities materially different from the amounts reported in the last annual financial statements.

Amendments to HKFRS 7 – Disclosures – Offsetting financial assets and financial liabilities

The amendments introduce new disclosures in respect of offsetting financial assets and financial liabilities. Those new disclosures are required for all recognised financial instruments that are set off in accordance with HKAS 32, *Financial instruments: Presentation* and those that are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments and transactions, irrespective of whether the financial instruments are set off in accordance with HKAS 32. To the extent that the requirements are applicable to the Group, the Group has expanded its disclosures about the offsetting of financial assets and financial liabilities in Note 43(a)(v).

4. Interest Income

	2013 HK\$ Mn	2012 HK\$ Mn
Securities classified as held-to-maturity or available-for-sale		
- listed	692	464
- unlisted	1,116	944
Trading assets		
- listed	16	18
- unlisted	241	218
Interest rate swaps	1,670	1,576
Financial assets designated at fair value through profit or loss		
- listed	401	433
- unlisted	184	220
Loans, deposits with banks and financial institutions, and trade bills	20,764	18,762
	<u>25,084</u>	<u>22,635</u>

Included above is interest income accrued on impaired financial assets of HK\$88 million (2012: HK\$85 million) which includes interest income on unwinding of discount on loan impairment losses of HK\$14 million (2012: HK\$20 million) (Note 28(b)) for the year ended 31st December, 2013.

5. Interest Expense

	2013 HK\$ Mn	2012 HK\$ Mn
Customer deposits, deposits of banks and other financial institutions and certificates of deposit issued which are stated at amortised cost	10,019	9,754
Debt securities issued	272	360
Subordinated notes carried at amortised cost	751	730
Interest rate swaps	1,736	1,877
Financial instruments designated at fair value through profit or loss	138	170
Other borrowings	1	20
	<u>12,917</u>	<u>12,911</u>

6. Fee and Commission Income

Fee and commission income arises from the following services:

	2013 HK\$ Mn	2012 HK\$ Mn
Corporate services	1,064	1,041
Credit cards	997	860
Loans, overdrafts and guarantees	970	599
Trade finance	458	400
Other retail banking services	417	369
Securities and brokerage	345	279
Trust and other fiduciary activities	202	152
Others	421	459
Total fee and commission income	<u>4,874</u>	<u>4,159</u>

of which:

Net fee income, other than amounts included in determining the effective interest rate, arising from financial assets or financial liabilities that are not held for trading nor designated at fair value through profit or loss

	4,011	3,396
Fee income	4,874	4,159
Fee expenses	(863)	(763)

7. Net Trading Profits

	2013 HK\$ Mn	2012 HK\$ Mn
Profit/(Loss) on dealing in foreign currencies	287	(68)
Profit on trading securities	38	275
Net gain on derivatives	518	526
Dividend income from listed trading securities	35	32
	<u>878</u>	<u>765</u>

8. Net Result from Financial Instruments Designated at Fair Value through Profit or Loss

	2013 HK\$ Mn	2012 HK\$ Mn
Revaluation gain on debts issued	16	17
Net loss on sale of other financial instruments designated at fair value through profit or loss	(87)	(113)
Profit on redemption of subordinated notes issued	-	24
Revaluation (loss)/gain on other financial instruments designated at fair value through profit or loss	(316)	736
	<u>(387)</u>	<u>664</u>

9. Net Hedging Loss

	2013 HK\$ Mn	2012 HK\$ Mn
Fair value hedges		
- Net gain/(loss) on hedged items attributable to the hedged risk	299	(229)
- Net (loss)/gain on hedging instruments	(321)	214
	<u>(22)</u>	<u>(15)</u>

There was insignificant ineffectiveness recognised in the Group's income statement arising from cash flow hedge for the year 2013 and 2012.

10. Other Operating Income

	2013 HK\$ Mn	2012 HK\$ Mn
Dividend income from available-for-sale financial assets		
- listed	8	8
- unlisted	35	34
Rental from safe deposit boxes	77	78
Net revenue from insurance activities	277	241
Rental income on properties	127	142
Others	101	89
	<u>625</u>	<u>592</u>

11. Operating Expenses

	2013 HK\$ Mn	2012 Restated HK\$ Mn
Contributions to defined contribution plan*		
- Hong Kong	146	142
- Outside Hong Kong	315	264
Equity-settled share-based payment expenses	21	22
Salaries and other staff costs	4,929	4,372
Total staff costs	5,411	4,800
Premises and equipment expenses excluding depreciation		
- Rental of premises	652	583
- Maintenance, repairs and others	585	551
Total premises and equipment expenses excluding depreciation	1,237	1,134
Depreciation on fixed assets (Note 34)	670	657
Amortisation of intangible assets (Note 33(b))	32	33
Other operating expenses		
- Stamp duty, overseas and PRC** business taxes, and value added taxes	680	580
- Communications, stationery and printing	316	325
- Advertising expenses	264	272
- Legal and professional fees	262	252
- Business promotions and business travel	203	176
- Card related expenses	101	160
- Insurance expenses	29	32
- Donations	19	14
- Audit fee	15	15
- Membership fees	15	12
- Administration expenses of corporate services	14	14
- Bank charges	10	12
- Bank licence	4	4
- Others	301	233
Total other operating expenses	2,233	2,101
Total operating expenses***	9,583	8,725

* Forfeited contributions totalling HK\$13 million (2012: HK\$8 million) were utilised to reduce the Group's contribution during the year. There were no forfeited contributions available for reducing future contributions at the year end (2012: Nil).

** PRC denotes the People's Republic of China.

*** Included in operating expenses are direct operating expenses of HK\$39 million (2012: HK\$22 million) in respect of investment properties which generated rental income during the year.

12. Impairment Losses on Loans and Advances

	2013 HK\$ Mn	2012 HK\$ Mn
Net charge for impairment losses on loans and advances		
Individual impairment loss		
- new provisions	492	398
- releases	(70)	(111)
- recoveries	(106)	(112)
	316	175
Collective impairment loss		
- new provisions (Note 28(b))	142	38
Net charge to income statement	458	213

13. Net Profit on Sale of Available-for-sale Financial Assets

	2013 HK\$ Mn	2012 HK\$ Mn
Net revaluation gain transferred from reserves (Note 41(h))	142	113
Loss arising in current year	(62)	(31)
	<u>80</u>	<u>82</u>

14. Net Profit on Sale of Fixed Assets

	2013 HK\$ Mn	2012 HK\$ Mn
Net profit on sale of investment properties	84	137
Net profit on sale of bank premises, furniture, fixtures and equipment	80	2
	<u>164</u>	<u>139</u>

15. Valuation Gains on Properties

	2013 HK\$ Mn	2012 HK\$ Mn
Investment properties (Note 34)	388	454
Bank premises (Note 34)	-	(3)
	<u>388</u>	<u>451</u>

16. Income Tax

(a) Taxation in the consolidated income statement represents:

	2013 HK\$ Mn	2012 HK\$ Mn
Current tax – Hong Kong (Note 36(a))		
Tax for the year	691	533
Under-provision in respect of prior years	17	35
	<u>708</u>	<u>568</u>
Current tax – outside Hong Kong		
Tax for the year	1,009	752
Write back of over-provision in respect of prior years	(51)	(22)
	<u>958</u>	<u>730</u>
Deferred tax (Note 36(b))		
Origination and reversal of temporary differences	113	113
	<u>1,779</u>	<u>1,411</u>

The provision for Hong Kong profits tax is calculated at 16.5% (2012: 16.5%) of the estimated assessable profits for the year.

Taxation for overseas branches and subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2013 HK\$ Mn	2012 HK\$ Mn
Profit before tax	<u>8,486</u>	<u>7,565</u>
Notional tax on profit before tax, calculated at the rates applicable to profits in the tax jurisdictions concerned	1,732	1,373
Tax effect of non-deductible expenses	365	306
Tax effect of non-taxable revenue	(302)	(307)
Tax effect of tax losses not recognised	18	23
Recognition of deferred tax assets on prior year tax losses	(8)	(2)
(Write back of over-provision)/Under-provision in respect of prior years	(34)	13
Others	8	5
Actual tax expense	<u>1,779</u>	<u>1,411</u>

17. Profit Attributable to Owners of the Parent

The consolidated profit attributable to owners of the parent includes a profit of HK\$3,277 million (2012: HK\$2,894 million) which has been dealt with in the accounts of the Bank.

Reconciliation of the above amount to the Bank's profit for the year

	2013 HK\$ Mn	2012 HK\$ Mn
Amount of consolidated profit attributable to equity holders dealt with in the Bank's accounts	3,277	2,894
Final dividends from subsidiaries and associates attributable to the profits of the previous financial year and general reserves, approved and paid during the year	109	103
Bank's profit for the year	<u>3,386</u>	<u>2,997</u>

18. Dividends

(a) Dividends attributable to the year

	2013 HK\$ Mn	2012 HK\$ Mn
Interim dividend declared and paid of HK\$0.43 per share on 2,264 million shares (2012: HK\$0.43 per share on 2,100 million shares) (Note 41(j))	973	903
Second interim dividend paid in respect of the previous financial year on shares issued under the share option schemes subsequent to the end of the reporting period and before the close of the Register of Members of the Bank, of HK\$0.63 per share (2012: HK\$0.51 per share)	1	-
Second interim dividend in lieu of the final dividend of HK\$0.68 per share on 2,290 million shares (2012: HK\$0.63 per share on 2,227 million shares)	1,557	1,403
	<u>2,531</u>	<u>2,306</u>

The second interim dividend in lieu of the final dividend has not been recognised as a liability at the end of the reporting period.

(b) Dividends attributable to the previous financial year, approved and paid during the year

	2013 HK\$ Mn	2012 HK\$ Mn
Second interim dividend in respect of the previous financial year, approved and paid during the year, of HK\$0.63 per share on 2,227 million shares (2012: HK\$0.51 per share on 2,076 million shares)	<u>1,403</u>	<u>1,059</u>

(c) Distribution to holders of Hybrid Tier 1 capital instruments

	2013 HK\$ Mn	2012 HK\$ Mn
Interest payable on the Hybrid Tier 1 capital instruments, the details of which are disclosed in Note 38 and Note 41(j)	<u>330</u>	<u>331</u>

19. Earnings Per Share**(a) Basic earnings per share**

The calculation of basic earnings per share is based on earnings of HK\$6,283 million (2012: HK\$5,725 million) after the distribution of HK\$330 million (2012: HK\$331 million) to Hybrid Tier 1 issue holders and on the weighted average of 2,261 million (2012: 2,105 million) ordinary shares outstanding during the year, calculated as follows:

Weighted average number of ordinary shares

	2013 Number of shares million	2012 Number of shares million
Issued ordinary shares at 1 st January	2,227	2,076
Effect of share options exercised and shares issued in lieu of dividends	34	29
Weighted average number of ordinary shares at 31 st December	<u>2,261</u>	<u>2,105</u>

(b) Diluted earnings per share

The calculation of diluted earnings per share is based on earnings of HK\$6,283 million (2012: HK\$5,725 million) after the distribution of HK\$330 million (2012: HK\$331 million) to Hybrid Tier 1 issue holders and on 2,262 million (2012: 2,106 million) ordinary shares, being the weighted average number of ordinary shares outstanding during the year, adjusted for the effects of all dilutive potential shares.

Weighted average number of ordinary shares (diluted)

	2013 Number of shares million	2012 Number of shares million
Weighted average number of ordinary shares at 31 st December	2,261	2,105
Effect of deemed issue of ordinary shares under the Bank's share option schemes for nil consideration	1	1
Weighted average number of ordinary shares (diluted) at 31 st December	<u>2,262</u>	<u>2,106</u>

20. Directors' Remuneration

Directors' remuneration disclosed pursuant to Section 161 of the Hong Kong Companies Ordinance is as follows:

	Directors' fees HK\$ Mn	Salaries, allowances and benefits in kind HK\$ Mn	Discretionary bonuses HK\$ Mn	Share options HK\$ Mn	Retirement scheme contributions HK\$ Mn	2013 Total HK\$ Mn
Chairman and Chief Executive						
Dr. the Hon. Sir David LI Kwok-po	0.5	9.8	22.1	7.5	1.0	40.9
Non-executive Directors						
Prof. Arthur LI Kwok-cheung	0.3	-	-	-	-	0.3
Mr. Aubrey LI Kwok-sing	0.4	-	-	-	-	0.4
Mr. Richard LI Tzar-kai	0.3	-	-	-	-	0.3
Mr. Eric LI Fook-chuen	0.4	-	-	-	-	0.4
Mr. Stephen Charles LI Kwok-sze	0.3	-	-	-	-	0.3
Dr. Isidro FAINÉ CASAS	0.3	-	-	-	-	0.3
Mr. Peter LEE Ka-kit	0.3	-	-	-	-	0.3
Independent Non-executive Directors						
Dr. Allan WONG Chi-yun	0.5	-	-	-	-	0.5
Mr. WONG Chung-hin	0.3	-	-	-	-	0.3
Mr. Winston LO Yau-lai	0.5	-	-	-	-	0.5
Tan Sri Dr. KHOO Kay-peng	0.3	-	-	-	-	0.3
Dr. Thomas KWOK Ping-kwong	0.3	-	-	-	-	0.3
Mr. Kenneth LO Chin-ming	0.4	-	-	-	-	0.4
Mr. William DOO Wai-hoi	0.4	-	-	-	-	0.4
Mr. KUOK Khoon-ean	0.3	-	-	-	-	0.3
Mr. Valiant CHEUNG Kin-piu	0.6	-	-	-	-	0.6
	<u>6.4</u>	<u>9.8</u>	<u>22.1</u>	<u>7.5</u>	<u>1.0</u>	<u>46.8</u>

20. Directors' Remuneration (continued)

	Directors' fees HK\$ Mn	Salaries, allowances and benefits in kind HK\$ Mn	Discretionary bonuses HK\$ Mn	Share options HK\$ Mn	Retirement scheme contributions HK\$ Mn	2012 Total HK\$ Mn
Chairman and Chief Executive						
Dr. the Hon. Sir David LI Kwok-po	0.4	9.4	20.9	7.4	0.9	39.0
Non-executive Directors						
Prof. Arthur LI Kwok-cheung	0.2	-	-	-	-	0.2
Mr. Aubrey LI Kwok-sing	0.3	-	-	-	-	0.3
Tan Sri Dr. KHOO Kay-peng	0.2	-	-	-	-	0.2
Mr. Richard LI Tzar-kai	0.2	-	-	-	-	0.2
Mr. Eric LI Fook-chuen	0.3	-	-	-	-	0.3
Mr. Stephen Charles LI Kwok-sze	0.2	-	-	-	-	0.2
Dr. Isidro FAINÉ CASAS	0.3	-	-	-	-	0.3
Independent Non-executive Directors						
Dr. Allan WONG Chi-yun	0.4	-	-	-	-	0.4
Mr. WONG Chung-hin	0.3	-	-	-	-	0.3
Dr. LEE Shau-kee	0.3	-	-	-	-	0.3
Mr. Winston LO Yau-lai	0.4	-	-	-	-	0.4
Dr. Thomas KWOK Ping-kwong	0.3	-	-	-	-	0.3
Mr. Kenneth LO Chin-ming	0.3	-	-	-	-	0.3
Mr. William DOO Wai-hoi	0.3	-	-	-	-	0.3
Mr. KUOK Khoo-eon	0.3	-	-	-	-	0.3
Mr. Valiant CHEUNG Kin-piu	0.5	-	-	-	-	0.5
	<u>5.2</u>	<u>9.4</u>	<u>20.9</u>	<u>7.4</u>	<u>0.9</u>	<u>43.8</u>

Included in the above remuneration were share options granted to Executive Director under the Bank's Staff Share Option Schemes. The details of these benefits in kind are disclosed under the paragraph "Information on Share Options" in the Report of the Directors and Note 39.

21. Five Top-paid Employees

	2013 HK\$ Mn	2012 HK\$ Mn
Salaries and other emoluments	25	24
Performance-related bonuses	41	39
Share options	17	17
Pension contributions	2	2
	<u>85</u>	<u>82</u>

The remuneration of the five top-paid employees is within the following bands:

HK\$	2013 Number of Employees	2012 Number of employees
10,500,001 - 11,000,000	-	3
11,000,001 - 11,500,000	4	1
38,500,001 - 39,000,000	-	1
40,500,001 - 41,000,000	1	-

Included in the emoluments of the five top-paid employees were the emoluments of 1 (2012: 1) Director and all senior management members (2013 and 2012). His director's emoluments have been included in Note 20 above.

22. Segment Reporting

The Group manages its businesses by divisions, which are organised by a mixture of both business lines and geography. In a manner consistent with the way in which information is reported internally to the Group's senior management for the purposes of resource allocation and performance assessment, the Group has presented the following nine reportable segments. No operating segments have been aggregated to form the following reportable segments.

(a) Business segments

The Group has identified the following nine reportable segments.

Personal banking, which includes branch operations, personal internet banking, consumer finance, property loans and credit card business in Hong Kong.

Corporate banking, which includes corporate lending and loan syndication, asset based lending, commercial lending and securities lending in Hong Kong.

Treasury markets, which include treasury operations and securities dealing in Hong Kong.

Wealth management, which includes private banking business and related assets in Hong Kong.

Financial institutions, which includes trade financing activities with correspondent banks in Hong Kong.

Other Hong Kong banking operations, which include insurance business, trust business, securities & futures broking, money lender activities and corporate financial advisory in Hong Kong.

China operations include the back office unit for China operations in Hong Kong, all branches, subsidiaries and associates operated in China, except those subsidiaries carrying out corporate services, data processing and other back office operations in China.

Overseas operations include the back office unit for overseas banking operations in Hong Kong, all branches, subsidiaries and associates operated in overseas, except those subsidiaries carrying out corporate services in overseas.

Corporate services include company secretarial services, share registration and business services, and offshore corporate and trust services.

22. Segment Reporting (continued)

(a) Business segments (continued)

Other businesses include property-related business, supporting units of Hong Kong operations, investment properties, bank premises, the net results of other subsidiaries in Hong Kong except for those subsidiaries which are included in other Hong Kong banking operations.

For the purposes of assessing segment performance and allocating resources between segments, the Group's senior management monitors the results, assets and liabilities attributable to each reportable segment on the following bases:

Segment assets include all tangible assets, intangible assets and financial assets with the exception of interests in associates, deferred tax assets and other corporate assets. Segment liabilities include deposits, financial liabilities and other liabilities attributable to the individual segments.

Revenue and expenses are allocated to the reportable segments with reference to interest and fee and commission income generated by those segments and the expenses incurred by those segments or which otherwise arise from the depreciation or amortisation of assets attributable to those segments. Segment revenue and expenses do not include the Group's share of revenue and expenses arising from the activities of the Group's associates. Other than reporting inter-segment income, assistance provided by one segment to another, including sharing of assets, is not measured.

In addition to receiving segment information concerning profit before taxation, management is provided with segment information concerning revenue (including inter segment lending), interest expense, depreciation, amortisation and impairment losses and additions to non-current segment assets used by the segments in their operations.

22. Segment Reporting (continued)

2013

	Hong Kong banking operations									Total reportable segments	Others	Inter-segment elimination	Total
	Personal banking	Corporate banking	Treasury markets	Wealth management	Financial institutions	Others	China operations	Overseas operations	Corporate services				
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Net interest income/(expense)	2,129	2,435	(27)	295	93	201	5,868	986	5	11,985	180	2	12,167
Non-interest income	705	620	80	313	22	588	1,118	403	1,069	4,918	504	(336)	5,086
Operating income	2,834	3,055	53	608	115	789	6,986	1,389	1,074	16,903	684	(334)	17,253
Operating expenses	(1,592)	(194)	(129)	(179)	(14)	(541)	(4,263)	(449)	(784)	(8,145)	(1,772)	334	(9,583)
Operating profit/(loss) before impairment losses	1,242	2,861	(76)	429	101	248	2,723	940	290	8,758	(1,088)	-	7,670
(Charge for)/Write back of impairment losses on loans and advances and other accounts	(91)	(68)	2	(1)	-	(10)	(280)	(5)	(5)	(458)	-	-	(458)
Impairment losses on available-for-sale financial assets and held-to-maturity investments	-	-	(68)	-	-	(1)	-	-	-	(69)	-	-	(69)
Operating profit/(loss) after impairment losses	1,151	2,793	(142)	428	101	237	2,443	935	285	8,231	(1,088)	-	7,143
Profit on sale of fixed assets, available-for-sale financial assets and loans and receivables	-	4	62	-	-	7	131	22	-	226	18	-	244
Profit on sale of subsidiaries/associates	-	-	-	-	-	-	27	-	-	27	-	-	27
Valuation gains on properties	-	-	-	-	-	-	-	164	-	164	224	-	388
Share of profits less losses of associates	-	-	-	-	-	1	182	502	(1)	684	-	-	684
Profit/(Loss) before taxation	1,151	2,797	(80)	428	101	245	2,783	1,623	284	9,332	(846)	-	8,486
Depreciation for the year	(72)	(2)	(6)	(3)	(1)	(22)	(343)	(19)	(31)	(499)	(171)	-	(670)
Segment assets	52,808	163,639	121,734	25,895	9,945	15,801	357,153	79,518	2,968	829,461	30,334	(110,620)	749,175
Investments in associates	-	-	-	-	-	59	536	4,164	20	4,779	-	-	4,779
Total assets	52,808	163,639	121,734	25,895	9,945	15,860	357,689	83,682	2,988	834,240	30,334	(110,620)	753,954
Total liabilities	260,517	1,631	75,166	21,171	1	11,600	330,958	67,928	745	769,717	2,218	(86,215)	685,720
Capital expenditure incurred during the year	35	1	3	2	-	37	318	59	161	616	97	-	713

22. Segment Reporting (continued)

	2012 (Restated)												
	Hong Kong banking operations									Total reportable segments HK\$ Mn	Others HK\$ Mn	Inter-segment elimination HK\$ Mn	Total HK\$ Mn
	Personal banking HK\$ Mn	Corporate banking HK\$ Mn	Treasury markets HK\$ Mn	Wealth management HK\$ Mn	Financial institutions HK\$ Mn	Others HK\$ Mn	China operations HK\$ Mn	Overseas operations HK\$ Mn	Corporate services HK\$ Mn				
Net interest income/(expense)	2,224	1,389	(221)	172	172	174	4,774	909	4	9,597	125	2	9,724
Non-interest income	643	551	756	289	18	510	966	396	1,049	5,178	538	(331)	5,385
Operating income	2,867	1,940	535	461	190	684	5,740	1,305	1,053	14,775	663	(329)	15,109
Operating expenses	(1,536)	(178)	(122)	(156)	(13)	(484)	(3,594)	(533)	(729)	(7,345)	(1,709)	329	(8,725)
Operating profit/(loss) before impairment losses	1,331	1,762	413	305	177	200	2,146	772	324	7,430	(1,046)	-	6,384
(Charge for)/Write back of impairment losses on loans and advances and other accounts	(51)	(79)	60	13	-	(4)	(158)	57	(8)	(170)	(43)	-	(213)
(Charge for)/Write back of impairment losses on available-for-sale financial assets and held-to-maturity investments	-	-	(61)	-	-	(1)	-	10	-	(52)	-	-	(52)
Operating profit/(loss) after impairment losses	1,280	1,683	412	318	177	195	1,988	839	316	7,208	(1,089)	-	6,119
Profit/(Loss) on sale of fixed assets, available-for-sale financial assets and loans and receivables	(6)	3	69	-	-	7	11	-	-	84	172	-	256
Profit/(Loss) on sale of subsidiaries	-	-	-	-	-	-	-	203	(4)	199	4	-	203
Valuation gains on properties	-	-	-	-	-	-	50	39	-	89	362	-	451
Share of profits less losses of associates	-	-	-	-	-	9	106	421	-	536	-	-	536
Profit/(Loss) before taxation	1,274	1,686	481	318	177	211	2,155	1,502	312	8,116	(551)	-	7,565
Depreciation for the year	(71)	(2)	(5)	(3)	(1)	(17)	(354)	(22)	(22)	(497)	(160)	-	(657)
Segment assets	46,544	143,869	121,226	21,989	7,372	13,268	329,624	70,989	2,897	757,778	27,659	(98,000)	687,437
Investments in associates	-	-	-	-	-	59	513	4,105	-	4,677	-	-	4,677
Total assets	46,544	143,869	121,226	21,989	7,372	13,327	330,137	75,094	2,897	762,455	27,659	(98,000)	692,114
Total liabilities	252,630	1,606	55,176	17,427	-	9,837	305,303	60,201	715	702,895	2,514	(74,934)	630,475
Capital expenditure incurred during the year	69	-	2	1	-	24	198	33	28	355	74	-	429

22. Segment Reporting (continued)

(b) Geographical segments

The information concerning geographical analysis has been classified by the location of the principal operations of the subsidiaries, or in the case of the Bank itself, by the location of the branches of the Bank responsible for reporting the results or booking the assets.

	2013					
	Hong Kong HK\$ Mn	People's Republic of China HK\$ Mn	Other Asian Countries HK\$ Mn	Others HK\$ Mn	Inter- segment elimination HK\$ Mn	Consolidated HK\$ Mn
The Group						
Operating income	8,719	7,150	1,019	760	(395)	17,253
Profit before taxation	3,898	2,892	929	767	-	8,486
Total assets	421,996	359,850	56,588	40,940	(125,420)	753,954
Total liabilities	372,375	332,523	50,997	33,851	(104,026)	685,720
Contingent liabilities and commitments	72,240	152,792	5,653	4,431	-	235,116
Capital expenditure during the year	229	332	93	59	-	713
	2012 (Restated)					
	Hong Kong HK\$ Mn	People's Republic of China HK\$ Mn	Other Asian Countries HK\$ Mn	Others HK\$ Mn	Inter- segment elimination HK\$ Mn	Consolidated HK\$ Mn
The Group						
Operating income	7,856	5,920	907	798	(372)	15,109
Profit before taxation	3,661	2,328	852	724	-	7,565
Total assets	384,675	329,794	48,117	36,693	(107,165)	692,114
Total liabilities	339,306	305,644	42,728	29,885	(87,088)	630,475
Contingent liabilities and commitments	67,258	133,508	4,863	4,151	-	209,780
Capital expenditure during the year	175	202	29	23	-	429

23. Cash and Balances with Banks and Other Financial Institutions (Note 46(c))

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Cash in hand	1,714	1,420	1,201	910
Balances with central banks	50,553	69,139	7,661	6,874
Balances with banks and other financial institutions	16,510	14,953	13,350	11,972
	<u>68,777</u>	<u>85,512</u>	<u>22,212</u>	<u>19,756</u>

24. Placements with Banks and Other Financial Institutions (Note 46(c))

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Placements with banks and authorised institutions	57,372	50,381	13,399	19,098
Placements with central banks	-	237	-	237
	<u>57,372</u>	<u>50,618</u>	<u>13,399</u>	<u>19,335</u>
Maturing				
- within one month	38,290	25,409	11,279	12,698
- between one month and one year	19,082	25,209	2,120	6,637
	<u>57,372</u>	<u>50,618</u>	<u>13,399</u>	<u>19,335</u>

25. Trade Bills

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Gross trade bills	59,936	55,744	52,743	47,935
Less: Individual impairment allowances	(4)	(4)	(4)	(4)
	<u>59,932</u>	<u>55,740</u>	<u>52,739</u>	<u>47,931</u>

Movement of individual impairment allowances

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
At 1 st January	4	12	4	4
New provisions charged to income statement	-	1	-	1
Net provisions released back to income statement	(1)	(1)	(1)	(1)
Amounts written off	-	(8)	-	-
Recoveries	1	-	1	-
At 31 st December	<u>4</u>	<u>4</u>	<u>4</u>	<u>4</u>

26. Trading Assets

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Treasury bills (including Exchange Fund Bills) (Note 46(c))	26	9	26	9
Debt securities (Note 46(c))	3,876	3,048	470	561
Equity securities	1,407	1,138	1,407	1,138
Investment funds	22	18	22	18
	<u>5,331</u>	<u>4,213</u>	<u>1,925</u>	<u>1,726</u>
Issued by:				
Central governments and central banks	236	26	45	26
Public sector entities	58	336	7	12
Banks and other financial institutions	2,864	681	309	323
Corporate entities	2,117	3,152	1,508	1,347
Other entities	56	18	56	18
	<u>5,331</u>	<u>4,213</u>	<u>1,925</u>	<u>1,726</u>
Analysed by place of listing:				
Debt securities				
Listed in Hong Kong	19	15	19	15
Listed outside Hong Kong	<u>281</u>	<u>342</u>	<u>281</u>	<u>342</u>
	300	357	300	357
Unlisted	<u>3,602</u>	<u>2,700</u>	<u>196</u>	<u>213</u>
	<u>3,902</u>	<u>3,057</u>	<u>496</u>	<u>570</u>
Equity securities				
Listed in Hong Kong	1,119	904	1,119	904
Listed outside Hong Kong	<u>288</u>	<u>234</u>	<u>288</u>	<u>234</u>
	<u>1,407</u>	<u>1,138</u>	<u>1,407</u>	<u>1,138</u>
Investment funds				
Listed in Hong Kong	7	8	7	8
Listed outside Hong Kong	<u>15</u>	<u>10</u>	<u>15</u>	<u>10</u>
	<u>22</u>	<u>18</u>	<u>22</u>	<u>18</u>
	<u>5,331</u>	<u>4,213</u>	<u>1,925</u>	<u>1,726</u>

27. Financial Assets Designated at Fair Value through Profit or Loss

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Certificates of deposits held (Note 46(c))	128	-	128	-
Debt securities (Note 46(c))	11,071	14,751	11,071	14,751
Equity securities	354	412	-	119
Investment funds	53	6	-	-
	<u>11,606</u>	<u>15,169</u>	<u>11,199</u>	<u>14,870</u>
Issued by:				
Central governments and central banks	355	450	355	450
Banks and other financial institutions	5,894	6,794	5,868	6,775
Corporate entities	5,303	7,920	4,976	7,645
Other entities	54	5	-	-
	<u>11,606</u>	<u>15,169</u>	<u>11,199</u>	<u>14,870</u>
Analysed by place of listing:				
Debt securities				
Listed in Hong Kong	1,520	3,330	1,520	3,330
Listed outside Hong Kong	5,887	6,792	5,887	6,792
	<u>7,407</u>	<u>10,122</u>	<u>7,407</u>	<u>10,122</u>
Unlisted	3,792	4,629	3,792	4,629
	<u>11,199</u>	<u>14,751</u>	<u>11,199</u>	<u>14,751</u>
Equity securities				
Listed in Hong Kong	115	224	-	119
Listed outside Hong Kong	239	188	-	-
	<u>354</u>	<u>412</u>	<u>-</u>	<u>119</u>
Investment funds				
Unlisted	53	6	-	-
	<u>11,606</u>	<u>15,169</u>	<u>11,199</u>	<u>14,870</u>

28. Advances to Customers and Other Accounts

(a) Advances to customers and other accounts

	The Group		The Bank	
	2013	2012	2013	2012
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
(i) Advances to customers	405,357	350,720	259,483	221,572
Less: Impairment allowances				
- Individual	(323)	(238)	(171)	(128)
- Collective	(699)	(681)	(450)	(474)
	<u>404,335</u>	<u>349,801</u>	<u>258,862</u>	<u>220,970</u>
(ii) Other accounts				
Advances to banks and other financial institutions *	5	146	5	146
Less: Impairment allowances - Individual	(2)	(4)	(2)	(4)
	<u>3</u>	<u>142</u>	<u>3</u>	<u>142</u>
Notes and bonds (Note 46(c))	1	1	-	-
Certificates of deposit held (Note 46(c))	116	77	116	77
Accrued interest	2,641	2,688	1,404	1,292
Customer liability under acceptance	31,393	24,633	312	296
Other accounts	<u>9,796</u>	<u>9,962</u>	<u>6,229</u>	<u>5,452</u>
	43,947	37,361	8,061	7,117
Less: Impairment allowances				
- Individual	(13)	(28)	(1)	(3)
- Collective	(17)	(3)	-	-
	<u>43,917</u>	<u>37,330</u>	<u>8,060</u>	<u>7,114</u>
	<u>448,255</u>	<u>387,273</u>	<u>266,925</u>	<u>228,226</u>

* The above advances to banks and other financial institutions include:

Receivables from reverse repurchase agreements under which the Group obtains securities on terms which permit it to re-pledge or resell securities to others in the absence of default. At 31st December, 2013, the fair value of financial assets accepted as collateral that the Group is permitted to sell or re-pledge under such terms is Nil (2012: NIL).

28. Advances to Customers and Other Accounts (continued)

(b) Impairment allowances against advances and other accounts for 2013

	The Group							
	<u>Advances to customers</u>		<u>Advances to banks</u>		<u>Other accounts</u>		<u>Total</u>	
	Individual HK\$ Mn	Collective HK\$ Mn	Individual HK\$ Mn	Collective HK\$ Mn	Individual HK\$ Mn	Collective HK\$ Mn	Individual HK\$ Mn	Collective HK\$ Mn
At 1 st January	238	681	4	-	28	3	270	684
New provisions charged to income statement	469	131	-	-	23	11	492	142
Net provisions released back to income statement	(149)	-	(2)	-	(10)	-	(161)	-
Amounts written off	(353)	(115)	-	-	(5)	-	(358)	(115)
Recoveries	105	-	-	-	-	-	105	-
Effect of discounting (Note 4)	(14)	-	-	-	-	-	(14)	-
Transfer	22	-	-	-	(22)	-	-	-
Exchange adjustments	5	2	-	-	(1)	3	4	5
At 31 st December	<u>323</u>	<u>699</u>	<u>2</u>	<u>-</u>	<u>13</u>	<u>17</u>	<u>338</u>	<u>716</u>

	The Bank							
	<u>Advances to customers</u>		<u>Advances to banks</u>		<u>Other accounts</u>		<u>Total</u>	
	Individual HK\$ Mn	Collective HK\$ Mn	Individual HK\$ Mn	Collective HK\$ Mn	Individual HK\$ Mn	Collective HK\$ Mn	Individual HK\$ Mn	Collective HK\$ Mn
At 1 st January	128	474	4	-	3	-	135	474
New provisions charged to income statement	194	83	-	-	-	-	194	83
Net provisions released back to income statement	(99)	-	(2)	-	(2)	-	(103)	-
Amounts written off	(110)	(103)	-	-	-	-	(110)	(103)
Recoveries	67	-	-	-	-	-	67	-
Effect of discounting	(8)	-	-	-	-	-	(8)	-
Exchange adjustments	(1)	(4)	-	-	-	-	(1)	(4)
At 31 st December	<u>171</u>	<u>450</u>	<u>2</u>	<u>-</u>	<u>1</u>	<u>-</u>	<u>174</u>	<u>450</u>

28. Advances to Customers and Other Accounts (continued)

(b) Impairment allowances against advances and other accounts for 2012

	The Group							
	<u>Advances to customers</u>		<u>Advances to banks</u>		<u>Other accounts</u>		<u>Total</u>	
	Individual	Collective	Individual	Collective	Individual	Collective	Individual	Collective
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1 st January	205	763	3	-	88	4	296	767
New provisions charged to income statement	346	38	1	-	50	-	397	38
Net provisions released back to income statement	(178)	-	-	-	(24)	-	(202)	-
Amounts written off	(288)	(101)	-	-	(12)	(1)	(300)	(102)
Recoveries	112	-	-	-	-	-	112	-
Effect of discounting (Note 4)	(20)	-	-	-	-	-	(20)	-
Transfer	75	-	-	-	(75)	-	-	-
Reversal due to disposal of a subsidiary	(17)	(30)	-	-	-	-	(17)	(30)
Exchange adjustments	3	11	-	-	1	-	4	11
At 31 st December	<u>238</u>	<u>681</u>	<u>4</u>	<u>-</u>	<u>28</u>	<u>3</u>	<u>270</u>	<u>684</u>

	The Bank							
	<u>Advances to customers</u>		<u>Advances to banks</u>		<u>Other accounts</u>		<u>Total</u>	
	Individual	Collective	Individual	Collective	Individual	Collective	Individual	Collective
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1 st January	130	535	3	-	3	-	136	535
New provisions charged to income statement	172	23	1	-	6	-	179	23
Net provisions released back to income statement	(118)	-	-	-	-	-	(118)	-
Amounts written off	(136)	(93)	-	-	(6)	-	(142)	(93)
Recoveries	92	-	-	-	-	-	92	-
Effect of discounting	(14)	-	-	-	-	-	(14)	-
Exchange adjustments	2	9	-	-	-	-	2	9
At 31 st December	<u>128</u>	<u>474</u>	<u>4</u>	<u>-</u>	<u>3</u>	<u>-</u>	<u>135</u>	<u>474</u>

28. Advances to Customers and Other Accounts (continued)

(c) Advances to customers - by industry sectors

The analysis of gross advances to customers and the percentage of secured advances by industry sector is based on the categories and definitions used by the Hong Kong Monetary Authority.

	2013		2012	
	Gross advances	% of secured advances	Gross advances	% of secured advances
	HK\$ Mn	%	HK\$ Mn	%
The Group				
Loans for use in Hong Kong				
Industrial, commercial and financial				
- Property development	13,743	71.01	13,460	71.28
- Property investment	37,574	87.51	39,522	90.10
- Financial concerns	13,780	81.80	11,557	86.79
- Stockbrokers	1,222	88.85	804	85.26
- Wholesale and retail trade	14,296	34.11	10,232	41.50
- Manufacturing	6,963	37.04	6,331	34.07
- Transport and transport equipment	5,954	66.01	5,414	64.01
- Recreational activities	96	33.02	215	44.22
- Information technology	1,063	8.88	1,170	8.28
- Others	10,189	50.34	7,580	47.25
- Sub-total	104,880	68.31	96,285	72.25
Individuals				
- Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	1,096	100.00	1,171	100.00
- Loans for the purchase of other residential properties	28,537	99.99	25,337	99.98
- Credit card advances	4,137	0.00	3,802	0.00
- Others	19,453	68.64	16,297	75.17
- Sub-total	53,223	80.76	46,607	83.15
Total loans for use in Hong Kong	158,103	72.50	142,892	75.80
Trade finance	5,895	39.60	5,156	41.08
Loans for use outside Hong Kong *	241,359	71.02	202,672	70.42
Total advances to customers	405,357	71.14	350,720	72.18

* Loans for use outside Hong Kong include the following loans for use in Mainland China.

	2013		2012	
	Gross advances	% of secured advances	Gross advances	% of secured advances
	HK\$ Mn	%	HK\$ Mn	%
Property development	33,980	52.70	27,835	55.35
Property investment	29,801	98.45	29,895	98.45
Wholesale and retail trade	35,088	79.84	26,872	74.89
Manufacturing	12,081	47.34	10,116	46.81
Others	68,844	66.67	57,015	63.41
	179,794	70.57	151,733	69.76

28. Advances to Customers and Other Accounts (continued)

(c) Advances to customers - by industry sectors (continued)

	2013		2012	
	Gross advances HK\$ Mn	% of secured advances %	Gross advances HK\$ Mn	% of secured advances %
The Bank				
Loans for use in Hong Kong				
Industrial, commercial and financial				
- Property development	13,733	71.06	13,450	71.33
- Property investment	37,491	87.49	39,437	90.08
- Financial concerns	13,779	81.80	11,557	86.80
- Stockbrokers	1,222	88.85	804	85.26
- Wholesale and retail trade	14,207	33.69	9,875	39.39
- Manufacturing	6,926	36.70	6,288	33.63
- Transport and transport equipment	5,930	65.87	5,386	63.82
- Recreational activities	96	33.02	215	44.22
- Information technology	1,062	8.88	1,170	8.28
- Others	9,473	46.59	7,061	43.37
- Sub-total	103,919	68.02	95,243	71.95
Individuals				
- Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	1,096	100.00	1,171	100.00
- Loans for the purchase of other residential properties	28,533	99.99	25,331	99.98
- Credit card advances	4,137	0.00	3,802	0.00
- Others	18,123	68.11	14,944	75.11
- Sub-total	51,889	80.88	45,248	83.36
Total loans for use in Hong Kong	155,808	72.31	140,491	75.63
Trade finance	5,504	36.19	4,606	36.28
Loans for use outside Hong Kong *	98,171	57.31	76,475	56.59
Total advances to customers	259,483	65.87	221,572	68.24

* Loans for use outside Hong Kong include the following loans for use in Mainland China.

	2013		2012	
	Gross advances HK\$ Mn	% of secured advances %	Gross advances HK\$ Mn	% of secured advances %
Property development	15,603	8.80	11,905	4.82
Property investment	803	49.75	805	96.85
Wholesale and retail trade	7,561	93.70	3,640	78.27
Manufacturing	4,523	42.09	3,415	52.47
Others	10,321	11.58	5,932	12.81
	38,811	30.81	25,697	26.28

28. Advances to Customers and Other Accounts (continued)

(c) Advances to customers - by industry sectors (continued)

Individually impaired loans, as well as relevant information, in respect of industry sectors which constitute 10% or more of total advances to customers are as follows:

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
(i) Property development				
a. Individually impaired loans	131	166	94	156
b. Individual impairment allowance	16	21	6	11
c. Collective impairment allowance	62	59	35	35
d. Provision charged to income statement				
- individual impairment loss	-	7	-	7
- collective impairment loss	22	18	8	8
e. Written off	-	8	-	8
(ii) Property investment				
a. Individually impaired loans	242	174	122	131
b. Individual impairment allowance	5	7	5	7
c. Collective impairment allowance	140	177	97	133
d. Provision charged to income statement				
- individual impairment loss	-	12	-	7
- collective impairment loss	35	56	27	42
e. Written off	-	19	-	14
(iii) Loans for purchase of residential properties				
a. Individually impaired loans	169	102	111	83
b. Individual impairment allowance	2	1	-	-
c. Collective impairment allowance	55	54	28	31
d. Provision charged to income statement				
- individual impairment loss	3	5	2	1
- collective impairment loss	12	8	5	3
e. Written off	2	1	2	1
(iv) Wholesale and retail trade				
a. Individually impaired loans	314	264	64	61
b. Individual impairment allowance	106	77	24	33
c. Collective impairment allowance	109	94	68	58
d. Provision charged to income statement				
- individual impairment loss	120	170	43	40
- collective impairment loss	38	24	23	11
e. Written off	72	120	43	15

28. Advances to Customers and Other Accounts (continued)

(d) Advances to customers – by geographical areas

The information concerning the breakdown of the gross amount of advances to customers by countries or geographical areas is derived according to the location of the counterparties after taking into account any transfer of risk. In general, such transfer of risk takes place if the claims are guaranteed by a party in a country which is different from that of the counterparty or if the claims are on an overseas branch of a bank whose head office is located in another country.

The Group 2013					
	Total advances to customers	Advances overdue for over three months	Impaired advances to customers	Individual impairment allowance	Collective impairment allowance
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Hong Kong	172,436	188	384	81	210
People's Republic of China	189,924	653	840	159	316
Other Asian Countries	22,124	18	120	72	106
Others	20,873	65	237	11	67
Total	405,357	924	1,581	323	699
% of total advances to customers			0.39%		
Market value of security held against impaired advances to customers			3,779		
The Group 2012					
	Total advances to customers	Advances overdue for over three months	Impaired advances to customers	Individual impairment allowance	Collective impairment allowance
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Hong Kong	159,038	171	338	84	208
People's Republic of China	151,588	375	453	119	232
Other Asian Countries	19,446	29	43	17	118
Others	20,648	81	304	18	123
Total	350,720	656	1,138	238	681
% of total advances to customers			0.32%		
Market value of security held against impaired advances to customers			2,947		

28. Advances to Customers and Other Accounts (continued)

(d) Advances to customers – by geographical areas (continued)

	The Bank 2013				
	Total advances to customers	Advances overdue for over three months	Impaired advances to customers	Individual impairment allowance	Collective impairment allowance
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Hong Kong	158,402	184	367	70	188
People's Republic of China	58,888	126	130	18	90
Other Asian Countries	21,838	18	120	72	106
Others	20,355	64	237	11	66
Total	259,483	392	854	171	450

% of total advances to
customers

0.33%

Market value of security held
against impaired advances
to customers

2,312

	The Bank 2012				
	Total advances to customers	Advances overdue for over three months	Impaired advances to customers	Individual impairment allowance	Collective impairment allowance
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Hong Kong	143,354	149	304	74	182
People's Republic of China	39,563	98	127	19	53
Other Asian Countries	18,863	29	43	17	117
Others	19,792	80	303	18	122
Total	221,572	356	777	128	474

% of total advances to
customers

0.35%

Market value of security
held against impaired
advances to customers

2,262

Impaired loans and advances are individually assessed loans with objective evidence of impairment on an individual basis. The above information by countries or geographical areas is derived according to the location of the counterparties after taking into account any transfer of risk.

28. Advances to Customers and Other Accounts (continued)

(e) Advances to customers – net investment in finance leases

Advances to customers include net investment in equipment leased under finance leases. The total minimum lease payments receivable under finance leases and their present values at the year end are as follows:

	The Group and the Bank		
	2013		
	Present value of the minimum lease payments HK\$ Mn	Interest income relating to future periods HK\$ Mn	Total minimum lease payments HK\$ Mn
	Present value of the minimum lease payments HK\$ Mn	Interest income relating to future periods HK\$ Mn	Total minimum lease payments HK\$ Mn
Amounts receivable:			
Within one year	1,349	186	1,535
After one year but within five years	1,672	269	1,941
After five years	2,367	380	2,747
	5,388	835	6,223
Less: Individual impairment allowances	(7)		
Net investment in finance leases	5,381		4,723

The net investment in finance leases is carried on the statement of financial position as a receivable. No accrual is made for the interest income relating to future periods.

29. Available-For-Sale Financial Assets

	The Group		The Bank	
	2013	2012	2013	2012
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Treasury bills (including Exchange Fund Bills) (Note 46(c))	18,797	22,873	18,796	22,873
Certificates of deposit held (Note 46(c))	2,386	2,914	1,205	1,609
Debt securities (Note 46(c))	47,499	36,546	25,818	19,330
Equity securities	2,722	2,307	1,327	1,132
Investment funds	185	91	184	72
	<u>71,589</u>	<u>64,731</u>	<u>47,330</u>	<u>45,016</u>
Issued by:				
Central governments and central banks	19,694	23,087	18,100	22,363
Public sector entities	2,273	2,198	324	66
Banks and other financial institutions	25,350	20,855	11,150	11,121
Corporate entities	24,048	18,462	17,573	11,394
Other entities	224	129	183	72
	<u>71,589</u>	<u>64,731</u>	<u>47,330</u>	<u>45,016</u>
Analysed by place of listing:				
Debt securities				
Listed in Hong Kong	8,165	5,450	6,276	4,303
Listed outside Hong Kong	<u>12,292</u>	<u>12,519</u>	<u>9,603</u>	<u>10,108</u>
	20,457	17,969	15,879	14,411
Unlisted	<u>48,225</u>	<u>44,364</u>	<u>29,940</u>	<u>29,401</u>
	<u>68,682</u>	<u>62,333</u>	<u>45,819</u>	<u>43,812</u>
Equity securities				
Listed in Hong Kong	580	553	140	142
Listed outside Hong Kong	<u>1,318</u>	<u>978</u>	<u>403</u>	<u>282</u>
	1,898	1,531	543	424
Unlisted	<u>824</u>	<u>776</u>	<u>784</u>	<u>708</u>
	<u>2,722</u>	<u>2,307</u>	<u>1,327</u>	<u>1,132</u>
Investment funds				
Listed outside Hong Kong	1	19	-	-
Unlisted	<u>184</u>	<u>72</u>	<u>184</u>	<u>72</u>
	<u>185</u>	<u>91</u>	<u>184</u>	<u>72</u>
	<u>71,589</u>	<u>64,731</u>	<u>47,330</u>	<u>45,016</u>

30. Held-To-Maturity Investments (Note 46 (c))

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Treasury bills (including Exchange Fund Bills)	649	615	649	615
Certificates of deposit held	1,186	1,070	1,186	1,039
Debt securities	<u>3,213</u>	<u>2,635</u>	<u>2,105</u>	<u>1,565</u>
	<u>5,048</u>	<u>4,320</u>	<u>3,940</u>	<u>3,219</u>
Issued by:				
Central governments and central banks	1,745	1,552	1,741	1,548
Public sector entities	153	316	50	168
Banks and other financial institutions	803	1,108	263	390
Corporate entities	<u>2,347</u>	<u>1,344</u>	<u>1,886</u>	<u>1,113</u>
	<u>5,048</u>	<u>4,320</u>	<u>3,940</u>	<u>3,219</u>
Analysed by place of listing:				
Debt securities				
Listed in Hong Kong	1,119	627	782	570
Listed outside Hong Kong	<u>1,777</u>	<u>1,527</u>	<u>1,522</u>	<u>1,096</u>
	2,896	2,154	2,304	1,666
Unlisted	<u>2,152</u>	<u>2,166</u>	<u>1,636</u>	<u>1,553</u>
	<u>5,048</u>	<u>4,320</u>	<u>3,940</u>	<u>3,219</u>
Fair value:				
Listed securities	2,983	2,295	2,378	1,783
Unlisted securities	<u>2,152</u>	<u>2,179</u>	<u>1,637</u>	<u>1,553</u>
	<u>5,135</u>	<u>4,474</u>	<u>4,015</u>	<u>3,336</u>
Movement of impairment allowances				
	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
At 1 st January	-	11	-	11
Written back	<u>-</u>	<u>(11)</u>	<u>-</u>	<u>(11)</u>
At 31 st December	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

31. Investments in Subsidiaries

	The Bank	
	2013	2012
	HK\$ Mn	HK\$ Mn
Unlisted shares, at cost	15,494	14,093
Less: Impairment allowances	(224)	(135)
	<u>15,270</u>	<u>13,958</u>

The following list contains only the particulars of subsidiaries which principally affected the results, assets or liabilities of the Group. The class of shares held is ordinary.

Details of these companies are as follows:

Name of company	Place of incorporation and operation	Issued and paid-up capital	% Held by The Bank The Group		Nature of business
Ample Delight Limited	Hong Kong	HK\$450,000,000	100%		Investment holding
Bank of East Asia (Trustees) Limited	Hong Kong	HK\$150,000,000	100%		Trustee
BEA Life Limited	Hong Kong	HK\$500,000,000	100%		Life insurance
Blue Cross (Asia-Pacific) Insurance Limited	Hong Kong	HK\$625,000,000	100%		Insurance
BEA Union Investment Management Limited	Hong Kong	HK\$374,580,000	51%		Asset management
BEA Wealth Management Services (Taiwan) Limited	Taiwan, Republic of China	NTD273,200,000	100%		Wealth management services
Central Town Limited	Hong Kong	HK\$2	100%		Property investment
Century Able Limited	Hong Kong	HK\$929,752,849	100%		Investment holding
Corona Light Limited	BVI	HK\$929,752,849	100%		Investment holding
Credit Gain Finance Company Limited	Hong Kong	HK\$370,000,000	100%		Money lenders
Crystal Gleaming Limited	BVI	HK\$929,752,849	100%		Investment holding
East Asia Electronic Data Processing (Guangzhou) Limited (Note 1)	PRC	US\$3,000,000	100%		Servicing
* East Asia Holding Company, Inc.	U.S.A.	US\$5	100%		Bank holding company
East Asia Investments Holdings (BVI) Ltd.	BVI	HK\$186,038,725	100%		Investment holding
* East Asia Properties (US), Inc.	U.S.A.	US\$5	100%		Property Holding
East Asia Property Holdings (Jersey) Limited	BVI	GBP9	100%		Property Holding

31. Investments in Subsidiaries (continued)

Name of company	Place of incorporation and operation	Issued and paid-up capital	% Held by The Bank The Group		Nature of business
East Asia Secretaries (BVI) Limited	BVI	HK\$300,000,000		75.61%	Investment holding
East Asia Securities Company Limited	Hong Kong	HK\$25,000,000	100%		Securities broking
East Asia Strategic Holdings Limited	BVI	US\$50,000,000	100%		Investment holding
Innovate Holdings Limited	BVI	US\$1 (Ordinary) US\$500,000,000 (with a liquidation preference of US\$1,000 per share)	100%		Special purpose vehicle company
Shaanxi Fuping BEA Rural Bank Corporation (Note 1)	PRC	CNY20,000,000	100%		Banking and other financial businesses
Shenzhen Credit Gain Finance Company Limited (Note 1)	PRC	CNY300,000,000	100%		Micro-finance loan
Skyray Holdings Limited	BVI	HK\$450,000,000	100%		Investment holding
Speedfull Limited	BVI	HK\$450,000,000		100%	Investment holding
The Bank of East Asia (China) Limited (Note 1)	PRC	CNY8,000,000,000	100%		Banking and related financial services
Tricor Consultancy (Beijing) Limited (Note 1)	PRC	US\$1,850,000		75.61%	Business consultancy in China
Tricor Holdings Limited	BVI	US\$7,001		75.61%	Investment holding
Tricor Holdings Pte. Ltd.	Singapore	S\$5,000,002		75.61%	Investment holding
Tricor Investor Services Limited	Hong Kong	HK\$2		75.61%	Investor services
Tricor Services Limited	Hong Kong	HK\$2		75.61%	Business, corporate and investor services
Tricor Services (Malaysia) Sdn. Bhd.	Malaysia	RM5,672,484		68.05%	Investment holding
Tung Shing Holdings Company Limited	BVI	US\$20,000,000	100%		Investment holding

Notes: 1. Represents a wholly foreign owned enterprise registered under the PRC laws.
2. BVI denotes the British Virgin Islands and PRC denotes the People's Republic of China.
3. The above subsidiaries have no non-controlling interests material to the Group.

* Company not audited by KPMG. The accounts of the subsidiaries not audited by KPMG reflect total net assets and total income constituting approximately 0.2% and 0.1% respectively of the related consolidated totals.

32. Investments in Associates

	The Group		The Bank	
	2013	2012	2013	2012
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Listed shares, at cost	-	-	2,040	2,040
Unlisted shares, at cost	-	-	465	525
Share of net assets	4,407	4,322	-	-
Goodwill	372	355	-	-
	<u>4,779</u>	<u>4,677</u>	<u>2,505</u>	<u>2,565</u>
Less: Impairment allowances	-	-	-	-
	<u>4,779</u>	<u>4,677</u>	<u>2,505</u>	<u>2,565</u>

Loans to associates amounting to HK\$233 million (2012: HK\$233 million) are included under placements with banks and other financial institutions.

Share of associates' taxation for the year amounted to HK\$205 million (2012: HK\$173 million).

Shareholdings in associates held by the Bank include listed investments of HK\$2,040 million (2012: HK\$2,040 million). As at the end of the reporting period, the fair value of these investments held by the Group, based on quoted market prices, was HK\$3,449 million (2012: HK\$3,063 million).

The following list contains only the particulars of associates which principally affected the results or assets of the Group:

Name of company	Place of incorporation and operation	% of ordinary shares held by		Nature of business
		The Bank	The Group	
Listed				
AFFIN Holdings Berhad	Malaysia	23.52%		Investment holding
Unlisted				
Dolford Property Holdings Limited	BVI		30%	Investment holding
Founder BEA Trust Company Limited	PRC	19.99%		Trust and other financial businesses
Industrial and Commercial Bank of China (Canada)	Canada	20%		Banking services
Industrial and Commercial Bank of China (USA) N.A.	U.S.A.		20%	Banking services
Platinum Holdings Company Limited	Cayman Islands	29.99%		Investment holding
PT. Bank Resona Perdana	Indonesia		30%	Banking and related financial services

Notes: BVI denotes the British Virgin Islands and PRC denotes the People's Republic of China.

32. Investments in Associates (continued)

	2013 HK\$ Mn	2012 HK\$ Mn
<u>Summarised financial information of the material associates, adjusted for any differences in accounting policies, and reconciled to the carrying amounts in the consolidated financial statements</u>	<u>NIL</u>	<u>NIL</u>
<u>Aggregate information of associates that are not individually material</u>		
Aggregate carrying amount of individually immaterial associates in the consolidated financial statements	<u>4,779</u>	<u>4,677</u>
Aggregate amounts of the Group's share of those associates'		
Profit from continuing operations	684	536
Post-tax profit or loss from discounted operations	-	-
Other comprehensive income	<u>(370)</u>	<u>78</u>
Total comprehensive income	<u>314</u>	<u>614</u>
<u>Reconciliation of carrying amounts to the Group's total interest in the associates</u>		
Carrying amount of material associates	-	-
Carrying amount of individual immaterial associates	<u>4,779</u>	<u>4,677</u>
Interest in associates in the consolidated financial statements	<u>4,779</u>	<u>4,677</u>

33. Goodwill and Intangible Assets

Goodwill and intangible assets include goodwill arising on business combinations and acquired intangible assets. Acquired intangible assets are amortised over their estimated economic useful life.

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Goodwill	2,724	2,743	1,460	1,460
Acquired intangible assets	<u>1,266</u>	<u>1,298</u>	<u>-</u>	<u>-</u>
	<u>3,990</u>	<u>4,041</u>	<u>1,460</u>	<u>1,460</u>

(a) Goodwill

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
At 1 st January	2,743	2,882	1,460	1,460
Additions through acquisition of subsidiaries	1	11	-	-
Reversal due to disposal of a subsidiary	-	(172)	-	-
Exchange adjustments	<u>(20)</u>	<u>22</u>	<u>-</u>	<u>-</u>
At 31 st December	<u>2,724</u>	<u>2,743</u>	<u>1,460</u>	<u>1,460</u>

33. Goodwill and Intangible Assets (continued)Impairment tests for cash-generating units containing goodwill

Goodwill is allocated to the Group's cash-generating units (CGU) identified according to business segments as follows:

	2013 HK\$ Mn	2012 HK\$ Mn
Personal banking	849	849
Corporate banking	453	453
Treasury markets	158	158
Corporate services	1,216	1,235
Others	48	48
	<u>2,724</u>	<u>2,743</u>

The recoverable amount of the CGU is determined based on value-in-use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimated rates stated below. The growth rate does not exceed the long-term average growth rate for the business in which the CGU operates.

The pre-tax discount rate used for value-in-use calculations is 11.50% - 12.95% (2012: 11.39% - 12.5%) and the long-term growth rate is 4% - 10% (2012: 4% - 10%).

Management determined the budgeted net profit based on past performance and its expectation for market development. The weighted average growth rates used are consistent with the internal forecasts.

(b) Intangible assets (other than goodwill)

Intangible assets consist of naming rights only. Intangible assets are stated at cost less accumulated amortisation and impairment loss (Note 2(k)(iv)).

Amortisation of intangible assets with finite useful lives is charged to the income statement over the assets' estimated useful lives. The following intangible assets with finite useful lives are amortised from the date they are available to use and their estimated useful lives are as follows:

Naming rights	Over the shorter of the lease period of building or land
---------------	--

Both the period and method of amortisation are reviewed annually.

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Cost				
At 1 st January	1,419	1,433	-	-
Reversal due to disposal of a subsidiary	-	(14)	-	-
At 31 st December	<u>1,419</u>	<u>1,419</u>	<u>-</u>	<u>-</u>
Accumulated amortisation				
At 1 st January	(121)	(100)	-	-
Amortisation charge for the year (Note 11)	(32)	(33)	-	-
Reversal due to disposal of a subsidiary	-	12	-	-
At 31 st December	<u>(153)</u>	<u>(121)</u>	<u>-</u>	<u>-</u>
Carrying amount at 31 st December	<u>1,266</u>	<u>1,298</u>	<u>-</u>	<u>-</u>

34. Fixed Assets

2013					
The Group					
	Investment properties HK\$ Mn	Bank premises HK\$ Mn	Furniture, fixtures and equipment HK\$ Mn	Sub-total HK\$ Mn	Total HK\$ Mn
Cost or valuation					
At 1 st January, 2013	3,100	9,054	4,671	13,725	16,825
Additions	10	212	490	702	712
Revaluation surplus (Note 15)	388	-	-	-	388
Revaluation of bank premises transferred to investment properties (Note)	1,123	(1,123)	-	(1,123)	-
Revaluation surplus on bank premises (Note)	-	664	-	664	664
Redevelopment cost	144	48	-	48	192
Disposals	(380)	(92)	(146)	(238)	(618)
Exchange adjustments	15	112	42	154	169
At 31 st December, 2013	4,400	8,875	5,057	13,932	18,332
Accumulated depreciation and amortisation					
At 1 st January, 2013	-	1,170	3,103	4,273	4,273
Charge for the year (Note 11)	-	175	495	670	670
Revaluation of bank premises transferred to investment properties (Note)	-	(6)	-	(6)	(6)
Written off on disposal	-	(45)	(135)	(180)	(180)
Exchange adjustments	-	20	25	45	45
At 31 st December, 2013	-	1,314	3,488	4,802	4,802
Net book value at 31 st December, 2013	4,400	7,561	1,569	9,130	13,530
The gross amounts of the above assets are stated:					
At cost	-	8,063	5,057	13,120	13,120
At Directors' valuation					
- 1989	-	812	-	812	812
At professional valuation					
- 2013	4,400	-	-	-	4,400
	4,400	8,875	5,057	13,932	18,332

34. Fixed Assets (continued)

2013					
The Bank					
	Investment properties HK\$ Mn	Bank premises HK\$ Mn	Furniture, fixtures and equipment HK\$ Mn	Sub-total HK\$ Mn	Total HK\$ Mn
Cost or valuation					
At 1 st January, 2013	2,428	4,138	2,617	6,755	9,183
Additions	-	-	195	195	195
Revaluation surplus	187	-	-	-	187
Revaluation of bank premises transferred to investment properties (Note)	1,145	(1,145)	-	(1,145)	-
Revaluation surplus on bank premises (Note)	-	664	-	664	664
Redevelopment cost	96	48	-	48	144
Disposals	(118)	-	(36)	(36)	(154)
Exchange adjustments	-	(24)	(1)	(25)	(25)
At 31 st December, 2013	<u>3,738</u>	<u>3,681</u>	<u>2,775</u>	<u>6,456</u>	<u>10,194</u>
Accumulated depreciation and amortisation					
At 1 st January, 2013	-	493	1,854	2,347	2,347
Charge for the year	-	48	232	280	280
Revaluation of bank premises transferred to investment properties (Note)	-	(6)	-	(6)	(6)
Written off on disposal	-	-	(35)	(35)	(35)
Exchange adjustments	-	(1)	-	(1)	(1)
At 31 st December, 2013	<u>-</u>	<u>534</u>	<u>2,051</u>	<u>2,585</u>	<u>2,585</u>
Net book value at					
31 st December, 2013	<u>3,738</u>	<u>3,147</u>	<u>724</u>	<u>3,871</u>	<u>7,609</u>
The gross amounts of the above assets are stated:					
At cost	-	2,869	2,775	5,644	5,644
At Directors' valuation					
- 1989	-	812	-	812	812
At professional valuation					
- 2013	<u>3,738</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,738</u>
	<u>3,738</u>	<u>3,681</u>	<u>2,775</u>	<u>6,456</u>	<u>10,194</u>

Note: On 28th June, 2013, a portion of property development previously classified as bank premises was transferred to investment properties. The carrying value of the bank premises prior to being revalued was HK\$475 million. Upon transfer, the property was remeasured at fair value, which was externally appraised at HK\$1,145 million.

34. Fixed Assets (continued)

	2012				
	The Group				
	Investment properties HK\$ Mn	Bank premises HK\$ Mn	Furniture, fixtures and equipment HK\$ Mn	Sub-total HK\$ Mn	Total HK\$ Mn
Cost or valuation					
At 1 st January, 2012	2,940	8,991	4,563	13,554	16,494
Additions	17	22	386	408	425
Revaluation surplus (Note 15)	454	-	-	-	454
Revaluation of bank premises transferred to investment properties	36	(36)	-	(36)	-
Revaluation loss on bank premises (Note 15)	-	(3)	-	(3)	(3)
Redevelopment cost	21	28	-	28	49
Reversal due to disposal of a subsidiary	-	-	(116)	(116)	(116)
Disposals	(375)	(25)	(183)	(208)	(583)
Exchange adjustments	7	77	21	98	105
At 31 st December, 2012	<u>3,100</u>	<u>9,054</u>	<u>4,671</u>	<u>13,725</u>	<u>16,825</u>
Accumulated depreciation and amortisation					
At 1 st January, 2012	-	1,012	2,843	3,855	3,855
Charge for the year (Note 11)	-	168	489	657	657
Reversal due to disposal of a subsidiary	-	-	(78)	(78)	(78)
Written off on disposal	-	(16)	(163)	(179)	(179)
Exchange adjustments	-	6	12	18	18
At 31 st December, 2012	<u>-</u>	<u>1,170</u>	<u>3,103</u>	<u>4,273</u>	<u>4,273</u>
Net book value at 31 st December, 2012	<u>3,100</u>	<u>7,884</u>	<u>1,568</u>	<u>9,452</u>	<u>12,552</u>
The gross amounts of the above assets are stated:					
At cost	-	8,242	4,671	12,913	12,913
At Directors' valuation					
- 1989	-	812	-	812	812
At professional valuation					
- 2012	3,100	-	-	-	3,100
	<u>3,100</u>	<u>9,054</u>	<u>4,671</u>	<u>13,725</u>	<u>16,825</u>

34. Fixed Assets (continued)

2012					
The Bank					
	Investment properties HK\$ Mn	Bank premises HK\$ Mn	Furniture, fixtures and equipment HK\$ Mn	Sub-total HK\$ Mn	Total HK\$ Mn
Cost or valuation					
At 1 st January, 2012	2,433	4,071	2,576	6,647	9,080
Additions	-	-	168	168	168
Revaluation surplus	361	-	-	-	361
Redevelopment cost	9	28	-	28	37
Disposals	(375)	-	(134)	(134)	(509)
Exchange adjustments	-	39	7	46	46
At 31 st December, 2012	<u>2,428</u>	<u>4,138</u>	<u>2,617</u>	<u>6,755</u>	<u>9,183</u>
Accumulated depreciation and amortisation					
At 1 st January, 2012	-	444	1,758	2,202	2,202
Charge for the year	-	48	217	265	265
Written off on disposal	-	-	(122)	(122)	(122)
Exchange adjustments	-	1	1	2	2
At 31 st December, 2012	<u>-</u>	<u>493</u>	<u>1,854</u>	<u>2,347</u>	<u>2,347</u>
Net book value at					
31 st December, 2012	<u>2,428</u>	<u>3,645</u>	<u>763</u>	<u>4,408</u>	<u>6,836</u>
The gross amounts of the above assets are stated:					
At cost	-	3,326	2,617	5,943	5,943
At Directors' valuation					
- 1989	-	812	-	812	812
At professional valuation					
- 2012	2,428	-	-	-	2,428
	<u>2,428</u>	<u>4,138</u>	<u>2,617</u>	<u>6,755</u>	<u>9,183</u>

34. Fixed Assets (continued)

Fair value measurement of properties

(i) Fair value hierarchy

The following table presents the fair value of the Group's properties measured at the end of the reporting period on a recurring basis, categorised into the three-level fair value hierarchy as defined in HKFRS 13, *Fair value measurement*. The level into which a fair value measurement is classified is determined with reference to the observability and significance of the inputs used in the valuation technique as follows:

Level 1 valuations: Fair value measured using only Level 1 inputs i.e. unadjusted quoted prices in active markets for identical assets or liabilities at the measurement date

Level 2 valuations: Fair value measured using Level 2 inputs i.e. observable inputs which fail to meet Level 1, and not using significant unobservable inputs. Unobservable inputs are inputs for which market data are not available

Level 3 valuations: Fair value measured using significant unobservable inputs

	Fair value at 31 st December, 2013	Fair value measurements as at 31 st December, 2013 categorised into		
		Level 1 HK\$ Mn	Level 2 HK\$ Mn	Level 3 HK\$ Mn
The Group				
Recurring fair value measurement				
Investment properties:				
- Commercial - Hong Kong	3,843	-	-	3,843
- Commercial - People's Republic of China	459			459
- Commercial - Others	98	-	-	98
	<u>4,400</u>	<u>-</u>	<u>-</u>	<u>4,400</u>
The Bank				
Recurring fair value measurement				
Investment properties				
- Commercial - Hong Kong	3,738	-	-	3,738

During the year ended 31st December, 2013, there were no transfers between Level 1 and Level 2, or transfers into or out of Level 3. The Group's policy is to recognise transfers between levels of fair value hierarchy as at the end of the reporting period in which they occur.

All of the Group's investment properties were revalued by independent valuers as at 31st December, 2013.

Investment properties in Hong Kong were valued at HK\$3,843 million as at 31st December, 2013 by an independent valuer, Savills Valuation and Professional Services Limited, Chartered Surveyors, who has among their staff Fellows of the Hong Kong Institute of Surveyors with recent experience in the location and category of property being valued. The valuation has been incorporated in the accounts as at 31st December, 2013 and it was performed on an open market value basis. Details of valuation techniques are described below.

(ii) Information about Level 3 fair value measurements

	Valuation techniques	Unobservable input
Investment properties	Income capitalisation approach	Market rental
		Capitalisation rate
	Direct comparison approach	Premium (discount) on quality of the buildings

34. Fixed Assets (continued)**(ii) Information about Level 3 fair value measurements (continued)***Investment properties not under construction*

The fair value of investment properties is determined by adoption of the Income Capitalisation Approach whereby the existing rental income of all lettable units of the property are capitalised for their respective unexpired terms of contractual tenancies whilst vacant units are assumed to be let at their respective market rents as at the valuation date. Upon expiry of the existing tenancies, each unit is assumed to be let at its market rent as at the valuation date, which in turn capitalised at the market yield as expected by investors for each type of property. Due consideration has been given to expectations of the renewals of Government lease upon its expiry. The summation of the capitalised value of the term income for the leased portion, the capitalised value of the reversion income as appropriately deferred for the leased portion and the capitalised value for the vacant portion provides the market value of the property.

The market rentals of all lettable units are made (a) by reference to the rentals fetched in the property and/or (b) by reference to the lettings of similar properties in the neighbourhood. The capitalisation rate adopted is made by reference to the yields achieved in analysed market sales transactions and the market expectation from property investors. This expected return reflects implicitly the quality of the investment, the expectation of the potential for future rental growth and capital appreciation, operating costs, risk factor and the like.

As a supporting approach to the Income Capitalisation Approach, the Direct Comparison Approach is also adopted as a check for the valuation. Comparable sales transactions of similar properties in the locality are collected and analysed each in terms of a price per square footage. The collected comparables are then adjusted to take account of the discrepancies between the property and comparables in terms of time, location, age, building quality and the like.

The fair value measurement is positively correlated to the market rental and negatively correlated to the capitalisation rate.

Investment properties under construction

The fair value of investment properties under construction is prepared on a residual basis which is a method of valuation normally used to value development land by deducting the outstanding development costs (including constructions cost, professional fees, finance cost and demolition cost etc.) and developer's profit from the Gross Development Value (GDV).

GDV is determined using direct comparison approach by reference to recent sales prices of comparable properties on a price per square foot basis, adjusted for a premium or a discount specific to the quality of the Group's buildings compared to the recent sales. Higher premium for higher quality buildings will result in a higher fair value measurement.

The movements during the period in the balance of these Level 3 fair value measurements are as follows:

	The Group HK\$ Mn	The Bank HK\$ Mn
Investment properties – Commercial – Hong Kong		
At 1 st January, 2013	2,448	2,428
Disposal	(118)	(118)
Revaluation of bank premises transferred to investment properties	1,145	1,145
Revaluation surplus	224	187
Redevelopment cost	144	96
At 31 st December, 2013	<u>3,843</u>	<u>3,738</u>
Investment properties – Commercial – People's Republic of China		
At 1 st January, 2013	457	-
Disposal	(11)	-
Exchange adjustments	13	-
At 31 st December, 2013	<u>459</u>	<u>-</u>
Investment properties – Commercial – Others		
At 1 st January, 2013	195	-
Additions	10	-
Disposal	(251)	-
Revaluation of investment properties transferred to bank premises	(22)	-
Revaluation surplus	164	-
Exchange adjustments	2	-
At 31 st December, 2013	<u>98</u>	<u>-</u>

34. Fixed Assets (continued)

Fair value adjustment of investment properties is recognised in the line item "valuation gains on investment property" on the face of the consolidated income statement.

All the gains recognised in the income statement for the year arise from the properties held at the end of the reporting period.

The net book value of bank premises and investment properties comprises:

	The Group			
	2013		2012	
	Investment properties HK\$ Mn	Bank premises HK\$ Mn	Investment properties HK\$ Mn	Bank premises HK\$ Mn
Freeholds				
Held outside Hong Kong	98	701	195	742
Leaseholds				
Held in Hong Kong				
On long lease (over 50 years)	3,458	1,228	2,083	1,664
On medium-term lease (10 - 50 years)	385	1,266	365	1,300
Held outside Hong Kong				
On long lease (over 50 years)	-	117	-	40
On medium-term lease (10 - 50 years)	459	4,174	457	4,138
On short-term lease (below 10 years)	-	75	-	-
	<u>4,400</u>	<u>7,561</u>	<u>3,100</u>	<u>7,884</u>
The Bank				
	2013		2012	
	Investment properties HK\$ Mn	Bank premises HK\$ Mn	Investment properties HK\$ Mn	Bank premises HK\$ Mn
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Freeholds				
Held outside Hong Kong	-	679	-	707
Leaseholds				
Held in Hong Kong				
On long lease (over 50 years)	3,031	1,201	1,771	1,637
On medium-term lease (10 - 50 years)	707	1,163	657	1,194
Held outside Hong Kong				
On medium-term lease (10 - 50 years)	-	104	-	107
	<u>3,738</u>	<u>3,147</u>	<u>2,428</u>	<u>3,645</u>

The carrying amount of the bank premises of the Group and the Bank would have been HK\$5,884 million (2012: HK\$6,217 million) and HK\$1,677 million (2012: HK\$2,040 million) respectively had they been stated at cost less accumulated depreciation.

The Group leases out investment properties under operating leases. The leases typically run for an initial period from 1 to 10 years, with an option to renew the leases after that date at which time all terms are renegotiated. None of the leases includes contingent rentals.

Rental income receivable from investment properties held for use under operating leases amounted to HK\$127 million in 2013 (2012: HK\$142 million). There was no contingent rental recognised during the year 2013 (2012: Nil).

34. Fixed Assets (continued)

The total future minimum lease payments of bank premises and investment properties held for use under non-cancellable operating leases are receivable as follows:

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Within one year	75	122	51	57
After one year but within five years	57	82	43	21
After five years	1	-	-	-
	<u>133</u>	<u>204</u>	<u>94</u>	<u>78</u>

35. Amounts Due from and Due to Subsidiaries

During the year, the Bank entered into transactions with certain subsidiaries in the ordinary course of its banking business. Details of the amounts due from and due to subsidiaries are as follows:

	The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn
Amounts due from subsidiaries	24,124	15,566
Amounts due to subsidiaries	3,108	3,105
	<u>21,016</u>	<u>12,461</u>

	The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn
Assets		
Cash and balances with banks and other financial institutions	11,101	5,809
Placements with banks and other financial institutions	3,832	2,319
Trading assets	242	166
Other assets	10,889	8,790
	<u>26,064</u>	<u>17,084</u>
Liabilities		
Deposits and balances of banks and other financial institutions	2,393	1,825
Deposits from customers	2,349	2,508
Trading liabilities	64	113
Other liabilities	242	177
	<u>5,048</u>	<u>4,623</u>
	<u>21,016</u>	<u>12,461</u>

36. Income Tax in the Statement of Financial Position

(a) Current taxation in the statement of financial position represents:

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Provision for Hong Kong profits tax for the year (Note 16(a))	691	533	646	484
Impact of leasing partnerships	(9)	(19)	(9)	(19)
	682	514	637	465
Provisional profits tax paid	(308)	(52)	(259)	-
	374	462	378	465
Balance of profits tax provision relating to prior years	455	206	450	189
Taxation outside Hong Kong	524	320	269	218
	<u>1,353</u>	<u>988</u>	<u>1,097</u>	<u>872</u>

(b) Deferred tax assets and liabilities recognised

The components of deferred tax (assets) / liabilities recognised in the consolidated statement of financial position and the movements during the year are as follows:

Deferred tax arising from:	The Group						
	Depreciation allowances in excess of related depreciation HK\$ Mn	Revaluation of properties HK\$ Mn	Impairment losses on financial assets HK\$ Mn	Revaluation of available-for-sale securities HK\$ Mn	Tax losses HK\$ Mn	Others HK\$ Mn	Total HK\$ Mn
At 1 st January, 2013	392	163	(42)	63	(10)	(83)	483
(Credited)/charged to income statement (Note 16(a))	(2)	34	154	-	(1)	(72)	113
Credited to reserves (Notes 41(c) and (h))	-	(1)	-	(71)	-	-	(72)
Exchange and other adjustments	(2)	3	5	(1)	-	(2)	3
At 31 st December, 2013	<u>388</u>	<u>199</u>	<u>117</u>	<u>(9)</u>	<u>(11)</u>	<u>(157)</u>	<u>527</u>

Deferred tax arising from:	The Group						
	Depreciation allowances in excess of related depreciation HK\$ Mn	Revaluation of properties HK\$ Mn	Impairment losses on financial assets HK\$ Mn	Revaluation of available-for-sale securities HK\$ Mn	Tax losses HK\$ Mn	Others HK\$ Mn	Total HK\$ Mn
At 1 st January, 2012	366	150	(94)	(57)	(25)	(256)	84
Charged to income statement (Note 16(a))	26	13	21	-	15	38	113
(Credited)/charged to reserves (Notes 41(c) and (h))	-	(1)	-	120	-	-	119
Reversal due to disposal of a subsidiary	-	-	31	-	-	134	165
Exchange and other adjustments	-	1	-	-	-	1	2
At 31 st December, 2012	<u>392</u>	<u>163</u>	<u>(42)</u>	<u>63</u>	<u>(10)</u>	<u>(83)</u>	<u>483</u>

36. Income Tax in the Statement of Financial Position (continued)**(b) Deferred tax assets and liabilities recognised (continued)**

Deferred tax arising from:	The Bank						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Impairment losses on financial assets	Revaluation of available- for-sale securities	Tax losses	Others	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1 st January, 2013	376	89	(115)	87	1	32	470
(Credited)/charged to income statement	(6)	-	20	-	-	20	34
Credited to reserves (Notes 41(c) and (h))	-	(1)	-	(10)	-	-	(11)
Exchange and other adjustments	-	-	-	-	-	2	2
At 31 st December, 2013	<u>370</u>	<u>88</u>	<u>(95)</u>	<u>77</u>	<u>1</u>	<u>54</u>	<u>495</u>

Deferred tax arising from:	The Bank						
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Impairment losses on financial assets	Revaluation of available- for-sale securities	Tax losses	Others	Total
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 1 st January, 2012	354	90	(129)	(12)	(13)	11	301
Charged to income statement	22	-	14	-	14	18	68
(Credited)/charged to reserves (Notes 41(c) and (h))	-	(1)	-	99	-	-	98
Exchange and other adjustments	-	-	-	-	-	3	3
At 31 st December, 2012	<u>376</u>	<u>89</u>	<u>(115)</u>	<u>87</u>	<u>1</u>	<u>32</u>	<u>470</u>

	The Group		The Bank	
	2013	2012	2013	2012
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Net deferred tax assets recognised on the statement of financial position	(120)	(143)	(101)	(130)
Net deferred tax liabilities recognised on the statement of financial position	<u>647</u>	<u>626</u>	<u>596</u>	<u>600</u>
	<u>527</u>	<u>483</u>	<u>495</u>	<u>470</u>

36. Income Tax in the Statement of Financial Position (continued)**(c) Deferred tax assets not recognised**

The Group has not recognised deferred tax assets in respect of cumulative tax losses of HK\$1,005 million (2012: HK\$965 million) as it is not probable that future taxable profits against which the losses can be utilized will be available in the relevant tax jurisdiction and entity. Under the current tax legislation, the expiry dates of the tax losses were as follows:

	2013 HK\$ Mn	2012 HK\$ Mn
Expiring within 5 years	35	29
Expiring more than 5 years	150	122
No expiry date	820	814
	<u>1,005</u>	<u>965</u>

37. Other Liabilities

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
(a) Trading liabilities				
Shares sold	<u>11</u>	<u>21</u>	<u>11</u>	<u>21</u>
(b) Other accounts and provisions				
Accrued interest payable	4,131	3,912	1,377	1,399
Acceptance draft payable	31,393	24,633	312	296
Other accounts	<u>18,457</u>	<u>16,832</u>	<u>4,641</u>	<u>5,338</u>
	<u>53,981</u>	<u>45,377</u>	<u>6,330</u>	<u>7,033</u>

38. Loan Capital

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
USD500 million Hybrid Tier 1	-	-	4,478	4,410
USD600 million subordinated notes, measured at amortised cost	4,815	5,139	4,815	5,139
USD500 million subordinated notes (under the Euro Medium Term Note Programme), measured at amortised cost	3,923	3,976	3,923	3,976
SGD800 million subordinated notes (under the Euro Medium Term Note Programme), measured at amortised cost	<u>4,894</u>	<u>5,148</u>	<u>4,894</u>	<u>5,148</u>
	<u>13,632</u>	<u>14,263</u>	<u>18,110</u>	<u>18,673</u>

The Group has not had any defaults of principal, interest or other breaches with respect to its debt securities during the years ended 31st December, 2013 and 2012.

The carrying amount of financial liabilities designated at fair value through profit or loss for the Group as at 31st December, 2013 was Nil (2012: HK\$Nil) and for the Bank was HK\$69 million (2012: HK\$534 million) higher than the contractual amount at maturity. The difference in the accumulated amount of the changes in fair value attributable to changes in credit risk for the Group was Nil (2012: HK\$Nil) and for the Bank were HK\$407 million (2012: HK\$67 million). The change for the year ended 31st December, 2013 for the Group was Nil (2012: HK\$853 million) and for the Bank was HK\$474 million (2012: HK\$1,588 million).

38. Loan Capital (continued)

Hybrid Tier 1 capital instruments comprising step-up subordinated notes ("Notes") of face value HK\$3,877 million (USD500 million) and carrying amount of HK\$4,478 million and HK\$3,877 million (USD500 million) non-cumulative preference shares ("Innovate Preference Shares") were issued respectively by the Bank and by Innovate Holdings Limited, a wholly owned subsidiary of the Bank, on 5th November, 2009. The Notes bear a fixed interest rate of 8.5% per annum and will mature on 5th November, 2059. The Innovate Preference Shares are perpetual securities on which no dividend is payable. The Notes and the Innovate Preference Shares are listed, and traded together as units, on the Singapore Stock Exchange. The Hybrid Tier 1 capital instruments are qualified as Additional Tier 1 capital of the Bank and the Group. In the consolidated accounts, the Notes are eliminated and the Innovate Preference Shares are classified as non-controlling interests.

Two tranches of loan capital of face value totalling HK\$4,652 million (USD600 million) and carrying amount totalling HK\$4,815 million (2012: HK\$5,139 million) were issued on 16th July, 2010 (USD450 million) and on 23rd July, 2010 (USD150 million) by the Bank. These subordinated notes carrying a coupon rate of 6.125% qualifying as Tier 2 capital are listed on the Singapore Stock Exchange and will mature on 16th July, 2020. Hedge ineffectiveness of HK\$7 million loss in 2013 (2012: HK\$0.3 million loss) was recorded under fair value hedge accounting.

Loan capital of face value of HK\$3,877 million (USD500 million) and carrying amount of HK\$3,923 million (2012: HK\$3,976 million) represents 6.375% subordinated notes (under the Euro Medium Term Note Programme) qualifying as Tier 2 capital issued on 4th November, 2011 by the Bank. The notes are listed on the Singapore Stock Exchange and will mature on 4th May, 2022. Hedge ineffectiveness of HK\$1 million loss in 2013 (2012: HK\$8 million profit) was recorded under the fair value hedge accounting for the USD400 million subordinated notes. The fair value as of 31st December, 2013 for the USD100 million subordinated notes was HK\$849 million (USD109.5 million).

Loan capital of face value of HK\$4,904 million (SGD800 million) and carrying amount of HK\$4,894 million represents two tranches of 4.25% subordinated notes (under the Euro Medium Term Note Programme) qualifying as Tier 2 capital issued on 13th March, 2012 (SGD600 million) and on 27th April, 2012 (SGD200 million) by the Bank. The notes are listed on the Singapore Stock Exchange and will mature on 13th September, 2022. Hedge ineffectiveness of approximately HK\$1 million profit in 2013 (2012: HK\$18 million loss) was recorded under the fair value hedge accounting.

39. Equity Settled Share-based Transactions

The Bank has adopted Staff Share Option Schemes whereby the Board of the Bank may at its discretion grant to any employees, including Executive Director and Chief Executive, of the Group options to subscribe for ordinary shares of the Bank. Except as provided otherwise in the rules of the relevant Schemes, share options granted under Staff Share Option Scheme 2007, may be exercised during the period beginning on the first anniversary of the Date of Grant and ending on the fifth anniversary of the Date of Grant while share options granted under the Staff Share Option Scheme 2011 may be exercised beginning on the Vesting Date and ending on the fifth anniversary of the Vesting Date. All options were granted for nil consideration.

(a) Particulars of share options:**(i) Share options granted under Staff Share Option Scheme 2007 in years 2008 to 2010:**

<u>Date of grant</u>	<u>Vesting period</u>	<u>Exercise period</u>	<u>Exercise price per share HK\$</u>
05/5/2008	05/5/2008 – 04/5/2009	05/5/2009 – 05/5/2013	40.09
05/5/2009	05/5/2009 – 04/5/2010	05/5/2010 – 05/5/2014	21.25
06/7/2010	06/7/2010 – 05/7/2011	06/7/2011 – 06/7/2015	28.49

39. Equity Settled Share-based Transactions (continued)

(a) Particulars of share options: (continued)

(ii) Share options granted under Staff Share Option Scheme 2011 in year 2011:

<u>Date of grant</u>	<u>Tranche</u>	<u>Vesting period</u>	<u>Exercise period</u>	<u>Exercise price per share</u> HK\$
05/5/2011	T1	05/5/2011 – 04/5/2012	05/5/2012 – 05/5/2017	32.00
05/5/2011	T2	05/5/2011 – 04/5/2013	05/5/2013 – 05/5/2018	32.00
05/5/2011	T3	05/5/2011 – 04/5/2014	05/5/2014 – 05/5/2019	32.00

(iii) Share options granted under Staff Share Option Scheme 2011 in year 2012:

<u>Date of grant</u>	<u>Tranche</u>	<u>Vesting period</u>	<u>Exercise period</u>	<u>Exercise price per share</u> HK\$
10/5/2012	T1	10/5/2012 – 09/5/2013	10/5/2013 – 10/5/2018	28.99
10/5/2012	T2	10/5/2012 – 09/5/2014	10/5/2014 – 10/5/2019	28.99
10/5/2012	T3	10/5/2012 – 09/5/2015	10/5/2015 – 10/5/2020	28.99

(iv) Share options granted under Staff Share Option Scheme 2011 in year 2013:

<u>Date of grant</u>	<u>Tranche</u>	<u>Vesting period</u>	<u>Exercise period</u>	<u>Exercise price per share</u> HK\$
03/5/2013	T1	03/5/2013 – 02/5/2014	03/5/2014 – 03/5/2019	31.40
03/5/2013	T2	03/5/2013 – 02/5/2015	03/5/2015 – 03/5/2020	31.40
03/5/2013	T3	03/5/2013 – 02/5/2016	03/5/2016 – 03/5/2021	31.40

(b) The number and weighted average exercise prices of share options are as follows:

	2013		2012 (Restated)	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
	HK\$	Mn	HK\$	Mn
Outstanding at the beginning of the year	30.52	25	31.83	22
Exercised during the year	24.78	(5)	23.07	(1)
Granted during the year	31.40	6	28.99	6
Lapsed during the year	39.52	(5)	42.84	(2)
Outstanding at the end of the year	30.21	21	30.52	25
Exercisable at the end of the year	29.65	10	30.73	15

The weighted average share price at the date of exercise for share options exercised during the year was HK\$31.19 (2012: HK\$28.71).

The options outstanding at 31st December, 2013 had an exercise price from HK\$21.25 to HK\$40.09 (2012: from HK\$21.25 to HK\$42.84) and a weighted average remaining contractual life of 4.58 years (2012: 3.61 years).

39. Equity Settled Share-based Transactions (continued)**(c) Fair value of share options and assumptions**

The fair value of services received in return for share options granted is measured by reference to the fair value of share options granted. The estimate of the fair value of the share options granted is measured based on a trinomial lattice model. The contractual life of the option is used as an input into this model.

	2013	2012
Fair value at measurement date		
- Tranche 1	HK\$3.18	HK\$3.95
- Tranche 2	HK\$3.17	HK\$4.02
- Tranche 3	HK\$3.09	HK\$3.99
Share price	HK\$31.40	HK\$28.90
Exercise price	HK\$31.40	HK\$28.99
Expected volatility (expressed as weighted average volatility used in the modelling under trinomial lattice model)	17.14%	22.08%
Option life		
- Tranche 1	6 years	6 years
- Tranche 2	7 years	7 years
- Tranche 3	8 years	8 years
Expected dividends	3.64%-3.70%	3.87%-3.94%
Risk-free interest rate (based on Exchange Fund Notes)	0.28%	0.45%

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility based on publicly available information. Expected dividends are based on historical dividends. Changes in the subjective input assumptions could materially affect the fair value estimate.

Share options were granted under a service condition. This condition has not been taken into account in the grant date fair value measurement of the services received. There were no market conditions associated with the share option grants.

40. Share Capital

	2013		2012	
	No. of shares million	Nominal value	No. of shares million	Nominal value
Authorised:				
Ordinary shares of HK\$2.50 each	<u>4,000</u>	<u>HK\$10,000Mn</u>	<u>4,000</u>	<u>HK\$10,000Mn</u>
Substitute preference shares of US\$1,000 each	<u>0.5</u>	<u>US\$500Mn</u>	<u>0.5</u>	<u>US\$500Mn</u>
		HK\$ Mn		HK\$ Mn
Issued and fully paid:				
At 1 st January	2,227	5,568	2,076	5,190
Shares issued under Staff Share Option Schemes	5	12	1	2
Subscription for new shares	-	-	111	279
Shares issued in lieu of dividends	58	144	39	97
At 31 st December	<u>2,290</u>	<u>5,724</u>	<u>2,227</u>	<u>5,568</u>

Pursuant to the approved Staff Share Option Schemes (the "Schemes"), options to purchase ordinary shares in the Bank were granted to eligible employees. The option price of the Schemes equals the fair value of the underlying shares at the date of grant. Except as provided otherwise in the rules of the relevant Schemes, the share options granted under the Scheme 2007 will be exercisable between the first and the fifth anniversaries of the date of grant while share options granted under Scheme 2011 will be exercisable on the Vesting Date and ending on the fifth anniversary of the Vesting Date.

40. Share Capital (continued)**(a) Shares issued under Staff Share Option Scheme**

During the year, options were exercised to subscribe for 5 million ordinary shares in the Bank at a consideration of HK\$118 million of which HK\$12 million was credited to share capital and the balance of HK\$106 million was credited to the share premium account (Note 41). HK\$31 million has been transferred from the capital reserve to the share premium account in accordance with policy set out in Note 2(q)(iv).

(b) Terms of unexpired and unexercised share options at the end of the reporting period

Date of options granted	Option price	2013 No. of shares	2012 No. of shares
05/5/2008	HK\$40.09	-	4,070,000
05/5/2009	HK\$21.25	435,000	2,920,000
06/7/2010	HK\$28.49	3,600,000	5,750,000
05/5/2011 (T1)	HK\$32.00	1,930,000	1,980,000
05/5/2011 (T2)	HK\$32.00	1,930,000	1,980,000
05/5/2011 (T3)	HK\$32.00	1,940,000	1,990,000
10/5/2012 (T1)	HK\$28.99	1,830,000	1,980,000
10/5/2012 (T2)	HK\$28.99	1,930,000	1,980,000
10/5/2012 (T3)	HK\$28.99	1,940,000	1,990,000
03/5/2013 (T1)	HK\$31.40	1,880,000	-
03/5/2013 (T2)	HK\$31.40	1,880,000	-
03/5/2013 (T3)	HK\$31.40	1,890,000	-
		<u>21,185,000</u>	<u>24,640,000</u>

41. Reserves

	2013	
	The Group HK\$ Mn	The Bank HK\$ Mn
(a) Share premium		
At 1 st January	16,083	16,083
Net premium on shares issued under Staff Share Option Schemes	106	106
Transfer of the fair value of options from capital reserve – share options issued	31	31
Shares issued in lieu of dividends	1,550	1,550
At 31 st December	<u>17,770</u>	<u>17,770</u>
(b) General reserve		
At 1 st January	13,823	13,434
Transfer to capital reserve	(1)	-
Transfer from other reserves	22	-
Realised surplus on disposals transferred from property revaluation reserve	7	7
Transfer from retained profits	26	-
At 31 st December	<u>13,877</u>	<u>13,441</u>

41. Reserves (continued)

	2013	
	The Group HK\$ Mn	The Bank HK\$ Mn
(c) Revaluation reserve on bank premises		
At 1 st January	976	914
Realised surplus on disposals transferred to general reserve	(7)	(7)
Recognition of deferred tax liabilities (Note 36(b))	1	1
Revaluation surplus on bank premises transferred to investment properties	670	670
Exchange adjustments	2	-
At 31 st December	<u>1,642</u>	<u>1,578</u>
(d) Statutory reserves		
At 1 st January	2,547	-
Transfer from retained profits	1,135	-
Exchange adjustments	64	-
At 31 st December	<u>3,746</u>	<u>-</u>
(e) Capital reserve		
At 1 st January	130	-
Transfer from general reserve	1	-
Transfer from retained profits	69	-
At 31 st December	<u>200</u>	<u>-</u>
(f) Exchange revaluation reserve		
At 1 st January	2,769	104
Exchange adjustments	105	(6)
At 31 st December	<u>2,874</u>	<u>98</u>
(g) Capital reserve – staff share options issued		
At 1 st January	135	135
Transfer of the fair value of options to share premium	(31)	(31)
Forfeited options transferred to retained profits	(56)	(56)
Additions	21	21
At 31 st December	<u>69</u>	<u>69</u>
(h) Investment revaluation reserve		
At 1 st January	1,012	652
Changes in fair value of securities	(46)	235
Reversal upon disposal (Note 13)	(142)	(35)
Recognition of deferred tax liabilities (Note 36(b))	71	10
Impairment loss and amortisation	84	66
Exchange adjustments	(1)	-
At 31 st December	<u>978</u>	<u>928</u>

41. Reserves (continued)

	2013	
	The Group	The Bank
	HK\$ Mn	HK\$ Mn
(i) Other reserves		
At 1 st January	64	-
Transfer to general reserve	(22)	-
Share of changes in equity of associates	(18)	-
At 31 st December	<u>24</u>	<u>-</u>
(j) Retained profits		
At 1 st January	14,046	4,578
Net profit for the year	6,613	3,386
Transfer to general reserve	(26)	-
Transfer to statutory reserve	(1,135)	-
Transfer to capital reserve	(69)	-
Forfeited options transferred to retained profits	56	56
Dividends (Note 18)		
- Interim dividend	(973)	(973)
- Second interim dividend	(1,404)	(1,404)
- Hybrid Tier 1 USD500M	(330)	-
At 31 st December	<u>16,778</u>	<u>5,643</u>
(k) Total reserves	<u>57,958</u>	<u>39,527</u>

41. Reserves (continued)

	2012	
	The Group	The Bank
	HK\$ Mn	HK\$ Mn
(a) Share premium		
At 1 st January	12,037	12,037
Net premium on shares issued under Staff Share Option Schemes	16	16
Transfer of the fair value of options from capital reserve – share options issued	6	6
Subscription of new shares	3,022	3,022
Shares issued in lieu of dividends	1,002	1,002
At 31 st December	<u>16,083</u>	<u>16,083</u>
(b) General reserve		
At 1 st January	13,744	13,376
Transfer from retained profits	21	-
Realised surplus on disposals transferred from property revaluation reserve	58	58
At 31 st December	<u>13,823</u>	<u>13,434</u>
(c) Revaluation reserve on bank premises		
At 1 st January	1,032	971
Recognition of deferred tax liabilities (Note 36(b))	1	1
Realised surplus on disposals transferred to general reserve	(58)	(58)
Exchange adjustments	1	-
At 31 st December	<u>976</u>	<u>914</u>
(d) Statutory reserves		
At 1 st January	2,142	2
Transfer from retained profits	390	(2)
Exchange adjustments	15	-
At 31 st December	<u>2,547</u>	<u>-</u>
(e) Capital reserve		
At 1 st January	86	-
Transfer from retained profits	48	-
Disposal of a subsidiary	(4)	-
At 31 st December	<u>130</u>	<u>-</u>
(f) Exchange revaluation reserve		
At 1 st January	2,390	22
Exchange adjustments	379	82
At 31 st December	<u>2,769</u>	<u>104</u>

41. Reserves (continued)

	2012	
	The Group	The Bank
	HK\$ Mn	HK\$ Mn
(g) Capital reserve – staff share options issued		
At 1 st January	140	140
Transfer of the fair value of options to share premium	(6)	(6)
Forfeited options transferred to retained profits	(21)	(21)
Additions	22	22
At 31 st December	<u>135</u>	<u>135</u>
(h) Investment revaluation reserve		
At 1 st January	27	67
Changes in fair value of securities	1,121	635
Reversal upon disposal (Note 13)	(113)	(15)
Recognition of deferred tax liabilities (Note 36(b))	(120)	(99)
Impairment loss and amortisation	98	61
Exchange adjustments	(1)	3
At 31 st December	<u>1,012</u>	<u>652</u>
(i) Other reserves		
At 1 st January	60	-
Share of changes in equity of associates	4	-
At 31 st December	<u>64</u>	<u>-</u>
(j) Retained profits		
At 1 st January	10,768	3,520
Net profit for the year	6,056	2,997
Transfer to general reserve	(21)	-
Transfer (to)/from statutory reserve	(390)	2
Transfer to capital reserve	(48)	-
Forfeited options transferred to retained profits	21	21
Transfer to non-controlling interests	(47)	-
Dividends (Note 18)		
- Interim dividend	(903)	(903)
- Second interim dividend	(1,059)	(1,059)
- Hybrid Tier 1 USD500M	(331)	-
At 31 st December	<u>14,046</u>	<u>4,578</u>
(k) Total reserves	<u>51,585</u>	<u>35,900</u>

41. Reserves (continued)

The application of the share premium account is governed by Section 48B of the Hong Kong Companies Ordinance.

General reserve was set up from the transfer of retained earnings and the realised revaluation surplus on disposal of properties.

Revaluation reserve on bank premises and exchange revaluation reserve have been set up and are dealt with in accordance with the accounting policies adopted for the revaluation of bank premises and foreign currency translation.

Statutory reserves are set up to satisfy the statutory requirements of certain overseas subsidiaries and associates mainly for the purpose of covering unidentified potential losses on risk assets in addition to those recognised under the prevailing accounting requirements in their jurisdictions.

Capital reserve represents the capitalisation of subsidiaries' and associates' reserves.

Capital reserve - staff share options issued comprises the fair value of the actual or estimated number of unexercised share options granted to employees of the Bank recognised in accordance with the accounting policy adopted for share based payment in Note 2(q)(iv).

Investment revaluation reserve comprises the cumulative net change in the fair value of available-for-sale securities held until the securities are derecognised and is dealt with in accordance with the accounting policies in Notes 2(f) and (k).

Other reserves represent share of changes in equity of associates in respect of investment revaluation reserve and revaluation reserve of bank premises.

A regulatory reserve is maintained to satisfy the provisions of the Hong Kong Banking Ordinance for prudential supervision purposes by earmarking amounts in respect of losses which the Bank will or may incur on loans and advances and investments in addition to impairment losses recognised. Movements in the reserve are earmarked directly through retained earnings and in consultation with the Hong Kong Monetary Authority. As at 31st December, 2013, HK\$5,381 million (2012: HK\$4,580 million) was included in the retained profits in this respect which was distributable to equity holders of the Group subject to consultation with the Hong Kong Monetary Authority.

At 31st December, 2013 the aggregate amount of reserves available for distribution to equity holders of the Bank was HK\$12,816 million (2012: HK\$12,473 million). After the end of the reporting period the directors declared a second interim dividend of HK\$0.68 per ordinary share (2012: HK\$0.63 per share), amounting to HK\$1,557 million (2012: HK\$1,403 million). The dividend has not been recognised as a liability at the end of the reporting period.

42. Non-controlling interests

	2013 HK\$ Mn	2012 HK\$ Mn
At 1 st January	4,486	4,428
- purchase of interests in businesses from non-controlling interests investors	33	-
- final dividend in respect of previous year	(64)	(68)
- transfer from retained profits	-	47
- exchange adjustments	3	(19)
Profit for the year	94	98
At 31 st December	<u>4,552</u>	<u>4,486</u>

43. Financial Risk Management

This section presents information on the Group's management of principal risks.

The Group has established comprehensive risk management procedures in line with the requirements set out by the HKMA to identify, measure, monitor, control and report on the various types of risk that the Group faces, including credit risk, interest rate risk, market risk, liquidity risk and operational risk, and, where appropriate, to allocate capital to cover those risks.

To further enhance the Group's risk management framework, and in line with the best practices encouraged by the HKMA, the Group established the Risk Committee in 2013. The Risk Committee comprises the Group's Chairman & Chief Executive, two Independent Non-executive Directors, and two Non-executive Directors. One of the major responsibilities of the Risk Committee is to assist the Board of Directors to manage risks associated with strategic issues of the Group. The Risk Committee is also responsible for the regular review of the Group's risk appetite statement before its submission to the Board of Directors for final review and approval. The related risk levels, where appropriate, are laid down in the risk management policies.

The risk management mechanisms are built around a centralised framework and include the Risk Committee, Crisis Management Committee, Risk Management Committee, specialised risk management committees – namely, Credit Committee, Asset and Liability Management Committee and Operational Risk Management Committee – and the Risk Management Division. These mechanisms capture the different risk-related management activities on a Group basis, including the formulation of policies, risk assessment, setting up of procedures and control limits, and ongoing monitoring before the same are reported to the Board of Directors. The mechanisms ensure compliance with the Group's policies, and legal and regulatory requirements in Hong Kong, China, and overseas. They are supplemented by active management involvement, effective internal controls, and comprehensive audits.

The Crisis Management Committee and Risk Management Committee comprise the Group's Chairman & Chief Executive, Senior Advisors, Deputy Chief Executives and the Group Chief Risk Officer.

The specialised risk management committees comprise the Group's Senior Advisors, Deputy Chief Executives, the Group Chief Risk Officer and where appropriate division heads from the relevant areas.

An independent centralised risk management unit, Risk Management Division, is responsible for monitoring the activities relating to the principal risks. The internal auditors also perform regular audits on business units to check compliance with policies and procedures.

Management of the Group's major risks is governed by the respective risk management policies. The Group's major risk management policies and control limits are approved by the Board of Directors and they are monitored and regularly reviewed. The Board of Directors has delegated the responsibility of on-going risk management to the Risk Committee, Risk Management Committee and specialised risk management committees. Significant risk management related issues are required to be reported to the Board of Directors to assist its oversight on risk management.

Regular stress tests are carried out by the Group to assess the impact of a number of historical and hypothetical stress scenarios on the Group's financial position, in particular capital adequacy, profitability and liquidity.

Each new product launch must go through an evaluation process, which includes business and financial analysis and risk assessment. Approval for the launch of new products must be obtained from the New Product Development Working Group, the membership of which is comprised of heads of support and control units. This Working Group further reports to the New Product Development Steering Group chaired by the Bank's Group Chief Risk Officer, with other members being division heads of support functions.

(a) Credit risk management

Credit risk arises from the possibility that a customer or counterparty in a transaction may default. Such risk may arise from counterparty risks from loans and advances, issuer risks from the securities business and counterparty risks from trading activities.

43. Financial Risk and Management (continued)

(a) Credit risk management (continued)

The Credit Committee is responsible for dealing with all credit risk related issues of the Group, while the Credit Risk Management Department under the Risk Management Division of the Group is responsible for monitoring activities relating to credit risk. The Group identifies and manages credit risk through defining the target market segment, formulating appropriate credit policies, and carrying out credit assessment and monitoring of asset quality. Credit risk control limits are set for different levels. Risk, return and market situation are considered when setting all limits. Active limit monitoring is undertaken.

In evaluating the credit risk associated with an individual customer or counterparty, financial strength and repayment ability are always the primary considerations. Credit risk may be mitigated by obtaining collateral from the customer or counterparty.

The Group has established policies, procedures and rating systems to identify, measure, monitor, control and report on credit risk. In this connection, guidelines for management of credit risk have been laid down in the Group's Credit Risk Management Manual. These guidelines stipulate delegated lending authorities, credit extension criteria, credit monitoring process, internal rating structure, credit recovery and provisioning policy. They are reviewed and enhanced on an on-going basis to cater for market changes, statutory requirements and best practice in risk management processes.

The Group's credit risk management for the major types of credit risk is depicted as follows:

(i) Corporate and bank credit risk

The Group has laid down policies and procedures to evaluate the potential credit risk of a particular counterparty or transaction and to approve the transaction. For corporate and bank customers, the Group has different internal rating systems that are applied to each counterparty. For exposure classified as Specialised Lending in particular, supervisory slotting criteria are used. To monitor concentration risk, the Group has preset limits for exposures to individual industries and for borrowers and groups of borrowers. The Group also has a review process to ensure that the level of review and approval is proper and will depend on the size of the facility and rating of the credit.

The Group undertakes on-going credit analysis and monitoring at several levels. The policies are designed to promote early detection of counterparty, industry or product exposures that require special monitoring. The overall portfolio risk as well as individual impaired loans and potential impaired loans are monitored on a regular basis.

(ii) Retail credit risk

The Group's retail credit policy and approval process are designed for the fact that there are high volumes of relatively homogeneous and small value transactions in each retail loan category. The design of internal rating system and formulation of credit policies are primarily based on the demographic factors and the loss experience of the loan portfolios. The Group monitors its own and industry experience to determine and periodically revise product terms and desired customer profiles.

(iii) Credit for treasury transactions

The credit risk of the Group's treasury transactions is managed in the same way as the Group manages its corporate and bank lending risk. The Group applies an internal rating system to its counterparties and sets individual counterparty limits.

(iv) Credit-related commitment

The risks involved in credit-related commitments and contingencies are essentially the same as the credit risk involved in extending loan facilities to customers. These transactions are subject to the same credit application, portfolio maintenance and collateral requirements as for customers applying for loans.

43. Financial Risk Management (continued)**(a) Credit risk management (continued)****(v) Master netting arrangements**

To mitigate credit risks, the Group enters into master netting arrangements with same counterparties. Netting agreements provide that, if an event of default occurs, all outstanding transactions with the counterparty will be terminated and all amounts outstanding will be settled on a net basis. Except for the event of default, all outstanding transactions with the counterparty are settled on a gross basis and generally do not result in offsetting the assets and liabilities in the statement of financial position.

The following tables present details of financial instruments subject to offsetting, enforceable master netting arrangements and similar agreements.

At 31st December, 2013

	Gross amounts of recognised financial assets HK\$ Mn	Gross amounts of recognised liabilities set off in the balance sheet HK\$ Mn	Net amounts of financial assets presented in the balance sheet HK\$ Mn	Related financial instruments that are not set off HK\$ Mn	Net amount HK\$ Mn
Assets					
Positive fair value of derivatives	66	-	66	(54)	12
Other accounts	745	(681)	64	-	64
Total	811	(681)	130	(54)	76

At 31st December, 2013

	Gross amounts of recognised financial liabilities HK\$ Mn	Gross amounts of recognised assets set off in the balance sheet HK\$ Mn	Net amounts of financial liabilities presented in the balance sheet HK\$ Mn	Related financial instruments that are not set off HK\$ Mn	Net amount HK\$ Mn
Liabilities					
Negative fair value of derivatives	254	-	254	(54)	200
Other accounts	779	(681)	98	-	98
Total	1,033	(681)	352	(54)	298

43. Financial Risk Management (continued)

(a) Credit risk management (continued)

(v) Master netting arrangements (continued)

At 31st December, 2012

	Gross amounts of recognised financial assets HK\$ Mn	Gross amounts of recognised financial liabilities set off in the balance sheet HK\$ Mn	Net amounts of financial assets presented in the balance sheet HK\$ Mn	Related financial instruments that are not set off HK\$ Mn	Net amount HK\$ Mn
Assets					
Positive fair value of derivatives	105	-	105	(105)	-
Other accounts	726	(593)	133	-	133
Total	831	(593)	238	(105)	133

At 31st December, 2012

	Gross amounts of recognised financial assets HK\$ Mn	Gross amounts of recognised financial liabilities set off in the balance sheet HK\$ Mn	Net amounts of financial liabilities presented in the balance sheet HK\$ Mn	Related financial instruments that are not set off HK\$ Mn	Net amount HK\$ Mn
Liabilities					
Negative fair value of derivatives	275	-	275	(105)	170
Other accounts	593	(593)	-	-	-
Total	868	(593)	275	(105)	170

43. Financial Risk Management (continued)**(a) Credit risk management (continued)****(vi) Concentrations of credit risk**

Concentration of credit risk exists when changes in geographic, economic or industry factors similarly affect groups of counterparties whose aggregate credit exposure is material in relation to the Group's total exposures. The Group's credit portfolio is diversified along geographic, industry and product sectors.

The Group monitors its concentration risk by adopting appropriate risk control measures, such as setting limits on exposures to different industries and loan portfolios.

(vii) Maximum exposure

The maximum exposure to credit risk at the end of the reporting period without taking into consideration of any collateral held or other credit enhancements is represented by the carrying amount of each financial assets in the statement of financial position after deducting any impairment allowance. A summary of the maximum exposure is as follows:

	The Group		The Bank	
	2013	2012	2013	2012
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Cash and balances with banks, central banks and other financial institutions	67,063	84,092	21,011	18,846
Placements with banks, central banks and other financial institutions	57,372	50,618	13,399	19,335
Trade bills	59,932	55,740	52,739	47,931
Trading assets	3,902	3,057	496	570
Financial assets designated at fair value through profit or loss	11,199	14,751	11,199	14,751
Positive fair value of derivatives	3,625	3,125	1,729	2,267
Loans and advances to customers	404,335	349,801	258,862	220,970
Available-for-sale financial assets	68,682	62,333	45,819	43,812
Held-to-maturity investments	5,048	4,320	3,940	3,219
Other assets	43,023	36,502	7,383	6,518
Financial guarantees and other credit related contingent liabilities	22,644	17,597	6,975	7,239
Loan commitments and other credit related commitments	212,472	192,183	84,100	74,479
	<u>959,297</u>	<u>874,119</u>	<u>507,652</u>	<u>459,937</u>

43. Financial Risk Management (continued)

(a) Credit risk management (continued)

(viii) Credit quality of loans and advances

Loans and advances to banks are only made to banks with good credit standing. The credit quality of loans and advances to customers can be analysed as follows:

	The Group		The Bank	
	2013	2012	2013	2012
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Gross loans and advances to customers				
- neither past due nor impaired	403,434	349,294	258,504	220,696
- past due but not impaired	341	288	125	99
- impaired	1,582	1,138	854	777
	<u>405,357</u>	<u>350,720</u>	<u>259,483</u>	<u>221,572</u>

Of which:

	The Group		The Bank	
	2013	2012	2013	2012
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Gross loans and advances to customers that are neither past due nor impaired				
- pass	402,503	348,019	258,067	219,706
- special mention	931	1,275	437	990
	<u>403,434</u>	<u>349,294</u>	<u>258,504</u>	<u>220,696</u>

The Group classifies the loans and advances in accordance with the loan classification system required to be adopted for reporting to the HKMA.

The ageing analysis of loans and advances to customers that are past due but not impaired is as follows:

	The Group		The Bank	
	2013	2012	2013	2012
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Gross loans and advances to customers that are past due but not impaired				
- overdue 3 months or less	<u>341</u>	<u>288</u>	<u>125</u>	<u>99</u>

Loans and advances that would be past due or impaired had the terms not been renegotiated amounted to HK\$86 million as at 31st December, 2013 (2012: HK\$91 million).

43. Financial Risk Management (continued)**(a) Credit risk management (continued)****(ix) Credit quality of financial assets other than loans and advances**

Credit risk of treasury transactions is managed in the same way as the Group manages its corporate and bank lending risk and risk gradings are applied to the counterparties with individual counterparty limits set.

At the end of the reporting period, the credit quality of investment in debt securities analysed by designation of external credit assessment institution, Moody's Investor Services, or equivalent, is as follows:

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Aaa	10,468	15,637	6,994	10,243
Aa1 to Aa3	22,488	35,387	21,130	26,816
A1 to A3	30,100	13,711	13,279	11,234
P-1 (Short term)	1,109	1,280	918	-
Baa1 to Baa3	10,777	9,371	6,700	5,306
Below Baa3	4,624	2,395	3,615	2,089
(NB)	79,566	77,781	52,636	55,688
Unrated	9,382	6,758	8,934	6,741
Total	88,948	84,539	61,570	62,429

NB As at 31st December 2013, the Group has debt securities of HK\$6,112 million with investment grade assigned by PRC local rating agencies (2012: HK\$7,710 million).

(x) Collateral and other credit enhancements

The Group has established guidelines on the acceptability of various classes of collateral and determined the corresponding valuation parameters. The guidelines and collateral valuation parameters are subject to regular reviews to ensure their effectiveness over credit risk management.

The extent of collateral coverage over the Group's loans and advances to customer depends on the type of customers and the product offered. Types of collateral include residential properties (in the form of mortgages over property), other properties, other registered securities over assets, cash deposits, standby letters of credit and guarantees. Collateral generally is not held over balances and placements with banks and other financial institutions, and loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity. The Group takes possession of collateral through court proceedings or voluntary delivery of possession by the borrowers during the course of the recovery of impaired loans and advances. These repossessed assets are reported in the statement of financial position within "other assets" (Note 2(m)). If the recovery from the repossessed assets exceeds the corresponding exposure, the surplus fund is made available either to repay the borrower's other secured loans with lower priority or is returned to the borrower.

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured with the exception of asset-based securities and similar instruments, which are secured by pools of financial assets. However the credit risk may be implicit in the terms or reflected in the fair value of the corresponding instruments.

43. Financial Risk Management (continued)**(a) Credit risk management (continued)****(x) Collateral and other credit enhancements (continued)**

The Group's preferred agreement for documenting derivatives activity is the ISDA Master Agreement which covers the contractual framework within which dealing activity across a full range of over-the-counter products is conducted and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement, if either party defaults or following other pre-agreed termination events. It is also common for the Group to execute a Credit Support Annex in conjunction with the ISDA Master Agreement with the counterparty under which collateral is passed between the parties to mitigate the market contingent counterparty risk inherent in the outstanding position.

For contingent liabilities and commitments that are unconditionally cancellable (Note 45), the Group will assess the necessity to withdraw the credit line when there is a concern over the credit quality of the customers. Accordingly, the exposure to significant credit risk is considered as minimal. For commitments that are not unconditionally cancellable, the Group assesses the necessity of collateral depending on the type of customer and the product offered.

The lower of gross loan amount and the estimate of the fair value of collateral and other credit enhancements held against financial assets is as follows:

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Fair value of collateral and other credit enhancements held against financial assets that are:				
- neither past due nor impaired	286,564	251,750	169,906	150,244
- past due but not impaired	338	287	124	98
	<u>286,902</u>	<u>252,037</u>	<u>170,030</u>	<u>150,342</u>

(b) Market risk management

Market risk arises from all market risk sensitive financial instruments, including debt securities, foreign exchange contracts, equity and derivative instruments, as well as from balance sheet or structural positions. The aim in managing market risk is to reduce the Group's exposure to the volatility inherent in financial instruments.

The Asset and Liability Management Committee deals with all market risk related issues of the Group. It is also responsible for conducting a regular review of interest rate trends and deciding the corresponding future business strategy. The Asset & Liability Management Department under the Risk Management Division of the Group is responsible for monitoring activities relating to market risk.

The use of derivatives for proprietary trading and the sale of derivatives to customers as risk management products is an integral part of the Group's business activities. These instruments are also used to manage the Group's own exposures to market risk, as part of its asset and liability management process. The principal derivatives instruments used by the Group are interest rate, foreign exchange and equity related contracts, in the form of both over-the-counter derivatives and exchange traded derivatives. Most of the Group's derivatives positions have been entered into to meet customer demand and to manage the risk of these and other trading positions.

43. Financial Risk Management (continued)**(b) Market risk management (continued)**

In this connection, the key types of market risk that must be managed are:

(i) Currency risk

The Group's foreign currency positions arise from foreign exchange dealing, commercial banking operations and structural foreign currency exposures. The Group's non-structural foreign currency exposures are dominated in USD. For other currencies, currency concentrations are maintained below 10% of the total net position in all non-structural foreign currencies of the Group. All foreign currency positions are managed within limits approved by the Board of Directors or the Asset and Liability Management Committee.

Structural foreign currency positions, which arise mainly from foreign currency investments in the Group's branches, subsidiaries and associated companies, are excluded from value-at-risk ("VaR") measurements, as related gains or losses are taken to reserves. Such foreign currency positions are managed with the principal objective of ensuring that the Group's reserves are protected from exchange rate fluctuations. The Group seeks to match closely its foreign currency denominated assets with corresponding liabilities in the same currencies.

The Group had the following net structural positions which were not less than 10% of the total net structural foreign currency position at the end of the reporting period:

	The Group and The Bank			
	2013		2012	
	USD	RMB	USD	RMB
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Net structural position	<u>2,475</u>	<u>8,960</u>	<u>2,488</u>	<u>8,703</u>

(ii) Interest rate risk

The Group's interest rate positions arise from treasury and commercial banking activities. Interest rate risk arises in both trading portfolios and non-trading portfolios. Interest rate risk primarily results from the timing differences in the repricing of interest-bearing assets, liabilities and commitments. It also relates to positions from non-interest bearing liabilities including shareholders' funds and current accounts, as well as from certain fixed-rate loans and liabilities. Interest rate risk is managed daily by the Treasury Markets Division within the limits approved by the Board of Directors or the Asset and Liability Management Committee. The instruments used to manage interest rate risk include interest rate swaps and other derivatives.

(iii) Equity risk

The Group's equity positions arise from equity investment and dynamic hedging of customer-driven business. Equity risk is managed daily by the Investment Department within the limits approved by the Board of Directors, Investment Committee or the Asset and Liability Management Committee.

Market risk control limits have been set at varying levels according to the practical requirements of different units. The Board of Directors approves the control limits and has delegated the authority to set detailed control limits to the Asset and Liability Management Committee. Risk, return and market conditions are considered when setting limits. Active limit monitoring is carried out.

In this connection, the Asset and Liability Management Committee monitors the related market risk arising from risk-taking activities of the Group, to ensure that overall and individual market risks are within the Group's risk tolerance level. Risk exposures are monitored on a frequent basis to ensure that they are within established control limits.

43. Financial Risk Management (continued)**(b) Market risk management (continued)**

The Group quantifies the market risk of the underlying trading portfolio by means of VaR. VaR is a statistical estimate that measures the potential losses in market value of a portfolio as a result of unfavourable movements in market rates and prices, if positions are held unchanged over a certain horizon time period.

The Group estimates VaR for the Group's trading portfolio by the Parametric Approach, where the VaR is derived from the underlying variances and co-variances of the constituents of a portfolio. This methodology uses historical movements in market rates and prices, a 99% confidence level, a one-day holding period and a one-year historical observation period. An equal or higher weighting scheme is applied to more recent observations under which higher VaR should be used.

Structural foreign exchange positions arising from net investments in branches and subsidiaries are not included in the VaR for the foreign exchange trading position.

The book value of listed shares, as well as the book value of private equity funds and unlisted equities (collectively the "Unlisted Securities"), are subject to limits and these are monitored by the management of the Group. The Unlisted Securities and listed non-trading equities are not included in the VaR for the equity trading position, and are managed through delegated limits. The limits are subject to regular review by the Asset and Liability Management Committee.

Value-at-risk statistics

	2013			
	At 31 st December	Maximum	Minimum	Mean
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
VaR for total trading activities	26	43	24	29
VaR for foreign exchange trading positions *	6	10	4	7
VaR for interest rate trading positions	4	10	2	4
VaR for equity trading positions	21	34	20	23

	2012			
	At 31 st December	Maximum	Minimum	Mean
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
VaR for total trading activities	16	38	16	26
VaR for foreign exchange trading positions *	4	8	3	5
VaR for interest rate trading positions	1	5	1	3
VaR for equity trading positions	12	32	12	21

* Including all foreign exchange positions but excluding structured foreign exchange positions.

43. Financial Risk Management (continued)

(b) Market risk management (continued)

	2013			
	At 31 st December HK\$ Mn	Maximum HK\$ Mn	Minimum HK\$ Mn	Mean HK\$ Mn
Stressed VaR for total trading activities	87	102	74	89

	2012			
	At 31 st December HK\$ Mn	Maximum HK\$ Mn	Minimum HK\$ Mn	Mean HK\$ Mn
Stressed VaR for total trading activities	68	106	65	80

A Stressed VaR measure is intended to replicate a VaR calculation that would be generated on current market risk portfolio if the relevant market factors were experiencing a period of stress.

(c) Operational risk management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

The objective of operational risk management is to identify, assess, monitor and report on operational risk and to comply with the relevant regulatory requirements.

The Operational Risk Management Committee is responsible for overseeing operational risk management of the Group while the Operational Risk Management Department under the Risk Management Division of the Group is responsible for monitoring activities relating to operational risk.

Operational risk management tools adopted include operational risk incidents reporting, control self-assessment, key risk indicators, operation manuals, insurance policies, and business continuity planning, etc.

Furthermore, the Operational Risk Management Department under the Risk Management Division of the Group has also performed self-assessment on the Group's compliance with the requirements of HKMA Supervisory Policy Manual on Operational Risk Management, with satisfactory result which had been reviewed independently by Internal Audit Department.

(d) Liquidity risk management

Liquidity pertains to the Group's ability to meet obligations as they fall due. Funding liquidity relates to the ability to meet expected and unexpected current and future cash flow and collateral needs without affecting daily operations or the financial position. Market liquidity concerns the inability to offset or eliminate a position at market price because of inadequate market depth or market disruption.

The purpose of liquidity risk management is to ensure sufficient cash flows to meet all financial commitments and to capitalise on opportunities for business expansion. This includes the Group's ability to meet deposit withdrawals either on demand or at contractual maturity, to repay borrowings as they mature, to comply with the statutory liquidity ratio, and to make new loans and investments as opportunities arise.

43. Financial Risk Management (continued)**(d) Liquidity risk management (continued)**

The Asset and Liability Management Committee is delegated by the Board of Directors to oversee the Group's liquidity risk management. The Asset and Liability Management Committee sets the strategy, policy and limits for managing liquidity risk and the means for ensuring that such strategy and policy are implemented. Regular meetings are held to review the compliance status of the monitoring matrix established and the needs for any change in strategy and policy. Liquidity is managed daily by the Capital Markets & Liquidity Management Department under the Treasury Markets Division within the limits. The Asset and Liability Management Department under the Risk Management Division of the Group is responsible for monitoring the activities relating to liquidity risk. The Internal Audit Department performs periodic reviews to make sure the liquidity risk management functions are carried out effectively.

The Group's strong retail customer base provides a significant portion of the Group's funding. The retail customer base constitutes a broad spectrum of depositors with whom the Group maintains strong relationships. Funding diversification is achieved by issuance of certificates of deposit, medium term notes and subordinated debts. Professional markets are accessed for the purposes of providing additional funding, maintaining a presence in local money markets and optimising asset and liability maturities.

Internally, intra-group funding transactions are carried out at arm's length and treated in a manner in line with other third party transactions, with regular monitoring and appropriate control.

In addition to observing the statutory liquidity ratio, the Group has established different liquidity metrics, including but not limited to the liquidity ratio, loan-to-deposit ratio, cumulative mismatch ratio, funding concentration ratios, intra-group exposure threshold and cross currency funding ratio to measure and analyse the Group's liquidity risks. As a majority of the Group's liquidity risk arises from the maturity mismatch gap between the Group's asset and liability portfolios, the Group manages liquidity risk by conducting cash flow analysis and projections. These are carried out on a regular basis to identify funding needs arising from on- and off-balance sheet items in a specific time bucket over a set of time horizons. The Group also holds sufficient liquid assets (e.g. cash, short term funds and securities) of appropriate quality to ensure that short term funding requirements are covered within prudent limits. Contingent funding sources are maintained to provide strategic liquidity to meet unexpected and material cash outflows.

The Group also conducts stress testing regularly to analyse liquidity risk. In the Group's stress test, both on- and off-balance sheet items with cash flow impact are considered, with applicable hypothetical as well as historical assumptions. Both funding and market liquidity risks are addressed. Three stress scenarios, namely the institution-specific crisis, the general market crisis and the combined crisis are adopted with minimum survival period defined according to HKMA's latest Supervisory Policy Manual "Sound Systems and Controls for Liquidity Risk Management".

With reference to the stress-testing results, the Group identifies potential vulnerabilities within the Group, and formulates a Contingency Funding Plan that describes the Group's strategy for dealing with any liquidity problem and the procedures for making up cash flow deficits in emergency situations.

The Contingency Funding Plan is designed to be pro-active and pre-emptive, and stipulates the following 3 stages:

In the first stage, the Group utilises early warning indicators, which cover both qualitative and quantitative measures, and monitors both internal and external factors. Should there be any early signs of significant impact on the Group's liquidity position, management is informed.

In the second stage, a Crisis Management Committee, which is chaired by Senior Management, is formed to handle the crisis. Strategy and procedures for obtaining contingency funding, as well as roles and responsibilities of parties concerned are clearly stated.

In the final stage, a detailed review is carried out to recommend necessary improvements to avoid incidents of a similar nature in future.

Annual drill test is conducted and the Contingency Funding Plan is subject to regular review in order to cope with the changes of business environment. Any significant changes to the Contingency Funding Plan are approved by the Board.

43. Financial Risk Management (continued)

(d) Liquidity risk management (continued)

Analysis of assets and liabilities by remaining maturity:

The Group

	2013							
	Repayable on demand HK\$ Mn	Within 1 month HK\$ Mn	3 months or less but over 1 month HK\$ Mn	1 year or less but over 3 months HK\$ Mn	5 years or less but over 1 year HK\$ Mn	Over 5 years HK\$ Mn	Undated or overdue HK\$ Mn	Total HK\$ Mn
Assets								
Cash and balances with banks and other financial institutions	28,794	70	-	29	-	-	39,884	68,777
Placements with banks and other financial institutions	-	38,290	16,153	2,929	-	-	-	57,372
Trade bills	13	9,069	11,579	39,271	-	-	-	59,932
Trading assets	-	64	230	890	2,667	51	1,429	5,331
Financial assets designated at fair value through profit or loss	-	194	39	3,980	5,087	1,899	407	11,606
Positive fair value of derivatives	-	-	-	-	-	-	3,625	3,625
Advances to customers and other accounts	7,434	57,018	36,227	96,870	162,913	82,925	4,868	448,255
Available-for-sale financial assets	-	5,236	12,303	11,621	33,450	6,072	2,907	71,589
Held-to-maturity investments	104	1,256	334	597	2,711	46	-	5,048
Undated assets	-	-	-	-	-	-	22,419	22,419
Total assets	36,345	111,197	76,865	156,187	206,828	90,993	75,539	753,954
Liabilities								
Deposits and balances of banks and other financial institutions	3,691	10,319	9,231	4,609	1,073	-	-	28,923
Deposits from customers	163,343	136,534	104,544	108,409	22,141	-	-	534,971
- Demand deposits and current accounts	69,259	-	-	-	-	-	-	69,259
- Savings deposit	92,936	-	-	-	-	-	-	92,936
- Time, call and notice deposits	1,148	136,534	104,544	108,409	22,141	-	-	372,776
Trading liabilities	-	-	-	-	-	-	11	11
Negative fair value of derivatives	-	-	-	-	-	-	4,545	4,545
Certificates of deposit issued	-	8,765	7,820	18,991	7,353	-	-	42,929
Current taxation	-	-	-	1,353	-	-	-	1,353
Debt securities issued	-	-	792	2,656	1,280	-	-	4,728
Loan capital	-	-	-	-	8,817	4,815	-	13,632
Other liabilities	1,226	8,533	11,285	17,545	6,466	2,221	7,352	54,628
Total liabilities	168,260	164,151	133,672	153,563	47,130	7,036	11,908	685,720
Net gap	(131,915)	(52,954)	(56,807)	2,624	159,698	83,957		

43. Financial Risk Management (continued)**(d) Liquidity risk management (continued)****The Group**

The Group	2012							Total HK\$ Mn
	Repayable on demand HK\$ Mn	Within 1 month HK\$ Mn	3 months or less but over 1 month HK\$ Mn	1 year or less but over 3 months HK\$ Mn	5 years or less but over 1 year HK\$ Mn	Over 5 years HK\$ Mn	Undated or overdue HK\$ Mn	
Assets								
Cash and balances with banks and other financial institutions	55,308	46	70	91	-	-	29,997	85,512
Placements with banks and other financial institutions	-	25,409	5,581	19,628	-	-	-	50,618
Trade bills	5	7,758	9,295	38,673	-	-	9	55,740
Trading assets	-	72	400	1,327	1,165	93	1,156	4,213
Financial assets designated at fair value through profit or loss	-	-	129	1,447	10,804	2,371	418	15,169
Positive fair value of derivatives	-	-	-	-	-	-	3,125	3,125
Advances to customers and other accounts	5,791	46,793	33,877	84,085	132,032	77,479	7,216	387,273
Available-for-sale financial assets	-	14,589	7,500	5,907	29,307	5,030	2,398	64,731
Held-to-maturity investments	107	1,102	201	985	1,879	46	-	4,320
Undated assets	-	-	-	-	-	-	21,413	21,413
Total assets	61,211	95,769	57,053	152,143	175,187	85,019	65,732	692,114
Liabilities								
Deposits and balances of banks and other financial institutions	1,128	19,221	4,306	5,801	141	-	-	30,597
Deposits from customers	157,048	144,532	84,329	98,893	13,968	-	-	498,770
- Demand deposits and current accounts	68,950	-	-	-	-	-	-	68,950
- Savings deposit	86,549	-	-	-	-	-	-	86,549
- Time, call and notice deposits	1,549	144,532	84,329	98,893	13,968	-	-	343,271
Trading liabilities	-	-	-	-	-	-	21	21
Negative fair value of derivatives	-	-	-	-	-	-	3,806	3,806
Certificates of deposit issued	-	3,122	3,548	14,907	5,793	-	-	27,370
Current taxation	-	-	-	988	-	-	-	988
Debt securities issued	-	-	3,146	4,152	1,359	-	-	8,657
Loan capital	-	-	-	-	9,124	5,139	-	14,263
Other liabilities	1,090	6,373	11,122	12,347	5,150	2,174	7,747	46,003
Total liabilities	159,266	173,248	106,451	137,088	35,535	7,313	11,574	630,475
Net gap	(98,055)	(77,479)	(49,398)	15,055	139,652	77,706		

43. Financial Risk Management (continued)**(d) Liquidity risk management (continued)****The Bank**

The Bank	2013							Total HK\$ Mn
	Repayable on demand HK\$ Mn	Within 1 month HK\$ Mn	3 months or less but over 1 month HK\$ Mn	1 year or less but over 3 months HK\$ Mn	5 years or less but over 1 year HK\$ Mn	Over 5 years HK\$ Mn	Undated or overdue HK\$ Mn	
Assets								
Cash and balances with banks and other financial institutions	16,998	57	-	-	-	-	5,157	22,212
Placements with banks and other financial institutions	-	11,279	901	1,219	-	-	-	13,399
Trade bills	8	6,756	8,471	37,504	-	-	-	52,739
Trading assets	-	-	26	291	128	51	1,429	1,925
Financial assets designated at fair value through profit or loss	-	194	39	3,980	5,087	1,899	-	11,199
Positive fair value of derivatives	-	-	-	-	-	-	1,729	1,729
Advances to customers and other accounts	6,099	46,264	17,548	43,801	103,049	45,962	4,202	266,925
Available-for-sale financial assets	-	4,825	11,675	8,094	18,730	2,495	1,511	47,330
Held-to-maturity investments	104	1,185	334	463	1,846	8	-	3,940
Undated assets	-	-	-	-	-	-	51,069	51,069
Total assets	23,209	70,560	38,994	95,352	128,840	50,415	65,097	472,467
Liabilities								
Deposits and balances of banks and other financial institutions	3,684	6,864	7,940	4,179	840	-	-	23,507
Deposits from customers	114,135	110,867	63,540	33,701	871	-	-	323,114
- Demand deposits and current accounts	21,652	-	-	-	-	-	-	21,652
- Savings deposit	91,791	-	-	-	-	-	-	91,791
- Time, call and notice deposits	692	110,867	63,540	33,701	871	-	-	209,671
Trading liabilities	-	-	-	-	-	-	11	11
Negative fair value of derivatives	-	-	-	-	-	-	2,766	2,766
Certificates of deposit issued	-	8,765	7,820	18,991	7,353	2,200	-	45,129
Current taxation	-	-	-	1,097	-	-	-	1,097
Debt securities issued	-	-	792	2,656	-	-	-	3,448
Loan capital	-	-	-	-	8,817	9,293	-	18,110
Other liabilities	66	1,599	318	244	5	-	7,802	10,034
Total liabilities	117,885	128,095	80,410	60,868	17,886	11,493	10,579	427,216
Net gap	(94,676)	(57,535)	(41,416)	34,484	110,954	38,922		

43. Financial Risk Management (continued)**(d) Liquidity risk management (continued)****The Bank**

The Bank	2012							Total HK\$ Mn
	Repayable on demand HK\$ Mn	Within 1 month HK\$ Mn	3 months or less but over 1 month HK\$ Mn	1 year or less but over 3 months HK\$ Mn	5 years or less but over 1 year HK\$ Mn	Over 5 years HK\$ Mn	Undated or overdue HK\$ Mn	
Assets								
Cash and balances with banks and other financial institutions	19,307	-	-	-	-	-	449	19,756
Placements with banks and other financial institutions	-	12,698	3,559	3,078	-	-	-	19,335
Trade bills	-	4,564	6,639	36,728	-	-	-	47,931
Trading assets	-	10	51	73	417	19	1,156	1,726
Financial assets designated at fair value through profit or loss	-	-	129	1,447	10,804	2,371	119	14,870
Positive fair value of derivatives	-	-	-	-	-	-	2,267	2,267
Advances to customers and other accounts	4,986	37,962	15,304	37,537	83,084	44,380	4,973	228,226
Available-for-sale financial assets	-	14,402	6,876	3,673	17,010	1,851	1,204	45,016
Held-to-maturity investments	107	1,058	171	747	1,136	-	-	3,219
Undated assets	-	-	-	-	-	-	40,515	40,515
Total assets	24,400	70,694	32,729	83,283	112,451	48,621	50,683	422,861
Liabilities								
Deposits and balances of banks and other financial institutions	1,123	2,259	3,645	3,580	-	-	-	10,607
Deposits from customers	107,181	117,138	46,963	34,804	567	-	-	306,653
- Demand deposits and current accounts	21,690	-	-	-	-	-	-	21,690
- Savings deposit	85,279	-	-	-	-	-	-	85,279
- Time, call and notice deposits	212	117,138	46,963	34,804	567	-	-	199,684
Trading liabilities	-	-	-	-	-	-	21	21
Negative fair value of derivatives	-	-	-	-	-	-	3,059	3,059
Certificates of deposit issued	-	3,122	3,548	14,907	5,793	2,200	-	29,570
Current taxation	-	-	-	872	-	-	-	872
Debt securities issued	-	-	661	423	116	-	-	1,200
Loan capital	-	-	-	-	9,124	9,549	-	18,673
Other liabilities	8	1,478	281	201	10	-	8,760	10,738
Total liabilities	108,312	123,997	55,098	54,787	15,610	11,749	11,840	381,393
Net gap	(83,912)	(53,303)	(22,369)	28,496	96,841	36,872		

As the trading and available-for-sale portfolios may be sold before maturity or deposits from customers may mature without being withdrawn, the contractual maturity dates do not represent expected dates of future cash flows.

43. Financial Risk Management (continued)

(d) Liquidity risk management (continued)

The following tables provide an analysis of the undiscounted cashflow projection of the financial liabilities of the Group at the end of the reporting period based on the dates of their contractual payment obligations:

The Group	2013							
	Carrying amount HK\$ Mn	Gross cash outflow HK\$ Mn	Repayable on demand HK\$ Mn	Less than three months HK\$ Mn	Between three months and one year HK\$ Mn	Between one and five years HK\$ Mn	More than five years HK\$ Mn	Undated HK\$ Mn
Deposits and balances of banks and other financial institutions	28,923	28,961	3,691	19,579	4,618	1,073	-	-
Deposits from customers	534,971	539,180	163,387	241,770	110,196	23,827	-	-
- Demand deposits and current accounts	69,259	69,301	69,299	2	-	-	-	-
- Savings deposit	92,936	92,937	92,937	-	-	-	-	-
- Time, call and notice deposits	372,776	376,942	1,151	241,768	110,196	23,827	-	-
Trading liabilities	11	11	-	-	-	-	-	11
Negative fair value of derivatives	4,545	4,545	-	-	-	-	-	4,545
Certificates of deposit issued	42,929	43,906	-	16,732	19,224	7,743	207	-
Current taxation	1,353	1,353	-	-	1,353	-	-	-
Debt securities issued	4,728	4,833	-	801	2,729	1,303	-	-
Loan capital	13,632	19,374	-	220	797	12,358	5,999	-
Interest rate swaps	6,255	6,255	-	593	1,279	3,929	454	-
Other liabilities	54,628	54,628	1,226	19,818	17,545	6,466	2,221	7,352
Total	691,975	703,046	168,304	299,513	157,741	56,699	8,881	11,908

The Group	2012							
	Carrying amount HK\$ Mn	Gross cash outflow HK\$ Mn	Repayable on demand HK\$ Mn	Less than three months HK\$ Mn	Between three months and one year HK\$ Mn	Between one and five years HK\$ Mn	More than five years HK\$ Mn	Undated HK\$ Mn
Deposits and balances of banks and other financial institutions	30,597	30,626	1,128	23,540	5,817	141	-	-
Deposits from customers	498,770	504,752	157,739	230,245	101,448	15,320	-	-
- Demand deposits and current accounts	68,950	69,620	69,620	-	-	-	-	-
- Savings deposit	86,549	86,550	86,550	-	-	-	-	-
- Time, call and notice deposits	343,271	348,582	1,569	230,245	101,448	15,320	-	-
Trading liabilities	21	21	-	-	-	-	-	21
Negative fair value of derivatives	3,806	3,806	-	-	-	-	-	3,806
Certificates of deposit issued	27,370	27,896	-	6,741	15,196	5,959	-	-
Current taxation	988	988	-	-	988	-	-	-
Debt securities issued	8,657	8,966	-	3,184	4,355	1,427	-	-
Loan capital	14,263	18,847	-	249	497	12,108	5,993	-
Interest rate swaps	6,605	6,605	-	540	1,036	4,435	594	-
Other liabilities	46,003	46,003	1,090	17,495	12,347	5,150	2,174	7,747
Total	637,080	648,510	159,957	281,994	141,684	44,540	8,761	11,574

43. Financial Risk Management (continued)

(d) Liquidity risk management (continued)

The Bank

2013

	Carrying amount HK\$ Mn	Gross cash outflow HK\$ Mn	Repayable on demand HK\$ Mn	Less than three months HK\$ Mn	Between three months and one year HK\$ Mn	Between one and five years HK\$ Mn	More than five years HK\$ Mn	Undated HK\$ Mn
Deposits and balances of banks and other financial institutions	23,507	23,536	3,684	14,826	4,186	840	-	-
Deposits from customers	323,114	323,616	114,135	174,644	33,959	878	-	-
- Demand deposits and current accounts	21,652	21,654	21,652	2	-	-	-	-
- Savings deposit	91,791	91,791	91,791	-	-	-	-	-
- Time, call and notice deposits	209,671	210,171	692	174,642	33,959	878	-	-
Trading liabilities	11	11	-	-	-	-	-	11
Negative fair value of derivatives	2,766	2,766	-	-	-	-	-	2,766
Certificates of deposit issued	45,129	46,106	-	16,732	19,224	7,743	2,407	-
Current taxation	1,097	1,097	-	-	1,097	-	-	-
Debt securities issued	3,448	3,490	-	801	2,689	-	-	-
Loan capital	18,110	23,852	-	220	797	12,358	10,477	-
Interest rate swaps	6,163	6,163	-	509	1,272	3,928	454	-
Other liabilities	10,034	10,055	66	1,935	247	5	-	7,802
Total	433,379	440,692	117,885	209,667	63,471	25,752	13,338	10,579

The Bank

2012

	Carrying amount HK\$ Mn	Gross cash outflow HK\$ Mn	Repayable on demand HK\$ Mn	Less than three months HK\$ Mn	Between three months and one year HK\$ Mn	Between one and five years HK\$ Mn	More than five years HK\$ Mn	Undated HK\$ Mn
Deposits and balances of banks and other financial institutions	10,607	10,629	1,123	5,910	3,596	-	-	-
Deposits from customers	306,653	307,147	107,183	164,283	35,102	579	-	-
- Demand deposits and current accounts	21,690	21,692	21,692	-	-	-	-	-
- Savings deposit	85,279	85,279	85,279	-	-	-	-	-
- Time, call and notice deposits	199,684	200,176	212	164,283	35,102	579	-	-
Trading liabilities	21	21	-	-	-	-	-	21
Negative fair value of derivatives	3,059	3,059	-	-	-	-	-	3,059
Certificates of deposit issued	29,570	30,096	-	6,741	15,196	5,959	2,200	-
Current taxation	872	872	-	-	872	-	-	-
Debt securities issued	1,200	1,220	-	675	429	116	-	-
Loan capital	18,673	25,563	-	249	826	13,426	11,062	-
Interest rate swaps	6,466	6,466	-	411	1,026	4,435	594	-
Other liabilities	10,738	10,858	8	1,768	219	103	-	8,760
Total	387,859	395,931	108,314	180,037	57,266	24,618	13,856	11,840

43. Financial Risk Management (continued)

(e) Interest rate risk management

The Asset and Liability Management Committee is delegated by the Board of Directors to oversee the Group's interest rate risk management, set the strategy and policy for managing interest rate risk and the means for ensuring that such strategies and policies are implemented. Interest rate risk is managed daily by the Treasury Markets Division within the limits approved by the Board of Directors or the Asset and Liability Management Committee. The Asset and Liability Management Department under the Risk Management Division of the Group is responsible for monitoring the activities relating to interest rate risk. The Internal Audit Department performs periodic reviews to make sure that the interest rate risk management functions are implemented effectively.

The Group manages the interest rate risk on the banking book primarily by focusing on repricing mismatches. Gap analysis provides a static view of the maturity and repricing characteristics of the Group's balance sheet positions. Repricing gap limits are set to control the Group's interest rate risk.

Sensitivity analysis in relation to the impact of changes in interest rates on earnings and economic value is assessed through a hypothetical interest rate shock of 200 basis points across the yield curve on both sides of the balance sheet and is performed on a monthly basis. Sensitivity limits are set to control the Group's interest rate risk exposure under both earnings and economic value perspectives. The results are reported to the Asset and Liability Management Committee on a regular basis.

Sensitivity analysis on interest rate risk

The Group uses sensitivity analysis to measure the potential effect of changes in interest rates on our net interest income and economic value change based on methodology consistent with regulatory reporting.

	HKD HK\$ Mn	2013 USD HK\$ Mn	RMB HK\$ Mn	HKD HK\$ Mn	2012 USD HK\$ Mn	RMB HK\$ Mn
Impact on earnings over the next 12 months if interest rates rise by 200 basis points	289	(76)	706	235	(74)	475
Impact on economic value if interest rates rise by 200 basis points	(117)	122	622	(126)	8	58

This sensitivity analysis, which is based on a static interest rate risk profile of assets and liabilities, is used for risk management purposes only. The analysis is based on the following assumptions:

- (i) there is a parallel shift in the yield curve and in interest rates;
- (ii) there are no other changes to the portfolio;
- (iii) no loan prepayment is assumed as the majority of loans is on a floating rate basis; and
- (iv) deposits without fixed maturity dates are assumed to be repriced on the next day.

Actual changes in the Group's net interest income and the economic value resulting from the increases in interest rates may differ from the results of this sensitivity analysis.

43. Financial Risk Management (continued)**(e) Interest rate risk management (continued)**

The following table indicates the expected next repricing dates (or maturity dates whichever are earlier) for the interest bearing assets and liabilities at the end of the reporting period:

The Group	2013					Total HK\$ Mn
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non- interest bearing	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
Assets						
Cash and balances with banks and other financial institutions	62,507	29	8	-	6,233	68,777
Placements with banks and other financial institutions	55,001	2,371	-	-	-	57,372
Trade bills	26,970	32,907	-	-	55	59,932
Trading assets	2,524	948	379	51	1,429	5,331
Financial assets designated at fair value through profit or loss	310	3,979	5,010	1,952	355	11,606
Positive fair value of derivatives	-	-	-	-	3,625	3,625
Advances to customers and other accounts	335,596	57,734	11,391	649	42,885	448,255
Available-for-sale financial assets	32,485	9,772	20,572	5,849	2,911	71,589
Held-to-maturity investments	1,961	546	2,495	46	-	5,048
Non-interest bearing assets	-	-	-	-	22,419	22,419
Total assets	517,354	108,286	39,855	8,547	79,912	753,954
Liabilities						
Deposits and balances of banks and other financial institutions	25,893	1,680	298	-	1,052	28,923
Deposits from customers	392,041	107,156	18,872	-	16,902	534,971
Trading liabilities	-	-	-	-	11	11
Negative fair value of derivatives	-	-	-	-	4,545	4,545
Certificates of deposit issued	23,443	14,373	5,113	-	-	42,929
Debt securities issued	1,296	2,152	1,280	-	-	4,728
Loan capital	-	-	8,817	4,815	-	13,632
Non-interest bearing liabilities	-	-	-	-	55,981	55,981
Total liabilities	442,673	125,361	34,380	4,815	78,491	685,720
Interest rate sensitivity gap	74,681	(17,075)	5,475	3,732		

43. Financial Risk Management (continued)**(e) Interest rate risk management (continued)**

The Group	2012					Total
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non- interest bearing	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
Assets						
Cash and balances with banks and other financial institutions	80,508	91	8	-	4,905	85,512
Placements with banks and other financial institutions	31,486	19,132	-	-	-	50,618
Trade bills	36,317	19,416	-	-	7	55,740
Trading assets	610	1,327	1,017	93	1,166	4,213
Financial assets designated at fair value through profit or loss	554	1,291	10,535	2,371	418	15,169
Positive fair value of derivatives	-	-	-	-	3,125	3,125
Advances to customers and other accounts	291,083	42,152	15,886	1,667	36,485	387,273
Available-for-sale financial assets	30,052	5,236	22,268	4,773	2,402	64,731
Held-to-maturity investments	1,524	985	1,765	46	-	4,320
Non-interest bearing assets	-	-	-	-	21,413	21,413
Total assets	472,134	89,630	51,479	8,950	69,921	692,114
Liabilities						
Deposits and balances of banks and other financial institutions	28,585	360	-	-	1,652	30,597
Deposits from customers	373,704	98,532	10,409	-	16,125	498,770
Trading liabilities	-	-	-	-	21	21
Negative fair value of derivatives	-	-	-	-	3,806	3,806
Certificates of deposit issued	6,818	14,760	5,792	-	-	27,370
Debt securities issued	3,146	4,152	1,359	-	-	8,657
Loan capital	-	-	9,125	5,138	-	14,263
Non-interest bearing liabilities	-	-	-	-	46,991	46,991
Total liabilities	412,253	117,804	26,685	5,138	68,595	630,475
Interest rate sensitivity gap	59,881	(28,174)	24,794	3,812		

43. Financial Risk Management (continued)**(e) Interest rate risk management (continued)**

The Bank	2013					Total
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non- interest bearing	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	
Assets						
Cash and balances with banks and other financial institutions	17,219	-	-	-	4,993	22,212
Placements with banks and other financial institutions	12,738	661	-	-	-	13,399
Trade bills	21,557	31,128	-	-	54	52,739
Trading assets	26	291	128	51	1,429	1,925
Financial assets designated at fair value through profit or loss	310	3,980	5,010	1,899	-	11,199
Positive fair value of derivatives	-	-	-	-	1,729	1,729
Advances to customers and other accounts	240,187	11,647	7,166	79	7,846	266,925
Available-for-sale financial assets	24,270	6,245	13,028	2,272	1,515	47,330
Held-to-maturity investments	1,890	412	1,630	8	-	3,940
Non-interest bearing assets	-	-	-	-	51,069	51,069
Total assets	318,197	54,364	26,962	4,309	68,635	472,467
Liabilities						
Deposits and balances of banks and other financial institutions	20,710	1,680	65	-	1,052	23,507
Deposits from customers	273,405	33,445	872	-	15,392	323,114
Trading liabilities	-	-	-	-	11	11
Negative fair value of derivatives	-	-	-	-	2,766	2,766
Certificates of deposit issued	23,443	14,373	5,113	2,200	-	45,129
Debt securities issued	1,296	2,152	-	-	-	3,448
Loan capital	-	-	8,817	9,293	-	18,110
Non-interest bearing liabilities	-	-	-	-	11,131	11,131
Total liabilities	318,854	51,650	14,867	11,493	30,352	427,216
Interest rate sensitivity gap	(657)	2,714	12,095	(7,184)		

43. Financial Risk Management (continued)**(e) Interest rate risk management (continued)**

The Bank	2012					Total
	3 months or less	Over 3 months to 1 year	Over 1 year to 5 years	Over 5 years	Non- interest bearing	
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Assets						
Cash and balances with banks and other financial institutions	16,188	-	-	-	3,568	19,756
Placements with banks and other financial institutions	16,753	2,582	-	-	-	19,335
Trade bills	25,953	21,971	-	-	7	47,931
Trading assets	51	73	417	19	1,166	1,726
Financial assets designated at fair value through profit or loss	554	1,291	10,535	2,371	119	14,870
Positive fair value of derivatives	-	-	-	-	2,267	2,267
Advances to customers and other accounts	197,604	9,524	12,883	1,294	6,921	228,226
Available-for-sale financial assets	28,335	3,002	10,877	1,594	1,208	45,016
Held-to-maturity investments	1,450	747	1,022	-	-	3,219
Non-interest bearing assets	-	-	-	-	40,515	40,515
Total assets	286,888	39,190	35,734	5,278	55,771	422,861
Liabilities						
Deposits and balances of banks and other financial institutions	8,595	360	-	-	1,652	10,607
Deposits from customers	255,714	35,222	476	-	15,241	306,653
Trading liabilities	-	-	-	-	21	21
Negative fair value of derivatives	-	-	-	-	3,059	3,059
Certificates of deposit issued	6,818	14,760	5,792	2,200	-	29,570
Debt securities issued	661	423	116	-	-	1,200
Loan capital	-	-	9,125	9,548	-	18,673
Non-interest bearing liabilities	-	-	-	-	11,610	11,610
Total liabilities	271,788	50,765	15,509	11,748	31,583	381,393
Interest rate sensitivity gap	15,100	(11,575)	20,225	(6,470)		

43. Financial Risk Management (continued)

(e) Interest rate risk management (continued)

The following table summarises the range of effective average interest rates for the year ended 31st December for monetary financial instruments:

	The Group		The Bank	
	2013 %	2012 %	2013 %	2012 %
Assets				
Cash and short-term funds and placements with banks and other financial institutions	0-6.31	0-5.92	0-4.4	0-5.08
Trade bills, advances to customers and advances to banks and other financial institutions	0.01-50.48	0.44-50.14	0.01-17.12	0.44-17.36
Securities (Note)	0.01-9.44	0.06-7.25	0.01-7.07	0.06-6.79
Liabilities				
Deposits and balances of banks and other financial institutions	0.01-5.58	0.03-5.26	0.01-4.4	0.03-4.44
Deposits from customers	0-5.75	0-7.18	0-5.75	0-6.25
Certificates of deposit issued and loan capital	0.15-8.5	0.5-8.54	0.15-8.5	0.5-8.54

Note: Securities include certificates of deposit held, trading assets, financial assets designated at fair value through profit or loss, securities measured as loans and receivables, available-for-sale financial assets and held-to-maturity investments.

43. Financial Risk Management (continued)

(f) Strategic risk management

The objective of strategic risk management is to monitor the risk to earnings or capital arising from bad business decisions or from an improper implementation of good business decisions.

The Asset and Liability Management Committee is responsible for ongoing strategic risk management. The Risk Management Division monitors the activities under the Group's prevailing interest earning asset mix and funding strategies and regularly reports the status to the Asset and Liability Management Committee, Risk Management Committee, Risk Committee and the Board of Directors, where appropriate.

(g) Legal risk and reputation risk management

Legal risk is the risk arising from the potential that unenforceable contracts, lawsuits or adverse judgements may disrupt or otherwise negatively affect the operations or financial condition of the Group.

Reputation risk is the risk that the Group's reputation is damaged by one or more than one event that results in negative publicity about the Group's business practices, conduct or financial condition. Such negative publicity, whether true or not, may impair public confidence in the Group, result in costly litigation, or lead to a decline in the Group's customer base, business or revenue.

The objective of managing the aforesaid risks is to identify, assess, monitor and report on these risks, and to comply with the relevant regulatory requirements.

The Operational Risk Management Committee is responsible for overseeing risk management of legal risk and reputation risk of the Group.

43. Financial Risk Management (continued)**(h) Capital management**

The HKMA sets and monitors capital requirements for the Group as a whole. In implementing current capital requirements the HKMA requires the Group to maintain a prescribed ratio of total capital to total risk-weighted assets. The Group calculates requirements for market risk in its trading portfolios based upon the Group's VaR models and uses its internal gradings as the basis for risk weightings for credit risk. Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

In addition to meeting the regulatory requirements, the Group's primary objectives when managing capital are to safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, by pricing products and services commensurately with the level of risk and by securing access to finance at a reasonable cost.

Capital managed by the Group to achieve these objectives includes ordinary share capital, share premium, retained profits, other reserves, and non-controlling interests after deductions for goodwill and intangible assets. It also includes subordinated liabilities and collectively assessed impairment allowances.

The HKMA supervises the Group on a consolidated basis, which sets capital requirements and receives information of capital adequacy on a regular basis for the Group as a whole. Individual branches are directly regulated by respective domestic banking supervisors, who set and monitor their capital adequacy requirements. In certain jurisdictions, non-banking financial subsidiaries are also subject to the supervision and capital requirements of domestic regulatory authorities.

The Group actively and regularly reviews and manages its capital structure to maintain a balance between the higher shareholder returns that might otherwise be possible with greater gearing and the advantages and security afforded by a sound capital position, and makes adjustments to the capital structure in light of changes in economic conditions.

The process of allocating capital to specific operations and activities is undertaken by Asset and Liability Management Committee and is reviewed regularly by the Risk Committee and the Board of Directors.

Consistent with industry practice, the Group monitors its capital structure on the basis of the capital adequacy ratio and there have been no material changes in the Group's policy on the management of capital during the year, except for a change in the calculation methodology in the capital adequacy ratios.

The capital adequacy ratios as at 31st December, 2013 and 31st December, 2012 are computed on the consolidated basis of the Bank and certain of its subsidiaries as specified by the HKMA for its regulatory purposes, and are in accordance with the Banking (Capital) Rules of the Hong Kong Banking Ordinance which became effective on 1st January, 2007.

The Group and its individually regulated operations have complied with all externally imposed capital requirements throughout the year ended 31st December, 2013 and 31st December, 2012 and the Group are well above the minimum required ratio set by the HKMA.

44. Fair values of Financial Instruments

(a) Financial instruments carried at fair value

Fair value estimates are generally subjective in nature, and are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. The Group measures fair values using the following hierarchy of methods:

Level 1 – Quoted market price in an active market for an identical instrument.

Level 2 – Valuation techniques based on observable input. This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

Level 3 – Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs could have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or counterparty quotations. For all other financial instruments the Group determines fair values using valuation techniques. Valuation techniques include net present value and discounted cash flow models and various market widely recognised option pricing models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, equity prices, foreign currency exchange rates, index prices, historical or implied volatilities and correlations. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date, that would have been determined by market participants acting at arm's length.

The Group uses widely recognised valuation models for determining the fair value of common and simpler financial instruments, like interest rate and currency swaps that use only observable market data and require little management judgement and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over-the-counter (OTC) derivatives like interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex instruments, the Group uses valuation models, which usually are developed from recognised valuation methodologies. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in determination of fair value. Management judgement and estimation are usually required for selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instrument being valued, determination of probability of counterparty default and prepayments and selection of appropriate discount rates.

The Group has an established control framework with respect to the measurement of fair values. This framework includes a valuation control function, namely Financial Instruments Valuation Group ("FIVG") which comprises control units independent of front office management. Procedures for price verification have been established. Any pricing models to be used would be subject to a rigorous validation and approval process.

44. Fair values of Financial Instruments (continued)**(a) Financial instruments carried at fair value (continued)**

The table below analyses financial instruments carried at fair value, by valuation method:

	2013							
	Level One HK\$ Mn	The Group Level Two HK\$ Mn	Level Three HK\$ Mn	Total HK\$ Mn	Level One HK\$ Mn	The Bank Level Two HK\$ Mn	Level Three HK\$ Mn	Total HK\$ Mn
<u>Recurring fair value measurement</u>								
Assets								
Trading assets	5,161	170	-	5,331	1,755	170	-	1,925
Financial assets designated at fair value through profit or loss	7,761	3,845	-	11,606	7,407	3,792	-	11,199
Positive fair value of derivatives	-	3,040	585	3,625	-	1,378	351	1,729
Available-for-sale financial assets	55,638	14,941	1,010	71,589	33,014	13,345	971	47,330
	<u>68,560</u>	<u>21,996</u>	<u>1,595</u>	<u>92,151</u>	<u>42,176</u>	<u>18,685</u>	<u>1,322</u>	<u>62,183</u>
Liabilities								
Trading liabilities	11	-	-	11	11	-	-	11
Negative fair value of derivatives	-	3,980	565	4,545	-	2,214	552	2,766
Financial liabilities designated at fair value through profit or loss	-	8,659	-	8,659	4,478	8,659	-	13,137
	<u>11</u>	<u>12,639</u>	<u>565</u>	<u>13,215</u>	<u>4,489</u>	<u>10,873</u>	<u>552</u>	<u>15,914</u>
	2012							
	Level One HK\$ Mn	The Group Level Two HK\$ Mn	Level Three HK\$ Mn	Total HK\$ Mn	Level One HK\$ Mn	The Bank Level Two HK\$ Mn	Level Three HK\$ Mn	Total HK\$ Mn
<u>Recurring fair value measurement</u>								
Assets								
Trading assets	4,009	204	-	4,213	1,522	204	-	1,726
Financial assets designated at fair value through profit or loss	10,416	4,753	-	15,169	10,122	4,748	-	14,870
Positive fair value of derivatives	-	2,571	554	3,125	-	1,873	394	2,267
Available-for-sale financial assets	51,988	11,978	765	64,731	34,135	10,184	697	45,016
	<u>66,413</u>	<u>19,506</u>	<u>1,319</u>	<u>87,238</u>	<u>45,779</u>	<u>17,009</u>	<u>1,091</u>	<u>63,879</u>
Liabilities								
Trading liabilities	21	-	-	21	21	-	-	21
Negative fair value of derivatives	-	3,244	562	3,806	-	2,564	495	3,059
Financial liabilities designated at fair value through profit or loss	-	6,793	-	6,793	4,410	6,793	-	11,203
	<u>21</u>	<u>10,037</u>	<u>562</u>	<u>10,620</u>	<u>4,431</u>	<u>9,357</u>	<u>495</u>	<u>14,283</u>

During the year there were no significant transfers of financial instruments between Level 1 and Level 2 of the fair value hierarchy. The Group's policy is to recognise transfers between levels of fair value hierarchy as at the end of the reporting period in which they occur.

44. Fair values of Financial Instruments (continued)

(a) Financial instruments carried at fair value (continued)

Information about significant unobservable inputs in Level 3 valuations

	Valuation technique	Significant unobservable input(s)
Unlisted available-for-sale equity instruments	Discounted cash flow model	Forecasted cash flows and terminal growth rate
Structured derivatives	Option model	Expected volatility

The fair value of unlisted available-for-sale equity instruments is determined using the discounted cash flow model and the significant unobservable inputs used in the fair value measurement are forecasted cash flows and terminal growth rate. The fair value measurement is positively correlated to the net cash inflows and terminal growth rate.

The fair value of embedded options in structured derivatives is determined using option valuation model and the significant unobservable input used in the fair value measurement is the expected volatility. The fair value of the instrument is positively correlated to the expected volatility.

Valuation of financial instruments in Level 3 is subject to the same valuation control framework as described above and reviewed regularly by FIVG.

(1) Valuation of financial instruments with significant unobservable inputs

Movements in the recognised fair values of instruments with significant unobservable inputs were as follows:

	Positive fair value of derivatives HK\$ Mn	The Group Available-for-sale financial assets HK\$ Mn	Total HK\$ Mn
Assets			
At 1 st January, 2013	554	765	1,319
Purchases	-	193	193
Settlements	(196)	(54)	(250)
Changes in fair value recognised in the income statement	227	(68)	159
Changes in fair value recognised in the other comprehensive income	-	174	174
At 31 st December, 2013	<u>585</u>	<u>1,010</u>	<u>1,595</u>
Total gains or losses for the year included in available-for-sale fair value reserve of the other comprehensive income for assets held at the end of the reporting period	<u>-</u>	<u>174</u>	<u>174</u>
Total gains or losses for the year included in the income statement for assets held at the end of the reporting period recorded in net trading income	<u>227</u>	<u>(68)</u>	<u>159</u>

44. Fair values of Financial Instruments (continued)

(a) Financial instruments carried at fair value (continued)

	Positive fair value of derivatives HK\$ Mn	The Bank Available-for- sale financial assets HK\$ Mn	Total HK\$ Mn
Assets			
At 1 st January, 2013	394	697	1,091
Purchases	-	192	192
Settlements	(68)	(54)	(122)
Changes in fair value recognised in the income statement	25	(68)	(43)
Changes in fair value recognised in the other comprehensive income	-	204	204
At 31 st December, 2013	<u>351</u>	<u>971</u>	<u>1,322</u>
 Total gains or losses for the year included in available-for-sale fair value reserve of the other comprehensive income for assets held at the end of the reporting period	 <u>-</u>	 <u>204</u>	 <u>204</u>
 Total gains or losses for the year included in the income statement for assets held at the end of the reporting period recorded in net trading income	 <u>25</u>	 <u>(68)</u>	 <u>(43)</u>

44. Fair values of Financial Instruments (continued)

(a) Financial instruments carried at fair value (continued)

(1) Valuation of financial instruments with significant unobservable inputs (continued)

	Positive fair value of derivatives HK\$ Mn	The Group Available-for- sale financial assets HK\$ Mn	Total HK\$ Mn
Assets			
At 1 st January, 2012	351	676	1,027
Purchases	-	136	136
Settlements	(87)	(76)	(163)
Changes in fair value recognised in the income statement	290	(62)	228
Changes in fair value recognised in the other comprehensive income	-	89	89
Exchange adjustments	-	2	2
At 31 st December, 2012	<u>554</u>	<u>765</u>	<u>1,319</u>
Total gains or losses for the year included in available-for-sale fair value reserve of the other comprehensive income for assets held at the end of the reporting period	<u>-</u>	<u>89</u>	<u>89</u>
Total gains or losses for the year included in the income statement for assets held at the end of the reporting period recorded in net trading income	<u>290</u>	<u>(62)</u>	<u>228</u>
	Positive fair value of derivatives HK\$ Mn	The Bank Available-for- sale financial assets HK\$ Mn	Total HK\$ Mn
Assets			
At 1 st January, 2012	138	568	706
Purchases	-	136	136
Settlements	(14)	(34)	(48)
Changes in fair value recognised in the income statement	270	(62)	208
Changes in fair value recognised in the other comprehensive income	-	89	89
At 31 st December, 2012	<u>394</u>	<u>697</u>	<u>1,091</u>
Total gains or losses for the year included in available-for-sale fair value reserve of the other comprehensive income for assets held at the end of the reporting period	<u>-</u>	<u>89</u>	<u>89</u>
Total gains or losses for the year included in the income statement for assets held at the end of the reporting period recorded in net trading income	<u>270</u>	<u>(62)</u>	<u>208</u>

44. Fair values of Financial Instruments (continued)**(a) Financial instruments carried at fair value (continued)****(1) Valuation of financial instruments with significant unobservable inputs (continued)**

	The Group Negative fair value of derivatives HK\$ Mn	The Bank Negative fair value of derivatives HK\$ Mn
Liabilities		
At 1 st January, 2013	562	495
Settlements	(219)	(219)
Changes in fair value recognised in the income statement	<u>222</u>	<u>276</u>
At 31 st December, 2013	<u>565</u>	<u>552</u>
Total gains or losses for the year included in the income statement for liabilities held at the end of the reporting period recorded in net trading income	<u>222</u>	<u>276</u>

	The Group Negative fair value of derivatives HK\$ Mn	The Bank Negative fair value of derivatives HK\$ Mn
Liabilities		
At 1 st January, 2012	333	320
Settlements	(87)	(75)
Changes in fair value recognised in the income statement	<u>316</u>	<u>250</u>
At 31 st December, 2012	<u>562</u>	<u>495</u>
Total gains or losses for the year included in the income statement for liabilities held at the end of the reporting period recorded in net trading income	<u>316</u>	<u>250</u>

(2) Effects of changes in significant unobservable assumptions to reasonably possible alternative assumptions

	2013			
	Effect recorded in profit or loss		Effect recorded directly in equity	
	Favourable	(Unfavourable)	Favourable	(Unfavourable)
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Positive fair value of derivatives	49	(49)	-	-
Available-for-sale financial assets	<u>-</u>	<u>-</u>	<u>84</u>	<u>(84)</u>
	<u>49</u>	<u>(49)</u>	<u>84</u>	<u>(84)</u>
Negative fair value of derivatives	<u>47</u>	<u>(47)</u>	<u>-</u>	<u>-</u>

44. Fair values of Financial Instruments (continued)

(a) Financial instruments carried at fair value (continued)

- (2) Effects of changes in significant unobservable assumptions to reasonably possible alternative assumptions (continued)

	2012			
	Effect recorded in profit or loss		Effect recorded directly in equity	
	Favourable HK\$ Mn	(Unfavourable) HK\$ Mn	Favourable HK\$ Mn	(Unfavourable) HK\$ Mn
Positive fair value of derivatives	46	(46)	-	-
Available-for-sale financial assets	-	-	64	(64)
	<u>46</u>	<u>(46)</u>	<u>64</u>	<u>(64)</u>
Negative fair value of derivatives	<u>47</u>	<u>(47)</u>	<u>-</u>	<u>-</u>

The fair values of financial instruments are in certain circumstances, measured using valuation models that incorporate assumptions that are not supported by prices from observable current market transactions in the same instrument and are not based on observable market data. The table above shows the sensitivity of fair values due to parallel movement of plus or minus 10 per cent in reasonably possible alternative assumptions.

(b) Fair values of financial instruments carried at other than fair value

The following methods and significant assumptions have been applied in determining the fair values of financial instruments presented below:

- (i) The fair value of demand deposits and savings accounts with no specific maturity is assumed to be the amount payable on demand at the end of the reporting period.
- (ii) The fair value of variable rate financial instruments is assumed to be approximated by their carrying amounts and, in the case of loans and unquoted debt securities, does not, therefore, reflect changes in their credit quality, as the impact of credit risk is recognised separately by deducting the amount of the impairment allowances from both the carrying amount and fair value.
- (iii) The fair value of fixed rate loans and mortgages carried at amortised cost is estimated by comparing market interest rates when the loans were granted with current market rates offered on similar loans. Changes in the credit quality of loans within the portfolio are not taken into account in determining gross fair values, as the impact of credit risk is recognised separately by deducting the amount of the impairment loss and allowances from both the carrying amount and fair value.
- (iv) The fair value of unquoted equity investments is estimated, if possible, using the applicable dividend discount model, or share of net asset value in the investment, or applying a discount to the market value of investments with a lock-up period.
- (v) The fair value of unlisted open-ended investment funds is estimated using the net asset value per share as reported by the managers of such funds.
- (vi) The fair value of financial guarantees issued is determined by reference to fees charged in an arm's length transaction for similar services, when such information is obtainable, or is otherwise estimated by reference to interest rate differentials, by comparing the actual rates charged by lenders when the guarantee is made available with the estimated rates that lenders would have charged, had the guarantees not been available, where reliable estimates of such information can be made.

44. Fair values of Financial Instruments (continued)**(b) Fair values of financial instruments carried at other than fair value (continued)**

The carrying amounts of the Group's and the Bank's financial instruments carried at cost or amortised cost are not materially different from their fair values as at 31st December, 2013 and 2012 except as follows:

The Group	2013					2012	
	Carrying amount HK\$ Mn	Fair value HK\$ Mn	Level 1 HK\$ Mn	Level 2 HK\$ Mn	Level 3 HK\$ Mn	Carrying amount HK\$ Mn	Fair value HK\$ Mn
Financial assets							
Held-to-maturity investments	5,048	5,135	3,104	2,031	-	4,320	4,474
Financial liabilities							
Certificates of deposit issued	34,420	34,443	-	34,443	-	21,275	21,289
Debt securities issued	4,578	5,095	-	5,095	-	7,959	8,103
Subordinated liabilities	13,632	14,380	-	14,380	-	14,263	15,105
The Bank	2013					2012	
	Carrying amount HK\$ Mn	Fair value HK\$ Mn	Level 1 HK\$ Mn	Level 2 HK\$ Mn	Level 3 HK\$ Mn	Carrying amount HK\$ Mn	Fair value HK\$ Mn
Financial assets							
Held-to-maturity investments	3,940	4,015	2,499	1,516	-	3,219	3,336
Financial liabilities							
Certificates of deposit issued	36,620	36,643	-	36,643	-	23,475	23,489
Debt securities issued	3,298	3,801	-	3,801	-	502	502
Subordinated liabilities	13,632	14,380	-	14,380	-	14,263	15,105

Fair value estimates are generally subjective in nature, and are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. The Group measures level 2 fair values using the following method and there is no change to the valuation technique:

Level 2 – Valuation techniques based on observable input. This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

45. Off-Balance Sheet Exposures**(a) Contingent liabilities and commitments**

The following is a summary of the contractual amounts of each significant class of contingent liabilities and commitments:

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Direct credit substitutes	18,670	13,303	5,153	4,756
Transaction-related contingencies	2,655	2,364	869	1,224
Trade-related contingencies	1,319	1,930	953	1,259
Commitments that are unconditionally cancellable without prior notice	126,463	52,631	50,778	47,885
Other commitments with an original maturity				
- up to 1 year	56,690	103,119	6,855	7,091
- over 1 year	29,319	36,433	26,467	19,503
	<u>235,116</u>	<u>209,780</u>	<u>91,075</u>	<u>81,718</u>
Credit risk weighted amounts	<u>44,605</u>	<u>71,525</u>	<u>20,345</u>	<u>18,063</u>

45. Off-Balance Sheet Exposures (continued)

Contingent liabilities and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client default. Since a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the contract amounts does not represent expected future cash flows.

(b) Derivatives**(i) Notional amount of derivatives**

Derivatives refer to financial contracts whose value depends on the value of one or more underlying assets or indices.

The following is a summary of the notional amounts of each significant type of derivative for the Group and the Bank:

The Group

	2013			
	Qualifying for hedge accounting HK\$ Mn	Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$ Mn	Others, including held for trading HK\$ Mn	Total HK\$ Mn
Exchange rate contracts				
Forwards and futures	542	-	52,221	52,763
Swaps	-	-	403,232	403,232
Options purchased	-	-	54,822	54,822
Options written	-	-	55,970	55,970
Interest rate contracts				
Forwards and futures	-	-	528	528
Swaps	23,641	17,954	154,460	196,055
Equity contracts				
Swaps	-	-	9,996	9,996
Options purchased	-	-	3,478	3,478
Options written	-	-	3,095	3,095
Others	-	-	3,905	3,905
	<u>24,183</u>	<u>17,954</u>	<u>741,707</u>	<u>783,844</u>

The Group

	2012			
	Qualifying for hedge accounting HK\$ Mn	Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$ Mn	Others, including held for trading HK\$ Mn	Total HK\$ Mn
Exchange rate contracts				
Forwards and futures	129	-	35,516	35,645
Swaps	-	-	285,627	285,627
Options purchased	-	-	42,415	42,415
Options written	-	-	43,433	43,433
Interest rate contracts				
Forwards and futures	-	-	860	860
Swaps	16,886	20,318	112,088	149,292
Equity contracts				
Swaps	-	-	8,809	8,809
Options purchased	-	-	2,683	2,683
Options written	-	-	2,181	2,181
Others	-	-	3,478	3,478
	<u>17,015</u>	<u>20,318</u>	<u>537,090</u>	<u>574,423</u>

45. Off-Balance Sheet Exposures (continued)

(b) Derivatives (continued)

(i) Notional amount of derivatives (continued)

The Bank

	2013			
	Qualifying for hedge accounting HK\$ Mn	Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$ Mn	Others, including held for trading HK\$ Mn	Total HK\$ Mn
Exchange rate contracts				
Forwards and futures	-	-	46,333	46,333
Swaps	-	-	228,164	228,164
Options purchased	-	-	54,821	54,821
Options written	-	-	55,970	55,970
Interest rate contracts				
Forwards and futures	-	-	528	528
Swaps	23,641	17,954	46,892	88,487
Equity contracts				
Swaps	-	-	10,034	10,034
Options purchased	-	-	3,478	3,478
Options written	-	-	3,758	3,758
Others	-	-	3,906	3,906
	<u>23,641</u>	<u>17,954</u>	<u>453,884</u>	<u>495,479</u>

The Bank

	2012			
	Qualifying for hedge accounting HK\$ Mn	Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$ Mn	Others, including held for trading HK\$ Mn	Total HK\$ Mn
Exchange rate contracts				
Forwards and futures	-	-	28,912	28,912
Swaps	-	-	189,084	189,084
Options purchased	-	-	42,415	42,415
Options written	-	-	43,434	43,434
Interest rate contracts				
Forwards and futures	-	-	860	860
Swaps	16,886	20,318	47,966	85,170
Equity contracts				
Swaps	-	-	8,860	8,860
Options purchased	-	-	2,683	2,683
Options written	-	-	2,844	2,844
Others	-	-	3,475	3,475
	<u>16,886</u>	<u>20,318</u>	<u>370,533</u>	<u>407,737</u>

Derivatives arise from futures, forward, swap and option transactions undertaken by the Group and the Bank in the foreign exchange, interest rate and equity markets. The notional amounts of these instruments indicate the volume of transactions outstanding at the end of the reporting period; they do not represent amounts at risk.

The fair value and credit risk weighted amounts of the aforesaid off-balance sheet exposures are as follows. These amounts do not take into account the effects of bilateral netting arrangements.

45. Off-Balance Sheet Exposures (continued)

(b) Derivatives (continued)

(ii) Fair value and credit risk weighted amounts of derivatives

The Group

	2013			2012		
	Fair value		Credit risk weighted amounts* HK\$ Mn	Fair value		Credit risk weighted amounts* HK\$ Mn
	Assets HK\$ Mn	Liabilities HK\$ Mn		Assets HK\$ Mn	Liabilities HK\$ Mn	
Exchange rate contracts						
Forward and futures	413	581	524	226	174	354
Swaps	1,137	1,629	3,586	995	1,327	1,809
Options purchased	125	120	1,205	58	42	427
Options written	-	5	888	-	16	288
Interest rate contracts						
Forward and futures	10	-	2	-	-	-
Swaps	1,528	1,813	1,943	1,502	1,924	1,618
Options purchased	-	-	265	-	-	-
Equity contracts						
Swaps	217	193	469	120	99	331
Options purchased	86	38	260	71	37	175
Options written	-	57	112	-	34	68
Others	109	109	703	153	153	301
	<u>3,625</u>	<u>4,545</u>	<u>9,957</u>	<u>3,125</u>	<u>3,806</u>	<u>5,371</u>

The Bank

	2013			2012		
	Fair value		Credit risk weighted amounts* HK\$ Mn	Fair value		Credit risk weighted amounts* HK\$ Mn
	Assets HK\$ Mn	Liabilities HK\$ Mn		Assets HK\$ Mn	Liabilities HK\$ Mn	
Exchange rate contracts						
Forward and futures	286	541	512	203	108	321
Swaps	370	701	1,701	346	886	1,065
Options purchased	125	120	1,260	58	42	427
Options written	-	4	888	-	16	288
Interest rate contracts						
Forward and futures	10	-	2	-	-	-
Swaps	705	1,016	861	1,349	1,751	1,443
Options purchased	-	-	269	-	-	-
Equity contracts						
Swaps	42	181	549	89	32	394
Options purchased	86	38	260	71	37	175
Options written	-	57	113	1	34	68
Others	105	108	704	150	153	303
	<u>1,729</u>	<u>2,766</u>	<u>7,119</u>	<u>2,267</u>	<u>3,059</u>	<u>4,484</u>

* The Bank adopted the Foundation Internal Ratings Based ("IRB") approach according to Banking (Capital) Rules for calculating the credit risk weighted amount as at 31st December, 2013.

The tables above give the contractual or notional amounts, fair value and credit risk weighted amounts of off-balance sheet transactions. The fair value is calculated for the purposes of deriving the credit risk weighted amounts. These are assessed in accordance with the Banking (Capital) Rules. Fair value represents the cost of replacing all contracts which have a positive value when marked to market.

Fair value is a close approximation of the credit risk for these contracts as at the end of the reporting period. The credit risk weighted amount refers to the amount as computed in accordance with the Banking (Capital) Rules.

45. Off-Balance Sheet Exposures (continued)

(b) Derivatives (continued)

(iii) Fair values of derivatives designated as hedging instruments

The following is a summary of the fair values of derivatives held for hedging purposes by product type:

	The Group and The Bank			
	2013		2012	
	Assets	Liabilities	Assets	Liabilities
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Exchange rate contracts	-	-	-	-
Interest rate contracts	350	57	712	89
	<u>350</u>	<u>57</u>	<u>712</u>	<u>89</u>

(a) Cash flow hedges

The Group's cash flow hedge principally consists of foreign exchange contracts that are used to hedge against the variability in cash flows of certain debt securities subject to foreign exchange rate movement.

At 31st December, 2013 and 2012, the net fair value of derivatives held as cash flow hedges was insignificant.

The time periods in which the hedged cash flows are expected to occur and affect the consolidated statement of comprehensive income are as follows:

The Group	Within one year	Over one year but within five years	Over Five years
	HK\$ Mn	HK\$ Mn	HK\$ Mn
At 31 st December, 2013			
Cash inflows from assets	-	129	197
Cash inflows from liabilities	-	-	-
Net cash inflows	-	129	197
At 31 st December, 2012			
Cash inflows from assets	-	102	27
Cash inflows from liabilities	-	-	-
Net cash inflows	-	102	27

(b) Fair value hedges

The Group's fair value hedge principally consists of interest rate swaps that are used to protect against changes in the fair value of fixed rate long-term financial instruments due to movements in market interest rates.

At 31st December, 2013, the net fair value of interest rate swaps was \$293 million (2012: HK\$623 million) comprising assets of HK\$350 million (2012: HK\$712 million) and liabilities of HK\$57 million (2012: HK\$89 million).

45. Off-Balance Sheet Exposures (continued)**(b) Derivatives (continued)****(iv) Remaining life of derivatives**

The following table provides an analysis of the notional amounts of derivatives of the Group by relevant maturity grouping based on the remaining periods to settlement at the end of the reporting period.

The Group							
Notional amounts with remaining life of							
	2013				2012		
	1 year or less	Over 1 year to 5 years	Over 5 years	Total	1 year or less	Over 1 year to 5 years	Over 5 years
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Interest rate derivatives	103,843	84,326	8,414	196,583	86,001	53,932	10,219
Currency derivatives	459,280	105,859	1,648	566,787	345,390	60,930	800
Other derivatives	9,454	10,962	58	20,474	5,690	10,945	516
	<u>572,577</u>	<u>201,147</u>	<u>10,120</u>	<u>783,844</u>	<u>437,081</u>	<u>125,807</u>	<u>11,535</u>
							<u>574,423</u>

The Bank							
Notional amounts with remaining life of							
	2013				2012		
	1 year or less	Over 1 year to 5 years	Over 5 years	Total	1 year or less	Over 1 year to 5 years	Over 5 years
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Interest rate derivatives	40,022	40,644	8,349	89,015	41,776	34,035	10,219
Currency derivatives	282,338	101,912	1,038	385,288	242,613	60,432	800
Other derivatives	9,805	11,255	116	21,176	5,756	11,473	633
	<u>332,165</u>	<u>153,811</u>	<u>9,503</u>	<u>495,479</u>	<u>290,145</u>	<u>105,940</u>	<u>11,652</u>
							<u>407,737</u>

(c) Capital commitments

Capital commitments outstanding at 31st December and not provided for in the accounts were as follows:

	The Group		The Bank	
	2013	2012	2013	2012
	HK\$ Mn	HK\$ Mn	HK\$ Mn	HK\$ Mn
Expenditure authorised and contracted for	682	403	653	329
Expenditure authorised but not contracted for	<u>2,635</u>	<u>124</u>	<u>2,610</u>	<u>26</u>
	<u>3,317</u>	<u>527</u>	<u>3,263</u>	<u>355</u>

45. Off-Balance Sheet Exposures (continued)

(d) Operating lease commitments

At 31st December, 2013, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Properties				
Within one year	504	480	225	181
After one year but within five years	1,010	911	250	170
After five years	280	212	81	-
	<u>1,794</u>	<u>1,603</u>	<u>556</u>	<u>351</u>
	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Equipment				
Within one year	8	6	1	2
After one year but within five years	14	11	1	1
	<u>22</u>	<u>17</u>	<u>2</u>	<u>3</u>

The Group and the Bank lease certain properties and equipment under operating leases. The leases run for an initial period of one to twenty five years, with an option to renew the lease when all terms are renegotiated. Lease payments are usually adjusted annually to reflect market rentals. None of the leases includes contingent rentals.

46. Notes on Consolidated Cash Flow Statement**(a) Purchase of subsidiaries**

	2013 HK\$ Mn	2012 HK\$ Mn
Net assets acquired		
Cash and balances with banks and other financial institutions	-	-
Advances and other accounts less provisions	-	1
Fixed assets	-	-
Current taxation	-	-
Other accounts and provisions	-	(1)
	<u>-</u>	<u>-</u>
Goodwill arising on consolidation	-	11
Total purchase price	<u>-</u>	<u>11</u>
Less: Cash and cash equivalents acquired	-	-
Cash flow on acquisition net of cash acquired	<u><u>-</u></u>	<u><u>11</u></u>

(b) Disposal of subsidiary

	2013 HK\$ Mn	2012 HK\$ Mn
Net assets disposed of		
Cash and balances with banks and other financial institutions	-	436
Placements with banks and other financial institutions	-	287
Advances and other accounts less provisions	-	4,447
Available-for-sale financial assets	-	43
Held-to-maturity investments	-	45
Fixed assets	-	38
Deferred tax assets	-	165
Goodwill and intangible assets	-	174
Deposits and balances of banks and other financial institutions	-	(41)
Deposits from customers	-	(4,294)
Trading liabilities	-	(114)
Other accounts and provisions	-	(86)
	<u>-</u>	<u>1,100</u>
Add: Gain on disposal	-	203*
Less: Transferred to investment in associates	-	(283)*
Less: Cash and cash equivalents disposed	-	(436)
Cash flow on disposal of subsidiary	<u><u>-</u></u>	<u><u>584</u></u>

* Included HK\$55 million of gain attributable to recognizing any investment retained in the former subsidiary at its fair value at the date when control is lost.

(c) Cash and cash equivalents**(i) Components of cash and cash equivalents in the consolidated cash flow statement**

	2013 HK\$ Mn	2012 HK\$ Mn
Cash and balances with banks and other financial institutions	34,068	55,981
Placements with banks and other financial institutions with original maturity within three months	43,504	26,360
Treasury bills with original maturity within three months	11,202	16,425
Certificates of deposit held with original maturity within three months	1,131	972
Debt securities with original maturity within three months	102	-
	<u><u>90,007</u></u>	<u><u>99,738</u></u>

46. Notes on Consolidated Cash Flow Statement (continued)

(c) Cash and cash equivalents (continued)

(ii) Reconciliation with the consolidated statement of financial position

	2013 HK\$ Mn	2012 HK\$ Mn
Cash and balances with banks and other financial institutions (Note 23)	68,777	85,512
Placements with banks and other financial institutions (Note 24)	57,372	50,618
Treasury bills, certificates of deposit held and debt securities		
- trading assets (Note 26)	3,902	3,057
- designated at fair value through profit or loss (Note 27)	11,199	14,751
- advances and other accounts (Note 28(a))	117	78
- available-for-sale (Note 29)	68,682	62,333
- held-to-maturity (Note 30)	5,048	4,320
	<u>88,948</u>	<u>84,539</u>
Amounts shown in the consolidated statement of financial position	215,097	220,669
Less: Amounts with an original maturity of beyond three months	(90,381)	(91,400)
Cash balance with central bank subject to regulatory restriction	<u>(34,709)</u>	<u>(29,531)</u>
Cash and cash equivalents in the consolidated cash flow statement	<u>90,007</u>	<u>99,738</u>

47. Assets Pledged as Security

The following assets have been pledged as collateral for own liabilities at the end of the reporting period.

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Secured liabilities	<u>3,645</u>	<u>9,633</u>	<u>2,781</u>	<u>2,649</u>
Assets pledged:				
Advances to customers and other accounts	1,121	1,599	1,121	1,450
Financial assets designated at fair value through profit or loss	2,046	1,793	2,046	1,793
Available-for-sale financial assets	1,015	6,836	63	-
Held-to-maturity investments	601	792	601	792
	<u>4,783</u>	<u>11,020</u>	<u>3,831</u>	<u>4,035</u>

The following balances with banks have been pledged as collateral for securities borrowings and margin deposits of derivatives.

	The Group		The Bank	
	2013 HK\$ Mn	2012 HK\$ Mn	2013 HK\$ Mn	2012 HK\$ Mn
Cash collateral for borrowed securities	-	-	-	-
Margin accounts for open futures and forward contracts	744	1,085	736	1,077
	<u>744</u>	<u>1,085</u>	<u>736</u>	<u>1,077</u>

These transactions are conducted under terms that are usual and customary to standard lending and securities borrowing and lending activities.

48. Loans to Officers

The aggregate of loans to officers of the Bank disclosed pursuant to Section 161B(4B) and (4C) of the Hong Kong Companies Ordinance is as follows:

	2013 HK\$ Mn	2012 HK\$ Mn
Aggregate amount of relevant loans outstanding at 31 st December		
By the Bank	2,187	2,368
By subsidiaries	<u>1,106</u>	<u>1,296</u>
	<u>3,293</u>	<u>3,664</u>
The maximum aggregate amount of relevant loans outstanding during the year		
By the Bank	4,659	5,382
By subsidiaries	<u>1,618</u>	<u>1,431</u>
	<u>6,277</u>	<u>6,813</u>

There was no interest due but unpaid nor any impairment allowance made against these loans at 31st December, 2013 and 31st December, 2012.

49. Material Related Party Transactions**(a) Key management personnel remuneration**

Remuneration for key management personnel of the Group, including amounts paid to the Bank's directors as disclosed in Note 20 and certain of the highest paid employees as disclosed in Note 21, is as follows:

	2013 HK\$ Mn	2012 HK\$ Mn
Short-term employee benefits	132	123
Post-employment benefits	5	5
Equity compensation benefits	<u>22</u>	<u>22</u>
	<u>159</u>	<u>150</u>

(b) The Group maintains certain retirement benefit schemes for its staff as per Note 2(q)(iii). In 2013, the total amount of contributions the Group made to the schemes was HK\$152 million (2012: HK\$145 million).

The Group enters into a number of transactions with the Group's related parties, including its associates, and key management personnel and their close family members and companies controlled or significantly influenced by them. The transactions include accepting deposits from and extending credit facilities to them. All interest rates in connection with the deposits taken and credit facilities extended are under terms and conditions normally applicable to customers of comparable standing.

The interest received from and interest paid to the Group's related parties for the year, outstanding balances of amounts due from and due to at the year end, and maximum outstanding balance of amounts due from and due to them during the year are aggregated as follows:

49. Material Related Party Transactions (continued)

	Key management personnel		Subsidiaries		Associates	
	2013	2012	2013	2012	2013	2012
	HK\$ Mn	HK\$ Mn	HK\$ Mn	Restated HK\$ Mn	HK\$ Mn	HK\$ Mn
Interest income	104	123	441	412	10	11
Interest expense	49	54	85	125	-	-
Amounts due from	5,270	6,450	24,124	15,566	825	390
Amounts due to	4,979	4,616	3,108	3,105	28	228
Maximum amounts due from	10,552	9,683	26,545	17,890	1,455	503
Maximum amounts due to	8,595	9,656	3,108	3,105	1,565	485
Committed facilities to	4,202	4,247	2,738	1,079	219	10

50. Equity Compensation Plans

The Bank has adopted Staff Share Option Schemes whereby the Board of the Bank may at its discretion grant to any employees of the Group, including Executive Director and Chief Executive, options to subscribe for ordinary shares of the Bank. All options were granted for nil consideration.

(a) Particulars of share options

<u>Date of grant</u>	<u>Vesting period</u>	<u>Exercise period</u>	<u>Exercise price per share</u> HK\$
05/5/2008	05/5/2008 – 04/5/2009	05/5/2009 – 05/5/2013	40.09 *
05/5/2009	05/5/2009 – 04/5/2010	05/5/2010 – 05/5/2014	21.25
06/7/2010	06/7/2010 – 05/7/2011	06/7/2011 – 06/7/2015	28.49
05/5/2011(T1)	05/5/2011 – 04/5/2012	05/5/2012 – 05/5/2017	32.00
05/5/2011(T2)	05/5/2011 – 04/5/2013	05/5/2013 – 05/5/2018	32.00
05/5/2011(T3)	05/5/2011 – 04/5/2014	05/5/2014 – 05/5/2019	32.00
10/5/2012(T1)	10/5/2012 – 09/5/2013	10/5/2013 – 10/5/2018	28.99
10/5/2012(T2)	10/5/2012 – 09/5/2014	10/5/2014 – 10/5/2019	28.99
10/5/2012(T3)	10/5/2012 – 09/5/2015	10/5/2015 – 10/5/2020	28.99
03/5/2013(T1)	03/5/2013 – 02/5/2014	03/5/2014 – 03/5/2019	31.40
03/5/2013(T2)	03/5/2013 – 02/5/2015	03/5/2015 – 03/5/2020	31.40
03/5/2013(T3)	03/5/2013 – 02/5/2016	03/5/2016 – 03/5/2021	31.40

(b) Movement of share options during the period

2013		Number of share options					
<u>Date of grant</u>	<u>Tranche</u>	<u>Option price</u> HK\$	<u>Outstanding at 1/1/2013</u>	<u>Granted</u>	<u>Exercised</u>	<u>Lapsed</u>	<u>Outstanding at 31/12/2013</u>
05/5/2008		40.09 *	4,070,000	-	-	4,070,000	-
05/5/2009		21.25	2,920,000	-	2,485,000	-	435,000
06/7/2010		28.49	5,750,000	-	2,150,000	-	3,600,000
05/5/2011	T1	32.00	1,980,000	-	50,000	-	1,930,000
05/5/2011	T2	32.00	1,980,000	-	-	50,000	1,930,000
05/5/2011	T3	32.00	1,990,000	-	-	50,000	1,940,000
10/5/2012	T1	28.99	1,980,000	-	100,000	50,000	1,830,000
10/5/2012	T2	28.99	1,980,000	-	-	50,000	1,930,000
10/5/2012	T3	28.99	1,990,000	-	-	50,000	1,940,000
03/5/2013	T1	31.40	-	1,880,000	-	-	1,880,000
03/5/2013	T2	31.40	-	1,880,000	-	-	1,880,000
03/5/2013	T3	31.40	-	1,890,000	-	-	1,890,000
Total			24,640,000	5,650,000	4,785,000	4,320,000	21,185,000

* After adjusting for the bonus issue one for ten in April 2009.

50. Equity Compensation Plans (continued)**(b) Movement of share options during the period (continued)**

2012		Option price HK\$	Outstanding at 1/1/2012	Number of share options			Outstanding at 31/12/2012
Date of grant	Tranche			Granted	Exercised	Lapsed	
10/5/2007		42.84 *	2,035,000	-	-	2,035,000	-
05/5/2008		40.09 *	4,070,000	-	-	-	4,070,000
05/5/2009		21.25	3,515,000	-	595,000	-	2,920,000
06/7/2010		28.49	5,950,000	-	200,000	-	5,750,000
05/5/2011	T1	32.00	1,980,000	-	-	-	1,980,000
05/5/2011	T2	32.00	1,980,000	-	-	-	1,980,000
05/5/2011	T3	32.00	1,990,000	-	-	-	1,990,000
10/5/2012	T1	28.99	-	1,980,000	-	-	1,980,000
10/5/2012	T2	28.99	-	1,980,000	-	-	1,980,000
10/5/2012	T3	28.99	-	1,990,000	-	-	1,990,000
Total			21,520,000	5,950,000	795,000	2,035,000	24,640,000

(c) No share options were cancelled during the years ended 31st December, 2013 and 2012.

(d) Details of share options exercised

Exercise period	Date of grant	Number of share options	
		2013	2012
March	05/5/2009	10,000	60,000
	06/7/2010	1,100,000	-
April	05/5/2009	-	50,000
May	05/5/2009	30,000	-
July	05/5/2009	-	135,000
August	05/5/2009	1,695,000	160,000
	06/7/2010	1,000,000	-
October	05/5/2009	290,000	-
	05/5/2011 (T1)	50,000	-
November	05/5/2009	400,000	10,000
December	05/5/2009	60,000	180,000
	06/7/2010	50,000	200,000
	10/5/2012 (T1)	100,000	-
		<u>4,785,000</u>	<u>795,000</u>

51. Non-adjusting events after the reporting period

After the end of the reporting period the directors declared a second interim dividend. Further details are disclosed in Note 18(a).

52. Accounting Estimates and Judgements

The preparation of accounts requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of these accounts and the reported amounts of revenues and expenses for the years presented. Changes in assumptions may have a significant impact on the accounts in the periods where the assumptions are changed. The application of assumptions and estimates means that any selection of different assumptions would cause the Group's reporting to differ. The Group believes that the assumptions that have been made are appropriate and that the accounts therefore present the financial position and results fairly, in all material respects.

Management discussed with the Audit Committee the development, selection and disclosure of the Group's significant accounting policies and estimates and the application of these policies and estimates.

(a) Key sources of estimation uncertainty

Notes 33, 39 and 44 contain information about the assumptions and their risk factors relating to goodwill impairment, fair value of share options granted and fair values of financial instruments. Other key sources of estimation uncertainty are as follows:

(i) Impairment losses

Loans and advances

Loan portfolios are reviewed periodically to assess whether impairment losses exist. The Group makes judgement as to whether there is any objective evidence that a loan portfolio is impaired, i.e. whether there is a decrease in estimated future cash flows. Objective evidence for impairment includes observable data that the payment status of borrowers in a group has adversely changed. It may also include observable data that correlate with defaults on the assets in the Group. If management has determined, based on their judgement, that objective evidence for impairment exists, expected future cash flows are estimated based on historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of the current observable data. Management reviews the methodology and assumptions used in estimating future cash flows regularly to reduce any difference between loss estimates and actual loss experience.

Available-for-sale financial assets and held-to-maturity investments

The Group determines that available-for-sale financial assets and held-to-maturity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. The determination of when a decline in fair value below its cost is not recoverable within a reasonable time period is judgemental by nature, so profit and loss could be affected by differences in this judgement.

(ii) Valuation of financial instruments

The Group's accounting policy for valuation of financial instruments is included in Note 2. The fair value of the financial instruments is mainly based on the quoted market price on a recognised stock exchange or a price quoted from a broker/dealer for non-exchanged traded financial instruments. The fair value of collateralised debt obligations is based on bid prices quoted by reputable brokers and has been carefully assessed for reasonableness by management. The fair value of a SIV is based on its net asset values as provided by the SIV's manager.

52. Accounting Estimates and Judgements (continued)**(b) Critical accounting judgements in applying the Group's accounting policies**

Certain critical accounting judgements in applying the Group's accounting policies are described below:

(i) Held-to-maturity investments

The Group classifies non-derivative financial assets with fixed or determinable payments and fixed maturity and where the Group has a positive intention and ability to hold to maturity as held-to-maturity investments. In making this judgement, the Group evaluates its intention and ability to hold such investments till maturity.

If the Group fails to hold these investments to maturity other than for certain specific circumstances, the Group will have to reclassify the entire portfolio of held-to-maturity investments as available-for-sale, as such class is deemed to have been tainted.

This would result in held-to-maturity investments being measured at fair value instead of at amortised cost.

(ii) Recognition of deferred tax assets

The Group recognises deferred tax assets only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Estimates and judgements are applied in determining the amount of future taxable profits and the probability that such future taxable profits are available in the foreseeable future to support recognition of the deferred tax assets. The Group uses all readily available information, including estimates based on reasonable and supportable assumptions and projections of revenue and operating costs, in determining future taxable profits. Changes in these estimates could significantly affect the timing of deferred tax asset recognition and the amount of asset recognised.

53. Comparative Figures

The 2012 figures in Note 22 – Segment Reporting have been restated due to the modification of the internal fund transfer pricing methodology of the Bank with a view to further enhancing the allocation process of interest income and expenses of Hong Kong banking operations.

For other restatements, the comparative figure has been restated to conform with current year's presentation.

54. Possible Impact of Amendments, New Standards and Interpretations Issued but not Yet Effective for the Year Ended 31st December, 2013

Up to the date of issue of these accounts, the HKICPA has issued a number of amendments and five new standards which are not yet effective for the year ended 31st December, 2013 and which have not been adopted in these accounts. These include the following which may be relevant to the Group.

	Effective for accounting periods beginning on or after
Amendments to HKAS 32, <i>Offsetting financial assets and financial liabilities</i>	1 st January, 2014
Amendments to HKAS 39, <i>Novation of derivatives and continuation of hedge accounting</i>	1 st January, 2014
HKFRS 9, <i>Financial instruments</i>	Unspecified

The Group is in the process of making an assessment of what the impact of these amendments is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the consolidated financial statements except for the following:

HKFRS 9, Financial Instruments

HKFRS 9 was issued in November 2009 and establishes new principles for the classification and measurement of financial assets. In December 2010, the HKICPA issued additions to HKFRS 9 dealing with financial liabilities. The main changes to the requirements of HKAS 39 are summarised below.

All financial assets are classified into two measurement categories: amortised cost or fair value on the basis of both an entity's business model for managing groups of financial assets and the contractual cash flow characteristics of the individual assets. These two categories replace the four categories under the current HKAS 39, *Financial instruments: Recognition and Measurement*.

Financial assets are measured at fair value through profit or loss, if they do not meet the criteria specified for measurement at amortised cost or if doing so significantly reduces or eliminates an accounting mismatch. An entity has the option to designate all subsequent changes in fair value of an equity instrument not held for trading at fair value through other comprehensive income with no recycling of gains or losses to the income statement. Dividend income would continue to be recognised in the income statement.

Financial assets which contain embedded derivatives are to be classified in their entirety either at fair value or amortised cost depending on whether the contracts as a whole meet the relevant criteria under HKFRS 9.

HKFRS 9 retains all the existing requirements for derecognition of financial instruments and most of the requirements for financial liabilities, except that for financial liabilities designated under the fair value option other than loan commitments and financial guarantee contracts, fair value changes attributable to changes in own credit risk are to be presented in the statement of other comprehensive income, and are not subsequently reclassified to income statement but may be transferred within equity.

In December 2011, the amendment to HKFRS 9 and HKFRS 7 issued by HKICPA provided relief from the requirement to restate prior period comparative information and required additional disclosures on transition from HKAS39 to HKFRS 9. The Group is presently studying the implications of applying HKFRS 9 but it is impracticable to quantify its effect as at the date of publication of these consolidated financial statements.

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