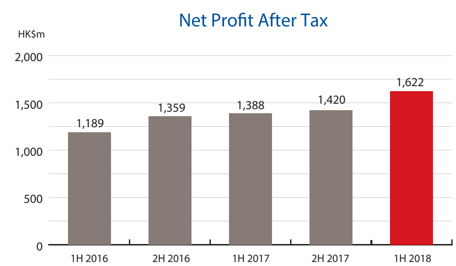
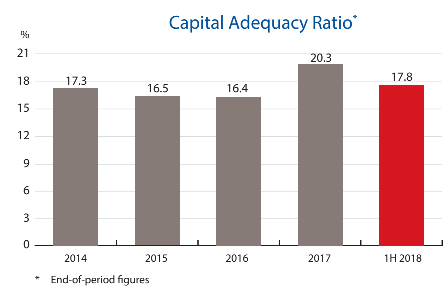
中信银行(国际)
CHINA CITIC BANK INTERNATIONAL

2018 Interim Results Highlights

Financial Performance

- **Net profit after tax** was HK$1.62 billion, up 16.9 % year on year.
- **Operating profit after impairment** was HK$1.97 billion, up 21.9%, with HK$773 million of impairment loss recorded for the first half of 2018.
- **Operating income** increased by 9.8% to HK$4.36 billion, with **net interest income** of HK$3.30 billion, 35.1% higher than the corresponding period last year. **Net interest margin** widened by 24 basis points from FY2017 to 1.92% mainly due to higher asset yields.
- **Non-interest income** decreased by 20.9%, owing to lower loan fees, bills commission income and income from foreign exchange funding swaps.
- **ROA** was up 9 basis points from FY2017 to 0.94%.
- **ROE** decreased by 1.15 percentage points from FY2017 to 8.96%.
- **Total assets** grew by 1.4% from end-2017 to HK$349.3 billion.
- **Impaired loan ratio** declined significantly to 0.63% from 1.26% as at end-2017, which was the lowest level since 2015, while non-performing loan coverage ratio rose from 61.8% as at end-2017 to 192.8%.
- **Capital adequacy ratio** and **CET1 ratio** were 17.8% and 12.7% respectively, while average **Liquidity Coverage Ratio** reached 213.1% for 2Q 2018.





Wholesale Banking Group (WBG)

- Operating income grew by 4.1% to HK$2.55 billion despite a stable customer loans balance, demonstrating improved efficiency and profitability of the corporate lending business.
- Successfully opened nearly 400 new accounts and brought in deposits of more than HK$4.8 billion.
- Continued to pursue the strategy of "Active Marketing, Conservative Underwriting". Exited relatively higher-risk loans to make room for more secure loans including those backed by direct mortgages, granted to state-owned enterprises and backed by parent bank standby letters of credit.
- Continued to strengthen collaboration with the CITIC Group and CNCB, achieving a 14.7% year-on-year growth in collaboration revenues, which accounted for 45.8% of WBG's total revenues during the period under review, up 4.2 percentage points year on year.
- Overseas branches continued to provide tailored services to customers having overseas banking needs while further strengthening their risk management capabilities and enhancing staff training and internal controls.

Personal and Business Banking Group (PBG)

- Achieved operating income of HK$1.27 billion, which was a new half-year record and represented an increase of 11.9% year on year.
- As at end-June, customer deposits and retail lending balances reached new highs of HK$140.98 billion and HK$49.02 billion respectively. The share of retail deposits already exceeded 50% of the total, with an improvement in the Bank's deposit structure and a stable source of funding.
- Remained focus on strengthening existing customer relationships while actively acquiring new customers. Total number of high net worth customers including CITIC*first* and private banking customers reached nearly 35,000 as at end-June, over 19% higher than six month ago.
- Continued to embrace FinTech to enhance competitive advantages. In early March, CNCBI was the first bank in the market to offer truly remote account opening service for Hong Kong identity card holders via the inMotion mobile application, and such service was later extended to investment accounts.
- CNCBI was awarded a Second Prize in the Shenzhen-Hong Kong FinTech Award jointly organized by the HKMA and the Shenzhen Office of Financial Development Service.

Treasury and Markets Group (TMG)

- Debt Capital Markets business maintained strong momentum and recognized HK$156 million of fee income as 58 deals for 31 Chinese issuers were completed with total issuance size of about US$26.4 billion, while CNCBI acted as global coordinator for 30 of these deals.
- As at end-June, according to Bloomberg Offshore China Bonds issuance volume, CNCBI ranked ninth among all managers and fourth among all Chinese financial institutions.
- The RMB trading team has conducted substantial transactions with average daily trading volume consistently maintained at a high level. Thomson Reuters has awarded CNCBI "Best e-FX Execution Chinese Bank" and "Best FX Data Contribution Bank".
- The Central Treasury Unit kept pace with the interest rate cycles of the USD and HKD to carefully manage liquidity positions and achieved higher returns on deployment, as well as adjusting internal fund transfer in a timely manner to ensure prudent liquidity management.

中信银行(国际)
CHINA CITIC BANK INTERNATIONAL

CHINA CITIC BANK INTERNATIONAL LIMITED

(Incorporated in Hong Kong with limited liability under the Companies Ordinance)

ANNOUNCEMENT OF 2018 INTERIM RESULTS

The Board of Directors of China CITIC Bank International Limited ("the Bank") is pleased to announce the unaudited consolidated results of the Bank and its subsidiaries ("the Group") for the six months ended 30 June 2018. The interim financial report is unaudited, but has been reviewed by PricewaterhouseCoopers, in accordance with Hong Kong Standards on Review Engagements 2410, *Review of interim financial information performed by the independent auditor of the entity*, issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

CONDENSED CONSOLIDATED INCOME STATEMENT
For the six months ended 30 June 2018 – unaudited
(Expressed in Hong Kong dollars)

		Six months ended 30 June	
		2018	2017
	Note	***HK$'000***	*HK$'000*
Interest income	*4(a)*	**5,441,182**	4,109,777
Interest expense	*4(b)*	**(2,138,071)**	(1,664,729)
Net interest income		**3,303,111**	2,445,048
Fee and commission income		**837,009**	1,032,181
Fee and commission expense		**(47,275)**	(34,736)
Net fee and commission income	*5*	**789,734**	997,445
Net trading income	*6*	**235,714**	483,602
Net hedging gain/(loss)	*7*	**4,344**	(21)
Net gain on disposal of financial assets at fair value through other comprehensive income	*8*	**9,936**	–
Net gain on disposal of available-for-sale securities	*8*	**–**	23,978
Other operating income	*9*	**19,458**	22,089
Operating income		**4,362,297**	3,972,141
Operating expenses	*10*	**(1,617,443)**	(1,487,028)
Operating profit before impairment		**2,744,854**	2,485,113
Expected credit losses on financial assets	*11*	**(741,030)**	–
Impairment losses on loans and advances and other accounts	*11*	**–**	(867,472)
Impairment losses on other assets	*18*	**(32,000)**	–
Impairment losses		**(773,030)**	(867,472)
Operating profit		**1,971,824**	1,617,641
Net loss on disposal of property and equipment		**(527)**	(3,905)
Revaluation (loss)/gain on investment properties		**(170)**	7,009
Profit before taxation		**1,971,127**	1,620,745
Income tax	*12*	**(348,638)**	(232,365)
Profit for the period		**1,622,489**	1,388,380
Profit attributable to shareholders		**1,622,489**	1,388,380

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
For the six months ended 30 June 2018 – unaudited
(Expressed in Hong Kong dollars)

	Six months ended 30 June	
	2018	2017
	HK$'000	*HK$'000*
Profit for the period	**1,622,489**	1,388,380
Other comprehensive income for the period		
Items that will be reclassified subsequently to consolidated income statement when specific conditions are met		
Exchange differences on translation of financial statements of overseas subsidiaries	**(20,873)**	52,184
Cash flow hedges		
– effective portion of changes in fair value of hedging instruments recognised during the period	**–**	(751)
– deferred tax related to the above	**–**	124
	–	(627)
Financial assets at fair value through other comprehensive income		
– change in the fair value of debt instruments	**(538,836)**	–
– transfer to income statement on disposal	**(11,120)**	–
– transfer to income statement on impairment	**74,011**	–
– deferred tax related to the above	**78,474**	–
	(397,471)	–
Available-for-sale securities		
– change in fair value	**–**	149,872
– transfer to income statement on disposal	**–**	(18,839)
– deferred tax related to the above	**–**	(20,577)
	–	110,456
Items that will not be reclassified subsequently to consolidated income statement		
Financial assets at fair value through other comprehensive income		
– change in fair value of equity instruments	**731**	–
– deferred tax related to the above	**(121)**	–
	610	–
Other comprehensive income for the period	**(417,734)**	162,013
Total comprehensive income for the period	**1,204,755**	1,550,393
Total comprehensive income attributable to shareholders	**1,204,755**	1,550,393

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION
At 30 June 2018 – unaudited
(Expressed in Hong Kong dollars)

	Note	**At 30 June 2018 HK$'000**	At 31 December 2017 HK$'000
ASSETS			
Cash and balances with banks, central banks and other financial institutions	14	**19,412,643**	31,657,854
Placements with and advances to banks, central banks and other financial institutions	15	**47,106,996**	47,402,438
Financial assets at fair value through profit or loss	16	**922,185**	1,029,044
Derivative financial instruments	17	**9,305,829**	4,770,495
Loans and advances to customers and other accounts	18	**203,497,497**	198,986,939
Financial assets at fair value through other comprehensive income	19	**67,582,200**	–
Available-for-sale securities	19	**–**	59,346,677
Property and equipment	20		
– Investment property		**132,610**	132,780
– Other premises		**364,744**	373,100
– Equipment		**500,689**	514,469
Tax recoverable	25(a)	**1,701**	29,047
Deferred tax assets	25(b)	**442,903**	65,841
Total Assets		**349,269,997**	344,308,684
LIABILITIES AND EQUITY			
Liabilities			
Deposits and balances of banks and other financial institutions	21	**5,383,446**	5,187,319
Deposits from customers	22	**270,855,292**	271,471,865
Derivative financial instruments	17	**9,021,831**	4,824,483
Certificates of deposit issued	23	**3,138,313**	3,421,769
Debt securities issued	24	**3,542,230**	3,584,064
Current tax liabilities	25(a)	**379,629**	497,575
Deferred tax liabilities	25(b)	**8,261**	1,631
Other liabilities	26	**9,996,563**	5,422,626
Loan capital	27	**6,287,099**	6,340,192
Total Liabilities		**308,612,664**	300,751,524
Equity			
Share capital	28(a)	**18,404,013**	18,404,013
Reserves		**16,080,068**	18,979,895
Total shareholders' equity		**34,484,081**	37,383,908
Additional equity instruments	29	**6,173,252**	6,173,252
Total Equity		**40,657,333**	43,557,160
Total Equity and Liabilities		**349,269,997**	344,308,684

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
For the six months ended 30 June 2018 – unaudited
(Expressed in Hong Kong dollars)

	Share capital	Capital reserve	General reserve	Exchange differences reserve	Property revaluation reserve	Cash flow hedging reserve	Investment revaluation reserve	Statutory reserve	Regulatory general reserve	Retained profits	Total reserves (note 28(b))	Additional equity instruments	Total equity
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
At 1 January 2018	**18,404,013**	**6,589**	**100,000**	**24,940**	**55**	**–**	**(88,136)**	**58,073**	**149,500**	**18,728,874**	**18,979,895**	**6,173,252**	**43,557,160**
Changes on initial adoption of HKFRS 9	–	–	–	–	–	–	69,369	–	–	(1,196,730)	(1,127,361)	–	(1,127,361)
Restated total equity at the beginning of the financial year	**18,404,013**	**6,589**	**100,000**	**24,940**	**55**	**–**	**(18,767)**	**58,073**	**149,500**	**17,532,144**	**17,852,534**	**6,173,252**	**42,429,799**
Changes in equity for the six months ended 30 June 2018:													
Profit for the period	–	–	–	–	–	–	–	–	–	1,622,489	1,622,489	–	1,622,489
Other comprehensive income for the period	–	–	–	(20,873)	–	–	(396,861)	–	–	–	(417,734)	–	(417,734)
Total comprehensive income for the period	–	–	–	(20,873)	–	–	(396,861)	–	–	1,622,489	1,204,755	–	1,204,755
Dividend paid	–	–	–	–	–	–	–	–	–	(2,808,437)	(2,808,437)	–	(2,808,437)
Transfer from retained profits	–	–	–	–	–	–	–	–	–	(168,784)	(168,784)	168,784	–
Distribution payment for Additional Tier 1 Capital Securities ("AT1 Capital Securities")	–	–	–	–	–	–	–	–	–	–	–	(168,784)	(168,784)
At 30 June 2018	**18,404,013**	**6,589**	**100,000**	**4,067**	**55**	**–**	**(415,628)**	**58,073**	**149,500**	**16,177,412**	**16,080,068**	**6,173,252**	**40,657,333**
At 1 January 2017	9,366,271	6,589	100,000	(94,212)	55	1,068	(61,975)	53,845	149,500	16,259,623	16,414,493	6,173,252	31,954,016
Changes in equity for the six months ended 30 June 2017:													
Profit for the period	–	–	–	–	–	–	–	–	–	1,388,380	1,388,380	–	1,388,380
Other comprehensive income for the period	–	–	–	52,184	–	(627)	110,456	–	–	–	162,013	–	162,013
Total comprehensive income for the period	–	–	–	52,184	–	(627)	110,456	–	–	1,388,380	1,550,393	–	1,550,393
Transfer from retained profits	–	–	–	–	–	–	–	–	–	(167,060)	(167,060)	167,060	–
Distribution payment for AT1 Capital Securities	–	–	–	–	–	–	–	–	–	–	–	(167,060)	(167,060)
At 30 June 2017	9,366,271	6,589	100,000	(42,028)	55	441	48,481	53,845	149,500	17,480,943	17,797,826	6,173,252	33,337,349
At 1 July 2017	9,366,271	6,589	100,000	(42,028)	55	441	48,481	53,845	149,500	17,480,943	17,797,826	6,173,252	33,337,349
Changes in equity for the six months ended 31 December 2017:													
Profit for the period	–	–	–	–	–	–	–	–	–	1,420,057	1,420,057	–	1,420,057
Other comprehensive income for the period	–	–	–	66,968	–	(441)	(136,617)	–	–	–	(70,090)	–	(70,090)
Total comprehensive income for the period	–	–	–	66,968	–	(441)	(136,617)	–	–	1,420,057	1,349,967	–	1,349,967
Issue and allotment of shares, net of transaction costs	9,037,742	–	–	–	–	–	–	–	–	–	–	–	9,037,742
Transfer from retained profits	–	–	–	–	–	–	–	4,228	–	(172,126)	(167,898)	167,898	–
Distribution payment for AT1 Capital Securities	–	–	–	–	–	–	–	–	–	–	–	(167,898)	(167,898)
At 31 December 2017	18,404,013	6,589	100,000	24,940	55	–	(88,136)	58,073	149,500	18,728,874	18,979,895	6,173,252	43,557,160

CONDENSED CONSOLIDATED CASH FLOWS STATEMENT
For the six months ended 30 June 2018 – unaudited
(Expressed in Hong Kong dollars)

	Note	Six months ended 30 June 2018 HK$'000	2017 HK$'000
Net cash flows (used in)/generated from operating activities	*30(a)*	**(8,144,058)**	16,081,753
Cash flows generated from/(used in) investing activities			
Dividends received from equity instruments		**4,361**	4,314
Purchase of property and equipment		**(79,073)**	(114,450)
Proceeds from disposal of property and equipment		**–**	52
Net cash flows used in investing activities		**(74,712)**	(110,084)
Cash flows generated from/(used in) financing activities			
Proceeds from debt securities issued		**–**	3,456,755
Dividend paid		**(2,808,437)**	–
Distribution paid on Additional Tier 1 Capital Securities		**(168,784)**	(167,060)
Interest paid on debt securities issued		**(162,523)**	–
Interest paid on loan capital		**(205,525)**	(249,289)
Net cash flows (used in)/generated from financing activities		**(3,345,269)**	3,040,406
Net (decrease)/increase in cash and cash equivalents		**(11,564,039)**	19,012,075
Cash and cash equivalents at 1 January		**89,385,112**	54,517,271
Cash and cash equivalents at 30 June	*30(b)*	**77,821,073**	73,529,346

(1) BASIS OF PREPARATION

The interim financial report has been prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34, *Interim financial reporting*, issued by the HKICPA. It also contains the disclosure information required under the Banking (Disclosure) Rules issued by the Hong Kong Monetary Authority ("HKMA"). The interim financial report should be read in conjunction with the annual financial statements for the year ended 31 December 2017 which have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs").

The preparation of the interim financial report that conforms with HKAS 34 requires that management make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses on a year-to-date basis. Actual results may differ from these estimates. In preparing this interim financial report, the significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements for the year ended 31 December 2017 except for the first time adoption of HKFRS 9 "Financial Instruments" as described in 2.3.4 below.

The financial information relating to the year ended 31 December 2017 that is included in the interim financial report for the six months ended 30 June 2018 as comparative information does not constitute the Group's statutory annual consolidated financial statements for that year but is derived from those financial statements. Further information relating to these statutory financial statements required to be disclosed in accordance with section 436 of the Hong Kong Companies Ordinance (Cap. 622) is as follows:

The Group has delivered the financial statements for the year ended 31 December 2017 to the Registrar of Companies as required by section 662(3) of, and Part 3 of Schedule 6 to, the Hong Kong Companies Ordinance (Cap. 622).

The Group's auditor has reported on those financial statements. The auditor's report was unqualified; did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying its report; and did not contain a statement under sections 406(2), 407(2) or (3) of the Hong Kong Companies Ordinance (Cap. 622).

The interim financial report has been prepared in accordance with the accounting policies adopted to be consistent with the 2017 annual financial statements and corresponding interim reporting period, which have been prepared in accordance with Hong Kong Financial Reporting Standards, except for the adoption of new and amended standards as set out below.

(2) ACCOUNTING POLICIES

2.1 New and amended standards adopted by the Group

A number of new or amended standards became applicable for the current reporting period and the Group had to change its accounting policies and make retrospective adjustments as a result of adopting the following standards:

– HKFRS 9 "Financial Instruments", and

– HKFRS 15 "Revenue from Contracts with Customers".

The impact of the adoption of HKFRS 9 and the related new accounting policies are disclosed in note 2.3 below. HKFRS 15 is effective from 1 January 2018 and replaces HKAS 18 "Revenue". HKFRS 15 is conceptually similar to HKAS 18, but includes more granular guidance on recognition and measurement of revenue. The Group has performed an assessment and concluded that the adoption of HKFRS 15 does not have significant impact on the Group's accounting policies and does not require retrospective adjustments.

2.2 Impact of standards issued but not yet applied by the Group

HKFRS 16 "Leases" will result in almost all leases being recognised on the balance sheet, as the distinction between an operating and finance lease is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognised. The only exemptions are short-term leases and leases of low-value assets. The accounting for lessors will not significantly change.

The standard will affect primarily the accounting for the Group's operating leases. However, the Group has not yet determined to what extent these commitments will result in the recognition of an asset and a liability for future payments and how this will affect the Group's profit and classification of cash flows.

(2) ACCOUNTING POLICIES (CONTINUED)

2.2 Impact of standards issued but not yet applied by the Group (continued)

The new standard is mandatory for financial years commencing on or after 1 January 2019. At this stage, the Group does not intend to adopt the standard before its effective date. The Group intends to apply the simplified transition approach and will not restate comparative amounts for the year prior to first adoption.

There are no other amended standards or interpretations that are effective for the first time for this interim period that could be expected to have a material impact on this Group.

2.3 Changes in accounting policies on adoption of HKFRS 9

The Group has adopted HKFRS 9 with a date of transition of 1 January 2018, which resulted in changes in accounting policies and adjustments to the amounts previously recognised in the financial statements. The Group did not early adopt any part of HKFRS 9 in previous periods.

As permitted by the transitional provisions of HKFRS 9, the Group elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognised in the opening retained earnings and other reserves of the current period. The Group has also elected to continue to apply the hedge accounting requirements of HKAS 39 on adoption of HKFRS 9.

Consequently, for notes disclosures, the consequential amendments to HKFRS 7 'Financial Instruments: Disclosures' disclosures have also only been applied to the current period. The comparative period notes disclosures repeat those disclosures made in the prior years.

The adoption of HKFRS 9 has resulted in changes in the Group's accounting policies for recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets. HKFRS 9 also significantly amends other standards dealing with financial instruments such as HKFRS 7 disclosures.

The classification and measurement of financial liabilities remains largely the same as it was under HKAS 39, except for the changes in the fair value of financial liabilities designated at fair value through profit or loss that are attributable to changes in the instrument's credit risk, which are now presented in other comprehensive income.

2.3.1 Classification and subsequent measurement

From 1 January 2018, the Group has applied HKFRS 9 and classifies its financial assets in the following measurement categories:

– Amortised cost
– Fair value through other comprehensive income ("FVOCI"); or
– Fair value through profit or loss ("FVPL")

(a) Debt instruments

Classification and subsequent measurement of debt instruments depends on:

(i) the Group's business model for managing the asset; and
(ii) the cash flow characteristics of the asset.

Based on these factors, the Group classifies its debt instruments into one of the following three measurement categories:

Amortised cost

Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ("SPPI"), and that are not designated at FVPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognised and measured as described in the credit risk management section of the Unaudited Supplementary Financial Information part of this Interim Financial Report. Interest income from these financial assets is included in 'interest income' using the effective interest rate method.

(2) ACCOUNTING POLICIES (CONTINUED)

2.3 Changes in accounting policies on adoption of HKFRS 9 (continued)

2.3.1 Classification and subsequent measurement (continued)

(a) Debt instruments (continued)

Fair value through other comprehensive income ("FVOCI")

Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at FVPL, are measured at fair value through other comprehensive income. Movements in the carrying amount are taken through other comprehensive income, except for the recognition of impairment, interest revenue and foreign exchange gains and losses which are recognised in profit or loss in the same manner as financial assets measured at amortised cost. On derecognition, cumulative gains and losses previously recognised in other comprehensive income are reclassified from other comprehensive income to profit or loss. Interest income from debt instruments at FVOCI is included in 'interest income' using the effective interest rate method.

Fair value through profit or loss ("FVPL")

Financial assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt instrument that is subsequently measured at FVPL is recognised in profit or loss and included in 'net trading income' in the period in which it arises.

Business model

The business model reflects how the Group manages the assets in order to generate cash flows; that is, whether the Group's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable and they are held for trading purposes, the financial assets are classified and measured at FVPL.

Factors considered by the Group in determining the business model for a group of assets include past experience on how the cash flows for these assets are collected, how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how managers are compensated.

SPPI

Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Group assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the "SPPI test"). In making this assessment, the Group considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement.

(b) Financial liabilities

There will be no impact on the Group's accounting for financial liabilities, as the new requirements only affect the accounting for financial liabilities that are designated at fair value through profit or loss and the Group does not have any such liabilities. The derecognition rules have been transferred from HKAS 39 and have not been changed.

(c) Equity instruments

Equity instruments are instruments that meet the definition of equity from the issuer's perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets.

The Group subsequently measures all equity investments at fair value through profit or loss, except where the Group's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Group's policy is to designate equity investments as FVOCI when those investments are held for purposes other than to generate investment returns. When this election is used, fair value gains and losses are recognised in other comprehensive income and are not subsequently reclassified to profit or loss, including on disposal.

(2) ACCOUNTING POLICIES (CONTINUED)

2.3 Changes in accounting policies on adoption of HKFRS 9 (continued)

2.3.1 Classification and subsequent measurement (continued)

(d) Hedge accounting

The new hedge accounting rules will align the accounting for hedging instruments more closely with the Group's risk management practices. As a general rule, more hedge relationships might be eligible for hedge accounting, as the standard introduces a more principles-based approach. HKFRS 9 provides a choice of accounting policy to be remained with HKAS 39 hedge accounting.

2.3.2 Measurement

At initial recognition, the Group measures financial assets at their fair values plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial assets, such as fees and commissions. Transaction costs of financial assets carried at fair value through profit or loss are expensed in profit or loss. Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payments of principal and interest.

2.3.3 Impairment of amortised cost and financial assets through other comprehensive income

The Group assesses on a forward-looking basis the expected credit losses ("ECL") associated with its debt instrument assets carried at amortised cost and FVOCI and with the exposures arising from loan commitment and financial guarantee contracts. The Group recognises a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

(i) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;

(ii) the time value of money; and

(iii) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecast of future economic conditions.

In general, the Group calculates ECL using three main components, probability of default ("PD"), a loss given default ("LGD") and the exposure at default ("EAD"). The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated using the lifetime PD instead. The 12-month and lifetime PD represent the probability of default occurring over the next 12 months and the remaining maturity of the financial asset respectively.

The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date date to the default event together with any expected drawdowns of committed facilities. The LGD represents expected losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral value at the time it is expected to be realised and the time value of money.

HKFRS 9 introduces a three stage approach to impairment for financial assets that are performing at the date of origination or purchase. This approach is summarised as follows:

– Stage 1: The Group recognises a credit loss allowance at an amount equal to 12-month expected credit losses. This represents the portion of lifetime expected credit losses from default events that are expected within 12 months of the reporting date, assuming that credit risk has not increased significantly after initial recognition.

– Stage 2: The Group recognises a credit loss allowance at an amount equal to lifetime expected credit losses for those financial assets which are considered to have experienced a significant increase in credit risk since initial recognition. Allowances for credit losses are higher in this stage because of an increase in credit risk and the impact of a longer time horizon being considered compared to 12 months in Stage 1.

– Stage 3: The Group recognises a credit loss allowance at an amount equal to lifetime expected credit losses, reflecting that financial assets are credit impaired with 100% probability of default. The Group's definition of default is aligned with the regulatory definition.

(2) ACCOUNTING POLICIES (CONTINUED)

2.3 Changes in accounting policies on adoption of HKFRS 9 (continued)

2.3.4 Critical accounting estimates and judgements

Measurement of the expected credit losses allowances

The measurement of the expected credit losses allowances for financial assets measured at amortised cost and FVOCI is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behaviour (e.g. the likelihood of customers defaulting and the resulting losses). Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in the disclosure information under credit risk management.

A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

– Determining criteria for significant increase in credit risk;

– Choosing appropriate models and assumptions for the measurement of ECL;

– Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and

– Establishing groups of similar financial assets for the purposes of measuring ECL.

Detailed information about the judgements and estimates made by the Group in the above areas is set out in the credit risk management section.

(2) ACCOUNTING POLICIES (CONTINUED)

2.3 Changes in accounting policies on adoption of HKFRS 9 (continued)

2.3.5 Summary of impact upon adoption of HKFRS 9

The following table summarises the classification and measurement impact at 1 January 2018. As a result of the changes in the Group's accounting policies, HKFRS 9 was generally adopted without restating comparative information. The carrying amount of the financial assets and financial liabilities due to changes in their measurements under HKFRS 9 are disclosed as follows:

	At 31 December 2017			**At 1 January 2018**		
	HKAS 39			**HKFRS 9**		**HKFRS 9**
	Measurement category	Carrying amount	**Additional impairment allowances on adoption of HKFRS 9 (*)**	**Carrying amount**	**Measurement category**	**Classification**
		HK$'000	***HK$'000***	***HK$'000***		
Assets						
Cash and balances with banks, central banks and other financial institutions	Amortised cost	31,657,854	**(16,876)**	**31,640,978**	**Amortised cost**	Cash and balances with banks, central banks and other financial institutions
Placements with and advances to banks, and other financial institutions	Amortised cost	47,402,438	**(10,171)**	**47,392,267**	**Amortised cost**	Placements with and advances to banks, and other financial institutions
Financial assets at fair value through profit or loss						Financial assets at fair value through profit or loss ("FVPL")
– Certificate of deposits	FVPL	213,103	**–**	**213,103**	**FVPL**	– Certificate of deposits
– Debt securities	FVPL	815,137	**–**	**815,137**	**FVPL**	– Debt securities
– Investment funds	FVPL	804	**–**	**804**	**FVPL**	– Investment funds
		1,029,044	**–**	**1,029,044**		
Derivative financial instruments	FVPL	4,770,495	**–**	**4,770,495**	**FVPL**	Derivative financial instruments
Loans and advances to customers and other accounts	Amortised cost	198,986,939	**(1,271,624)**	**197,715,315**	**Amortised cost**	Loans and advances to customers and other accounts
Available-for-sale securities ("AFS")						Financial assets at fair value through other comprehensive income ("FVOCI")
– AFS- Debt securities	FVOCI	59,254,976	**–**	**59,254,976**	**FVOCI**	– FVOCI- Debt securities
– AFS- Equity securities	FVOCI	91,701	**–**	**91,701**	**FVOCI**	– FVOCI- Equity securities
		59,346,677	**–**	**59,346,677**		
Total financial assets		343,193,447	**(1,298,671)**	**341,894,776**		
Deferred tax assets		65,841	**225,052**	**290,893**		
Non-financial assets		1,049,396	**–**	**1,049,396**		
Total Assets		344,308,684	**(1,073,619)**	**343,235,065**		
Liabilities						
Deposits and balances of banks and other financial institutions	Amortised cost	(5,187,319)	**–**	**(5,187,319)**	**Amortised cost**	Deposits and balances of banks and other financial institutions
Deposits from customers	Amortised cost	(271,471,865)	**–**	**(271,471,865)**	**Amortised cost**	Deposits from customers
Derivative financial instruments	FVPL	(4,824,483)	**–**	**(4,824,483)**	**FVPL**	Derivative financial instruments
Certificates of deposit issued	Amortised cost	(3,421,769)	**–**	**(3,421,769)**	**Amortised cost**	Certificates of deposit issued
Debt securities issued	Amortised cost	(3,584,064)	**–**	**(3,584,064)**	**Amortised cost**	Debt securities issued
Loan capital	Amortised cost	(6,340,192)	**–**	**(6,340,192)**	**Amortised cost**	Loan capital
Other financial liabilities	Amortised cost	(5,422,626)	**(53,742)**	**(5,476,368)**	**Amortised cost**	Other financial liabilities
Total financial liabilities		(300,252,318)	**(53,742)**	**(300,306,060)**		
Non-financial liabilities	Amortised cost	(499,206)	**–**	**(499,206)**	**Amortised cost**	
Total Liabilities		(300,751,524)	**(53,742)**	**(300,805,266)**		
Equity						
Share capital		(18,404,013)	**–**	**(18,404,013)**		
Reserves		(18,979,895)	**1,127,361**	**(17,852,534)**		
Total shareholders' equity		(37,383,908)	**1,127,361**	**(36,256,547)**		
Additional equity instruments		(6,173,252)	**–**	**(6,173,252)**		
Total Equity		(43,557,160)	**1,127,361**	**(42,429,799)**		
Total Equity and Liabilities		(344,308,684)	**1,073,619**	**(343,235,065)**		

(*) HKFRS 9 expected credit losses have decreased net assets (pre-tax) by HK$1,352,413,000, which mainly included HK$1,271,624,000 reduction in the carrying value of "loans and advances to customers and other accounts", and HK$53,742,000 increase in "provisions" under "other financial liabilities" relating to expected credit losses on loan commitments and financial guarantee contracts.

(2) ACCOUNTING POLICIES (CONTINUED)

2.3 Changes in accounting policies on adoption of HKFRS 9 (continued)

2.3.6 Summary of impact upon adoption of HKFRS 9 – Reserves

The total impact on the Group's reserves at 1 January 2018 from 31 December 2017 is as follows:

	Total *HK$'000*
Reserves at 31 December 2017	**18,979,895**
Changes on initial adoption of HKFRS 9:	
– Increase in ECL allowances for balances with banks and other financial institutions	**(16,876)**
– Increase in ECL allowances for placements with and advances to banks and financial institutions	**(10,171)**
– Increase in ECL allowances for loans and advances to customers and other accounts	**(1,271,624)**
– Increase in ECL provisions for loan commitments and financial guarantee contracts	**(53,742)**
– Increase in deferred tax assets relating to ECL allowances	**225,052**
Adjustment to reserves at 1 January 2018 – HKFRS 9	**(1,127,361)**
Restated opening reserves 1 January 2018 – HKFRS 9	**17,852,534**

(3) SEGMENT REPORTING

Segment information is presented consistently with reportable segments which are regularly reviewed or evaluated internally by the chief operating decision-maker to allocate resources to the segments and to assess their performance. The Group has identified the following four main reportable segments:

Wholesale and cross-border banking business includes wholesale banking business in Hong Kong and overseas branches, and China banking. Wholesale banking mainly comprises corporate lending and syndicated loans, trade financing, deposit account services and cash management. Overseas branches include the management office unit in Hong Kong and the branches operated overseas. China banking mainly includes a subsidiary bank in China.

Personal and business banking mainly comprises deposit account services, residential mortgages, other consumer lending, credit card services and small and medium enterprises ("SMEs") banking business, wealth management services and private banking.

Treasury and markets covers the provision of foreign exchange services, money market activities, the management of investment securities and central cash management.

Others mainly comprises unallocated revenue and expenses, head office and corporate expenses.

For the purpose of segment reporting, the allocation of operating income reflects the benefits of funding resources allocated to the business segments based on the internal funds transfer pricing mechanism. Cost allocation is based on the direct costs incurred by the respective business segments and the apportionment of overheads on a reasonable basis to the business segments. Rental charges at the market rate for the use of bank premises are reflected as inter-segment income for the "Others" segment and inter-segment expenses for the respective business segments.

During the period ended 30 June 2018, the Group has revised certain allocation methods of some income and expenses among different operating units in preparing the information reported to the Group's senior executive management for the purposes of performance assessment. Corresponding amounts have been provided on a basis consistent with the revised segment information.

(3) SEGMENT REPORTING (CONTINUED)

(a) Reportable segments

	Six months ended 30 June 2018				
	Wholesale and cross-border banking *HK$'000*	**Personal and business banking** *HK$'000*	**Treasury and markets** *HK$'000*	**Others** *HK$'000*	**Consolidated** *HK$'000*
Net interest income	1,985,583	867,466	291,551	158,511	3,303,111
Other operating income/(expenses)	557,747	398,620	248,705	(155,822)	1,049,250
Net gain on disposal of financial assets at fair value through other comprehensive income	3,821	–	6,115	–	9,936
Operating income	2,547,151	1,266,086	546,371	2,689	4,362,297
Operating expenses	(276,474)	(385,210)	(58,316)	(897,443)	(1,617,443)
Inter-segment income/(expenses)	(190,061)	(273,130)	(65,637)	528,828	–
Operating profit/(loss) before impairment	2,080,616	607,746	422,418	(365,926)	2,744,854
Expected credit losses on financial assets	(633,029)	(18,595)	(88,074)	(1,332)	(741,030)
Impairment losses on other assets	(32,000)	–	–	–	(32,000)
Operating profit/(loss)	1,415,587	589,151	334,344	(367,258)	1,971,824
Net loss on disposal of property and equipment	–	(527)	–	–	(527)
Revaluation loss on investment properties	–	–	–	(170)	(170)
Profit/(loss) before taxation	1,415,587	588,624	334,344	(367,428)	1,971,127
Income tax	–	–	–	(348,638)	(348,638)
Profit/(loss) for the period	1,415,587	588,624	334,344	(716,066)	1,622,489
Other segment items:					
Depreciation	7,966	7,823	281	84,430	100,500
	At 30 June 2018				
Other segment items:					
Segment assets	165,173,167	50,777,684	162,841,405	(29,522,259)	349,269,997
Segment liabilities	162,083,919	148,275,331	29,057,882	(30,804,468)	308,612,664
Capital expenditure during the period	7,046	24,098	165	47,764	79,073

(3) SEGMENT REPORTING (CONTINUED)

(a) Reportable segments (continued)

	Six months ended 30 June 2017 (Restated)				
	Wholesale and cross-border banking *HK$'000*	Personal and business banking *HK$'000*	Treasury and markets *HK$'000*	Others *HK$'000*	Consolidated *HK$'000*
Net interest income/(expense)	1,705,297	792,587	(103,421)	50,585	2,445,048
Other operating income/(expenses)	740,928	338,724	555,483	(132,020)	1,503,115
Net gain on disposal of available-for-sale securities	–	–	23,978	–	23,978
Operating income/(loss)	2,446,225	1,131,311	476,040	(81,435)	3,972,141
Operating expenses	(262,853)	(362,636)	(48,495)	(813,044)	(1,487,028)
Inter-segment (expenses)/income	(180,716)	(254,585)	(76,070)	511,371	–
Operating profit/(loss) before impairment	2,002,656	514,090	351,475	(383,108)	2,485,113
Impairment losses written-back/(charged) on loans and advances and other accounts	(867,367)	(515)	(12,617)	13,027	(867,472)
Operating profit/(loss)	1,135,289	513,575	338,858	(370,081)	1,617,641
Net gain/(loss) on disposal of property and equipment	13	(689)	–	(3,229)	(3,905)
Revaluation gain on investment properties	–	–	–	7,009	7,009
Profit/(loss) before taxation	1,135,302	512,886	338,858	(366,301)	1,620,745
Income tax	–	–	–	(232,365)	(232,365)
Profit/(loss) for the period	1,135,302	512,886	338,858	(598,666)	1,388,380
Other segment items:					
Depreciation	5,666	8,995	546	68,263	83,470
	At 31 December 2017				
Other segment items:					
Segment assets	169,309,209	46,734,253	154,693,458	(26,428,236)	344,308,684
Segment liabilities	169,622,631	136,958,804	22,065,874	(27,895,785)	300,751,524
Capital expenditure during the year	38,265	10,698	9,050	256,137	314,150

(3) SEGMENT REPORTING (CONTINUED)

(b) Geographical information

The geographical information analysis is based on the location of the principal operations of the subsidiaries, or in the case of the Bank itself, the location of the branches responsible for reporting the results or booking the assets and liabilities.

	Six months ended 30 June			
	2018	2017	**2018**	2017
	Profit/(loss) before taxation	Profit/(loss) before taxation	**Operating income/ (expense)**	Operating income
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*
Hong Kong	**1,864,017**	1,480,744	**3,955,728**	3,620,640
Mainland China	**(65,402)**	(68,081)	**134,997**	89,961
United States	**116,269**	84,808	**140,285**	117,664
Singapore	**47,333**	100,154	**98,559**	122,763
Others	**9,052**	23,104	**32,870**	21,097
Inter-segment items	**(142)**	16	**(142)**	16
	1,971,127	1,620,745	**4,362,297**	3,972,141

	At 30 June 2018	At 31 December 2017	**At 30 June 2018**	At 31 December 2017
	Total assets	Total assets	**Total liabilities**	Total liabilities
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*
Hong Kong	**334,212,620**	323,505,089	**294,212,208**	280,773,786
Mainland China	**11,104,564**	17,592,204	**9,537,388**	15,909,898
United States	**11,069,263**	11,781,864	**10,931,005**	11,593,690
Singapore	**15,099,222**	14,074,332	**15,044,048**	13,840,590
Others	**2,580,729**	2,863,100	**2,562,909**	2,824,018
Inter-segment items	**(24,796,401)**	(25,507,905)	**(23,674,894)**	(24,190,458)
	349,269,997	344,308,684	**308,612,664**	300,751,524

(4) INTEREST INCOME AND INTEREST EXPENSE

(a) Interest income

	Six months ended 30 June	
	2018	2017
	HK$'000	*HK$'000*
Listed securities	**556,487**	314,208
Unlisted securities	**264,114**	197,104
Balances and placements with banks and other financial institutions	**629,289**	312,151
Advances and other accounts *(Note)*	**3,991,292**	3,286,314
Interest income on financial assets that are not at fair value through profit or loss	**5,441,182**	4,109,777

Note:

Included in the above is interest income accrued on impaired financial assets of HK$27,216,000 (six months ended 30 June 2017: HK$21,633,000), which includes interest income of HK$24,764,000 for the six months ended 30 June 2018 (six months ended 30 June 2017: HK$17,606,000) on unwinding of the discount on loan impairment losses.

(4) INTEREST INCOME AND INTEREST EXPENSE (CONTINUED)

(b) Interest expense

	Six months ended 30 June	
	2018	2017
	HK$'000	*HK$'000*
Deposits from customers, banks and other financial institutions and others	**1,809,025**	1,303,509
Certificates of deposit issued	**39,792**	92,277
Debt securities issued	**82,909**	16,145
Loan capital issued	**206,345**	252,798
Interest expense on financial liabilities that are not at fair value through profit or loss	**2,138,071**	1,664,729

(5) NET FEE AND COMMISSION INCOME

	Six months ended 30 June	
	2018	2017
	HK$'000	*HK$'000*
Fee and commission income		
Bills commission	**44,146**	60,605
Card-related income	**18,851**	15,065
General banking services	**59,418**	77,981
Insurance	**188,738**	176,559
Investment and structured investment products	**255,222**	283,303
Loans, overdrafts and facilities fees	**270,284**	418,303
Others	**350**	365
	837,009	1,032,181
Fee and commission expense	**(47,275)**	(34,736)
	789,734	997,445
Of which:		
Net fee and commission income (other than the amounts included in determining the effective interest rate) relating to financial assets and liabilities not at fair value through profit or loss:		
– Fee and commission income	**333,281**	493,973
– Fee and commission expense	**(13,208)**	(11,037)
	320,073	482,936

(6) NET TRADING INCOME

	Six months ended 30 June	
	2018	2017
	HK$'000	*HK$'000*
Gains less losses from dealing in foreign currencies	**262,546**	368,319
Gains less losses from financial assets at fair value through profit or loss	**(24,184)**	(4,840)
Gains less losses from other dealing activities	**(48,804)**	61,087
Net interest income on trading activities		
– Listed	**22,139**	22,347
– Unlisted	**24,017**	36,689
	235,714	483,602

(7) NET HEDGING GAIN/(LOSS)

	Six months ended 30 June 2018 HK$'000	2017 HK$'000
Net hedging gain/(loss) on fair value hedges		
– Net (loss)/gain on hedged items attributable to the hedged risk	**(23,852)**	43,403
– Net gain/(loss) on hedging instruments	**28,196**	(43,293)
	4,344	110
– Net hedging loss on cash flow hedges	**–**	(131)
	4,344	(21)

(8) NET GAIN ON DISPOSAL OF FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME/AVAILABLE-FOR-SALE SECURITIES

	Six months ended 30 June 2018 HK$'000	2017 HK$'000
Net gain on disposal of financial assets at fair value through other comprehensive income		
Net revaluation gain transferred from reserves	**11,120**	–
Net loss arising in current period	**(1,184)**	–
	9,936	–
Net gain on disposal of available-for-sale debt securities		
Net revaluation gain transferred from reserves	**–**	18,839
Net gain arising in current period	**–**	5,139
	–	23,978

(9) OTHER OPERATING INCOME

	Six months ended 30 June 2018 HK$'000	2017 HK$'000
Dividend income		
– Listed investments	**201**	214
– Unlisted investments	**4,160**	4,100
Rental income from investment properties less direct outgoings of HK$150,000 (six months ended 30 June 2017: HK$147,000)	**2,710**	2,634
Others	**12,387**	15,141
	19,458	22,089

(10) OPERATING EXPENSES

		Six months ended 30 June	
		2018	2017
		HK$'000	*HK$'000*
(a)	**Staff costs**		
	Salaries and other staff costs	**981,123**	909,921
	Retirement costs	**53,456**	50,510
		1,034,579	960,431
(b)	**Depreciation**		
	Depreciation of property and equipment		
	– Assets held for use under operating leases	**9,528**	9,680
	– Other assets	**90,972**	73,790
		100,500	83,470
(c)	**Other operating expenses**		
	Property and equipment expenses (excluding depreciation) *(Note)*		
	– Rental of properties	**151,495**	135,784
	– Others	**135,361**	119,580
	Auditors' remuneration	**4,031**	4,027
	Advertising	**26,723**	16,413
	Communication, printing and stationery	**53,780**	47,338
	Legal and professional fees	**25,168**	23,245
	Others	**85,806**	96,740
		482,364	443,127
Total operating expenses		**1,617,443**	1,487,028

Note:

Included in other operating expenses are the minimum lease payments under operating leases of HK$2,904,000 (six months ended 30 June 2017: HK$2,599,000) for renting equipment, and HK$144,581,000 (six months ended 30 June 2017: HK$129,690,000) for renting property and other assets for the six months ended 30 June 2018.

(11) EXPECTED CREDIT LOSSES ON FINANCIAL ASSETS/IMPAIRMENT LOSSES ON LOANS AND ADVANCES AND OTHER ACCOUNTS

(a) Expected credit losses ("ECL") charged/(written back) on financial assets

	Six months ended 30 June 2018			
	Stage 1 ***HK$'000***	**Stage 2** ***HK$'000***	**Stage 3** ***HK$'000***	**Total** ***HK$'000***
Balances with banks, central banks and other financial institutions	**(39)**	**–**	**–**	**(39)**
Placements with and advances to banks, central banks and other financial institutions	**(5,309)**	**–**	**–**	**(5,309)**
Loans and advances to customers	**(170,569)**	**519,860**	**350,309**	**699,600**
Other accounts	**(1,006)**	**(372)**	**7,762**	**6,384**
Financial assets at fair value through other comprehensive income	**(33,977)**	**30,072**	**77,916**	**74,011**
Loan commitments and guarantees (included in contingent liabilities and commitments)	**187**	**–**	**–**	**187**
	(210,713)	**549,560**	**435,987**	**774,834**
Recoveries				**(33,804)**
				741,030

(11) EXPECTED CREDIT LOSSES ON FINANCIAL ASSETS/IMPAIRMENT LOSSES ON LOANS AND ADVANCES AND OTHER ACCOUNTS (CONTINUED)

(b) Impairment losses on loans and advances and other accounts

	Six months ended 30 June 2017 *HK$'000*
Impairment losses	
– Loans and advances	854,779
– Other accounts	12,693
	867,472
Impairment losses charged on loans and advances and other accounts	
– Individual assessment	801,766
– Collective assessment	65,706
	867,472
of which:	
– Additions	1,020,859
– Releases	(135,747)
– Recoveries	(17,640)
	867,472

(12) INCOME TAX IN THE CONSOLIDATED INCOME STATEMENT

	Six months ended 30 June	
	2018 ***HK$'000***	2017 *HK$'000*
Current tax – Hong Kong Profits Tax		
Provision for the period	**365,594**	220,204
Over-provision in respect of prior periods	**–**	(14,000)
	365,594	206,204
Current tax – Overseas		
Provision for the period	**46,544**	14,645
Under-provision in respect of prior periods	**3,388**	20,727
	49,932	35,372
Deferred tax		
Reversal of temporary differences *(note 25(b))*	**(66,888)**	(9,211)
	348,638	232,365

Taxes on income in the interim periods are accrued using the tax rate that would be applicable to expected total annual earnings.

The provision for Hong Kong Profits Tax is calculated at 16.5% (six months ended 30 June 2017: 16.5%) of the estimated assessable profits for the period. Taxation for overseas branches and subsidiaries is charged at the appropriate current rates of taxation in the relevant countries.

(13) DIVIDEND PAID

The final dividend of HK$2,808,437,000 in respect of 2017 was approved and paid during the period ended 30 June 2018 (30 June 2017: Nil).

(14) CASH AND BALANCES WITH BANKS, CENTRAL BANKS AND OTHER FINANCIAL INSTITUTIONS

	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
Cash in hand	**233,453**	294,775
Balances with central banks	**2,198,726**	4,626,082
Balances with banks	**10,347,232**	18,674,413
Balances with other financial institutions	**6,650,069**	8,062,584
	19,429,480	31,657,854
Expected credit losses allowances – Stage 1	**(16,837)**	–
	19,412,643	31,657,854

Included in the balances with central banks are balances subject to exchange control or regulatory restrictions, amounting to HK$591,117,000 at 30 June 2018 (31 December 2017: HK$956,962,000).

There were no impaired balances with banks and other financial institutions at 30 June 2018 and at 31 December 2017.

(15) PLACEMENTS WITH AND ADVANCES TO BANKS, CENTRAL BANKS AND OTHER FINANCIAL INSTITUTIONS

	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
Placements with banks	**44,508,156**	46,898,050
Advances to banks	**2,603,702**	504,388
	47,111,858	47,402,438
Expected credit losses allowances – Stage 1	**(4,862)**	–
	47,106,996	47,402,438
Maturing:		
– Within 1 month	**42,746,442**	34,613,848
– Between 1 month and 1 year	**4,360,554**	12,788,590
	47,106,996	47,402,438

There were no impaired advances to banks and other financial institutions at 30 June 2018 and at 31 December 2017.

(16) FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	At 30 June 2018 HK$'000	At 31 December 2017 HK$'000
Certificate of deposits	–	213,103
Debt securities	**921,605**	815,137
Investment funds	**580**	804
	922,185	1,029,044
Issued by:		
Sovereigns	**703**	572
Banks and other financial institutions	**571,631**	829,164
Corporate entities	**349,851**	199,308
	922,185	1,029,044
Listed	**725,037**	1,020,468
Unlisted	**197,148**	8,576
	922,185	1,029,044

(17) DERIVATIVE FINANCIAL INSTRUMENTS

(a) Notional amounts of derivatives

Derivatives refer to financial contracts whose value depends on the value of one or more underlying assets or index. The notional amounts of these instruments indicate the volume of outstanding transactions and do not represent amounts at risk.

The following is a summary of the notional amounts of each significant type of derivative entered into by the Group:

	At 30 June 2018			At 31 December 2017		
	Held for hedging HK$'000	**Others (including held for trading) HK$'000**	**Total HK$'000**	Held for hedging HK$'000	Others (including held for trading) HK$'000	Total HK$'000
Currency derivatives						
Forwards	–	**92,639,261**	**92,639,261**	–	64,036,378	64,036,378
Swaps	–	**723,679,859**	**723,679,859**	–	455,766,010	455,766,010
Options purchased	–	**16,461,831**	**16,461,831**	–	17,431,861	17,431,861
Options written	–	**17,312,770**	**17,312,770**	–	17,000,340	17,000,340
Interest rate derivatives						
Forwards/Futures	–	**7,571,181**	**7,571,181**	–	6,490,462	6,490,462
Swaps	**9,718,101**	**118,943,646**	**128,661,747**	11,767,566	63,403,485	75,171,051
Options purchased	–	–	–	–	1,000,000	1,000,000
Options written	–	–	–	–	1,078,151	1,078,151
	9,718,101	**976,608,548**	**986,326,649**	11,767,566	626,206,687	637,974,253

Trading includes the Group's proprietary positions in financial instruments, positions which arise from the execution of trade orders from customers and market making, and positions taken in order to hedge other elements of the trading book.

(17) DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

(b) Fair values and credit risk-weighted amounts of derivatives

	At 30 June 2018			At 31 December 2017		
	Fair value assets *HK$'000*	**Fair value liabilities** *HK$'000*	**Credit risk-weighted amount** *HK$'000*	Fair value assets *HK$'000*	Fair value liabilities *HK$'000*	Credit risk-weighted amount *HK$'000*
Currency derivatives	**8,860,968**	**8,725,572**	**9,087,660**	4,511,710	4,705,217	5,405,671
Interest rate derivatives	**444,861**	**296,259**	**140,639**	258,785	119,266	152,750
	9,305,829	**9,021,831**	**9,228,299**	4,770,495	4,824,483	5,558,421

The credit risk-weighted amount is the amount calculated in accordance with the Banking (Capital) Rules on capital adequacy and it depends on the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 150% (31 December 2017: 0% to 150%) for contingent liabilities and commitments, and from 0% to 150% (31 December 2017: 0% to 150%) for exchange rate, interest rate and other derivatives contracts.

The Group did not enter into any bilateral netting arrangement during the period, and accordingly, these amounts are shown on a gross basis.

(c) Fair value of derivatives designated as hedging instruments

The following is a summary of the fair value of derivatives held for hedging purposes by product type entered into by the Group:

	At 30 June 2018		At 31 December 2017	
	Fair value assets *HK$'000*	**Fair value liabilities** *HK$'000*	Fair value assets *HK$'000*	Fair value liabilities *HK$'000*
Interest rate contracts				
– Fair value hedge	**173,961**	**19,384**	147,493	21,811

Fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of certain fixed rate assets or liabilities due to movements in the market interest rates.

(d) Remaining life of derivatives

The following tables provide an analysis of the notional amounts of the Group's derivatives by relevant maturity grouping, based on the remaining periods to settlement at the end of the reporting period:

	At 30 June 2018 Notional amounts with remaining life of			
	Total *HK$'000*	**1 year or less** *HK$'000*	**Over 1 year to 5 years** *HK$'000*	**Over 5 years** *HK$'000*
Currency derivatives	**850,093,721**	**817,433,792**	**32,659,929**	**–**
Interest rate derivatives	**136,232,928**	**84,257,292**	**48,760,269**	**3,215,367**
	986,326,649	**901,691,084**	**81,420,198**	**3,215,367**

	At 31 December 2017 Notional amounts with remaining life of			
	Total *HK$'000*	1 year or less *HK$'000*	Over 1 year to 5 years *HK$'000*	Over 5 years *HK$'000*
Currency derivatives	554,234,589	531,212,264	22,835,977	186,348
Interest rate derivatives	83,739,664	44,272,259	36,619,831	2,847,574
	637,974,253	575,484,523	59,455,808	3,033,922

(18) LOANS AND ADVANCES TO CUSTOMERS AND OTHER ACCOUNTS

(a) Loans and advances to customers and other accounts less expected credit losses/impairment allowances

	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
Gross loans and advances to customers	**199,892,556**	196,286,922
– Expected credit losses allowances	**(2,411,281)**	–
– Individually assessed impairment allowances	**–**	(1,127,014)
– Collectively assessed impairment allowances	**–**	(395,843)
	197,481,275	194,764,065
Other accounts	**6,086,894**	4,325,352
– Expected credit losses allowances	**(38,672)**	–
– Individually assessed impairment allowances	**(32,000)**	(102,478)
	6,016,222	4,222,874
	203,497,497	198,986,939

(b) Loans and advances to customers analysed by industry sectors

The following economic sector analysis is based on the categories and definitions used by the HKMA.

	At 30 June 2018		At 31 December 2017	
	Gross loans and advances to customers *HK$'000*	**% of gross loans and advances to customers covered by collateral**	Gross loans and advances to customers *HK$'000*	% of gross loans and advances to customers covered by collateral
Industrial, commercial and financial				
– Property development	**1,086,535**	**66**	17,177,318	19
– Property investment	**14,574,522**	**90**	26,312,638	65
– Financial concerns	**17,932,087**	**25**	16,250,264	26
– Stockbrokers	**4,958,373**	**18**	6,564,251	20
– Wholesale and retail trade	**11,822,821**	**82**	14,236,238	80
– Manufacturing	**14,911,200**	**25**	17,020,091	24
– Transport and transport equipment	**2,156,979**	**21**	2,356,396	23
– Recreational activities	**3,870,360**	**18**	813,764	61
– Information technology	**6,381,041**	**5**	221,297	100
– Others	**10,964,893**	**87**	10,155,897	75
Individuals				
– Loans for the purchase of flats under the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	**23,358**	**100**	24,255	100
– Loans for the purchase of other residential properties	**14,677,827**	**100**	14,439,796	100
– Credit card advances	**489,699**	**–**	503,789	–
– Others	**10,786,896**	**90**	8,950,693	88
Gross loans and advances for use in Hong Kong	**114,636,591**	**59**	135,026,687	54
Trade finance	**5,040,752**	**33**	6,564,657	32
Gross loans and advances for use outside Hong Kong	**80,215,213**	**30**	54,695,578	31
Gross loans and advances to customers	**199,892,556**	**47**	196,286,922	47

(18) LOANS AND ADVANCES TO CUSTOMERS AND OTHER ACCOUNTS (CONTINUED)

(c) Reconciliation of gross carrying amount and ECL allowances for loans and advances to customers

	At 30 June 2018							
	Stage 1		Stage 2		Stage 3		Total	
	Gross carrying amount *HK$'000*	ECL allowances *HK$'000*	Gross carrying amount *HK$'000*	ECL allowances *HK$'000*	Gross carrying amount *HK$'000*	ECL allowances *HK$'000*	Gross carrying amount *HK$'000*	ECL allowances *HK$'000*
At 1 January 2018	**186,086,640**	**875,989**	**7,736,270**	**739,345**	**2,464,012**	**1,176,687**	**196,286,922**	**2,792,021**
Transfer:								
– Transfer to Stage 1	**266,460**	**22,381**	**(266,460)**	**(22,381)**	**–**	**–**	**–**	**–**
– Transfer to Stage 2	**(6,415,350)**	**(69,637)**	**6,415,590**	**69,876**	**(240)**	**(239)**	**–**	**–**
– Transfer to Stage 3	**(161,650)**	**(1,129)**	**(262,880)**	**(287)**	**424,530**	**1,416**	**–**	**–**
Net remeasurement of ECL allowances arsing from transfer between stage transfer	**–**	**(20,510)**	**–**	**635,881**	**–**	**94,441**	**–**	**709,812**
New financial assets originated or purchased	**66,437,850**	**317,026**	**3,379,950**	**30,252**	**2,010**	**2,006**	**69,819,810**	**349,284**
Financial assets derecognised or repaid during the period	**(62,880,182)**	**(136,004)**	**(1,692,874)**	**(68,130)**	**(585,544)**	**(12,752)**	**(65,158,600)**	**(216,886)**
Changes in PDs/ LGDs/EADs	**–**	**(237,788)**	**–**	**(125,351)**	**–**	**265,437**	**–**	**(97,702)**
Changes in other model inputs	**–**	**(44,908)**	**–**	**–**	**–**	**–**	**–**	**(44,908)**
Unwinding of discount on loan impairment losses *(Note 4(a))*	**–**	**–**	**–**	**–**	**–**	**(24,764)**	**–**	**(24,764)**
Amounts written-off	**(880)**	**(880)**	**(400)**	**(400)**	**(1,054,296)**	**(1,054,296)**	**(1,055,576)**	**(1,055,576)**
At 30 June 2018	**183,332,888**	**704,540**	**15,309,196**	**1,258,805**	**1,250,472**	**447,936**	**199,892,556**	**2,411,281**

The following impairment movement disclosures on loans and advances to customers were included in the 2017 interim/annual reports and do not reflect the adoption of HKFRS 9. Therefore, these impairment movement summary cannot directly comparable to the above 2018 current disclosures on an HKFRS 9 basis.

	At 31 December 2017		
	Individually assessed *HK$'000*	Collectively assessed *HK$'000*	Total *HK$'000*
Impairment allowances at 1 January 2017	627,498	322,864	950,362
Impairment losses charged to the income statement	940,267	67,894	1,008,161
Impairment losses released to the income statement	(151,194)	(2,188)	(153,382)
Amounts written off	(213,017)	(10,115)	(223,132)
Recoveries of loans and advances written off in previous year	15,452	2,188	17,640
Unwinding of discount on loan impairment losses *(Note 4(a))*	(17,606)	–	(17,606)
Impairment allowances at 30 June 2017	1,201,400	380,643	1,582,043
Impairment allowances at 1 July 2017	1,201,400	380,643	1,582,043
Impairment losses charged to the income statement	532,108	24,390	556,498
Impairment losses released to the income statement	(47,527)	(1,878)	(49,405)
Amounts written off	(544,574)	(9,190)	(553,764)
Recoveries of loans and advances written off in previous year	4,873	1,878	6,751
Unwinding of discount on loan impairment losses	(19,266)	–	(19,266)
Impairment allowances at 31 December 2017	1,127,014	395,843	1,522,857

(18) LOANS AND ADVANCES TO CUSTOMERS AND OTHER ACCOUNTS (CONTINUED)

(d) Impaired loans and advances to customers

	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
Gross impaired loans and advances to customers	**1,250,472**	2,464,012
Expected credit losses allowances – Stage 3	**(447,936)**	–
Individually assessed impairment allowances	**–**	(1,127,014)
	802,536	1,336,998
Gross impaired loans and advances as a % of total loans and advances to customers	**0.63%**	1.26%

Collateral amounts of HK$998,932,000 (31 December 2017: HK$812,652,000) have been taken into account in respect of the assessment of the expected credit loss allowances (2017: individually assessed allowances) on impaired loans and advances to customers. Collateral mainly comprises mortgages on residential or commercial properties and cash placed with the Group.

An analysis of impaired loans and advances to customers by individual loan usage, which accounted for 10% or more of the gross loans and advances to customers, is as follows:

	At 30 June 2018			
	Stage 1 ECL allowances *HK$'000*	**Stage 2 ECL allowances** *HK$'000*	**Stage 3 ECL allowances** *HK$'000*	**Impaired loans and advances to customers** *HK$'000*
Gross loans and advances for use outside Hong Kong	**410,864**	**449,903**	**380,918**	**1,105,010**

	31 December 2017		
	Individual impairment allowances *HK$'000*	Collective impairment allowances *HK$'000*	Impaired loans and advances to customers *HK$'000*
Gross loans and advances for use in Hong Kong:			
– Property investment	9	720	23,111
Gross loans and advances for use outside Hong Kong	729,479	106,013	1,355,216
	729,488	106,733	1,378,327

(19) FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME/AVAILABLE-FOR-SALE SECURITIES

	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
Financial assets at fair value through other comprehensive income		
Certificates of deposit held	**13,770,850**	–
Debt securities	**40,234,879**	–
Treasury bills (including Exchange Fund Bills)	**13,483,553**	–
Financial assets at fair value through other comprehensive income – Debt securities	**67,489,282**	–
Financial assets at fair value through other comprehensive income – Equity securities	**92,918**	–
	67,582,200	–

	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
Available-for-sale securities		
Certificates of deposit held	**–**	10,622,679
Debt securities	**–**	36,950,662
Treasury bills (including Exchange Fund Bills)	**–**	11,681,635
Available-for-sale securities – Debt securities	**–**	59,254,976
Available-for-sale securities – Equity securities	**–**	91,701
	–	59,346,677
Issued by:		
Sovereigns	**13,793,843**	12,796,288
Banks and other financial institutions	**40,469,499**	36,553,639
Corporate entities	**11,223,774**	8,614,579
Public entities	**2,095,084**	1,382,171
	67,582,200	59,346,677
Listed	**35,138,030**	32,193,830
Unlisted	**32,444,170**	27,152,847
	67,582,200	59,346,677

At 30 June 2018, the fair value of individually impaired debt securities was HK$44,851,000 (31 December 2017: HK$125,042,000).

(20) PROPERTY AND EQUIPMENT

	Investment properties *HK$'000*	Other premises *HK$'000*	Furniture, fixtures and equipment *HK$'000*	Computer equipment *HK$'000*	Total *HK$'000*
Cost or valuation:					
At 1 January 2018	**132,780**	**709,009**	**1,009,544**	**767,332**	**2,618,665**
Additions	**–**	**–**	**58,215**	**20,858**	**79,073**
Disposals	**–**	**–**	**(16,572)**	**(32)**	**(16,604)**
Deficit on revaluation	**(170)**	**–**	**–**	**–**	**(170)**
Exchange adjustments	**–**	**–**	**(862)**	**(750)**	**(1,612)**
At 30 June 2018	**132,610**	**709,009**	**1,050,325**	**787,408**	**2,679,352**
At 1 January 2017	138,490	689,009	961,215	527,868	2,316,582
Additions	–	–	69,166	244,984	314,150
Reclassification	(20,000)	20,000	–	–	–
Disposals	–	–	(29,813)	(5,520)	(35,333)
Surplus on revaluation	14,290	–	–	–	14,290
Exchange adjustments	–	–	8,976	–	8,976
At 31 December 2017	132,780	709,009	1,009,544	767,332	2,618,665
Accumulated depreciation:					
At 1 January 2018	**–**	**335,909**	**821,208**	**441,199**	**1,598,316**
Charge for the period *(note 10(b))*	**–**	**8,356**	**44,071**	**48,073**	**100,500**
Written back on disposals	**–**	**–**	**(16,045)**	**(32)**	**(16,077)**
Exchange adjustments	**–**	**–**	**(715)**	**(715)**	**(1,430)**
At 30 June 2018	**–**	**344,265**	**848,519**	**488,525**	**1,681,309**
At 1 January 2017	–	319,530	758,550	342,626	1,420,706
Charge for the year	–	16,379	83,384	100,903	200,666
Written back on disposals	–	–	(28,891)	(2,330)	(31,221)
Exchange adjustments	–	–	8,165	–	8,165
At 31 December 2017	–	335,909	821,208	441,199	1,598,316
Net book value:					
At 30 June 2018	**132,610**	**364,744**	**201,806**	**298,883**	**998,043**
At 31 December 2017	132,780	373,100	188,336	326,133	1,020,349

Investment properties

All investment properties of the Group were revalued and assessed by the management of the Group at 30 June 2018 with reference to a property valuation report which was conducted by an independent firm of surveyors. The basis of the property valuation was market value, which is consistent with the definition of fair value under HKFRS 13, Fair value measurement. The revaluation loss of HK$170,000 (year ended 31 December 2017: a revaluation gain of HK$14,290,000) was recognised and charged to the income statement for the period ended 30 June 2018.

(21) DEPOSITS AND BALANCES OF BANKS AND OTHER FINANCIAL INSTITUTIONS

	At 30 June 2018	At 31 December 2017
	HK$'000	*HK$'000*
Deposits and balances from banks	**5,383,446**	5,187,319

(22) DEPOSITS FROM CUSTOMERS

	At 30 June 2018	At 31 December 2017
	HK$'000	*HK$'000*
Demand deposits and current deposits	**26,504,241**	37,989,050
Savings deposits	**52,577,325**	60,305,655
Time, call and notice deposits	**191,773,726**	173,177,160
	270,855,292	271,471,865

(23) CERTIFICATES OF DEPOSIT ISSUED

	At 30 June 2018	At 31 December 2017
	HK$'000	*HK$'000*
At amortised cost	**3,138,313**	3,421,769

(24) DEBT SECURITIES ISSUED

	At 30 June 2018	At 31 December 2017
	HK$'000	*HK$'000*
At amortised cost	**3,542,230**	3,584,064

The debt securities were issued by the Bank in 2017, bear a coupon interest rate at 4.4% per annum and will mature in 2020.

(25) INCOME TAX IN THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(a) Current taxation in the consolidated statement of financial position represents:

	At 30 June 2018	At 31 December 2017
	HK$'000	*HK$'000*
Hong Kong Profits Tax	**351,357**	461,736
Overseas Taxation	**26,571**	6,792
	377,928	468,528
Of which:		
Tax recoverable	**(1,701)**	(29,047)
Current tax liabilities	**379,629**	497,575
	377,928	468,528

(25) INCOME TAX IN THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)

(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 period are as follows:

	Depreciation allowances in excess of related depreciation *HK$'000*	Impairment allowances for loans and advances *HK$'000*	Revaluation adjustments for properties *HK$'000*	Revaluation adjustments for FVOCI/ available-for-sale securities *HK$'000*	Others *HK$'000*	Total *HK$'000*
Deferred tax arising from:						
At 1 January 2018	**65,786**	**(99,394)**	**1,639**	**(20,463)**	**(11,778)**	**(64,210)**
Changes on initial adoption of HKFRS 9	**–**	**(209,483)**	**–**	**(15,569)**	**–**	**(225,052)**
Restated deferred tax at the beginning of the financial year	**65,786**	**(308,877)**	**1,639**	**(36,032)**	**(11,778)**	**(289,262)**
Charged/(credited) to consolidated income statement *(note 12)*	**(1,586)**	**(74,967)**	**6,630**	**–**	**3,035**	**(66,888)**
Credited to reserves	**–**	**–**	**–**	**(78,353)**	**–**	**(78,353)**
Exchange and other adjustments	**14**	**(203)**	**–**	**–**	**50**	**(139)**
At 30 June 2018	**64,214**	**(384,047)**	**8,269**	**(114,385)**	**(8,693)**	**(434,642)**
At 1 January 2017	45,017	(51,568)	1,525	(12,815)	1,144	(16,697)
Charged/(credited) to consolidated income statement	20,819	(47,878)	114	–	(12,691)	(39,636)
Credited to reserves	–	–	–	(7,648)	(211)	(7,859)
Exchange and other adjustments	(50)	52	–	–	(20)	(18)
At 31 December 2017	65,786	(99,394)	1,639	(20,463)	(11,778)	(64,210)

	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
Net deferred tax assets recognised in the consolidated statement of financial position	**(442,903)**	(65,841)
Net deferred tax liabilities recognised in the consolidated statement of financial position	**8,261**	1,631
	(434,642)	(64,210)

(c) Deferred tax assets not recognised

The Group has not recognised deferred tax assets in respect of cumulative tax losses of HK$694,000 at 30 June 2018 (31 December 2017: HK$686,000), as it is improbable that future taxable profits against which the losses can be utilised will be available in the relevant tax jurisdiction and entity. The tax losses do not expire under the current tax legislation.

(26) OTHER LIABILITIES

	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
Accruals and other payables and provisions	**9,996,563**	5,422,626

At 30 June 2018, included above is the provision for expected credit losses (Stage 1) on loan commitments and guarantees amounted to HK$53,931,000.

(27) LOAN CAPITAL

	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
Subordinated notes, at amortised cost with fair value hedge adjustments:		
US$500 million Subordinated Fixed Rate Notes at 6.875%, due 2020*	**3,953,994**	4,009,985
US$300 million Subordinated Fixed Rate Notes at 6.000%, due 2024**	**2,333,105**	2,330,207
	6,287,099	6,340,192

* Under a US$2 billion Medium Term Note Programme ("the Programme") issued in December 2007 and the new Offering Circular issued in June 2010, the Bank issued subordinated fixed rate notes on 24 June 2010 with a face value of US$500 million (equivalent to HK$3,888.9 million). The notes bear an interest rate of 6.875% per annum, payable semi-annually. The notes are listed on the Singapore Exchange Securities Trading Limited and mature on 24 June 2020.

** Under the Programme and the new Offering Circular issued in October 2013, the Bank issued subordinated notes on 7 November 2013 with a face value of US$300 million (equivalent to HK$2,325.8 million) and which qualified as Basel III-compliant Tier-2 capital. The notes bear interest at a fixed rate of 6.000% per annum, payable semi-annually until 7 May 2019, and thereafter fixed at the interest rate of the prevailing five-year US Treasury bonds yield plus 4.718% per annum if the notes are not redeemed on the call date. The notes are listed on The Stock Exchange of Hong Kong Limited and mature on 7 May 2024 with an optional redemption date falling on 7 May 2019.

(28) CAPITAL AND RESERVES

(a) Share capital

(i) Ordinary shares

	At 30 June 2018		At 31 December 2017	
	No. of shares	***HK$'000***	*No. of shares*	*HK$'000*
Ordinary shares, issued and fully paid:				
At 1 January	**12,111,121,568**	**18,404,013**	9,083,341,176	9,366,271
Shares issued during the year	**–**	**–**	3,027,780,392	9,053,063
	12,111,121,568	**18,404,013**	12,111,121,568	18,419,334
Less: Transaction costs arising on shares issued	**–**	**–**	–	(15,321)
At 30 June/31 December	**12,111,121,568**	**18,404,013**	12,111,121,568	18,404,013

(ii) Dividend

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings of the Bank. All ordinary shares rank equally with regard to the Bank's residual assets.

(28) CAPITAL AND RESERVES (CONTINUED)

(b) Nature and purpose of components of reserves

(i) Capital reserve

The capital reserve is not available for distribution to shareholders.

(ii) General reserve

The general reserve was set up from the transfer of retained earnings, and it is available for distribution to shareholders.

(iii) Exchange differences reserve

The exchange differences reserve comprises all foreign exchange differences arising from the translation of the financial statement of foreign operations.

(iv) Property revaluation reserve

The property revaluation reserve is not available for distribution to shareholders because it does not constitute realised profits within the meaning of Part 6 of the new Hong Kong Companies Ordinance (Cap. 622).

(v) Cash flow hedging reserve

The cash flow hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions.

(vi) Investment revaluation reserve

The investment revaluation reserve comprises the cumulative net change in the fair value of financial assets at fair value through other comprehensive income/available-for-sale securities held at the end of the reporting period.

(vii) Statutory reserve

Under the relevant legislation of Mainland China, the Bank's wholly-owned PRC subsidiary bank, CITIC Bank International (China) Limited ("CBI (China)") is required to transfer 10% of its profit after taxation to a non-distributable statutory reserve until such reserve has reached 50% of its registered share capital.

(viii) Regulatory general reserve

Pursuant to the banking regulations of Mainland China, CBI (China) is required to set up a regulatory general reserve through a direct transfer from the current year's profit appropriation, as determined based on 1% of the total risk assets at the end of the reporting period to cover its unidentified potential loss exposures. The regulatory general reserve forms part of the equity of the Group.

(ix) Retained profits

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 impairment losses which the Bank will or may incur on loans and advances. Movements in the reserve are earmarked directly through retained profits and in consultation with the HKMA. At 30 June 2018, HK$1,124,748,000 (31 December 2017: HK$2,814,520,000) was included in retained profits in this respect, which is distributable to equity holders of the Bank subject to consultation with the HKMA.

(29) ADDITIONAL EQUITY INSTRUMENTS

	At 30 June 2018	At 31 December 2017
	HK$'000	*HK$'000*
Undated non-cumulative subordinated capital securities of US$300 million*	**2,310,168**	2,310,168
Undated non-cumulative subordinated capital securities of US$500 million**	**3,863,084**	3,863,084
	6,173,252	6,173,252

* Under a US$2 billion Medium Term Note Programme ("the Programme") issued in December 2007 and the new Offering Circular issued in April 2014, the Bank issued Basel III compliant Undated Non-Cumulative Subordinated Additional Tier 1 Capital Securities (the "AT1 Capital Securities") on 22 April 2014 with a face value of US$300 million (equivalent to HK$2,313.47 million). The AT1 Capital Securities are perpetual and listed on The Stock Exchange of Hong Kong Limited, and bear a coupon of 7.250% per annum for the first 5 years from the date of issue to the optional redemption date falling on 22 April 2019. The coupon will be reset every five years, if the AT1 Capital Securities are not redeemed, at a fixed rate equivalent to the then-prevailing five-year US Treasury rate plus 5.627% per annum.

According to the terms and conditions, the AT1 Capital Securities confer a right to receive non-cumulative distributions (each a Distribution) on the principal amount (subject to adjustments following the occurrence of a non-viability event as defined) from, and including, the issue date at the applicable distribution rate, payable semi-annually in arrears on 22 April and 22 October each year. The Bank may, at its sole discretion, elect to cancel the distribution payment or redeem the AT1 Capital Securities, which are subject to prior written consent of the HKMA. A distribution payment of US$10,875,000 (equivalent to HK$85,373,000) was paid during the period ended 30 June 2018 (for the year ended 31 December 2017: US$21,750,000, equivalent to HK$169,426,000).

** Under a US$2 billion Medium Term Note Programme ("the Programme") issued in December 2007 and the new and supplemental offering circulars issued in August and September 2016, respectively, the Bank priced its US$500 million Basel III compliant Undated Non-Cumulative Subordinated Additional Tier 1 Capital Securities ("AT1 Capital Securities") with the legal binding subscription agreements signed on 29 September 2016. The AT1 Capital Securities with a face value and principal amount of US$500 million (equivalent to HK$3,877.86 million) are perpetual and listed on The Stock Exchange of Hong Kong Limited, and bear a coupon of 4.25% per annum for the first 5 years from the date of issue to the optional redemption date falling on 11 October 2021. The distribution rate will be reset every five years if the AT1 Capital Securities are not called by the Bank at a fixed rate equivalent to the then-prevailing five-year US Treasury rate plus 3.107% per annum.

According to the terms and conditions, the AT1 Capital Securities confer a right to the holders to receive non-cumulative distributions on the principal amount from, and including, the issue date at the applicable distribution rate, payable semi-annually in arrears on 11 April and 11 October in each year. The Bank may, at its sole discretion, elect to cancel the distribution payment or redeem the AT1 Capital Securities subject to prior written consent of the HKMA. The outstanding amount of AT1 Capital Securities can be written down by the Bank following the occurrence of a non-viability event as defined and set out in the terms and conditions. At the sole discretion of the relevant Hong Kong Resolution Authority following a non-viability event, the outstanding amount of AT1 Capital Securities can be adjusted upon the exercise of Hong Kong Bail-in Power in accordance with the Hong Kong Financial Institutions (Resolution) Ordinance (Cap.628). A distribution payment of US$10,625,000 (equivalent to HK$83,411,000) was paid during the period ended 30 June 2018 (for the year ended 31 December 2017: US$21,250,000, equivalent to HK$165,532,000).

(30) NOTES TO CONSOLIDATED CASH FLOWS STATEMENT

	At 30 June 2018 *HK$'000*	At 30 June 2017 *HK$'000*
(a) Reconciliation of operating profit to net cash flows from operating activities		
Operating activities		
Profit before taxation	**1,971,127**	1,620,745
Adjustments for non-cash items:		
Expected credit losses on financial assets	**741,030**	–
Impairment losses on loans and advances and other accounts	**–**	867,472
Impairment losses on other assets	**32,000**	–
Net gain on disposal of financial assets at fair value through other comprehensive income	**(9,936)**	–
Net gain on disposal of available-for-sale securities	**–**	(23,978)
Net loss on disposal of property and equipment	**527**	3,905
Revaluation loss/(gain) on investment properties	**170**	(7,009)
Amortisation of deferred expenses	**17,464**	7,492
Depreciation on property and equipment	**100,500**	83,470
Dividend income from equity securities	**(4,361)**	(4,314)
Interest expense on loan capital and debt securities issued	**289,254**	252,798
Foreign exchange differences	**(28,019)**	181,095
Operating profit before changes in working capital	**3,109,756**	2,981,676
(Increase)/decrease in operating assets		
Placements with and advances to banks, central banks and other financial institutions with original maturity beyond 3 months	**266,523**	3,447,557
Treasury bills with original maturity beyond 3 months	**(1,291,458)**	2,156,835
Certificates of deposit held with original maturity beyond 3 months	**(2,970,238)**	2,130,788
Derivative financial instruments	**(4,428,475)**	2,061,401
Loans and advances to customers and other accounts	**(6,498,981)**	(11,432,027)
Financial assets at fair value through other comprehensive income	**(3,824,722)**	–
Available-for-sale securities	**–**	(1,215,407)
	(18,747,351)	(2,850,853)
Increase/(decrease) in operating liabilities		
Deposits and balances of banks and other financial institutions	**196,127**	1,144,384
Deposits from customers	**(616,764)**	17,333,257
Derivative financial instruments	**4,197,348**	(850,191)
Certificates of deposit issued	**(374,435)**	56,399
Other liabilities	**4,596,630**	(1,635,556)
	7,998,906	16,048,293
Cash flows (used in)/generated from operating activities	**(7,638,689)**	16,179,116
Income tax paid		
Hong Kong Profits Tax paid	**(475,973)**	(80,162)
Overseas tax paid	**(29,396)**	(17,201)
Net cash flows (used in)/generated from operating activities	**(8,144,058)**	16,081,753
Cash flows from operating activities include:		
Interest received	**5,202,452**	4,075,040
Interest paid	**(1,509,550)**	(1,391,019)

(30) NOTES TO CONSOLIDATED CASH FLOWS STATEMENT (CONTINUED)

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

	At 30 June 2018 HK$'000	At 30 June 2017 HK$'000
Cash and balances with banks, central banks and other financial institutions	**18,838,363**	41,832,821
Placements with and advances to banks, central banks and other financial institutions with original maturity within 3 months	**46,209,694**	20,720,983
Treasury bills and certificates of deposit held with original maturity within 3 months		
– Financial assets at fair value through other comprehensive income	**12,773,016**	–
– Available-for-sale securities	**–**	10,975,542
	77,821,073	73,529,346

(c) Changes in liabilities arising from financing activities

	Liabilities from financing activities	
	Debt securities issued *HK$'000*	**Loan capital** *HK$'000*
At 1 January 2018	**3,584,064**	**6,340,192**
New issue during the year	**–**	**–**
Redemption	**–**	**–**
Foreign exchange differences	**(44,146)**	**24,756**
Other non-cash adjustments	**2,312**	**(77,849)**
At 30 June 2018	**3,542,230**	**6,287,099**

(31) MATURITY PROFILE

The following maturity profile is based on the remaining period at the end of the reporting period date and the contractual maturity date.

As the trading portfolio may be sold before maturity or deposits from customers mature without being withdrawn, the contractual maturity dates do not represent expected dates of future cash flows.

	At 30 June 2018							
	Total *HK$'000*	Repayable on demand *HK$'000*	Within 1 month *HK$'000*	3 months or less but over 1 month *HK$'000*	1 year or less but over 3 months *HK$'000*	5 years or less but over 1 year *HK$'000*	Over 5 years *HK$'000*	Undated *HK$'000*
Assets								
Cash and balances with banks, central banks and other financial institutions	19,412,643	18,821,526	–	–	–	–	–	591,117
Placements with and advances to banks, central banks and other financial institutions	47,106,996	–	42,746,442	4,029,928	330,626	–	–	–
Financial assets at fair value through profit or loss	922,185	–	–	200	387,966	533,439	–	580
Derivative financial instruments	9,305,829	9,305,829	–	–	–	–	–	–
Loans and advances to customers and other accounts	203,497,497	8,193,209	17,752,568	18,858,975	54,767,689	77,279,583	23,043,130	3,602,343
Financial assets at fair value through other comprehensive income	67,582,200	–	4,948,069	12,417,460	24,598,593	22,999,506	2,525,654	92,918
Tax recoverable	1,701	–	–	–	1,701	–	–	–
Undated assets	1,440,946	–	–	–	–	–	–	1,440,946
Total assets	349,269,997	36,320,564	65,447,079	35,306,563	80,086,575	100,812,528	25,568,784	5,727,904
Liabilities								
Deposits and balances of banks and other financial institutions	5,383,446	1,715,491	1,764,710	1,471,727	431,518	–	–	–
Deposits from customers	270,855,292	79,081,566	75,561,376	62,041,627	53,603,884	562,439	4,400	–
Derivative financial instruments	9,021,831	9,021,831	–	–	–	–	–	–
Certificates of deposit issued	3,138,313	–	–	–	3,138,313	–	–	–
Debt securities issued	3,542,230	–	–	–	–	3,542,230	–	–
Current tax liabilities	379,629	–	–	–	379,629	–	–	–
Other liabilities	9,996,563	–	1,870,295	399,004	71,755	–	–	7,655,509
Loan capital	6,287,099	–	–	–	2,333,105	3,953,994	–	–
Undated liabilities	8,261	–	–	–	–	–	–	8,261
Total liabilities	308,612,664	89,818,888	79,196,381	63,912,358	59,958,204	8,058,663	4,400	7,663,770
Asset-liability gap		(53,498,324)	(13,749,302)	(28,605,795)	20,128,371	92,753,865	25,564,384	

(31) MATURITY PROFILE (CONTINUED)

	At 31 December 2017							
	Total HK$'000	Repayable on demand HK$'000	Within 1 month HK$'000	3 months or less but over 1 month HK$'000	1 year or less but over 3 months HK$'000	5 years or less but over 1 year HK$'000	Over 5 years HK$'000	Undated HK$'000
Assets								
Cash and balances with banks, central banks and other financial institutions	31,657,854	30,700,892	–	–	–	–	–	956,962
Placements with and advances to banks, central banks and other financial institutions	47,402,438	–	34,613,848	12,369,195	419,395	–	–	–
Financial assets at fair value through profit or loss	1,029,044	–	213,103	–	103,779	630,698	80,660	804
Derivative financial instruments	4,770,495	4,770,495	–	–	–	–	–	–
Loans and advances to customers and other accounts	198,986,939	5,964,803	18,761,646	17,521,562	57,021,544	71,587,931	23,104,398	5,025,055
Available-for-sale securities	59,346,677	–	7,105,308	15,018,183	8,689,867	25,466,195	2,975,423	91,701
Tax recoverable	29,047	–	–	–	29,047	–	–	–
Undated assets	1,086,190	–	–	–	–	–	–	1,086,190
Total assets	344,308,684	41,436,190	60,693,905	44,908,940	66,263,632	97,684,824	26,160,481	7,160,712
Liabilities								
Deposits and balances of banks and other financial institutions	5,187,319	2,931,754	693,491	1,535,988	26,086	–	–	–
Deposits from customers	271,471,865	98,294,705	76,423,268	69,880,222	26,491,435	373,935	8,300	–
Derivative financial instruments	4,824,483	4,824,483	–	–	–	–	–	–
Certificates of deposit issued	3,421,769	–	1,406,774	2,014,995	–	–	–	–
Debt securities issued	3,584,064	–	–	–	–	3,584,064	–	–
Current tax liabilities	497,575	–	–	–	497,575	–	–	–
Other liabilities	5,422,626	–	417,561	747,577	117,846	–	–	4,139,642
Loan capital	6,340,192	–	–	–	–	6,340,192	–	–
Undated liabilities	1,631	–	–	–	–	–	–	1,631
Total liabilities	300,751,524	106,050,942	78,941,094	74,178,782	27,132,942	10,298,191	8,300	4,141,273
Asset-liability gap		(64,614,752)	(18,247,189)	(29,269,842)	39,130,690	87,386,633	26,152,181	

(32) MATERIAL RELATED-PARTY TRANSACTIONS

In addition to the transactions and balances disclosed elsewhere in these financial statements, the Group entered into the following material related-party transactions:

(a) Transactions with group companies

During the period, the Group entered into a number of transactions with related parties in the normal course of its banking business including, inter alia, lending, acceptance and placement of inter-bank deposits, and participation in loan syndicates, correspondent banking transactions and foreign exchange transactions. The transactions were priced based on relevant market rates at the time of each transaction, and were under the same terms as those available to other counterparties and customers of the Group. In the opinion of the Directors, these transactions were conducted under normal commercial terms.

The amount of related-party transactions during the periods and outstanding balances at the end of the period/year are set out below:

	Ultimate holding and intermediate parents		Immediate parent		Fellow subsidiaries		Associates *(note (i))*		Related companies *(note (ii))*	
	Six months ended 30 June									
	2018	2017	**2018**	2017	**2018**	2017	**2018**	2017	**2018**	2017
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*
Interest income	**46,462**	18,801	**–**	–	**22,141**	24,387	**23,673**	8,229	**–**	24,330
Interest expense	**(65,979)**	(95,161)	**(2,400)**	(2,189)	**(38,588)**	(23,864)	**(11,349)**	(11,610)	**(298)**	(2)
Fee and commission income/ (expense)	**(800)**	(1,723)	**–**	–	**–**	–	**10**	4,545	**–**	–
Operating expenses	**–**	–	**–**	–	**(4,179)**	(2,730)	**–**	–	**–**	–
Net trading gain/(loss)	**(111,989)**	100,191	**–**	–	**747**	769	**9,214**	14,667	**–**	(8,340)
	At 30 June 2018/ 31 December 2017									
Assets										
Financial assets at fair value through other comprehensive income	**204,039**	–	**–**	–	**–**	–	**172,172**	–	**–**	–
Available-for-sale securities	**–**	–	**–**	–	**–**	–	**–**	173,064	**–**	–
Financial assets at fair value through profit or loss	**–**	54,127	**–**	–	**–**	–	**–**	–	**–**	–
Derivative financial instruments	**80,148**	29,223	**–**	–	**–**	–	**21,577**	10,185	**–**	–
Other receivables	**21,007**	2,896	**–**	–	**3,659**	3,667	**3,421**	3,231	**–**	–
Liabilities										
Derivative financial instruments	**207,807**	351,294	**–**	–	**16,147**	18,455	**–**	–	**–**	–
Other payables	**28,697**	13,625	**1,392**	900	**12,205**	11,748	**1,860**	4,647	**131**	–
Lending activities:										
At 30 June/31 December	**2,767,463**	2,432,965	**–**	–	**965,205**	1,178,127	**1,083,426**	1,095,420	**–**	–
Average for the period/year	**2,776,369**	1,733,455	**–**	–	**965,661**	2,278,078	**1,382,116**	858,770	**–**	–
Acceptance of deposits:										
At 30 June/31 December	**10,139,492**	10,667,653	**645,916**	243,710	**5,691,944**	9,465,073	**6,363,245**	5,532,947	**40,754**	39,988
Average for the period/year	**8,642,480**	12,442,225	**448,254**	372,866	**6,452,767**	6,334,452	**6,082,667**	4,587,592	**40,629**	10,034
	At 30 June 2018/ 31 December 2017									
Off-statement of financial position items										
Acceptances, guarantees and letters of credit – contract amounts payable	**–**	–	**–**	–	**(3,000)**	(115,158)	**–**	–	**–**	–
Lease commitments	**–**	–	**–**	–	**5,162**	15,401	**–**	–	**–**	–
Other commitments	**–**	–	**–**	–	**779,618**	1,442,054	**913,593**	896,764	**–**	–
Derivative financial instruments – notional amounts	**24,328,658**	23,846,041	**–**	–	**925,802**	922,185	**190,971**	186,863	**–**	–

(32) MATERIAL RELATED-PARTY TRANSACTIONS (CONTINUED)

(a) Transactions with group companies (continued)

No impairment allowances were made in respect of the above loans to and placements with related parties.

Note:

(i) Associates of the Group include the associates of the ultimate controlling party and immediate parent respectively.

(ii) Related companies refers to companies with common directors of the intermediate parents.

(b) Transactions with key management personnel

The aggregate amount of remuneration of key management personnel of the Group, including the amount paid to the Bank's directors and certain employees with the highest emoluments are as follows:

	Six months ended 30 June	
	2018	2017
	HK$'000	*HK$'000*
Short-term employee benefits	**38,338**	42,698
Post-employment benefits	**1,795**	1,652
	40,133	44,350

Total remuneration is included in "staff costs" *(note 10(a))*.

During the period, the Bank provided credit facilities to key management personnel of the Bank and its holding companies and their close family members, as well as to companies controlled or significantly influenced by them. The credit facilities were provided in the ordinary course of business and on substantially the same terms as for comparable transactions with persons of a similar standing, or where applicable, with other employees.

	2018	2017
	HK$'000	*HK$'000*
At 1 January	**17,444**	21,404
At 30 June 2018/ 31 December 2017	**14,661**	17,444
Maximum amount during the period/year	**22,539**	23,559

No impairment losses have been recorded against balances outstanding with key management personnel during the period, and no individually assessed impairment allowance has been made on balances with key management personnel and their immediate relatives at the period end.

(33) FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS

(a) Financial instruments measured at fair value

(i) Fair value hierarchy

Fair value estimates are generally subjective in nature, and are made at a specific point in time based on the characteristics of the financial instruments and relevant market information. Fair values are determined according to the following fair value hierarchy:

	Fair value measurements as at 30 June 2018 using			
	Fair value (Total) *HK$'000*	**Quoted prices in active market for identical assets (Level 1)** *HK$'000*	**Significant other observable inputs (Level 2)** *HK$'000*	**Significant unobservable inputs (Level 3)** *HK$'000*
Recurring fair value measurements				
Assets				
Financial assets at fair value through profit or loss				
– Debt securities	**921,605**	**714,554**	**207,051**	**–**
– Investment funds	**580**	**–**	**–**	**580**
	922,185	**714,554**	**207,051**	**580**
Derivative financial instruments				
– Positive fair values of derivatives	**9,305,829**	**2,241**	**9,303,588**	**–**
Financial assets at fair value through other comprehensive income				
– Certificates of deposit held	**13,770,850**	**118,761**	**13,652,089**	**–**
– Treasury bills (including Exchange Fund Bills)	**13,483,553**	**13,483,553**	**–**	**–**
– Debt securities	**40,234,879**	**36,414,732**	**3,771,296**	**48,851**
– Equity securities	**92,918**	**–**	**–**	**92,918**
	67,582,200	**50,017,046**	**17,423,385**	**141,769**
	77,810,214	**50,733,841**	**26,934,024**	**142,349**
Liabilities				
Derivative financial instruments				
– Negative fair value of derivatives	**9,021,831**	**2,181**	**9,019,650**	**–**

(33) FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (CONTINUED)

(a) Financial instruments measured at fair value (continued)

(i) Fair value hierarchy (continued)

	Fair value measurements as at 31 December 2017 using			
	Fair value (Total) *HK$'000*	Quoted prices in active market for identical assets (Level 1) *HK$'000*	Significant other observable inputs (Level 2) *HK$'000*	Significant unobservable inputs (Level 3) *HK$'000*
Recurring fair value measurements				
Assets				
Financial assets at fair value through profit or loss				
– Certificates of deposit held	213,103	213,103	–	–
– Debt securities	815,137	785,249	29,888	–
– Investment funds	804	–	–	804
	1,029,044	998,352	29,888	804
Derivative financial instruments				
– Positive fair values of derivatives	4,770,495	1,743	4,768,752	–
Available-for-sale securities				
– Certificates of deposit held	10,622,679	125,199	10,497,480	–
– Treasury bills (including Exchange Fund Bills)	11,681,635	11,681,635	–	–
– Debt securities	36,950,662	34,344,626	2,602,036	4,000
– Equity securities	91,701	–	–	91,701
	59,346,677	46,151,460	13,099,516	95,701
	65,146,216	47,151,555	17,898,156	96,505
Liabilities				
Derivative financial instruments				
– Negative fair value of derivatives	4,824,483	478	4,824,005	–

During the period ended 30 June 2018 and year ended 31 December 2017, there were no significant transfers of financial instruments between Level 1 and Level 2 of the fair value hierarchy. For transfer in and out of Level 3 measurements see the note 33(a)(iii) below.

(33) FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (CONTINUED)

(a) Financial instruments measured at fair value (continued)

(ii) Determination of fair value

The Group measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

Level 1 – Quoted (unadjusted) market price in active markets for identical instruments at the measurement date.

Level 2 –

(i) Quoted market price for identical or similar instruments that are not active;

(ii) Valuation techniques based on observable inputs, either directly or indirectly, where all significant inputs are observable from market data. This category includes financial instruments with quoted prices in active markets for similar instruments; or quoted prices in markets that are considered less than active for identical or similar instruments.

Level 3 – Valuation techniques using significant unobservable inputs where the valuation techniques include one or more significant inputs that are unobservable. This category includes financial instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect the 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 dealer price quotations. For all other financial instruments, the Group determines fair values using valuation techniques. Valuation techniques include net present value, discounted cash flow models and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other parameters used in estimating discount rates, bond price and foreign currency exchange rates.

The most common valuation techniques applied by the Group to determine the fair value of financial instruments are from interest rates and currency swaps, which are observable market data with high reliability and do not require the significant involvement of management's 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. However, the 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.

Certain financial instruments need to be employed with valuation techniques where one or more significant market inputs involved are not observable. Examples of these financial instruments are structured investments, OTC structured derivatives and certain securities for which there is no active market. For valuation models involving significant unobservable inputs, a high degree of management judgement or estimation is required to select the appropriate valuation model, determine the expected future cash flows on the financial instruments being valued, determine the probability of counterparty default and prepayments, and select the appropriate discount rates.

(33) FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (CONTINUED)

(a) Financial instruments measured at fair value (continued)

(iii) Information about Level 3 fair value measurements

	Valuation techniques	Significant unobservable inputs	Fair value measurement sensitivity to unobservable inputs
Investment funds	Broker quote	Not applicable	Not applicable
Debt securities	Discounted cash flow model	Forecasted cash flows and estimated risk-free rate	Significant increase in the estimated risk-free rate would result in a lower fair value
Equity securities	See note below	See note below	Not applicable

Note:

Equity securities under Level 3 fair value measurements are generally classified as financial assets at fair value through other comprehensive income (2017: available-for-sale securities) and are not traded in an active market. In the absence of an active market, the fair value is estimated based on the analysis of the investee's financial position, results and dividend discounts or other factors. Accordingly, it is not practical to quote significant unobservable inputs.

The following table shows a reconciliation between the opening and the closing balance of fair value measurements in Level 3 of the fair value hierarchy:

	At 30 June 2018			
Assets	**Financial assets at fair value through profit or loss**	**Financial assets at fair value through other comprehensive income**		**Total**
	Investment funds	**Debt securities**	**Equity securities**	
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
At 1 January 2018	**804**	**4,000**	**91,701**	**96,505**
Purchases	**–**	**–**	**500**	**500**
Sales	**(29)**	**–**	**–**	**(29)**
Transfer from Level 2	**–**	**44,851**	**–**	**44,851**
Gains or losses recognised in the income statement	**(195)**	**–**	**(14)**	**(209)**
Change in fair value recognised in other comprehensive income	**–**	**–**	**731**	**731**
At 30 June 2018	**580**	**48,851**	**92,918**	**142,349**
Total gains or losses for the period included in the income statement for assets held at the end of the reporting period recorded in:				
– Gains less losses from dealing in foreign currencies	**–**	**–**	**(14)**	**(14)**
– Gains less losses from financial assets at fair value through profit or loss	**(195)**	**–**	**–**	**(195)**
Total change in fair value recognised in other comprehensive income	**–**	**–**	**731**	**731**

(33) FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (CONTINUED)

(a) Financial instruments measured at fair value (continued)

(iii) Information about Level 3 fair value measurements (continued)

	At 31 December 2017			
Assets	Financial assets at fair value through profit or loss	Available-for-sale securities		Total
	Investment funds	Debt securities	Equity securities	
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
At 1 January 2017	1,078	4,000	23,496	28,574
Purchases	–	–	18,500	18,500
Sales	(172)	–	–	(172)
Gains or losses recognised in the income statement	(102)	–	72	(30)
Change in fair value recognised in other comprehensive income	–	–	49,633	49,633
At 31 December 2017	804	4,000	91,701	96,505
Total gains or losses for the period included in the income statement for assets held at the end of the reporting period recorded in:				
– Gains less losses from dealing in foreign currencies	–	–	72	72
– Gains less losses from trading securities	(102)	–	–	(102)
Total change in fair value recognised in other comprehensive income	–	–	49,633	49,633

(33) FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (CONTINUED)

(a) Financial instruments measured at fair value (continued)

(iv) Effects of changes from using significant unobservable assumptions to reasonable possible alternative assumptions

The fair value of level 3 financial instruments is measured using valuation models that incorporate assumptions that are not based on observable market data. The following table shows the sensitivity of level 3 fair value measurements due to a parallel movement of plus or minus 10% of change in fair value to reasonably possible alternative assumptions.

	At 30 June 2018			
	Effect on income statement		**Effect on other comprehensive income**	
	Favourable *HK$'000*	**(Unfavourable)** *HK$'000*	**Favourable** *HK$'000*	**(Unfavourable)** *HK$'000*
Assets				
Financial assets at fair value through profit or loss				
– Investment funds	**58**	**(58)**	**–**	**–**
Financial assets at fair value through other comprehensive income				
– Debt securities	**–**	**–**	**4,885**	**(4,885)**
– Equity securities	**–**	**–**	**9,292**	**(9,292)**

	At 31 December 2017			
	Effect on income statement		Effect on other comprehensive income	
	Favourable *HK$'000*	(Unfavourable) *HK$'000*	Favourable *HK$'000*	(Unfavourable) *HK$'000*
Assets				
Financial assets at fair value through profit or loss				
– Investment funds	80	(80)	–	–
Available-for-sale securities				
– Debt securities	–	–	400	(400)
– Equity securities	–	–	9,170	(9,170)

The Group believes that its estimates of fair value for the above financial instruments are appropriate but the use of different methodologies or assumptions could lead to different measurements of fair value.

(33) FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (CONTINUED)

(b) Fair values of financial instruments measured at other than fair value

All financial instruments are stated at fair value or carried at amounts not materially different from their fair value at 30 June 2018 and 31 December 2017 unless otherwise stated.

(i) Financial assets

The Group's financial assets mainly include cash; placements with banks, central banks and other financial institutions; loans and advances to customers; investments; and financial derivative instruments.

The fair values of placements with banks, central banks and other financial institutions are mainly priced at market interest rates, and mature within one year. Accordingly, the carrying values approximate the fair value.

The fair values of loans and advances to customers, taking into account the relevant market interest rates and being mostly priced at floating rates close to the market interest rate which are mainly repriced within 3 months, approximately equals their carrying amount.

Financial assets at fair value through profit or loss and at fair value through other comprehensive income (2017: available-for-sale securities) are stated at fair value in the financial statements.

(ii) Financial liabilities

All financial liabilities are stated at fair value or carried at amounts not materially different from their fair values at 30 June 2018 and 31 December 2017, except the following:

	At 30 June 2018				
	Carrying amount *HK$'000*	**Fair value** *HK$'000*	**Level 1** *HK$'000*	**Level 2** *HK$'000*	**Level 3** *HK$'000*
Financial liabilities					
Certificates of deposit issued	**3,138,313**	**3,112,254**	**–**	**3,112,254**	**–**
Debt securities issued	**3,542,230**	**3,541,193**	**–**	**3,541,193**	**–**
Loan capital	**6,287,099**	**6,517,255**	**6,517,255**	**–**	**–**
	12,967,642	**13,170,702**	**6,517,255**	**6,653,447**	**–**

	At 31 December 2017				
	Carrying amount *HK$'000*	Fair value *HK$'000*	Level 1 *HK$'000*	Level 2 *HK$'000*	Level 3 *HK$'000*
Financial liabilities					
Certificates of deposit issued	3,421,769	3,421,510	–	3,421,510	–
Debt securities issued	3,584,064	3,531,079	–	3,531,079	–
Loan capital	6,340,192	6,642,421	6,642,421	–	–
	13,346,025	13,595,010	6,642,421	6,952,589	–

(34) ASSETS PLEDGED AS SECURITY

	At 30 June 2018	At 31 December 2017
	HK$'000	*HK$'000*
Assets pledged as security		
Cash and balances with banks, central banks and other financial institutions	**1**	13
Financial assets at fair value through other comprehensive income pledged as statutory deposits *(Note)*	**188,320**	–
Available-for-sale securities pledged as statutory deposits *(Note)*	**–**	140,660
	188,321	140,673

Note:

The assets pledged represented debt securities pledged as statutory deposits by the overseas branches of the Bank to the Office of the Comptroller of the Currency in the United States.

(35) CONTINGENT ASSETS, LIABILITIES AND COMMITMENTS

(a) Contingent liabilities and commitments to extend credit

The following is a summary of the contractual amounts of each significant class of contingent liability and commitment:

	At 30 June 2018	At 31 December 2017
	HK$'000	*HK$'000*
Direct credit substitutes	**2,529,513**	3,869,439
Transaction-related contingencies	**274,451**	365,203
Trade-related contingencies	**1,430,380**	1,987,228
Forward forward deposits placed	**1,726,072**	–
Other commitments:		
– which are unconditionally cancellable or automatically cancellable due to deterioration in the creditworthiness of the borrower	**76,947,653**	92,291,172
– with an original maturity of not more than 1 year	**2,736,040**	3,021,463
– with an original maturity of more than 1 year	**5,357,551**	3,986,946
	91,001,660	105,521,451
Credit risk-weighted amounts	**6,456,582**	5,445,027

Contingent liabilities and commitments are credit-related instruments, including forward forward deposits placed, letters of credit, guarantees and commitments to extend credit. The risk involved is essentially the same as the credit risk involved in extending loan facilities to customers. The contractual amounts represent the amounts at risk if the contract is fully drawn upon and the client defaults. As the facilities may expire without being drawn upon, the contractual amounts do not represent expected future cash flows.

The risk weights used in the computation of credit risk-weighted amounts range from 0% to 150% (31 December 2017: 0% to 150%).

(35) CONTINGENT ASSETS, LIABILITIES AND COMMITMENTS (CONTINUED)

(b) Capital commitments

Capital commitments for the purchase of properties and equipment outstanding at the date of financial position and not provided for in the financial statements are as follows:

	At 30 June 2018	At 31 December 2017
	HK$'000	*HK$'000*
Authorised and contracted for	**159,816**	170,569

(c) Contingent liability in respect of legal claim

The Group is not involved in any legal action that would be significant to the financial position of the Group at 30 June 2018 and 31 December 2017.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

(Expressed in Hong Kong dollars unless otherwise indicated)

(A) SUMMARY OF FINANCIAL POSITION

For the half-year ended	30 June 2018	30 June 2017
Financial ratios		
Average liquidity maintenance ratio for the period-ended*	**N/A**	57.9%
Average liquidity coverage ratio**	**220.7%**	N/A
Cost to income	**37.1%**	37.4%
Return on assets	**0.94%**	0.86%
Return on average total equity attributable to equity shareholders of the Bank	**8.96%**	10.41%

At period-ended/year-ended	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
Loans and advances to customers	**199,892,556**	196,286,922
Impairment allowances on loans and advances to customers	**2,411,281**	1,522,857
Total assets	**349,269,997**	344,308,684
Total customers deposits	**273,993,605**	274,893,634
Total equity	**40,657,333**	43,557,160
Financial ratios		
Common Equity Tier 1 ("CET1") capital ratio	**12.7%**	14.5%
Tier 1 capital ratio	**15.1%**	17.1%
Total capital ratio	**17.8%**	20.3%
Loans to deposits	**73.0%**	71.4%
Loans to total assets	**57.2%**	57.0%

* The average liquidity maintenance ratio ("LMR") was calculated based on the arithmetic mean of the average value of LMR for each month up to 30 September 2017, which was also computed on the consolidated basis covering the Bank and certain of its subsidiaries as required by the Hong Kong Monetary Authority ("HKMA").

** The Group was designated by the HKMA as a Category 1 institution with effect from 1 October 2017. As a result, under the Banking (Liquidity) Rules, the Group is required to maintain a Liquidity Coverage Ratio ("LCR") above the statutory minimum requirement, which superseded the regulatory requirements of the Liquidity Maintenance Ratio ("LMR").

(B) CAPITAL INFORMATION AVAILABLE ON THE BANK'S WEBSITE

For the purposes of compliance with the Banking (Disclosure) Rules, information relating to the Group's regulatory capital and other disclosures are published by using standard disclosure templates as specified by the HKMA and they can be viewed in the Regulatory Disclosures section of our Bank's corporate website at www.cncbinternational.com.

(C) CAPITAL ADEQUACY

(i) Capital base

Capital adequacy ratios ("CAR") comply with the Banking (Capital) Rules issued by the HKMA. The CAR are computed on a consolidated basis covering the Bank and some of its subsidiaries as required by the HKMA. The Bank has adopted the "standardised approach" for calculating the risk-weighted amount for credit risk and market risk and the "basic indicator approach" for calculating operational risk.

	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
Common Equity Tier 1 ("CET1") capital instruments and reserves		
Directly issued qualifying CET1 capital instruments plus any related share premium	**18,211,257**	18,404,013
Retained earnings	**16,177,317**	18,728,874
Disclosed reserves	**(97,344)**	251,021
CET1 capital before regulatory deductions	**34,291,230**	37,383,908
CET1 capital: regulatory deductions		
Deferred tax assets net of deferred tax liabilities	**442,903**	65,841
Cumulative fair value gains arising from the revaluation of land and buildings (covering both own-use and investment properties)	**84,163**	84,333
Regulatory reserve for general banking risks	**1,124,748**	2,814,520
Valuation adjustments	**5,434**	7,138
Debt valuation adjustments in respect of derivative contracts	**2,100**	1,285
Total regulatory deductions to CET1 capital	**1,659,348**	2,973,117
CET1 capital	**32,631,882**	34,410,791
Additional Tier 1 ("AT1") capital		
Total Additional Tier 1 capital	**6,177,015**	6,177,015
Tier 1 capital	**38,808,897**	40,587,806
Tier 2 capital instruments and provisions		
Qualifying Tier 2 capital instruments plus any related share premium	**3,921,714**	4,687,678
Reserve attributable to fair value gains on revaluation of holdings of land and buildings	**37,874**	37,950
Collective impairment allowances and regulatory reserve for general banking risks eligible for inclusion in Tier 2 capital	**2,927,675**	2,732,777
Tier 2 capital base before deductions	**6,887,263**	7,458,405
Tier 2 capital: regulatory deductions		
Total regulatory deductions to Tier 2 capital	**–**	–
Tier 2 capital	**6,887,263**	7,458,405
Total capital	**45,696,160**	48,046,211

(ii) Risk-weighted amount

– Credit risk	**237,313,828**	219,918,986
– Market risk	**5,994,788**	4,425,300
– Operational risk	**13,613,688**	12,572,238
	256,922,304	236,916,524

(C) CAPITAL ADEQUACY (CONTINUED)

(iii) Capital adequacy ratios

	At 30 June 2018	At 31 December 2017
– CET1 capital ratio	**12.7%**	14.5%
– Tier 1 capital ratio	**15.1%**	17.1%
– Total capital ratio	**17.8%**	20.3%

(iv) Capital conservation buffer ratio and countercyclical capital buffer ratio

With effect from 1 January 2016, the capital buffer ratios applicable to the Group on a consolidated basis are follows:

	At 30 June 2018	At 31 December 2017
Capital conservation buffer ratio	**1.875%**	1.250%
Countercyclical capital buffer ("CCyB") ratio	**1.011%**	0.707%
	2.886%	1.957%

The detailed relevant disclosure of the CCyB ratio for each jurisdiction and the geographical breakdown of risk-weighted assets in relation to private sector credit exposures using the standard templates as specified by the HKMA can be viewed in the Regulatory Disclosure section of our Bank's website.

(v) Capital instruments

The following is a summary of the Group's CET1, AT1 capital securities and Tier 2 capital instruments.

	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
CET1 capital instruments issued by the Bank		
Ordinary shares:		
12,111,121,568 issued and fully paid ordinary shares	**18,404,013**	18,404,013

	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
Additional Tier 1 Capital Securities		
Undated non-cumulative subordinated capital securities of US$300 million	**2,310,168**	2,310,168
Undated non-cumulative subordinated capital securities of US$500 million	**3,863,084**	3,863,084
	6,173,252	6,173,252

	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
Tier 2 capital instruments		
Issued by the Bank		
US$500 million Subordinated Fixed Rate Notes at 6.875%	**3,953,994**	4,009,985
US$300 million Subordinated Fixed Rate Notes at 6.000%	**2,333,105**	2,330,207
	6,287,099	6,340,192

(C) CAPITAL ADEQUACY (CONTINUED)

(vi) Leverage ratio

The Bank is required to disclose its leverage ratio calculated on a consolidated basis covering the Bank and some of its subsidiaries.

	At 30 June 2018	At 31 December 2017
	10.7%	11.3%

The detailed relevant disclosure of the leverage ratio using the standard templates as specified by the HKMA can be viewed in the Regulatory Disclosure section of our Bank's website.

(vii) Basis of consolidation

Unless otherwise stated, all financial information contained in the interim financial report is prepared on the consolidation basis for accounting purposes. The main difference between the consolidation basis for accounting and regulatory purposes is that the former includes the Bank and all its subsidiaries whereas the latter includes the Bank and only some of the Group's subsidiaries, which are discussed below:

The HKMA has granted approval under section 28(2)(a) of the Banking (Capital) Rules for the Bank to calculate its CAR on a solo-consolidated basis instead of on a solo basis in respect of the following subsidiary:

		At 30 June 2018	
Names of subsidiary	**Principal activities**	**Total assets** ***HK$'000***	**Total equity** ***HK$'000***
Viewcon Hong Kong Limited	Mortgage financing	**1,365**	**1,315**

On the other hand, the Bank is required under section 3C(1) of the Banking (Capital) Rules to calculate its total capital on a consolidated basis in respect of the following subsidiaries:

		At 30 June 2018	
Names of subsidiaries	**Principal activities**	**Total assets** ***HK$'000***	**Total equity** ***HK$'000***
Carford International Limited	Property holding	**37,730**	**8,401**
CITIC Bank International (China) Limited	Banking	**11,263,654**	**1,733,167**
CITIC Insurance Brokers Limited	Insurance broker	**1,344,460**	**119,479**
CKWB-SN Limited	Issue of structured notes and investments	**–**	**–**
CKWH-UT2 Limited	Issue of subordinated notes	**–**	**–**
HKCB Finance Limited	Consumer financing	**6,117,565**	**526,442**
Ka Wah International Merchant Finance Limited	Inactive	**3,904**	**3,859**
The Ka Wah Bank (Trustee) Limited	Trustee services	**5,483**	**5,468**
Viewcon Hong Kong Limited	Mortgage financing	**1,365**	**1,315**

(C) CAPITAL ADEQUACY (CONTINUED)

(vii) Basis of consolidation (continued)

Subsidiaries not included in consolidation for regulatory purposes are nominee services companies authorised and supervised by a regulator and are subject to supervisory arrangements regarding the maintenance of adequate capital to support business activities comparable to those prescribed for authorised institutions under the Banking (Capital) Rules and the Banking Ordinance. The following subsidiaries are deducted from the Bank's capital base under Part 3 of the Banking (Capital) Rules:

		At 30 June 2018	
Names of subsidiaries	**Principal activities**	**Total assets** *HK$'000*	**Total equity** *HK$'000*
The Hongkong Chinese Bank (Nominees) Limited	Nominee services	**4**	**–**
The Ka Wah Bank (Nominees) Limited	Nominee services	**3,535**	**101**
Security Nominees Limited	Nominee services	**–**	**–**
Sino-Allied Development Limited	Inactive	**10**	**10**
CNCBI Investment Holdings Limited	Investment holding	**11,000**	**11,000**
CNCBI Asset Management Limited	Inactive	**5,000**	**5,000**
CNCBI Financial Consultant Limited	Inactive	**–**	**–**

As at 30 June 2018, there are no subsidiaries which are included within both the accounting scope of consolidation and the regulatory scope of consolidation, the method of consolidation of which differs.

There is also no subsidiary which is included in the regulatory scope of consolidation but not in the accounting scope of consolidation.

(D) SEGMENTAL INFORMATION ON LOANS AND ADVANCES TO CUSTOMERS – BY GEOGRAPHICAL AREAS

	30 June 2018					
	Loans and advances to customers *HK$'000*	**Overdue loans and advances to customers** *HK$'000*	**Impaired loans and advances to customers** *HK$'000*	**Stage 1 ECL allowances** *HK$'000*	**Stage 2 ECL allowances** *HK$'000*	**Stage 3 ECL allowances** *HK$'000*
Hong Kong	**106,457,875**	**206,648**	**573,634**	**298,550**	**458,634**	**242,051**
Mainland China	**68,208,181**	**70,586**	**253,053**	**224,655**	**785,295**	**139,152**
United States	**6,167,504**	**7,004**	**–**	**47,681**	**3,791**	**–**
Singapore	**4,835,262**	**256,952**	**256,952**	**50,161**	**–**	**–**
Others	**14,223,734**	**–**	**166,833**	**83,493**	**11,085**	**66,733**
	199,892,556	**541,190**	**1,250,472**	**704,540**	**1,258,805**	**447,936**

	At 31 December 2017				
	Loans and advances to customers *HK$'000*	Overdue loans and advances to customers *HK$'000*	Impaired loans and advances to customers *HK$'000*	Individual impairment allowances *HK$'000*	Collective impairment allowances *HK$'000*
Hong Kong	107,422,724	874,934	1,230,989	611,854	189,954
Mainland China	71,077,957	931,923	965,597	404,880	143,775
United States	6,672,615	6,995	6,996	–	14,889
Singapore	3,705,562	–	–	–	2,201
Others	7,408,064	93,597	260,430	110,280	45,024
	196,286,922	1,907,449	2,464,012	1,127,014	395,843

The above geographical analysis is classified by the location of the counterparties after taking into account the transfer of risk. For a claim guaranteed by a party situated in a country different from the counterparty, risk will be transferred to the country of the guarantor.

Overdue loans and advances are loans that have been overdue for more than three months.

(E) OVERDUE LOANS AND ADVANCES TO CUSTOMERS

	At 30 June 2018		At 31 December 2017	
	HK$'000	**% of total loans and advances to customers**	*HK$'000*	% of total loans and advances to customers
The gross amount of loans and advances has been overdue for periods of:				
– 6 months or less but over 3 months	**1,328**	**0.00**	822,734	0.42
– 1 year or less but over 6 months	**275,722**	**0.14**	471,579	0.24
– over 1 year	**264,140**	**0.13**	613,136	0.31
	541,190	**0.27**	1,907,449	0.97
Secured overdue loans and advances	**477,457**		293,785	
Unsecured overdue loans and advances	**63,733**		1,613,664	
	541,190		1,907,449	
Market value of collateral held against the secured overdue loans and advances	**852,350**		375,391	
Expected credit losses allowances/ Individual impairment allowances made	**115,064**		1,068,504	

Loans and advances with a specific repayment date are classified as overdue when the principal or interest is overdue and remains unpaid at the period end. Loans repayable on demand are classified as overdue either when a demand for repayment has been served on the borrower but repayment has not been made in accordance with the demand notice, and/or when the loans have remained continuously outside the approved limit advised to the borrower for more than the overdue period in question.

Eligible collateral held in respect of the overdue loans and advances, is "Eligible Physical Collateral" which mainly comprises real estate properties. The eligible collateral should generally satisfy the following:

(a) The market value of the asset should be readily determinable or can be reasonably established and verified.

(b) The asset is marketable and there exists a readily available secondary market for disposing of the asset.

(c) The Bank's right to repossess the asset is legally enforceable and without impediment.

(d) The Bank is able to secure control over the asset if necessary.

There were no advances to banks and other financial institutions and other assets which were overdue for over three months at 30 June 2018 and 31 December 2017 respectively.

(F) RESCHEDULED LOANS

	At 30 June 2018		At 31 December 2017	
	HK$'000	**% of total loans and advances to customers**	*HK$'000*	% of total loans and advances to customers
Rescheduled loans	**537,289**	**0.269**	537,979	0.274

Rescheduled loans are those advances which have been restructured or renegotiated because of a deterioration in the financial position of the borrower, or the inability of the borrower to meet the original repayment schedule and for which the revised repayment terms are non-commercial to the Group. Rescheduled loans to customers are stated net of any advances that have subsequently become overdue for over three months and are reported as overdue advances in note (E).

There were no advances to banks and other financial institutions which were rescheduled at 30 June 2018 and 31 December 2017 respectively.

(G) REPOSSESSED ASSETS

	At 30 June 2018 ***HK$'000***	At 31 December 2017 *HK$'000*
Included in loans and advances to customers and other accounts	**188,688**	184,411

The amount represented the estimated market value of the repossessed assets at 30 June 2018 and 31 December 2017 respectively.

(H) INTERNATIONAL CLAIMS

International claim refers to the sum of cross-border claims in all currencies and local claims in foreign currencies determined as based on the calculation methodology specified in the HKMA's Return of International Banking Statistics. International claims are on-balance sheet exposures of counterparties which attributable to the country or segment, after taking into account risk recognised transfer, constitute to not less than 10% of the aggregate claims are shown as follows:

	At 30 June 2018				
			Non-bank private sector		
	Banks *HK$'000*	**Official Sector** *HK$'000*	**Non-bank financial institutions** *HK$'000*	**Non-financial private sector** *HK$'000*	**Total** *HK$'000*
Developed countries	**15,860,681**	**420,752**	**784,955**	**6,136,079**	**23,202,467**
Offshore centres	**7,441,575**	**448**	**12,191,358**	**39,511,861**	**59,145,242**
of which Hong Kong	**6,416,876**	**11**	**11,487,836**	**27,072,107**	**44,976,830**
Developing Asia-Pacific	**63,791,711**	**58,028**	**5,531,063**	**61,974,779**	**131,355,581**
of which Mainland China	**63,163,692**	**57,460**	**5,531,063**	**60,792,573**	**129,544,788**

	At 31 December 2017				
			Non-bank private sector		
	Banks *HK$'000*	Official Sector *HK$'000*	Non-bank financial institutions *HK$'000*	Non-financial private sector *HK$'000*	Total *HK$'000*
Offshore centres	7,120,802	869	13,827,960	37,914,745	58,864,376
of which Hong Kong	6,489,207	282	13,081,673	29,814,181	49,385,343
Developing Asia-Pacific	66,646,716	83,611	5,916,565	60,216,815	132,863,707
of which Mainland China	66,309,598	83,040	5,916,565	58,878,966	131,188,169

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

(I) MAINLAND ACTIVITIES

Mainland Activities are Mainland China exposures to non-bank counterparties and their categories and the type of direct exposures defined by the HKMA's Return of Mainland Activities.

		At 30 June 2018		
		On-statement of financial position exposure *HK$'000*	**Off-statement of financial position exposure** *HK$'000*	**Total** *HK$'000*
(1)	Central government, central government-owned entities and their subsidiaries and joint ventures (JVs)	**28,383,320**	**504,432**	**28,887,752**
(2)	Local governments, local government-owned entities and their subsidiaries and JVs	**13,803,990**	**269,405**	**14,073,395**
(3)	PRC nationals residing in Mainland China or other entities incorporated in Mainland China and their subsidiaries and JVs	**65,937,962**	**4,284,885**	**70,222,847**
(4)	Other entities of central government not reported in item 1 above	**14,359,898**	**540,611**	**14,900,509**
(5)	Other entities of local governments not reported in item 2 above	**194,362**	**197,632**	**391,994**
(6)	PRC nationals residing outside Mainland China or entities incorporated outside Mainland China where the credit is granted for use in Mainland China	**22,095,041**	**2,748,380**	**24,843,421**
(7)	Other counterparties where the exposures are considered by the reporting institution to be non-bank Mainland China exposures	**15,883,695**	**1,087,443**	**16,971,138**
Total		**160,658,268**	**9,632,788**	**170,291,056**
Total assets after provision		**349,269,997**		
On-balance sheet exposures as percentage of total assets		**46.0%**		

		At 31 December 2017		
		On-statement of financial position exposure *HK$'000*	Off-statement of financial position exposure *HK$'000*	Total *HK$'000*
(1)	Central government, central government-owned entities and their subsidiaries and joint ventures (JVs)	28,973,542	986,287	29,959,829
(2)	Local governments, local government-owned entities and their subsidiaries and JVs	15,138,695	745,750	15,884,445
(3)	PRC nationals residing in Mainland China or other entities incorporated in Mainland China and their subsidiaries and JVs	62,576,230	4,079,754	66,655,984
(4)	Other entities of central government not reported in item 1 above	6,796,166	297,253	7,093,419
(5)	Other entities of local governments not reported in item 2 above	188,578	206,342	394,920
(6)	PRC nationals residing outside Mainland China or entities incorporated outside Mainland China where the credit is granted for use in Mainland China	9,682,747	3,309,615	12,992,362
(7)	Other counterparties where the exposures are considered by the reporting institution to be non-bank Mainland China exposures	26,655,744	786,898	27,442,642
Total		150,011,702	10,411,899	160,423,601
Total assets after provision		344,308,684		
On-balance sheet exposures as percentage of total assets		43.6%		

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION

(J) RISK MANAGEMENT

The Group manages its risks under the oversight of the Board of Directors and its delegated committees. The Risk Management Group has been entrusted with the ongoing responsibilities of driving and implementing the Group's risk management framework and governance encompassing the identification, quantification, monitoring, reporting, and mitigation of the risks to which the Group is exposed.

The Group adopts the Standardised Approach for credit and market risk measurement, and the Basic Indicator Approach for operational risk measurement. The Group has established policies, procedures and processes to identify and set appropriate risk limits, as well as to analyse, control and monitor these risks. The Group continually strives to enhance its risk management framework and infrastructure in keeping with the market, product offerings and international best practices. The Group's internal auditor performs regular independent audits to ensure due compliance with internal policies and regulatory requirements.

The Group manages the following main types of risk:

(a) Credit risk management

Credit risk is the risk of financial loss due to the failure of a customer or counterparty to fulfill its contractual obligations. Credit exposure principally arises in loans and advances, debt securities, treasury bills and trading derivatives, as well as in the credit risk from financial arrangements in off-balance sheet financial positions such as loan commitments. The Group has developed standards, policies and procedures to measure, monitor and mitigate the risk of its lending business. The policies and procedures are reviewed as required, to respond quickly to the changing market environment and to better reflect the risk factors for the Group's credit considerations.

Since 2017, the Group has implemented a number of new credit risk initiatives to reinforce the risk management system, practices and culture. The Group has developed new credit rating models for corporate and retail segments. The Group has enhanced the credit rating framework by adopting a new and more granular 24-grade Rating Master Scale. Furthermore, the Group has implemented an automated solution for computing Expected Credit Losses (ECL) towards a more forward looking provisioning in compliance with the Hong Kong Financial Reporting Standard 9.

Credit risk is controlled and managed by the Risk Management Group ("RMG") under the oversight of the Credit Committee, and is reported to the Credit & Risk Management Committee ("CRMC") at the board level on a quarterly basis. These committees provide appropriate oversight of the Group's risk management practices by defining the Group's policies and risk appetite, and providing the RMG with the means to implement measures to mitigate credit risk arising from the Group's adopted strategy.

Credit risk embedded in products is identified and measured in product programmes. Credit risk pertaining to individual customers is identified and measured by credit officers utilising internal risk rating models. Credit applications are approved by credit officers under delegated authorities or by the Credit Committee.

The Group mitigates credit risk by taking collateral and entering into offsetting or netting agreements with borrowers and counterparties, as the case may be, should such clauses and agreements be legally established and enforceable.

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 portfolio of financial instruments is diversified among geographic, industry and product sectors.

Credit risk for treasury transactions is managed in the same way as the Group manages its corporate lending risk. Risk grading is applied to the debt issuers, with individual credit limits set.

Credit and counterparty risks related to countries and financial institutions are assessed and monitored regularly according to the Group's Country Risks and Financial Institution Risks policies. The policies are implemented together to effectively assess and control credit limits and tenors made available to the respective financial institutions under an umbrella country risk limit for each country.

The Group applies the same credit policy in respect of contingent liabilities as in respect of financial instruments recorded on the statement of financial position, based on loan approval procedures, use of limits to reduce risk and monitoring. Credit risk is also mitigated by obtaining collateral in the form of pledged assets and guarantees from borrowers and third parties.

(J) RISK MANAGEMENT (CONTINUED)

(a) Credit risk management (continued)

(i) Credit quality

The Group has adopted a granular 24-grade internal risk rating system (Grades G01-G21 for performing financial assets and Grades G22-G24 for non-performing financial assets) that maps to external credit rating agencies' rating scales. The integration of this framework into the Group's reporting structure has enabled more granular credit risk reporting, thus enhancing the internal management. The risk rating are assigned according to differing customer segments (manufacturing, trading, property development/investment, etc.) which enables the ranking of the credit quality of each customer and the governing of the credit exposure for individual customers or counterparties.

Customers' risk ratings are reviewed regularly and amendments, where necessary, are implemented promptly, particularly in times of fluctuating market conditions. The Group also maintains a committee to regularly oversee weaker credits (which have lower risk ratings of G19-G21) to preserve the Group's quality portfolio. The table below outlines the Group's rating scale benchmarked against external credit agencies:

	Reference ECAI Rating			
Obligor Grade	Moody's	S&P	Fitch	Rating Description
G01	Aaa	AAA	AAA	Obligations are judged to have the highest intrinsic, or standalone, financial strength, and thus subject to the lowest level of credit risk absent any possibility of extraordinary support from an affiliate or government.
G02 – G04	Aa1/Aa2/Aa3	AA+/AA/AA-	AA+/AA/AA-	Obligations are judged to have high intrinsic, or standalone, financial strength, and thus subject to very low credit risk absent any possibility of extraordinary support from an affiliate or government.
G05 – G07	A1/A2/A3	A+/A/A-	A+/A/A-	Obligations are judged to have upper-medium-grade intrinsic, or standalone, financial strength, and thus subject to low credit risk absent any possibility of extraordinary support from an affiliate or government.
G08 – G10	Baa1/Baa2/Baa3	BBB+/BBB/BBB-	BBB+/BBB/BBB-	Obligations are judged to have medium-grade intrinsic, or standalone, financial strength, and thus subject to moderate credit risk and, as such, may possess certain speculative credit elements absent any possibility of extraordinary support from an affiliate or government.
G11 – G13	Ba1/Ba2/Ba3	BB+/BB/BB-	BB+/BB/BB-	Obligations are judged to have speculative intrinsic, or standalone, financial strength, and are subject to substantial credit risk absent any possibility of extraordinary support from an affiliate or government.
G14 – G16	B1/B2/B3	B+/B/B-	B+/B/B-	Obligations are judged to have speculative intrinsic, or standalone, financial strength, and are subject to high credit risk absent any possibility of extraordinary support from an affiliate or government.
G17 – G18	Caa1/Caa2	CCC+/CCC	CCC+/CCC	Obligations are judged to have speculative intrinsic, or standalone, financial strength, and are subject to very high credit risk absent any possibility of extraordinary support from an affiliate or government.
G19 Special Mention	Caa3	CCC-	CCC-	Obligations are judged to have highly speculative intrinsic, and are likely in, or near, default, with some prospect of recovery of principal and interest.
G20 Special Mention	Ca	CC	CC	Obligations are judged to have highly speculative intrinsic, and are likely in, or very near, default, with some prospect of recovery of principal and interest.
G21 Special Mention	C	C	C	Obligations are the lowest rated and are typically in default, with little prospect for recovery of principal or interest.
G22 Substandard	D	D	D	Substandard. In accordance with the Asset Classification Policy.
G23 Doubtful	D	D	D	Doubtful. In accordance with the Asset Classification Policy.
G24 Loss	D	D	D	Loss. In accordance with the Asset Classification Policy.

(J) RISK MANAGEMENT (CONTINUED)

(a) Credit risk management (continued)

(ii) Exposure of credit risk

The maximum exposure to credit risk at the end of the reporting period, without considering any collateral held or other credit enhancements, is represented by the carrying amount of each financial asset in the statement of financial position after deducting any impairment allowances. A summary of the maximum exposure is as follows:

	At 30 June 2018 *HK$'000*	At 31 December 2017 *HK$'000*
Cash and balances with banks, central banks and other financial institutions	**19,412,643**	31,657,854
Placements with and advances to banks, central banks and other financial institutions	**47,106,996**	47,402,438
Financial assets at fair value through profit or loss	**921,605**	1,028,240
Derivative financial instruments	**9,305,829**	4,770,495
Loans and advances to customers and other accounts	**202,893,659**	198,539,113
Financial assets at fair value through other comprehensive income	**67,489,282**	–
Available-for-sale securities	**–**	59,254,976
Financial guarantees and other credit-related contingent liabilities	**5,960,416**	6,221,870
Loan commitments and other credit-related commitments	**85,041,244**	99,299,581
	438,131,674	448,174,567

Further detailed analyses of the credit quality of financial assets by credit quality and stage distribution are provided in the note (J)(a)(vii) of the Unaudited Supplementary Information.

(iii) Master netting arrangement

The Group enters into enforceable master netting arrangements with counterparties. If an event of default occurs, all outstanding transactions with the counterparty are terminated and all amounts outstanding are 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 Group discloses information for financial statement users to evaluate the effect or potential effect of netting arrangements, including the rights of set-off associated with the Group's recognised financial assets and recognised financial liabilities, on the Group's financial position.

	At 30 June 2018			
		Related amounts that are not offset in the statement of financial position		
	Derivative financial instruments presented in the statement of financial position *HK$'000*	**Financial instruments** *HK$'000*	**Cash collateral received** *HK$'000*	**Potential exposure** *HK$'000*
Financial assets				
– Derivative financial instruments *(note 17)*	**9,305,829**	**(5,066,354)**	**(2,761,374)**	**1,478,101**
Financial liabilities				
– Derivative financial instruments *(note 17)*	**9,021,831**	**(5,066,354)**	**–**	**3,955,477**

(J) RISK MANAGEMENT (CONTINUED)

(a) Credit risk management (continued)

(iii) Master netting arrangement (continued)

	At 31 December 2017			
		Related amounts that are not offset in the statement of financial position		
	Derivative financial instruments presented in the statement of financial position *HK$'000*	Financial instruments *HK$'000*	Cash collateral received *HK$'000*	Potential exposure *HK$'000*
Financial assets				
– Derivative financial instruments *(note 17)*	4,770,495	(3,087,306)	(466,466)	1,216,723
Financial liabilities				
– Derivative financial instruments *(note 17)*	4,824,483	(3,087,306)	–	1,737,177

(iv) Mitigation of credit risk – Collateral and other credit enhancements

The Group is dedicated to mitigating credit risk, and this takes many forms. In general, risk to the Group's ultimate credit exposure is mitigated by recognised collateral and credit risk enhancement. The Group continuously seeks to enhance its level of credit risk mitigation.

The principal collateral received to secure loans and advances includes mortgages, cash collateral, equities listed on a main index/recognised exchanges, accounts receivable assignments, standby letters of credit and listed debt securities acceptable to the Group. In some cases, depending on the customer's position and the types of credit products, some loans may be granted and backed by corporate or personal guarantees only.

The Group has guidelines on the acceptability of specific classes of collateral or credit risk enhancements accompanied by the determination of valuation parameters. Such parameters are expected to be conservative and reviewed regularly. Security structures and covenants (financial and non-financial) are subject to regular review to ensure they comply with the stipulated conditions. The collateral is important to mitigate credit risk, but it is the Group's policy to assess the repayment ability of individual customers or counterparties rather than just solely relying on securities.

The Group's collateralised credit risk at 30 June 2018 and 31 December 2017, excluding impaired exposure, is broken down as follows:

	At 30 June 2018 ***HK$'000***	At 31 December 2017 *HK$'000*
Lower of gross loans and advances and fair value of collateral and other credit enhancements held against financial assets that are:		
– neither past due nor impaired	**91,975,927**	89,089,655
– past due but not impaired	**1,092,142**	1,498,422
	93,068,069	90,588,077

(J) RISK MANAGEMENT (CONTINUED)

(a) Credit risk management (continued)

(v) Portfolio management and risk concentration

Portfolio management

As part of the Group's portfolio management practices, a Risk-based Pricing Model has been adopted with the aim of improving the overall return for the Group, after taking into account the risks of the customers and facilities, and thus the capital required to support the loan exposure and other costs. Stress tests on the Group's credit risk are conducted regularly. The result is approved by the relevant committees and is endorsed by the Board through the CRMC.

Risk concentration

A Credit Risk Concentration Policy is in place and the Group constantly reviews its loan exposure to monitor the concentration of credit risk relating to customers, countries, market segments and products.

(vi) Expected credit losses measurement

Under HKFRS 9, expected credit losses ("ECL") allowances are recognised on all financial assets that are debt instruments classified either as amortised or fair value through other comprehensive income and for loan commitments and financial guarantees that are not measured at fair value through profit and loss. The application of an ECL model represents a significant change from the incurred loss model under HKAS 39. The ECL allowance represents an unbiased scenario that is determined by evaluating a range of possible outcomes, the time value of money and reasonable and supportable information about past events, current conditions and forecast future economic conditions. Forward-looking information is explicitly incorporated into the estimation of ECL allowances and expert judgement on economic forecasts becomes one of the important factors to the ECL. In contrast, the incurred loss model incorporated factors, including macroeconomic factors and information about past events and current conditions.

Measurement of ECL

ECL allowances are measured at amounts equal to either: (i) 12-month ECL; or (ii) lifetime ECL for those financial instruments which have experienced a significant increase in credit risk ('SIC') since initial recognition. The calculation of ECL allowances is based on the expected value of probability-weighted scenarios with a combination of upside, base and downside scenario(s) to measure the expected cash shortfalls, discounted at the effective interest rate. A cash shortfall is the difference between the contractual cash flows that are due and the cash flows that the Group expects to receive. The calculation of ECL allowances for Stage 3 is based on probability-weighted recovery amount from an impaired financial asset that is determined by evaluating a range of possible outcomes and time value of money.

The key inputs in the measurement of ECL allowances for Stage 1 and Stage 2 are as follows:

– The probability of default ('PD') is an estimate of the likelihood of default over a given time horizon;

– The loss given default ('LGD') is an estimate of the loss arising in the case where a default occurs at a given time; and

– The exposure at default ('EAD') is an estimate of the exposure at a future default date.

(J) RISK MANAGEMENT (CONTINUED)

(a) Credit risk management (continued)

(vi) Expected credit losses measurement (continued)

Stage transfer and SIC

Stage 1 is comprised of all non-impaired financial assets which have not triggered a SIC since initial recognition. Their credit risk continuously monitored by the Group and in assessing whether credit risk has increased significantly, the Group compares the risk of a default occurring on the financial instruments as at the reporting date, with the risk of a default occurring on the financial instrument as at the date of its initial recognition.

Stage 2 is comprised of all non-impaired financial assets which have triggered a SIC since initial recognition. The Group recognises lifetime ECL for stage 2 financial assets. In subsequent reporting periods, if the credit risk of the financial assets improves such that there is no longer a SIC since initial recognition, then the Group reverts to recognising 12 months of ECL as the financial assets have transferred back stage 1.

Stage 3 financial assets are those that the Group has classified as credit-impaired. The Group recognises lifetime ECL for all stage 3 financial assets. The Group classifies financial assets as impaired when one or more events that have a detrimental impact on the estimated future cash flows of the financial assets have occurred after its initial recognition. Evidence of impairment includes indications that the borrower is experiencing significant financial difficulties, or a default or delinquency has occurred.

For purchased or originated credit-impaired financial assets that are credit-impaired on initial recognition, their ECL allowances are always measured on a lifetime basis.

As described above, and subject to using a maximum of a 12-month PD for financial assets for which credit risk has not significantly increased, the Group measures ECL considering the risk of default over the maximum contractual period (including any borrower's extension options) over which it is exposed to credit risk, even if, for risk management purposes, the Group has the right to consider a longer period.

Forward-looking information incorporated in the ECL models

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. The Group has performed historical analysis and identified the key economic variables impacting credit risk and expected credit losses for each portfolio.

These economic variables and their associated impact on the PD, EAD and LGD vary by financial instrument. Expert judgement has also been applied in this process. Forecasts of these economic variables (the 'base economic scenario') are provided by the Group's economic experts and include consideration of a variety of external actual and forecast information. The Group formulates a 'base case' view of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios such as 1 upside and 3 downside forecast scenarios.

In particular, the base scenario carrying weighting of 65% represents the most likely scenario of continuing the current economic situation; the one upside scenario, carrying 7% weighting, represents likelihood of further improving the current economic prospect; and the three downside scenarios, namely, mild, medium and severe, carrying weighting of 28% in total, represents the likelihood of economic downturn of different severities. The following economic figures characterise the upside, base and downside scenarios:

Average 3rd quarter 2018 – 2nd quarter 2023	Hong Kong			Mainland China		
	Upside	**Base**	**Downside**	**Upside**	**Base**	**Downside**
GDP growth rate (%)	3.1	3.0	0.7	6.8	6.5	4.9
Inflation (%)	2.8	2.6	0.8	1.6	1.6	-0.1
Unemployment (%)	3.1	3.2	4.4	3.8	4.0	4.8
Property price index	330.7	315.0	258.1			
Real exchange rate	121.3	115.5	98.7			
Settlement rate in 6 months (%)	1.5	1.4	0.9			
Settlement rate in 12 months (%)	2.0	1.9	1.3			

The ECL recognised in the financial statements reflect the probability weighted outcomes of a range of possible scenarios above and the management overlay where required.

(J) RISK MANAGEMENT (CONTINUED)

(a) Credit risk management (continued)

(vi) Expected credit losses measurement (continued)

Forward-looking information incorporated in the ECL models (continued)

The Base scenario

The Group's Base Scenario is characterised by largely stable growth over the forecast period 2018-2023. Global GDP growth is forecast to average 3.5% over the period, with 3.5%-4.0% during 2018-2020 and 3.0%-3.5% in 2020-2023. The slower growth in 2020-2023 reflects that global economic recovery will approach its end after 2020.

Mainland China GDP growth is forecast to be moderately slower over the forecast period than those recorded in the recent years, indicating a continued but gradual growth slowdown amid sustained economic rebalancing and reforms from a development stage point of view.

Hong Kong growth is expected to continue recovering in 2018-2020 and settle down towards 3.0% in 2020-2023.

Inflation is expected to edge higher in 2018 in major economies than in 2017, moving towards the central banks' target of 2% at different paces over the forecast period. As a result, US and Eurozone central banks are projected to hike interest rates at a gradual pace, pressing ahead with monetary policy normalisation.

Unemployment rates have experienced significant improvements in advanced economies and been near historical lows in Mainland China and Hong Kong. Such positive developments are expected to continue over the forecast period, with the unemployment rates falling further in advanced economies and remaining low in Mainland China and Hong Kong.

The Severe Scenario

Under the Severe Scenario, the global economy falls into recession hit by China -US and global trade wars, policy failures by governments in major economies, or geopolitical tensions. GDP growth is forecast to become negative in most of the advanced economies and see a significant slowdown in Mainland China. Consequently, property markets see significant falls, equity markets experience sharp corrections, commodity prices and hence inflation witness deep declines, and unemployment rates show considerable rises.

The Benign, Mild and Medium Scenarios

The Benign Scenario is a slight deviation from the Base Scenario in the positive direction, with the global economy expanding at a slightly faster than- expected-pace and other key economic indicators displaying slightly better-than-expected improvements.

The Mild Scenario is a slight deviation from the Base Scenario in the negative direction, with the global economy expanding at a slightly slower-than- expected pace and other key economic indicators displaying slightly worse-than-expected improvements.

The Medium Scenario is in the middle position between the Base Scenario and the Severe Scenario, with the global GDP growth rate and other key economic indicators standing at the medium points between those of the two scenarios.

(J) RISK MANAGEMENT (CONTINUED)

(a) Credit risk management (continued)

(vi) Expected credit losses measurement (continued)

Definition of default and credit-impaired assets

The Group defines a financial asset as in default, which is fully aligned with the definition of credit-impaired under HKFRS 9.

In assessing whether a borrower is in default, the Group considers indicators that are: (i) qualitative – e.g. in breach of financial covenant(s), deceased, insolvent or in long-term forbearance; (ii) quantitative – e.g. overdue status and non-payment on another obligation of the same issuer to the Group. These criteria have been applied to all financial assets held by the Group and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the PD, EAD and LGD throughout the Group's expected loss calculations. The Group considers a financial asset to be in default when contractual repayment of principal or payment of interest is past due more than 90 days.

A financial asset is no longer considered in default when all past due amounts, including interest, have been recovered, and it is determined that the principal and interest are fully collectible in accordance with the original contractual terms or revised market terms of the financial assets with all criteria for the impaired classification having been remedied.

Write-off

The Group writes off a financial asset in whole or in part, when it has no reasonable expectations of recovering the financial asset in its entirety or a portion thereof. Indicators that there is no reasonable expectation of recovery include: (i) ceasing enforcement activity and (ii) where the Group's recovery method is foreclosing on collateral and the value of the collateral is such that there is no reasonable expectation of recovering in full.

(J) RISK MANAGEMENT (CONTINUED)

(a) Credit risk management (continued)

(vii) Credit quality of financial assets

The Group manages and monitors its risks, and has an Asset Quality Classification Policy and Impairment Assessment Policy in place to govern this aspect. The Group has a professional team dedicated to handling recovery of non-performing loans, which include loan restructuring, taking legal action, repossession and disposal of collateral, etc.

Distribution of financial instruments to which the impairment requirements in HKFRS 9 are applied, by credit quality and stage distribution.

	Gross carrying/notional amount						
	Strong *HK$'000*	Satisfactory *HK$'000*	Higher risk *HK$'000*	Credit impaired *HK$'000*	Total *HK$'000*	ECL allowances *HK$'000*	Net carrying amount *HK$'000*
Balances with banks, central banks and other financial institutions at amortised cost	19,196,027	–	–	–	19,196,027	(16,837)	19,179,190
– Stage 1	19,196,027	–	–	–	19,196,027	(16,837)	19,179,190
– Stage 2	–	–	–	–	–	–	–
– Stage 3	–	–	–	–	–	–	–
Placements with and advances to banks, central banks and other financial institutions at amortised cost	46,920,499	191,359	–	–	47,111,858	(4,862)	47,106,996
– Stage 1	46,920,499	191,359	–	–	47,111,858	(4,862)	47,106,996
– Stage 2	–	–	–	–	–	–	–
– Stage 3	–	–	–	–	–	–	–
Loans and advances to customers at amortised cost	126,362,245	56,587,989	15,691,850	1,250,472	199,892,556	(2,411,281)	197,481,275
– Stage 1	124,648,069	55,156,248	3,528,571	–	183,332,888	(704,540)	182,628,348
– Stage 2	1,714,176	1,431,741	12,163,279	–	15,309,196	(1,258,805)	14,050,391
– Stage 3	–	–	–	1,250,472	1,250,472	(447,936)	802,536
Other financial assets at amortised cost	5,504,769	311,227	69,603	42,640	5,928,239	(38,672)	5,889,567
– Stage 1	5,467,804	311,227	51,509	–	5,830,540	(713)	5,829,827
– Stage 2	36,965	–	18,094	–	55,059	(79)	54,980
– Stage 3	–	–	–	42,640	42,640	(37,880)	4,760
Loan commitments and financial guarantee contracts *(Note 1)*	5,664,004	5,368,686	1,295,245	–	12,327,935	(53,931)	12,274,004
– Stage 1	5,664,004	5,368,686	1,295,245	–	12,327,935	(53,931)	12,274,004
– Stage 2	–	–	–	–	–	–	–
– Stage 3	–	–	–	–	–	–	–
At 30 June 2018	203,647,544	62,459,261	17,056,698	1,293,112	284,456,615	(2,525,583)	281,931,032
Financial assets at fair value through other comprehensive income – Debt securities *(Note 2)*	66,200,964	1,194,990	141,395	44,851	67,582,200	(159,014)	
– Stage 1	66,200,964	1,194,990	–	–	67,395,954	(39,359)	
– Stage 2	–	–	141,395	–	141,395	(41,739)	
– Stage 3	–	–	–	44,851	44,851	(77,916)	
At 30 June 2018	67,952,105	2,626,731	12,322,768	44,851	82,946,455	(1,417,898)	

(J) RISK MANAGEMENT (CONTINUED)

(a) Credit risk management (continued)

(vii) Credit quality of financial assets (continued)

Note:

(1) The notional amount of commitments and financial guarantee contracts refer to those commitments and financial guarantees which subject to impairment requirements under HKFRS 9. Figures disclosed in the above do not agree with the figures disclosed in note 34(a) of the interim financial report.

(2) Debt securities measured at financial assets at fair value through other comprehensive income are held at fair value at 30 June 2018. The expected credit losses allowances in respect of debt securities measured at FVOCI are held within reserves.

(3) **Classification of credit quality**

The Group adopts the following internal risk ratings to determine the credit quality for financial assets.

Credit quality description	Internal ratings
Strong	G01-G12
Satisfactory	G13-G16
Higher risk	G17-G21
Credit impaired	G22-G24

(viii) Credit quality of financial assets at debt securities measured at FVPL and FVOCI

For the usage of credit rating to debt securities, where issue specific rating from external credit agencies is available, the issue specific rating would be taken as reference for credit risk rating assignment. If issue specific rating is not available but issuer rating is available, issuer rating would be taken as reference for credit risk rating assignment. The following table presents an analysis of the credit quality of investments in debt securities at the end of the reporting period.

	At 30 June 2018		
	Debt securities measured at FVPL *HK$'000*	**Debt securities measured at FVOCI** *HK$'000*	**Total** *HK$'000*
Aaa	**–**	**2,548,700**	**2,548,700**
Aa3 to Aa1	**703**	**15,185,187**	**15,185,890**
A3 to A1	**28,216**	**36,861,108**	**36,889,324**
Lower than A3	**703,441**	**11,088,105**	**11,791,546**
	732,360	**65,683,100**	**66,415,460**
Unrated	**189,245**	**1,806,182**	**1,995,427**
Total	**921,605**	**67,489,282**	**68,410,887**

(J) RISK MANAGEMENT (CONTINUED)

(a) Credit risk management (continued)

(viii) Credit quality of financial assets at debt securities measured at FVPL and FVOCI (continued)

	At 31 December 2017		
	Debt Securities measured at FVPL *HK$'000*	Available-for-sale securities – debt securities *HK$'000*	Total *HK$'000*
Aaa	–	2,490,087	2,490,087
Aa3 to Aa1	36,473	13,423,924	13,460,397
A3 to A1	59,980	30,084,326	30,144,306
Lower than A3	739,541	10,977,542	11,717,083
	835,994	56,975,879	57,811,873
Unrated	192,246	2,279,097	2,471,343
Total	1,028,240	59,254,976	60,283,216

(b) Market risk management

Market risk is the risk of loss caused by an adverse change in valuation associated with holding either long or short market positions. The risk arises as a result of market making, underwriting, principal position taking and asset/liability management in interest rate, foreign exchange, equity, credit and commodity markets and their associated derivatives instruments. The Group manages its market risk exposures mainly through its trading and treasury business. The trading business is to facilitate customer activities, but as a result, takes on principal positions. The treasury business performs asset/liability management function including liquidity risk management, with securities positions intended for liquidity management and investment purposes under non-trading portfolio (debt securities measured at fair value through other comprehensive income).

The objective of market risk management is to consistently measure and monitor market risk on a timely and unbiased basis in order to better manage the portfolios and, by doing so, optimize financial performance. The business is responsible for managing market risks to meet corporate performance objectives within the market risk limit parameters. The Risk Management Group ("RMG") is responsible to independently monitor and report all market risks.

Market risk framework

The Board of the Group allocates capital or risk appetite through the limit process. The Board delegates Credit & Risk Management Committee ("CRMC") to establish limits for the different businesses. CRMC further delegates market risk limit establishment to the Market Risk Committee ("MRC") and then to RMG. RMG is responsibility for designing and drafting the market risk limits and framework and reviewing and updating the limits on a regular basis. The market risk limits are to be approved by MRC and endorsed by CRMC. In addition, the Board also establishes a set of risk indicators under the risk appetite statement ("RAS") in measuring different types of risks including market risk.

RMG is an independent function reporting to the Chief Risk Officer ("CRO"). RMG uses both quantitative and qualitative measures in analysing market risk. The analysis includes, but not limited to, Value-at-Risk ("VaR"), stress testing, risk sensitivities, market events, product liquidity and volatility, underlying quality, hedging strategy, performance including profit and loss, accuracy of valuations and balance sheet and capital consumptions. The results are regularly reported to senior management and CRO and to MRC and CRMC.

In addressing newly introduced risks, all new products are governed by the "New Product Evaluation and Approval Policy" approved by CRMC. Prior to execution, each of the new products are reviewed and concurred by various functions including the senior management of the business, the Financial Management Group, the Operations and Technology Group, the Legal Department, the Compliance Department, the Internal Control Group and RMG. After the concurrence, the sponsoring business head obtains an approval from the CEO/Deputy CEO/Alternate CEO, CIOO and CRO for the new product.

(J) RISK MANAGEMENT (CONTINUED)

(b) Market risk management (continued)

Methodology and characteristics of market risk model

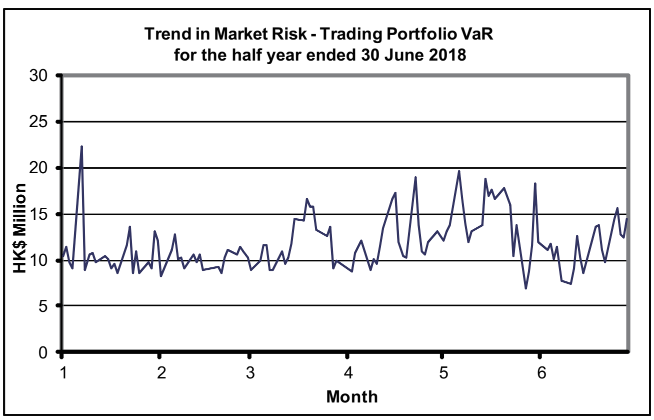
Value-at-risk (“VaR”)

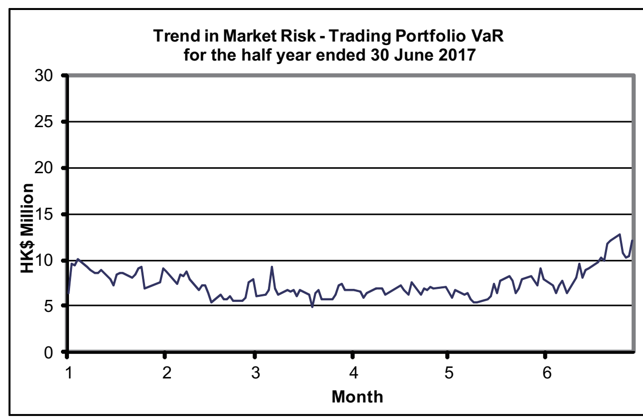
VaR is a technique in estimating the potential losses that could occur on market risk-taking positions due to market rates and prices movement under normal market conditions over a specified time horizon. The model is designed to capture different types of risk including interest rate risk, foreign exchange risk, credit spread risk, equity risk, commodity risk and volatility risk.

The VaR model used by the Group is based on the historical simulation technique. The technique predicts the value at risk by simulating or constructing position returns over time arise from the historical changes in rates and prices in the interest rate, foreign exchange, equity, credit and commodity markets.

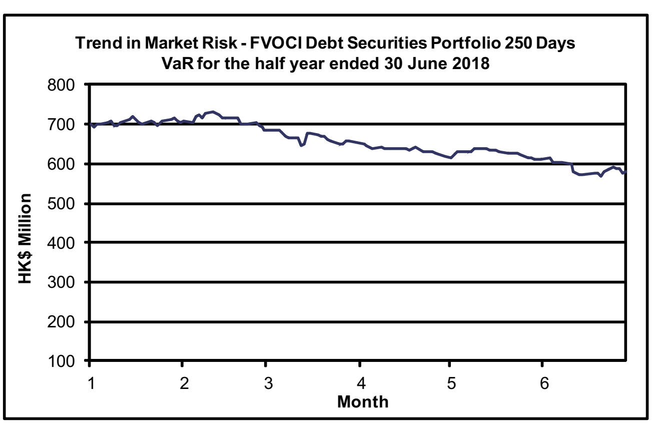
For the calculation of VaR, the Group uses the most recent two years of historical market rates, prices and volatilities.

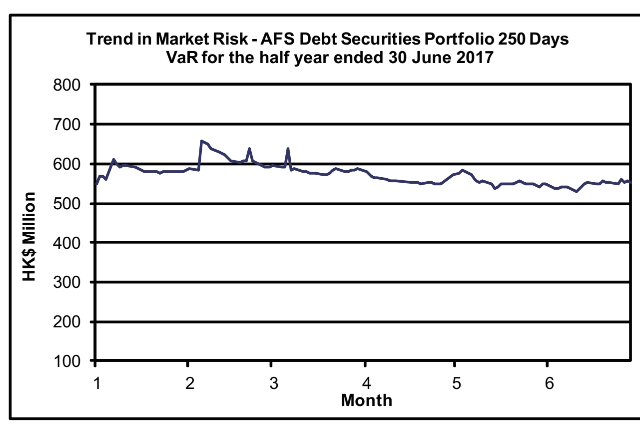
– For the trading positions, the VaR is calculated for one-day holding period.





– For the FVOCI/ available-for-sale debt securities and related positions, VaR is calculated for 250-day holding period.





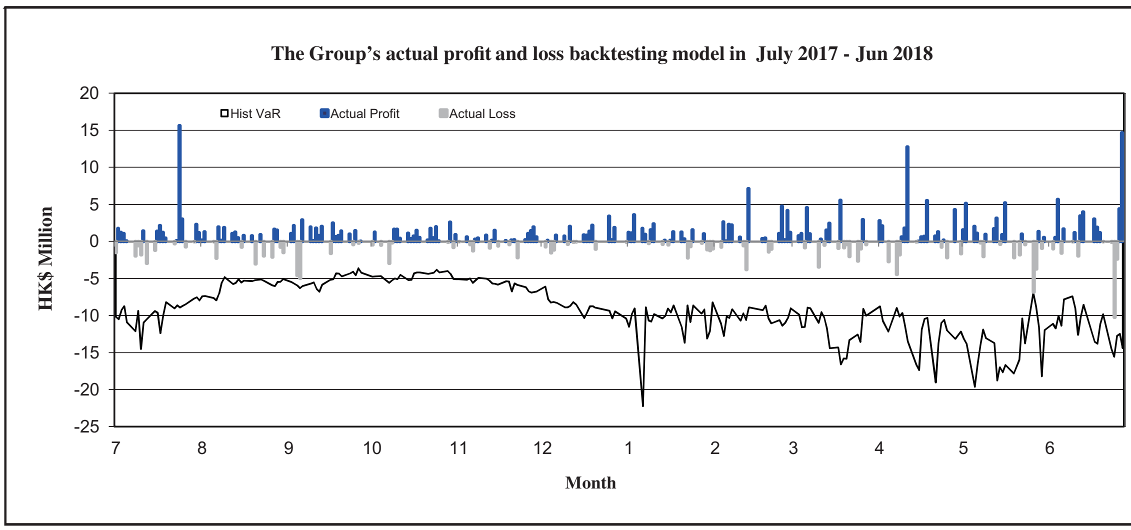
(J) RISK MANAGEMENT (CONTINUED)

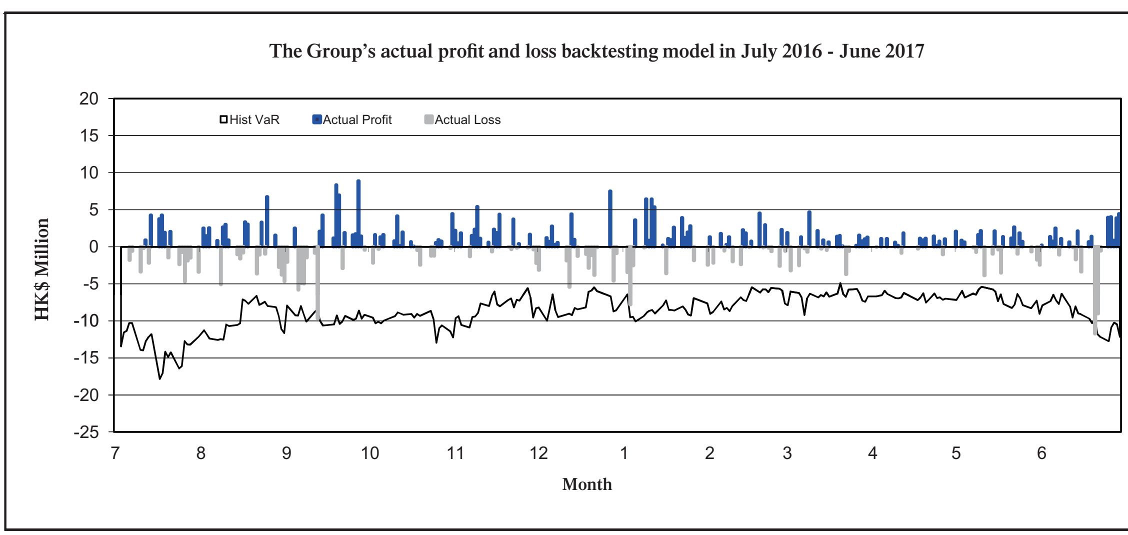
(b) Market risk management (continued)

Methodology and characteristics of market risk model (continued)

Value-at-risk ("VaR") (continued)

– The Group back-tests the accuracy of its VaR model by comparing the actual and hypothetical daily profit and loss, adjusted for items including fees and commissions, against the corresponding VaR figures. For the period from 1 July 2017 to 30 June 2018, there was no exception in the back-testing results (for the period of 1 July 2016 to 30 June 2017, there were 2 exceptions), which corresponds to the green zone specified by the HKMA and the international Basel principles.





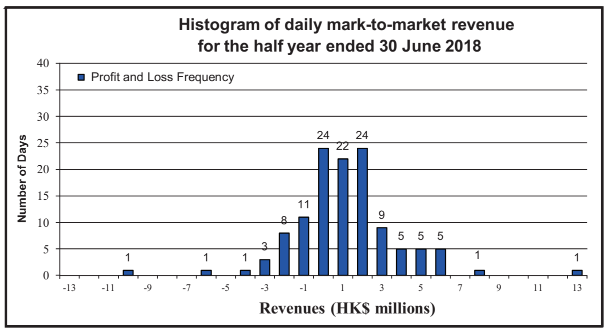
(J) RISK MANAGEMENT (CONTINUED)

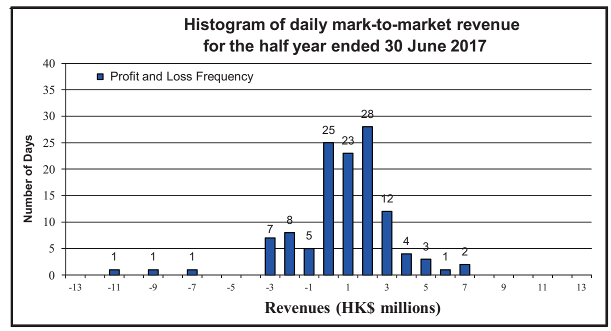
(b) Market risk management (continued)

Methodology and characteristics of market risk model (continued)

Value-at-risk ("VaR") (continued)

For the six months ended 30 June 2018, the average daily mark-to-market revenue from the Group's trading portfolio was a gain of HK$611,000 (six months ended 30 June 2017: gain of HK$300,000). The standard deviation of the daily revenue was HK$2,686,000 (six months ended 30 June 2017: HK$2,565,000). The graphs below show the histograms of the Group's daily mark-to-market revenue for the six-months periods ending 30 June 2018 and 2017, respectively.





The tables below decomposes VaR by risk factors for the trading positions and the FVOCI debt securities-related positions.

1-day VaR for the trading positions

	Six months ended 30 June 2018				Six months ended 30 June 2017			
	Approximate			**At 30 June**	Approximate			At 30 June
	maximum	**minimum**	**mean**	**2018**	maximum	minimum	mean	2017
	HK$'000	***HK$'000***	***HK$'000***	***HK$'000***	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Foreign exchange risk	**21,153**	**1,949**	**5,325**	**3,167**	11,517	2,672	5,597	10,524
Interest rate risk and credit spread risk	**19,368**	**7,166**	**10,506**	**13,548**	11,402	3,043	4,979	7,409
Total VaR	**22,224**	**6,913**	**11,831**	**14,577**	12,729	4,907	7,532	12,128

250-day VaR for the debt securities measured at FVOCI/ available-for-sale related positions

	Six months ended 30 June 2018				Six months ended 30 June 2017			
	Approximate			**At 30 June**	Approximate			At 30 June
	maximum	**minimum**	**mean**	**2018**	maximum	minimum	mean	2017
	HK$'000	***HK$'000***	***HK$'000***	***HK$'000***	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Interest rate risk	**760,890**	**628,118**	**701,746**	**634,917**	595,889	489,706	537,209	550,398
Credit spread risk	**703,407**	**595,238**	**672,672**	**604,498**	760,070	663,073	720,818	707,925
Total 250-day VaR	**732,689**	**567,893**	**656,106**	**582,308**	657,830	530,965	573,690	552,481

Stress testing

Stress testing is implemented as a compliment of the VaR model in order to capture remote, but plausible events. The Group uses both sensitivity-based and historical-based scenarios for market risk stress testing. The results are reported to senior management, MRC and CRMC.

(J) RISK MANAGEMENT (CONTINUED)

(b) Market risk management (continued)

Currency risk

The Group's foreign exchange risk stems from taking foreign exchange positions from commercial dealings, investments in foreign currency securities, and operations of the Group and its overseas branches and subsidiaries. The Group's foreign exchange positions are subject to exposure limits approved by the MRC. Methods adopted to measure foreign currency risk exposure against corresponding limits include individual currency positions, overall foreign exchange positions and sensitivities such as Greeks (for foreign exchange options). For the six months ended 30 June 2018, the Group's average daily trading profit and loss from foreign exchange positions was a gain of HK$1,246,000 (six months ended 30 June 2017: loss of HK$199,000), with a standard deviation of HK$6,843,000 (six months ended 30 June 2017: HK$3,590,000).

Significant foreign currency exposures at the end of the reporting period were as follows:

	At 30 June 2018				At 31 December 2017			
Equivalent in HK$'000	**USD**	**RMB**	**Others**	**Total**	USD	RMB	Others	Total
Spot assets	**149,531,586**	**19,482,599**	**19,244,008**	**188,258,193**	141,268,736	37,959,720	15,988,499	195,216,955
Spot liabilities	**(105,969,255)**	**(20,390,121)**	**(18,702,929)**	**(145,062,305)**	(109,407,468)	(31,800,014)	(15,182,196)	(156,389,678)
Forward purchases	**394,648,090**	**190,359,825**	**53,005,782**	**638,013,697**	242,910,664	118,395,468	26,779,741	388,085,873
Forward sales	**(437,094,063)**	**(188,392,412)**	**(53,405,659)**	**(678,892,134)**	(275,877,590)	(123,928,048)	(25,342,446)	(425,148,084)
Net options position	**51,912**	**(186,571)**	**(202,444)**	**(337,103)**	1,835,468	685,596	(2,379,021)	142,043
Net long/(short) position	**1,168,270**	**873,320**	**(61,242)**	**1,980,348**	729,810	1,312,722	(135,423)	1,907,109
Net structural position	**–**	**710,134**	**48,534**	**758,668**	–	718,963	48,676	767,639

The net option position is calculated using the Model User Approach, which has been approved by the HKMA.

Interest rate risk

The Group's interest rate risk arise from its banking and trading book. For the banking book, ALCO and RMG are responsible in overseeing the interest rate exposure arised from its assets and liabilities management. The treasury function ("CTU") is responsible in managing the interest rate risk using different financial products including interest rate derivatives, under which hedge accounting treatment is adopted. The interest rate risk includes repricing risks, basis risks, yield curve risks and embedded option risks, and are governed by the Interest Rate Risk Management Policy for the Banking Book.

For the trading book, MRC and RMG are responsible in overseeing the interest rate exposure from its trading portfolio. Global Markets is responsible in managing the interest rate risk using different financial products including derivatives, under which mark-to-market treatment is adopted. The interest rate risk includes basis risks, yield curve risks and embedded option risks, and are governed by the Market Risk Policy.

For the six months ended 30 June 2018, the Group's average daily trading profit and loss related to interest rate and fixed income trading strategy was a loss of HK$635,000 (six months ended 30 June 2017: a profit of HK$501,000), with a standard deviation of HK$6,303,000 (six months ended 30 June 2017: HK$3,132,000).

(J) RISK MANAGEMENT (CONTINUED)

(c) Liquidity risk management

Liquidity risk is the risk that the Group may not be able to fund an increase in assets or meet obligations as they fall due without incurring unacceptable losses. Such funding liquidity risk arises from the maturity mismatch of the assets and liabilities that the Group manages. Market liquidity risk is a risk that occurs when additional costs are involved in disposing of a position in the market under abnormal or stressed market conditions. Under these conditions, the bid-ask spreads for the position are much wider than usual or there could even be an extreme lack of buyers. As a result, the Bank will incur extra costs to dispose of the position.

The liquidity risk management framework is as follows:

– The management of the Group's liquidity risk is governed by the Liquidity Management Policy, concurred by the Asset and Liability Committee ("ALCO") and the CRMC, and approved by the Board of Directors.

– The CRMC is delegated by the Board of Directors to oversee the Group's liquidity risk management. Its main responsibilities are to review and approve policies, set strategies, and define risk appetite and tolerance limits.

– The ALCO is established by the Chief Executive Officer and ratified by the CRMC as the governing body responsible for formulating and implementing policies, strategies, guidelines and limit structures. It also identifies, measures and monitors the Group's liquidity risk profile to ensure current and future funding requirements are met. In addition, the ALCO monitors a set of risk indicators for liquidity risk. Daily liquidity stress testing, which includes market general, bank-specific and combined (market general and bank-specific) stress scenarios, is conducted by the Risk Management Group, and the stress results are regularly reviewed by the ALCO to assess the current risk tolerance level and the level of the liquidity cushion. A Contingency Funding Plan is established which sets out the strategies for addressing liquidity stress situations. The plan contains a set of policies, procedures and action plans, with clearly established lines of responsibility, as well as invocation and escalation procedures. This plan is reviewed and approved by the ALCO on a regular basis.

– Daily liquidity management is managed by the Central Treasury Unit to monitor funding requirements. This unit is supported by other functional departments including the Financial Management Group and Risk Management Group, which monitor the liquidity risk and provide regular reports to the management, committees and local regulatory bodies. Limits for net cash flow per different time bucket under stress scenarios have been set to ensure that adequate funding and liquid assets are available to meet liquidity needs. Moreover, limits, triggers or alerts are set for other liquidity risk indicators such as the statutory liquidity ratios, the loan-to-deposit ratio, the currency mismatch ratio and the maturity mismatch ratio. Both quantitative and qualitative measures are employed to identify and measure market liquidity risk. Limits and alert levels related to market and funding liquidity risk are monitored and reported by the Financial Management Group or Risk Management Group to the ALCO to review and approve on a regular basis. The Audit Department performs periodic reviews to ensure liquidity risk management functions are carried out effectively.

Liquidity management is conducted at the Group and the Bank levels, and at individual overseas branches and subsidiaries. Financial subsidiaries and overseas branches are responsible for implementing their own liquidity management policies under the framework established by the ALCO and local regulatory requirements, taking into account their different liquidity risk characteristics. The liquidity situation of overseas branches and subsidiaries falls under the overall supervision of the ALCO. Policy and respective counterparty limits are set for overseas branches and subsidiaries in respect of the funding support extended from the head office. The Group expects all business units to contribute to the success of managing liquidity under normal and contingency situations by maintaining a rapport with depositors, customers, interbank counterparties, related companies and the HKMA.

(J) RISK MANAGEMENT (CONTINUED)

(c) Liquidity risk management (continued)

The objective of liquidity management is to meet obligations payable under normal and emergency circumstances, to fund asset growth and to comply with the statutory liquidity requirements. To achieve this, the following liquidity management processes are in place:

– Projecting cash flows in normal and various stress scenarios, using the net mismatch gap between assets and liabilities to estimate the prospective net funding requirement;

– Factoring potential drawdown on irrevocable committed facilities into our normal and stress scenarios to cater for contingent liquidity risk;

– Monitoring the statutory liquidity ratios, the loan-to-deposit ratio, the currency mismatch ratio and the maturity mismatch ratio against internal and/or regulatory requirements;

– Ensuring a sound and diversified range of funding sources, through monitoring the structure and the stability of the deposit portfolio;

– Projecting the statutory liquidity ratios regularly for the short to medium term to permit early detection of liquidity issues and to ensure the ratios are within statutory requirements and internal triggers;

– Projecting a high-level funding requirement and funding structure during the annual budget process to ensure sufficient funding and an appropriate funding mix;

– Conducting liquidity risk assessment before launching a new product;

– Maintaining High Quality Liquid Assets ("HQLA") comprising cash and investment grade securities as a cushion against unexpected funding needs. The amount of HQLA that the Group maintains is determined with reference to the statutory requirement and the results of the liquidity stress tests;

– Maintaining access to the interbank money market;

– Maintaining a funding programme to tap debt funding on a regular basis;

– Monitoring the Group's collateral requirement. Periodically assess and review the additional collateral required under derivative contracts and credit downgrade events. Based on the positions at 30 June 2018, in the event of a 2-notch downgrade, the impact on the Group's additional collateral requirement is minimal; and

– Maintaining a Contingency Funding Plan, which integrates with the results of the scenarios and assumptions used in the stress test, including setting early warning indicators (including internal and market indicators), and describing actions to be taken in the event of a stress crisis, so as to minimise adverse long-term implications for business.

The Group funds its operations through a diversified funding source, primarily from the retail and corporate customer deposits. At the same time, it also participates in the wholesale funding market through the issuance of certificates of deposit ("CDs") to secure another source of term funding and to enable diversification of funding sources. Deposit tenor mix and debt maturities are regularly monitored to ensure there is an appropriate funding maturity mix.

The Group was designated by the HKMA as Category 1 institution with effect from 1 October 2017. Under the Banking (Liquidity) Rules, the Group being a Category 1 institution is required to maintain a Liquidity Coverage Ratio ("LCR") and Net Stable Funding Ratio ("NSFR") above the statutory minimum requirements.

An appropriate level and currency mix of HQLA has been maintained to ensure that the Group could handle sudden drains in market liquidity due to adverse or unexpected economic events under the HKMA's regulatory framework. Besides, the Group also observes and reports the LCR for each individual significant currency to ALCO regularly. The increase in average LCR in first half of 2018 was mainly driven by the increase in the Level 1 HQLA and the decrease in cash outflow.

(J) RISK MANAGEMENT (CONTINUED)

(c) Liquidity risk management (continued)

The average LCRs for the period are as follows:

	For quarter ended 30 June 2018 %	For quarter ended 31 March 2018 %	For quarter ended 31 December 2017 %
Average LCR	**213.1%**	**228.2%**	177.6%

The Group always maintains sufficient cash and liquid positions as well as a pool of HQLA as a liquidity cushion that can be liquidated in stress scenarios. The majority of HQLA included in the LCR is Level 1 assets as defined in Banking (Liquidity) Rules. The below table shows the composition of the Group's HQLA in the LCR framework:

	Weighted amount (average value)		
	For quarter ended 30 June 2018 *HK$'000*	**For quarter ended 31 March 2018** *HK$'000*	For quarter ended 31 December 2017 *HK$'000*
Level 1 assets	**32,666,235**	**38,172,653**	28,917,610
Level 2 assets	**7,489,966**	**7,421,968**	7,142,153
Total	**40,156,201**	**45,594,621**	36,059,763

The Group also maintains sufficient available stable funding in support of its longer-term assets to meet the statutory NSFR requirements. The decrease in the NSFR in the 2nd quarter was mainly driven by the dividend payment made in that quarter. There is no interdependent asset and liability as defined in the Banking (Liquidity) Rules in the Group.

The NSFRs as at the quarter-end in 2018 are as follows:

	Quarter ended 30 June 2018 %	Quarter ended 31 March 2018 %
NSFR	**132.5%**	**134.9%**

For the purposes of compliance with Banking (Disclosure) Rules, information relating to the Group's liquidity are published by using standard disclosure templates as specified by the HKMA and they can be viewed in the Regulatory Disclosures section of our Bank's corporate website at www.cncbinternational.com.

(J) RISK MANAGEMENT (CONTINUED)

(d) Capital management

The Group's primary objectives when managing capital are:

– to comply with the capital requirements set by the banking regulators in the markets where the entities within the Group operate;

– to maintain a strong capital base to support the development of its business; and

– 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.

The HKMA sets and monitors capital requirements for the Group as a whole. An individual banking subsidiary is directly regulated by its local banking supervisor. The HKMA requires that the Group maintain three prescribed minimum risk-weighted capital ratios: Common Equity Tier 1 ("CET1") capital ratio, Tier 1 capital ratio and total capital ratio. In accordance with the Banking (Capital) (Amendment) Rules 2014 which came into effect on 1 January 2015, the Basel III capital buffers, namely capital conservation buffer ("CCB") which is designed to ensure that banks build up capital outside periods of stress of 2.5% of risk-weighted amounts and countercyclical capital buffer ("CCyB") which is set on an individual country basis and is built up during periods of excessive credit growth, came into operation. Both would be gradually phased in from 1 January 2016 to 1 January 2019. The HKMA announced a CCyB ratio for Hong Kong of 0.625%, 1.25%, 1.875% and 2.5% of risk-weighted amounts from 1 January 2016, 1 January 2017, 1 January 2018 and 1 January 2019 respectively. Basel III framework also introduced a leverage ratio as a non-risk-based backstop limit, to supplement risk-based capital requirements. On 1 January 2018, the Banking (Capital) (Amendment) Rules 2017 came into operation and prescribed the statutory minimum leverage ratio of 3%.

The Group adopts the standardised approach of calculating market risk in its trading portfolios and risk weightings for credit risk, and the basic indicator approach for operational risk. Banking operations are categorised as either trading or banking book, and risk-weighted amounts are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

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. In order to comply with the risk-based supervisory framework of capital adequacy stipulated by the HKMA, the Group conducts ICAAP, which assesses the capital requirement for Pillar 2 risks and hence the capital requirement for Pillar 1 and 2 is derived. Moreover, as part of the capital management policy and to ensure capital adequacy, the Group conducts capital planning annually, which takes into account the strategic focus, future business growth, risk appetite and regulatory requirement. The plan covers the issuance of capital instruments, if required, to ensure the Group's capital ratios are well above their respective internal monitoring levels and regulatory requirement. Regular stress testing is performed to ensure that the impact of extreme but plausible scenarios on the risk profile and capital position is considered. Stress testing also gives an insight into the potential impact of significant adverse events and how these could be mitigated.

Consistent with industry practice, the Group monitors its capital structure on the basis of the capital adequacy ratio. There have been no material changes in the Group's policy on the management of capital during the period.

The capital adequacy ratios at 30 June 2018 were computed on the consolidated basis of the Group and some 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.

The Group and its individually regulated operations have complied with all externally imposed capital requirements throughout the period ended 30 June 2018 and year ended 31 December 2017, and the Group's capital ratios are well above the minimum required ratios set by the HKMA.

(J) RISK MANAGEMENT (CONTINUED)

(e) Operational risk management

Definition of operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Governance framework

The Group has established an Operational Risk Governance Framework ("ORGF") to identify, assess, mitigate, control, monitor and report operational risk. The ORGF encompasses every member within the Group and is governed by policies and guidelines which document the minimum requirements to ensure a consistent approach to manage operational risks. Operational Risk Management ("ORM") relevant matters are under the oversight of the Credit & Risk Management Committee ("CRMC"), a subcommittee of the Board of Directors, and the Operational Risk Management Committee ("ORMC"), a committee led by management. Implementation of ORM plans and tools is driven by the ORM team and senior management of business and support units.

Management of operational risk

Day-to-day operational risk management lies with our business units, support units and the Operational Risk and Control Head ("ORCH") of each unit assists the respective heads in this regard.

ORM team assists management in meeting their responsibility of understanding and managing operational risk and ensures the development and consistent application of operational risk policies, processes and procedures throughout the Group. Business and support units are responsible for monitoring operational risks and tracking Key Risk Indicators in their areas. The ORM team monitors the Group's overall operational risk exposures and ensures that all material risks are promptly and appropriately escalated to the ORMC, CRMC and senior management of the Group for their attention.

The Internal Audit Group examines and evaluates the adequacy and control effectiveness of the ORGF on an ongoing basis.

A web-based learning programme on operational risks is required for all new joiners and an annual refresher training on ORGF is compulsory for all staff. Training workshops led by the ORM team are offered to business and support units with the objectives of raising operational risk awareness, familiarizing with the ORM tools and enhancing employees' understanding of the ORGF along with their roles, responsibilities and accountabilities. This is further reinforced by strong, visible management support which encourages staff to embrace and pursue operational excellence. In December 2017, a Fraud Risk Management team was established to further enhance the Group's fraud risk management framework.

Risk assessments are conducted on all outsourced activities, new products and large projects.

(J) RISK MANAGEMENT (CONTINUED)

(e) Operational risk management (continued)

Tools and methodologies

The Group identifies, assesses, monitors and reports on operational risk through the ORM tools and systems as set out below:

– Operational Risk & Control Self-Assessment ("RCSA") is a tool to identify and assess the level of operational risk and effectiveness of control. RCSA has been rolled out across the business and support units under the guidance of the ORM team. RCSA leaders are nominated by the management of each business and support unit to conduct self-assessments and identify key risk factors in their daily business and support functions. Each key risk factor is assessed and quantified for financial impact, in terms of the estimated loss impact of each occurrence and estimated number of occurrences. In addition to the financial impact assessment, non-financial impacts including customer, regulatory and reputation impacts are also assessed taking into considerations of both likelihood of risk materializing and severity of impact.

– Key Risk Indicators ("KRIs") are statistical metrics that take various risk factors into consideration and serve to provide early warning signals for management's monitoring and action. Through regular monitoring of these KRIs, areas of potential operational control weaknesses can be identified at an early stage and addressed promptly. KRIs are developed at two levels, namely the group and the unit level. Unit level KRIs are developed by the respective units, and are monitored and tracked for progress towards completion of applicable mitigation plans. Thresholds are established for each business unit/service support unit KRI by reference to the business' acceptable risk level for each risk factor.

– Operational risk incidents are reported into a centralized operational loss database called the Incident Reporting System ("IRS"). Through the IRS, the ORM team ensures all material operational risk incidents are registered, properly investigated, with corrective and preventive actions promptly executed according to agreed timelines. The IRS data serves as a centralized database to produce regular reports for senior management, ORMC and CRMC review of impact of significant incidents and monitoring of the operational risk trends. An escalation protocol is in place to ensure that operational risk incidents with significant impact are reported to the regulatory authorities, if deemed necessary. Lesser impact operational risk events are also collected to assist trend analysis and provide a more forward looking perspective of potential risk issues that warrant for closer attention.

– Operational Risk Dashboard ("ORD") provides management with an overview of the key operational risk issues including but not limited to the progress of the RCSA reviews and KRI evaluation results. This information is submitted to the ORMC monthly and relevant summarized information is submitted to the CRMC quarterly as part of the Group-wide Risk Status Update Report. The Group-wide Risk Status Update Report captures the implementation status of ORM initiatives, contains analyses on the trend of operational losses, highlights operational risk incidents that have a material impact on the Group, and lists incident details during the reporting period.

The Group will continuously fine-tune and enhance its operational risk management framework in line with industrial developments.

The Group's long-term goal is to cultivate a proactive, responsible and accountable culture on ORM, and achieve operational excellence through robust and continuous operational risk management.

(J) RISK MANAGEMENT (CONTINUED)

(f) Legal risk management

The Group remains abreast of all legal and regulatory requirements applicable to its governance and operations, and continuously seeks to develop its people, enhance its systems and processes, and implement changes as necessary to meet the demands and create awareness of such requirements. Regular reviews are conducted with respect to the Group's policies and procedures to ensure the same reflect the latest legal and regulatory requirements. Issuance of new or substantially revised policies and procedures are often accompanied by relevant training. There is a strong process in place to ensure legal and regulatory risks are identified, monitored and mitigated. Any significant matters that arise relating to such risks are reported as appropriate by either the Legal or Compliance function to the Group's CRMC or senior management.

The Legal Department ("Legal") and Compliance Group ("Compliance") have been key partners in the business, providing legal and compliance advice and support to all parts of the Group and working with business and support units to ensure relevant controls are in place. In the first half of 2018, Legal and Compliance were actively involved in new product launches and new business initiatives, strategically important transactions and commercial agreements, outsourcing arrangements as well as day-to-day matters arising from the Group's business. Legal and Compliance will remain heavily involved in monitoring and ensuring compliance with changing regulatory requirements in various areas impacting the Group, and will continue to advise and support the Group in meeting the legal and regulatory challenges that lay ahead.

(g) Strategic and reputation risk management

Strategic risk management refers to the Group's efforts to develop, uphold and implement strategic decisions related to its long-term growth and development. Reputation risk management refers to the Group's efforts to protect its brand name and business franchise from any potential damages arising from negative publicity and information about its business practices, conduct or financial condition.

The CRMC of the Group meets regularly to monitor and oversee the Group's strategic and reputation risks. Senior management places high priority on ensuring that the Group's business and operational strategies are appropriately defined and are executed professionally and promptly. Such strategies are reviewed regularly to enable the Group to respond efficiently to changes in its operating and regulatory environment. Business priorities, set on a bank-wide basis, as well as for individual business and functional units, are aligned to support the Group's strategies, and measurable targets are assigned to ensure execution excellence. Great care is also taken to protect the Group's reputation and to maximise its brand equity. This includes ongoing efforts to monitor and ensure high standards of customer satisfaction, operational efficiency, legal and regulatory compliance, public communication and issues management.

REPORT OF THE CHIEF EXECUTIVE OFFICER

At the start of 2018, last year's trend of global synchronous economic recovery remained intact while US interest rates were on an orderly uptrend, creating a favourable operating environment for the banking industry. Nevertheless, risk factors have begun to surface since the second quarter, notably heightened US protectionism and pressure on emerging markets' currency values from rising US treasury yields and a stronger US dollar, which have resulted in capital flight from developing countries and volatility in financial markets. In the face of an external environment that is fraught with uncertainties, China CITIC Bank International Limited ("CNCBI") and its subsidiaries (together "the Group") capitalized on its core competitive strengths, especially close collaboration with the CITIC Group and China CITIC Bank Corporation Limited ("CNCB" or "parent bank"), continued to press ahead with business transformation, leveraged financial technologies ("FinTech") and strengthened risk management, delivering a satisfactory set of results for the first half of 2018.

OPERATING ENVIRONMENT

The global economy sustained its upswing in the first half of 2018. Steady growth was recorded in the US, while its benchmark interest rate was lifted twice by 25 basis points each. The Eurozone's economy also remained stable but displayed slightly weaker-than-expected growth momentum. This was primarily attributed to a slower pace of recovery in both Germany and France, while a change of government in Italy gave rise to new uncertainties, and the UK continued to be plagued by Brexit negotiations. For Mainland China, despite the central government's persistent efforts to implement supply-side reforms and deleveraging measures, GDP for the first six months of the year still registered a steady growth of 6.8%.

However, changes in the external environment started to occur in the second quarter. The US decided to impose extra tariffs on imports from its trading partners, targeting specifically at a number of goods made in China. This has triggered retaliatory moves by other countries and cast a shadow on the prospects for international trade. Meanwhile, the double whammy of higher US treasury yields and a stronger USD caused selected emerging markets' currencies to undergo substantial depreciation, sparking capital outflows and rendering financial markets much more volatile.

In the first half this year, the build-up of risk factors had yet to be fully reflected in the Hong Kong economy, which remained buoyant with generally good growth in both internal and external demand. The year-on-year growth in GDP at 4.0% for the first half of 2018 was ahead of the 3.8% achieved for the full year of 2017. The banking industry thus posted an encouraging performance against such a backdrop. Statistics of the Hong Kong Monetary Authority ("HKMA") show that net interest income and fee and commission income increased, contributing to a 32.9% year-on-year increase in the first-quarter pre-tax profits of retail banks in Hong Kong. However, widening spreads between Hong Kong dollar interest rates and their US counterparts stimulated arbitrage activities, prompting the HKMA to intervene several times in the market to defend the linked exchange rate. Despite still ample liquidity in the domestic banking sector, the growth in customer deposits has decelerated. As at end-June 2018, total deposits were up 1.6% from end-2017 but down 0.2% month on month. Meanwhile, a monthly increase of 0.9% was recorded for total loans and advances, which were 5.3% higher than the end-2017 level.

FINANCIAL PERFORMANCE

The Group recorded operating income of HK$4.36 billion in the first half this year, representing a 9.8% increase from the same period last year. Profit attributable to shareholders was HK$1.62 billion, a stable year-on-year growth of 16.9%. Return on average assets at 0.94% was up 9 basis points compared with 0.85% for the full year of 2017, while return on average shareholders' equity was down 1.15 percentage points to 8.96% due to completion of a capital injection exercise towards the end of last year which has enlarged the Group's share capital base.

During the period under review, the growth in net interest income at 35.1% year on year to HK$3.30 billion exceeded expectations, while net interest margin expanded by 24 basis points from last year's full-year level to 1.92%. Non-interest income was down 20.9% from the same period last year, mainly because the adoption of a more prudent loan strategy had lowered loan fees and bills commission income. Besides, income from foreign exchange ("FX") funding swaps was affected by widened differential between Hong Kong dollar and US dollar interest rates. Encouragingly, the Group's debt capital markets ("DCM") business continued to perform well, while promising growth was evident for trading business.

The Group manages its loan portfolio prudently to ensure that healthy asset quality can be maintained. Impairment at HK$773 million for the first half this year was down 10.8% from the HK$867 million made for the corresponding period last year.

The Group continued to increase investments in IT and human resources in line with its business growth and development. Operating expenses rose by 8.8% to HK$1.62 billion year on year, remaining within budget and below the growth in operating income. Cost to income ratio was 37.1%, 3.2 percentage points lower than the full-year figure for 2017.

FINANCIAL POSITION

As at 30 June 2018, the Group's total assets stayed stable, amounting to HK$349.27 billion, up 1.4% from end-2017. Customer loans including trade bills at HK$199.89 billion were slightly higher than the level as at end-2017. Meanwhile, customer deposits including certificates of deposit issued stood at HK$273.99 billion, similar to six months ago, with sustained growth in retail deposits resulting in a continued rise in their share of the total to 51.5%. The deposit base was thus more solid and the structure more favourable.

During the period under review, benefiting from substantial recovery in cash and write-off, impaired loans balance decreased significantly to HK$1.25 billion as at end-June, down 49.3% from the amount as at end-2017, while impaired loan ratio was reduced noticeably to 0.63% from 1.26% as at end-2017, which was the lowest level since 2015. In the meantime, partly due to the implementation of Hong Kong Financial Reporting Standard 9 ("HKFRS 9") which requires the recognition of impairment on financial assets based on a forward-looking expected credit loss model, non-performing loan coverage ratio increased from 61.8% as at 31 December 2017 to 192.8%.

As at 30 June 2018, the Group's total capital adequacy ratio was 17.8%, while tier 1 capital ratio and common equity tier 1 capital ratio were 15.1% and 12.7% respectively, meeting regulatory requirements. Moreover, average liquidity coverage ratio for the second quarter of 2018 was at a sound level of 213.1%.

BUSINESS REVIEW

Wholesale Banking Group ("WBG")

WBG adhered to the strategy of "Active Marketing, Conservative Underwriting" in the first half of 2018 and achieved a breakthrough in its business. Despite a stable customer loans balance, operating income grew by 4.1% to HK$2.55 billion, demonstrating improved efficiency and profitability of the corporate lending business. Besides, during the first six months of the year, Hong Kong headquarters successfully opened 391 new accounts, bringing in deposits of HK$4.83 billion. The good results for the period under review were attributable to the following four factors:

Prudent risk management. In a bid to improve asset quality, WBG continued to adopt the strategy of completely withdrawing from relatively higher-risk loans to make room for more secure loans, including those with direct mortgages, granted to state-owned enterprises and backed by parent bank standby letters of credit ("SBLC"). At the same time, post-lending review and on-site examination have been strengthened to ensure sustained stability of the loans. In the first half of the year, WBG strategically exited HK$4.6 billion of lower-quality loans, while new loans with direct mortgages, granted to state-owned enterprises and backed by parent bank SBLC amounted to HK$13.15 billion, representing another step in achieving a better customer mix and higher asset quality.

Strong backing by the CITIC Group and CNCB. In the first six months this year, WBG closely collaborated with the CITIC Group and parent bank to jointly provide comprehensive services to customers with cross-border banking demand. During the period under review, the number of collaboration customers reached 1,171, up 3.0% from the corresponding period in 2017. There was a 14.7% year-on-year growth in collaboration revenues, which accounted for 45.8% of WBG's total revenues, up 4.2 percentage points from the same period last year.

Stable growth in real estate loans. During the period under review, WBG spearheaded a campaign for increasing lending to real estate companies, aiming at exploring business opportunities in the three strategic areas of Beijing, Shanghai and the Greater Bay Area (including Hong Kong, Guangzhou and Shenzhen, etc.). Specifically, credit facilities have been extended to companies able to provide direct mortgages to raise the security for the loans. In the first half of the year, over 70% of facilities approved on real estate were direct mortgage structure.

Collaboration with overseas branches. WBG shifted its strategic focus area in the first six months this year, with business development being concentrated in Hong Kong headquarters. As WBG's overseas platform, overseas branches have further increased their risk management capabilities, enhanced staff training and internal controls, as well as joining forces with headquarters to provide services to customers with overseas business needs.

The customer structure decides the business structure, which will decide the revenue structure. In the second half of the year, WBG will make every effort to adjust the customer structure, further deepen its relationships with customers and introduce more secure products. In the meantime, it will continue to tighten internal controls to ensure long-term stable growth of CNCBI's corporate business.

Personal and Business Banking Group ("PBG")

PBG achieved strong record-breaking results for the first half of 2018. Operating income set a new half-year record of HK$1.27 billion, representing an increase of 11.9% year on year. As at 30 June 2018, customer deposits reached a new high of HK$140.98 billion, up 7.8% versus end-2017. On the asset side, in the midst of an extremely competitive mortgage market, PBG proactively targeted small and medium-sized enterprises ("SME") loan business and consumer finance business. As a result, total retail lending balance rose to a record high of HK$49.02 billion, up 6.8% compared to end-2017, underpinning a 9.5% year-on-year growth in net interest income. Non-interest income also grew impressively by 17.7%, primarily driven by PBG's ability to respond quickly to changing market conditions to provide timely investment products and services, and encouraging results related to the provision of insurance solutions to customers.

Operating expenses increased by 6.7% from the same period last year to HK$658 million, reflecting PBG's commitment to invest in technology, an increase in its sales and service channel capabilities and its support to the branch network for long-term sustainable growth. Asset quality remained healthy, with credit cost of HK$18.6 million for the first half of 2018. As a result, profit before taxation reached HK$589 million, representing a 14.8% increase year on year.

Capitalizing on a more diversified product range and stronger sales and service channel capabilities, PBG has continued to deepen its relationships with existing customers while actively acquiring new customers. As at end-June 2018, the total number of high net worth customers including CITIC*first* and private banking customers exceeded 34,900, 19.1% higher than as at the end of last year. Total assets under management for high net worth customers increased to about HK$144.34 billion, representing a 14.4% growth from end-2017.

PBG embraces FinTech to enhance its competitive advantages, providing innovative products and services to its target customers. In early March, CNCBI officially launched the inMotion mobile application. It was the first bank in the market to offer truly remote account opening service for Hong Kong identity card holders. CNCBI has been awarded a Second Prize in the Shenzhen-Hong Kong Fintech Award jointly organized by the HKMA and the Shenzhen Office of Financial Development Service ("OFDS") in recognition of its leading position and continuous breakthrough in the applications of FinTech.

For the second half of the year, with the launch of a new wealth management system, PBG is confident that it can continue to expand its customer base. Moreover, it will further step up its investments in e-business capabilities.

Treasury and Markets Group ("TMG")

TMG continued to enjoy sustained development in the first six months of 2018, with Global Markets recording an operating income of HK$372 million. The DCM team and marketing teams worked closely together on corporate issuer referrals, selling bonds to corporate investors and following up on potential treasury business opportunities, which has produced remarkable results. The corporate marketing team saw good flows in various treasury products (including FX and interest rate products). Meanwhile, the financial institutions ("FI") marketing team brought about a marked increase in the volume of secondary market bond trading by FI clients, and the revenue from selling FX products to them also rose significantly year on year, showing that the team's effort in building up a portfolio of FI clients has been bearing fruit, and its capability for dealing with clients' demand has also increased greatly.

The performance of the Renminbi ("RMB") trading team in the first half of the year was outstanding as well. While building up a substantial trading volume, the average daily volume was consistently maintained at a high level. Thomson Reuters has thus awarded CNCBI "Best e-FX Execution Chinese Bank" and "Best FX Data Contribution Bank" in recognition of its effort and contribution in the two areas respectively.

For the DCM business, building on the momentum last year, its results in the first six months of 2018 remained satisfactory, with fee income of HK$156 million recognized in the period. The DCM team has completed 58 deals for 31 Chinese issuers with total issuance size amounting to US$26.41 billion. There were 30 transactions where CNCBI acted as global coordinator. As at 30 June 2018, according to Bloomberg Offshore China Bonds issuance volume, CNCBI ranked ninth among all managers and fourth among Chinese financial institutions in Hong Kong.

The Central Treasury Unit ("CTU") also performed well in the first half this year. To keep pace with the interest rate cycles of the US dollar and Hong Kong dollar, the CTU carefully managed the mismatch in the Group's liquidity positions and achieved higher returns on deployment. Coupled with lower losses on the internal funding pool, this resulted in strong financial performance during the period under review. Meanwhile, the team adjusted internal fund transfer pricing in a timely manner, ensuring that the Group could maintain prudent liquidity management and a sound loans to deposits ratio. In addition, proactive management of FX funding swaps helped reduce mark-to-market volatility and losses due to a sharp surge in Hong Kong dollar interest rates. The team also actively participated in onshore Bond Connect business, with outstanding position once hitting a high of approximately RMB3.0 billion.

Risk Management and Internal Controls

During the first half of 2018, the Group continued to reinforce its risk management and internal controls, with a particular focus on credit risk and compliance risk (especially anti-money laundering) management. The Group is committed to upholding stringent credit policies, conducting intensive in-depth credit assessments and strengthening post-lending monitoring, as well as proactively performing portfolio reviews and stress testing. Moreover, the Group continued to implement more robust anti-money laundering controls by enhancing the transaction monitoring system and name screening system, ensuring that its domestic and overseas businesses can satisfy the compliance requirements of the regulators in Hong Kong as well as other relevant jurisdictions, especially in respect of applicable sanctions compliance and legal requirements.

The Group has always emphasized the importance of fortifying its risk management structure, tools and capabilities. This encompasses initiatives which focus on strengthening (i) risk culture, (ii), fraud risk management capabilities, (iii) market and liquidity modelling, (iv) bank-wide stress testing programmes, (v) credit scorecards and rating models, and (vi) impairment models and framework development. Since the implementation of HKFRS 9, the Group has endeavoured to continue to strengthen its governance, model framework and impairment computation process. The Risk Appetite Statement ("RAS") and Risk Appetite Framework ("RAF"), expressed in both qualitative and quantitative terms, enable the measurement and monitoring of the Group's risk profile under various dimensions, comprising credit, market, interest rate, liquidity, compliance, operational (including legal), reputation and strategic risks, etc.

OUTLOOK

Looking ahead into the second half of 2018, the prospects for the global economy will continue to hinge on US policies. While resurgent inflation pressures may precipitate faster rate hikes by the Federal Reserve, causing wilder fluctuations in financial markets, should the US escalate its trade friction with other countries, particularly with worsening Sino-US trade disputes, it is set to take its toll on consumer confidence and investment sentiment or may even reverse the trend of concurrent expansion of major economies that has lasted for more than a year. Moreover, China's economy is facing pressure of slower growth and with a series of debt default cases, the credit environment is exhibiting signs of higher risk and giving cause for concern.

To tackle a complex and fluid external environment, the Group will strive to ensure that it can maintain a healthy balance sheet structure with stable expansion to drive sustainable growth. As to business, one of the emphases is to develop private banking wealth management business, making use of the new electronic sales and services platform of inMotion mobile banking to enhance service quality and customer experience. In addition, sustained effort will be devoted to expanding the DCM and other treasury businesses to satisfy customers' demand for hedging against interest rate and currency risks. There are also plans to launch new products and services, such as asset management business. At the same time, the Group will keep strengthening risk management and adjusting the customer mix, especially enhancing the management of credit, market, liquidity, compliance and operational risks.

In spite of strong headwinds in the operating environment, the Group will batten down the hatches by robust risk management and steer ahead with well-planned business transformation, with all hands on deck and unflinching commitment, ensuring that values are created for shareholders, customers and staff, and sustainable healthy growth can be achieved in the years ahead.

Zhang Xiaowei
President & Chief Executive Officer

Hong Kong, 24 August 2018