Hong Kong Exchanges and Clearing Limited and The Stock Exchange of Hong Kong Limited take no responsibility for the contents of this announcement and the listing document attached hereto, make no representation as to their accuracy or completeness and expressly disclaim any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this announcement and the listing documents attached hereto.

This announcement and the listing document attached hereto have been published for information purposes only as required by the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and do not constitute an invitation or offer to acquire, purchase or subscribe for securities. Neither this announcement nor anything referred to herein (including the listing document attached hereto) forms the basis for any contract or commitment whatsoever. *For the avoidance of doubt, the publication of this announcement and the listing document attached hereto shall not be deemed to be an offer of securities made pursuant to a prospectus issued by or on behalf of the Bank (as defined below) for the purposes of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32 of the Laws of Hong Kong) nor shall it constitute an advertisement, invitation or document containing an invitation to the public to enter into or offer to enter into an agreement to acquire, dispose of, subscribe for or underwrite securities for the purposes of the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong).*

*This announcement does not constitute or form a part of any offer of securities for sale in the United States. Any Bonds (as defined below) will not be registered under the U.S. Securities Act of 1933, as amended (the "**Securities Act**") and may not be offered or sold in the United States absent registration or an exemption from registration under the Securities Act. No public offering of the securities will be made in the United States.*

Notice to Hong Kong investors: *The Bank confirms that the Bonds (as defined below) are intended for purchase by Professional Investors (as defined in Chapter 37 of the Listing Rules) only and have been listed on The Stock Exchange of Hong Kong Limited on that basis. Accordingly, the Bank confirms that the Bonds are not appropriate as an investment for retail investors in Hong Kong. Investors should carefully consider the risks involved.*

PUBLICATION OF OFFERING CIRCULAR ON THE STOCK EXCHANGE OF HONG KONG LIMITED

交通銀行
BANK OF COMMUNICATIONS

BANK OF COMMUNICATIONS (HONG KONG) LIMTED
交通銀行(香港)有限公司

(incorporated in Hong Kong with limited liability)

U.S.$1,000,000,000 Subordinated Tier 2 Bonds due 2031
(the "Bonds")
(Stock Code: 40751)

Joint Global Coordinators, Joint Bookrunners and Joint Lead Managers

Bank of Communications	**BOCOM International**	**Citigroup**	**HSBC**

Joint Bookrunners and Joint Lead Managers

Agricultural Bank of China Limited Hong Kong Branch	**Bank of China**	**China CITIC Bank International**	**China Everbright Bank Hong Kong Branch**
China International Capital Corporation	**China Minsheng Banking Corp., Ltd.**	**China Securities International**	**CLSA**
CMB International	**Crédit Agricole CIB**	**Guotai Junan International**	**Haitong International**

Huarong International Securities	**ICBC**	**J.P. Morgan**	**Shanghai Pudong Development Bank**	**Standard Chartered Bank**

This announcement is issued pursuant to Rule 37.39A of the Listing Rules.

Reference is made to the notice of listing of the Bonds with an initial interest rate of 2.304 per cent. per annum on The Stock Exchange of Hong Kong Limited dated 8 July 2021 published by Bank of Communications (Hong Kong) Limited (the "**Bank**").

Please refer to the offering circular dated 29 June 2021 (the "**Offering Circular**") appended herein. The Offering Circular is published in English only. No Chinese version of the Offering Circular has been published. As disclosed in the Offering Circular, the Bonds were intended for purchase by professional investors (as defined in Chapter 37 of the Listing Rules) only and have been listed on The Stock Exchange of Hong Kong Limited on that basis.

The Offering Circular does not constitute a prospectus, notice, circular, brochure or advertisement offering to sell any securities to the public in any jurisdiction, nor is it an invitation to the public to make offers to subscribe for or purchase any securities, nor is it circulated to invite offers by the public to subscribe for or purchase any securities.

The Offering Circular must not be regarded as an inducement to subscribe for or purchase any securities of the Bank and no such inducement is intended. No investment decision should be made based on the information contained in the Offering Circular.

Hong Kong, 9 July 2021

As at the date of this announcement, the directors of the Bank are Mr. WANG Feng, Ms. WU Ye, Mr. ZHU Bin, Mr. FAN Chaorong, Ms. ZHU Chen, Mr. MA Zequan*, Ms. CHAN Ching Har Eliza**, Mr. TANG Kwai Chang**, Mr. CHAN Ka Lok** and Mr. LAM Yim Nam**.*

** Non-executive Directors*
*** Independent Non-executive Directors*

APPENDIX

OFFERING CIRCULAR DATED 29 June 2021

IMPORTANT NOTICE

NOT FOR DISTRIBUTION IN THE UNITED STATES

Important: You must read the following before continuing. The following applies to the offering circular following this page (the "**Offering Circular**"), and you are therefore advised to read this carefully before reading, accessing or making any other use of this Offering Circular. In accessing this Offering Circular, you agree to be bound by the following terms and conditions, including any modifications to them any time you receive any information from us as a result of such access.

NOTHING IN THIS ELECTRONIC TRANSMISSION CONSTITUTES AN OFFER OF SECURITIES FOR SALE IN THE UNITED STATES OR ANY OTHER JURISDICTION WHERE IT IS UNLAWFUL TO DO SO. THE SECURITIES DESCRIBED HEREIN HAVE NOT BEEN, AND WILL NOT BE, REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "**SECURITIES ACT**"), OR THE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR OTHER JURISDICTION AND THE SECURITIES DESCRIBED HEREIN MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND APPLICABLE STATE OR LOCAL SECURITIES LAWS.

THIS OFFERING CIRCULAR MAY NOT BE FORWARDED OR DISTRIBUTED TO ANY OTHER PERSON AND MAY NOT BE REPRODUCED IN ANY MANNER WHATSOEVER, AND IN PARTICULAR, MAY NOT BE FORWARDED TO ANY U.S. ADDRESS. ANY FORWARDING, DISTRIBUTION OR REPRODUCTION OF THIS DOCUMENT IN WHOLE OR IN PART IS UNAUTHORISED. FAILURE TO COMPLY WITH THIS DIRECTIVE MAY RESULT IN A VIOLATION OF THE SECURITIES ACT OR THE APPLICABLE LAWS OF OTHER JURISDICTIONS. ANY INVESTMENT DECISION SHOULD BE MADE ON THE BASIS OF THE INFORMATION CONTAINED IN AN OFFERING CIRCULAR THAT WILL BE DISTRIBUTED TO YOU ON OR PRIOR TO THE ISSUE DATE AND NOT ON THE BASIS OF THE ATTACHED DOCUMENTS. IF YOU HAVE GAINED ACCESS TO THIS TRANSMISSION CONTRARY TO ANY OF THE FOREGOING RESTRICTIONS, YOU ARE NOT AUTHORISED AND WILL NOT BE ABLE TO PURCHASE ANY OF THE SECURITIES DESCRIBED THEREIN.

Confirmation of the Representation: In order to be eligible to view this Offering Circular or make an investment decision with respect to the securities described herein, investors must not be located in the United States. This Offering Circular is being sent at your request and by accepting the electronic mail and accessing this Offering Circular, you shall be deemed to have represented to us that the electronic mail address that you gave us and to which this electronic mail has been delivered is not located in the United States, and that you consent to delivery of such Offering Circular by electronic transmission.

You are reminded that this Offering Circular has been delivered to you on the basis that you are a person into whose possession this Offering Circular may be lawfully delivered in accordance with the laws of jurisdiction in which you are located and you may not, nor are you authorised to, deliver this Offering Circular to any other person.

The materials relating to any offering of securities to which this Offering Circular relates do not constitute, and may not be used in connection with, an offer or solicitation in any place where offers or solicitations are not permitted by law. If a jurisdiction requires that such offering be made by a licensed broker or dealer and the underwriters or any affiliate of the underwriters is a licensed broker or dealer in that jurisdiction, such offering shall be deemed to be made by the underwriters or such affiliate on behalf of the Issuer (as defined in this Offering Circular) in such jurisdiction.

This Offering Circular has been sent to you in an electronic form. You are reminded that documents transmitted via this medium may be altered or changed during the process of electronic transmission and consequently none of the Joint Lead Managers (as defined in this Offering Circular) or any person who controls any of Joint Lead Managers or any director, officer, employee or agent of any of the Joint Lead Managers or any affiliate of any such person accepts any liability or responsibility whatsoever in respect of any difference between this Offering Circular distributed to you in electronic format and the hard copy version available to you on request from any of the Joint Lead Managers.

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

The Bonds (as defined in this Offering Circular) are complex financial instruments. The Bondholders (as defined in this Offering Circular) have no right to require redemption of the Bonds. Furthermore, in the event of a write-off, reduction, cancellation or conversion of the principal amount of the Bonds, an investor may lose the entire value of its investment. A potential investor must not invest in the Bonds unless it has the expertise to evaluate how the Bonds may perform under changing conditions, the resulting effects on the value of such Bonds and the impact the investment and any related losses may have on the potential investor's overall investment portfolio. See "*Investment Considerations — Investment Considerations Relating to the Bonds — The Issuer's obligations under the Bonds are subordinated*" on page 34.

交通銀行
BANK OF COMMUNICATIONS

BANK OF COMMUNICATIONS (HONG KONG) LIMITED

(incorporated with limited liability in Hong Kong)

U.S.$1,000,000,000 2.304 per cent. Subordinated Tier 2 Bonds due 2031

Issue Price: 100 per cent.

The 2.304 per cent. Subordinated Tier 2 Bonds due 2031 (the "**Bonds**") will be issued in an initial aggregate principal amount of U.S.$1,000,000,000 by Bank of Communications (Hong Kong) Limited (the "**Bank**" or the "**Issuer**"). The Bonds constitute direct, unconditional, unsecured and subordinated obligations of the Issuer ranking *pari passu* without any preference among themselves. The rights and claims of the Bondholders are subordinated in the manner described in the Terms and Conditions of the Bonds (the "**Conditions**"). See "*Terms and Conditions of the Bonds — Status and Subordination of the Bonds*". The Bonds bear interest on their outstanding principal amount (subject to adjustments following the occurrence of a Non-Viability Event (as defined in the Conditions) in accordance with Condition 5 of the Conditions) from, and including, 8 July 2021 (the "**Issue Date**") at the applicable Interest Rate (as defined in the Conditions), payable semi-annually in arrear on 8 January and 8 July in each year in equal instalments.

The Bonds will mature on 8 July 2031, if not redeemed or purchased and cancelled earlier. Subject to satisfaction of certain regulatory approval requirements (if applicable), the Issuer may, in certain circumstances as set out in the Conditions, redeem the Bonds then outstanding in whole, but not in part on 8 July 2026 (the "**First Call Date**"), at their outstanding principal amount together with interest accrued to (but excluding) the date fixed for redemption, subject to any adjustments following the occurrence of a Non-Viability Event in accordance with Condition 5 of the Conditions. See "*Terms and Conditions of the Bonds — Redemption and Purchase — Redemption at the option of the Issuer (Issuer Call)*". The holders of the Bonds (the "**Bondholders**") have no ability to require the Issuer to redeem their Bonds whereas the Issuer can redeem the Bonds in certain circumstances as described in the Conditions. However, the Issuer is under no obligation to redeem the Bonds at any time. The ability of the Issuer to redeem Bonds is subject to the Issuer obtaining the prior written consent of the Hong Kong Monetary Authority (the "**Monetary Authority**") to the extent such consent is required under the Banking Ordinance (Cap. 155) of Hong Kong, the Banking (Capital) Rules (Cap. 155L) of Hong Kong, or any successor legislation or regulations made thereunder, or any supervisory guidance issued by the Monetary Authority in relation thereto.

If a Non-Viability Event occurs and is continuing, the Issuer shall, on or prior to the provision of a Non-Viability Event Notice (as defined in the Conditions), irrevocably (without the need for the consent of the Bondholders) reduce the then outstanding principal amount of, and cancel any accrued but unpaid interest in respect of, each Bond (in each case in whole or in part) by an amount equal to the Non-Viability Event Write-off Amount (as defined in the Conditions) per Bond. Once the outstanding principal amount of, and any accrued but unpaid interest under, the Bonds has been Written-off (as defined in the Conditions), the relevant amount(s) Written-off will not be restored in any circumstances including where the relevant Non-Viability Event ceases to continue. No Bondholder may exercise, claim or plead any right to any amount that has been Written-off, and each Bondholder shall, by virtue of his holding of any Bonds, be deemed to have waived all such rights to such amount that has been Written-off. Bondholders could risk losing up to the full principal amount of the Bonds, as well as the cancellation of any accrued (and unpaid) interest, without receiving any compensation for such loss or cancellation.

The Bonds are expected to be assigned a rating of "BBB+" by Fitch Ratings, Inc. ("**Fitch**") and "BBB" by Standard & Poor's Ratings Group ("**S&P**"). A rating is not a recommendation to buy, sell or hold any security, does not address the likelihood or timing of payment of the Bonds and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

Application will be made to The Stock Exchange of Hong Kong Limited (the "**Hong Kong Stock Exchange**") for the listing of the Bonds by way of debt issues to professional investors (as defined in Chapter 37 of the Rules Governing the Listing of Securities on the Hong Kong Stock Exchange) ("**Professional Investors**") only. This Offering Circular is for distribution to Professional Investors only.

Notice to Hong Kong investors: The Issuer confirms that the Bonds are intended for purchase by Professional Investors only and will be listed on the Hong Kong Stock Exchange on that basis. Accordingly, the Issuer confirms that the Bonds are not appropriate as an investment for retail investors in Hong Kong. Investors should carefully consider the risks involved.

The Hong Kong Stock Exchange has not reviewed the contents of this Offering Circular, other than to ensure that the prescribed form disclaimer and responsibility statements, and a statement limiting distribution of this Offering Circular to Professional Investors only have been reproduced in this Offering Circular. Listing of the Bonds on the Hong Kong Stock Exchange is not to be taken as an indication of the commercial merits or credit quality of the Bonds or the Issuer or quality of disclosure in this Offering Circular. Hong Kong Exchanges and Clearing Limited and the Hong Kong Stock Exchange take no responsibility for the contents of this Offering Circular, make no representation as to its accuracy or completeness and expressly disclaim any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this Offering Circular.

The Bonds have not been and will not be registered under the United States Securities Act of 1933, as amended (the "**Securities Act**") and may not be offered or sold within the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and the applicable state securities laws. The Bonds are being offered and sold only outside the United States in accordance with Regulation S under the Securities Act ("**Regulation S**").

The Bonds will be initially evidenced by a global certificate (the "**Global Certificate**") in registered form, which will be registered in the name of a nominee of, and deposited with a common depositary for, Euroclear Bank SA/NV ("**Euroclear**") and Clearstream Banking S.A. ("**Clearstream**") on or about the Issue Date. Beneficial interests in the Global Certificate will be shown on, and transfers thereof will be effected only through the records maintained by Euroclear and Clearstream and their respective accountholders. Except in the limited circumstances set out herein, individual certificates for Bonds will not be issued in exchange for beneficial interests in the Global Certificate. See "*The Global Certificate*".

THE BONDS ARE OFFERED TO PROFESSIONAL INVESTORS ONLY AND ARE NOT SUITABLE FOR RETAIL INVESTORS. INVESTORS MUST NOT PURCHASE THE BONDS IN THE PRIMARY OR SECONDARY MARKETS UNLESS THEY ARE PROFESSIONAL INVESTORS. INVESTING IN THE BONDS INVOLVES RISKS. SEE "*INVESTMENT CONSIDERATIONS*" BEGINNING ON PAGE 18. INVESTORS SHOULD HAVE SUFFICIENT KNOWLEDGE AND EXPERTISE TO EVALUATE EFFECT OR THE LIKELIHOOD OF THE OCCURRENCE OF NON-VIABILITY EVENT FOR THE BONDS WHICH FEATURE LOSS ABSORPTION.

Investing in the Bonds involves risks. In particular, the Bonds are complex and of high risk. There are risks inherent in the holding of the Bonds, including the risks in relation to their subordination, the circumstances in which the Bonds may be written down or converted to into shares or other securities or other obligations of the Issuer or another person and the implications on holders of Bonds (such as a substantial loss), the circumstances in which such holders may suffer loss as a result of holding the Bonds are difficult to predict and the quantum of any loss incurred by investors in the Bonds in such circumstances is also highly uncertain. See "*Investment Considerations — Investment Considerations Relating to the Bonds — The Issuer's obligations under the Bonds are subordinated*" on page 34.

Joint Global Coordinators, Joint Bookrunners and Joint Lead Managers

Bank of Communications | **BOCOM International** | **Citigroup** | **HSBC**

Joint Bookrunners and Joint Lead Managers

Agricultural Bank of China Limited Hong Kong Branch | **Bank of China** | **China CITIC Bank International** | **China Everbright Bank Hong Kong Branch**

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CMB International | **Crédit Agricole CIB** | **Guotai Junan International** | **Haitong International**

Huarong International Securities | **ICBC** | **J.P. Morgan** | **Shanghai Pudong Development Bank** | **Standard Chartered Bank**

Offering Circular dated 29 June 2021

IMPORTANT NOTICE

The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the offer of Bonds. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

The Issuer, having made all reasonable enquiries, confirms that (i) this Offering Circular contains all information with respect to the Issuer and the Issuer's subsidiaries (collectively, the "**Group**"), and the issue of the Bonds, which is material in the context of the issue and offering of the Bonds; (ii) the statements contained herein relating to the Issuer or the Group are in every material respect true and accurate and not misleading; (iii) the opinions and intentions expressed in this Offering Circular with regard to the Issuer or the Group are honestly held, have been reached after considering all relevant circumstances and are based on reasonable assumptions; (iv) there are no other facts in relation to the Issuer or the Group or the Bonds, the omission of which would, in the context of the issue and offering of the Bonds (the "**Offering**"), make any statement in this Offering Circular misleading in any material respect; and (v) all reasonable enquiries have been made by the Issuer to ascertain such facts and to verify the accuracy of all such information and statements. In addition, the Issuer accepts full responsibility for the accuracy of the information contained in this Offering Circular.

This Offering Circular includes particulars given in compliance with the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited for the purpose of giving information with regard to the Issuer. The Issuer accepts full responsibility for the accuracy of the information contained in this Offering Circular, having made all reasonable enquiries, that to the best of its knowledge and belief there are no other facts the omission of which would make any statement herein misleading.

Hong Kong Exchanges and Clearing Limited and the Hong Kong Stock Exchange take no responsibility for the contents of this Offering Circular, make no representation as to its accuracy or completeness and expressly disclaim any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this Offering Circular.

This Offering Circular has been prepared by the Issuer solely for use in connection with the proposed offering of the Bonds described in this Offering Circular. The distribution of this Offering Circular and the offering of the Bonds in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Issuer and the joint lead managers as set forth in "*Subscription and Sale*" (the "**Joint Lead Managers**") and the Agents (as defined in the Conditions) to inform themselves about and to observe any such restrictions. No action is being taken to permit a public offering of the Bonds or the distribution of this Offering Circular in any jurisdiction where action would be required for such purposes. There are restrictions on the offer, sale and resale of the Bonds, and the circulation of documents relating thereto, in certain jurisdictions and to persons connected therewith. For a description of certain further restrictions on offers, sales and resales of the Bonds and distribution of this Offering Circular, see "*Subscription and Sale*".

The Bonds are expected to be assigned a rating of "BBB+" by Fitch and "BBB" by S&P. A rating is not a recommendation to buy, sell or hold any security, does not address the likelihood or timing of payment of the Bonds and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

PRIIPs REGULATION - PROHIBITION OF SALES TO EEA RETAIL INVESTORS — The Bonds are not intended to be offered, sold or otherwise made available to and should not be offered, sold or otherwise made available to any retail investor in the European Economic Area ("**EEA**"). For these purposes, a retail investor means a person who is one (or more) of: (i) a retail client as defined in point (11) of Article 4(1) of Directive 2014/65/EU (as amended, "**MiFID II**"); or (ii) a customer within the meaning of Directive (EU) 2016/97 (the "**Insurance Distribution Directive**"), where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II. Consequently no key information document required by Regulation (EU) No 1286/2014 (as amended, the "**PRIIPs Regulation**") for offering or selling the Bonds or otherwise making them available to retail investors in the EEA has been prepared and therefore offering or selling the Bonds or otherwise making them available to any retail investor in the EEA may be unlawful under the PRIIPS Regulation.

UK PRIIPs REGULATION - PROHIBITION OF SALES TO UK RETAIL INVESTORS — The Bonds are not intended to be offered, sold or otherwise made available to and should not be offered, sold or otherwise made available to any retail investor in the United Kingdom (the "**UK**"). For these purposes, a retail investor means a person who is one (or more) of: (i) a retail client, as defined in point (8) of Article 2 of Regulation (EU) No 2017/565 as it forms part of domestic law by virtue of the European Union (Withdrawal) Act 2018 (the "**EUWA**"); or (ii) a customer within the meaning of the provisions of the Financial Services and Markets Act 2000 (the "**FSMA**") and any rules or regulations made under the FSMA to implement the Insurance Distribution Directive, where that customer would not qualify as a professional client, as defined in point (8) of Article 2(1) of Regulation (EU) No 600/2014 as it forms part of domestic law by virtue of the EUWA. Consequently no key information document required by the PRIIPs Regulation as it forms part of domestic law by virtue of the EUWA (the "**UK PRIIPs Regulation**") for offering or selling the Bonds or otherwise making them available to retail investors in the UK has been prepared and therefore offering or selling the Bonds or otherwise making them available to any retail investor in the UK may be unlawful under the UK PRIIPs Regulation.

NOTIFICATION UNDER SECTION 309B(1)(C) OF THE SECURITIES AND FUTURES ACT (CHAPTER 289) OF SINGAPORE — In connection with Section 309B of the Securities and Futures Act (Chapter 289) of Singapore, as modified or amended from time to time (the "**SFA**") and the Securities and Futures (Capital Markets Products) Regulations 2018 (the "**CMP Regulations 2018**"), the Issuer has determined, and hereby notifies all relevant persons (as defined in Section 309A(1) of the SFA), that the Bonds are "prescribed capital markets products" (as defined in the CMP Regulations 2018) and Excluded Investment Products (as defined in MAS Notice SFA 04-N12: Notice on the Sale of Investment Products and MAS Notice FAA-N16: Notice on Recommendations on Investment Products).

By purchasing the Bonds, investors are deemed to have represented and agreed to all of those provisions contained in that section of this Offering Circular. This Offering Circular is personal to each offeree and does not constitute an offer to any other person or to the public generally to subscribe for, or otherwise acquire, the Bonds. Any reproduction or distribution of this Offering Circular, in whole or in part, to any person other than the prospective investor and any person retained to advise such prospective investor with respect to its purchase is unauthorised and any disclosure of its contents or use of any information herein for any purpose other than the consideration of an investment in the Bonds offered by this Offering Circular is prohibited. Each prospective investor, by accepting delivery of this Offering Circular, is deemed to have agreed to these restrictions.

No person has been or is authorised to give any information or to make any representation concerning the Issuer, the Group or the Bonds other than as contained herein and, if given or made, any such other information or representation should not be relied upon as having been authorised by the Issuer, the Joint Lead Managers or the Agents. Neither the delivery of this Offering Circular nor any offering, sale or delivery made in connection with the issue of the Bonds shall, under any circumstances, constitute a representation that there has been no change or development reasonably likely to involve a change in the affairs of the Issuer or any member of the Group since the date hereof or create any implication that the information contained herein is correct as at any date subsequent to the date hereof. This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Issuer, the Joint Lead Managers or the Agents to subscribe for or purchase any of the Bonds and may not be used for the purpose of an offer to, or a solicitation by, anyone in any jurisdiction or in any circumstances in which such offer or solicitation is not authorised or is unlawful.

The information contained in this Offering Circular has been provided by the Issuer and other sources identified in this Offering Circular. None of the Joint Lead Managers or the Agents or any of their respective affiliates, directors or advisers has independently verified the information contained in this Offering Circular. No representation or warranty, express or implied, is made or given by the Joint Lead Managers, the Agents or their affiliates or advisers as to the accuracy, completeness or sufficiency of the information contained in this Offering Circular. To the fullest extent permitted by law, none of the Joint Lead Managers or the Agents accept any responsibility for the contents of this Offering Circular or for any other statement, made or purported to be made by the Joint Lead Managers or the Agents or on its behalf in connection with the Issuer, the Group or the issue and offering of the Bonds. Each of the Joint Lead Managers and the Agents accordingly disclaims all and any liability whether arising in tort or contract or otherwise (save as referred to above) which it might otherwise have in respect of this Offering Circular or any such statement. Neither this Offering Circular nor any other financial statements are intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by any of the Issuer, the Joint Lead Managers, the Agents or their affiliates or advisers that any recipient of this Offering Circular or any other financial statements should purchase the Bonds. Each potential purchaser of Bonds should determine for itself the relevance of the information contained in this Offering Circular and its purchase of Bonds should be based upon such investigation as it deems necessary. None of the Joint Lead Managers or the Agents undertakes to review the financial condition or affairs of the Issuer or the Group during the life of the arrangements contemplated by this Offering Circular nor to advise any investor or potential investor in the Bonds of any information coming to the attention of any of the Joint Lead Managers or the Agents.

IN CONNECTION WITH THE ISSUE OF THE BONDS, ANY OF THE JOINT LEAD MANAGERS OR PERSONS ACTING ON BEHALF OF ANY OF THEM MAY OVER-ALLOT BONDS OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE BONDS AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL. HOWEVER, STABILISATION MAY NOT NECESSARILY OCCUR. ANY STABILISATION ACTION MAY BEGIN ON OR AFTER THE DATE ON WHICH ADEQUATE PUBLIC DISCLOSURE OF THE TERMS OF THE OFFER OF THE BONDS IS MADE AND, IF BEGUN, MAY CEASE AT ANY TIME AND MUST BE BROUGHT TO AN END AFTER A LIMITED PERIOD.

Any purchase or acquisition of the Bonds is in all respects conditional on the satisfaction of certain conditions set out in the Subscription Agreement (as defined in "*Subscription and Sale*") and the issue of the Bonds by the Issuer to the Joint Lead Managers pursuant to the Subscription Agreement. Any offer, invitation to offer or agreement made in connection with the purchase or acquisition of the Bonds pursuant to this Offering Circular shall (without liability or responsibility on the part of the Issuer or the Joint Lead Managers) lapse and cease to have any effect if (for any reason whatsoever) the Bonds are not issued by the Issuer to the Joint Lead Managers pursuant to the Subscription Agreement.

In making an investment decision, investors must consult its own legal, business and tax advisers as needed and rely on their own examination of the Issuer, the Group and the terms of the offering of the Bonds, including the merits and risks involved. See "*Investment Considerations*" for a discussion of certain considerations to be taken into account in connection with an investment in the Bonds.

Each person receiving this Offering Circular acknowledges that such person has not relied on the Joint Lead Managers or the Agents or any person affiliated with the Joint Lead Managers or the Agents in connection with its investigation of the accuracy of such information or its investment decision.

CERTAIN DEFINED TERMS AND CONVENTIONS

Unless otherwise specified or the context requires otherwise, references herein to the "**Issuer**" or the "**Bank**" are to Bank of Communications (Hong Kong) Limited.

Unless otherwise specified or the context requires, references herein to "**Hong Kong dollars**", "**HK dollars**" and "**HK$**" are to the lawful currency of the Hong Kong Special Administrative Region of the People's Republic of China ("**Hong Kong**"), references herein to "**U.S. dollars**" or "**U.S.$**" are to the lawful currency of the United States of America, references herein to "**Renminbi**" or "**RMB**" are to the lawful currency of the People's Republic of China, references to the "**PRC**" are to the People's Republic of China excluding Hong Kong, Macau and Taiwan, references to "**HKAS**" are to Hong Kong Accounting Standards and references to "**HKFRS**" are to Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants ("**HKICPA**").

Unless otherwise specified, where financial information has been translated into U.S. dollars, it has been so translated for information purposes only at the rate of HK$7.7647 equal to U.S.$1.00. No representation is made that the Hong Kong dollar or U.S. dollar amounts referred herein could have been or could be converted into Hong Kong dollars or U.S. dollars, as the case may be, at any particular rate or at all.

PRESENTATION OF FINANCIAL INFORMATION

The Issuer has prepared audited financial statements for the years ended 31 December 2019 and 2020 in accordance with the HKFRS and the Companies Ordinance (Cap. 622) of Hong Kong (the "**Companies Ordinance**").

The Bank has adopted HKFRS 16 Leases ("**HKFRS 16**") from 1 January 2019, but has not restated comparatives for the year ended 31 December 2018, as permitted under the specific transitional provisions in HKFRS 16. The reclassifications and the adjustments arising from the new leasing rules are therefore recognised in the opening consolidated statement of financial position on 1 January 2019. The impact of the adoption of HKFRS 16 are disclosed in Note 2.2.1 to the 2019 Annual Financial Statements. Therefore, the financial statements of the Bank as of and for the year ended 31 December 2018 may not be directly comparable to the financial statements of the Bank after 1 January 2019. Potential investors must therefore exercise caution when making comparisons of such data and when evaluating the financial condition and results of operations of the Bank. Investors should consult their own independent financial advisers for professional advice.

In this Offering Circular, where information has been presented in thousands or millions of units, amounts may have been rounded up or down. Accordingly, totals of columns or rows of numbers in tables may not be equal to the apparent total of the individual items and actual numbers may differ from those contained herein due to rounding. References to information in billions of units are to the equivalent of a thousand million units.

FORWARD-LOOKING STATEMENTS

This Offering Circular contains forward-looking statements regarding the intent, belief or current expectations of the Issuer held reasonably with respect to its financial condition and future results of operations. In many cases, but not all, words such as "anticipate", "believe", "estimate", "expect", "intend", "may", "plan", "probability", "project", "risk", "seek", "should", "target" and similar expressions are used in relation to the Issuer or the Group to identify forward-looking statements. Investors can also identify forward-looking statements in discussions of strategy, plans or intentions. These statements reflect the current views of the Issuer with respect to future events and are subject to risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialise, or should underlying assumptions prove incorrect, the Issuer's or the Group's actual results may vary materially from those it currently anticipates. Given these risks and uncertainties, prospective investors are cautioned not to place undue reliance on forward-looking statements, which speak only as at the date of this Offering Circular. The Issuer disclaims any obligation to update, or to announce publicly any revision to, any of the forward-looking statements contained in this Offering Circular to reflect future actual events or developments. The information contained in this Offering Circular, including without limitation the information under "*Investment Considerations*" and "*Business of the Bank*", identifies important factors that might cause the forward-looking statements not to be realised.

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SUMMARY

The summary below is only intended to provide a limited overview of information described in more detail elsewhere in this Offering Circular. As it is a summary, it does not contain all of the information that may be important to investors and terms defined elsewhere in this Offering Circular shall have the same meanings when used in this summary. Prospective investors should therefore read this Offering Circular in its entirety.

Overview

Bank of Communications (Hong Kong) Limited is a leading retail and corporate bank in Hong Kong. The Bank offers a wide range of retail and corporate banking products and services through 44 outlets (including 37 BComBEST Services Centres and seven Business Services Centres) and one private banking centre across Hong Kong in 2020. The Bank's personal banking business provides conventional transactional banking services such as foreign exchange and cash services, RMB services, deposits, loans, investments, mortgage, insurance, mandatory provident fund ("**MPF**") and credit cards, while its private banking business offers personalised investments, family office services, wealth management solutions and life style services. The Bank's corporate banking business provides a wide variety of products in cash management, corporate loans, trade finance, small and medium-sized enterprise ("**SME**") lending, treasury, insurance, initial public offering services ("**IPO**") and MPF. The Bank is a public company incorporated with limited liability in Hong Kong.

The Bank is a wholly owned subsidiary of Bank of Communications Co., Ltd. ("**BoCom**", and together with its subsidiaries, "**BoCom Group**"), a leading commercial bank in Mainland China providing comprehensive range of commercial banking products and services. BoCom's principal lines of business are corporate banking, personal banking and interbank and financial market businesses. Within BoCom's primary business lines, it also offers insurance, financial leasing, asset management, trust services, fund, overseas securities and debt-to-equity conversion. BoCom's strategy is to become "the First-tier Bank with Wealth Management Characteristics and Global Competitive Capabilities in the World". In accordance with BoCom's strategy, the retail banking business and private banking business (including corporate banking business which relates wholly to private banking business and retail banking business) of BoCom Hong Kong Branch were transferred to the Bank in January 2018. As a wholly owned subsidiary of BoCom, the Bank receives extensive support from BoCom in terms of funding, settlement, information technology ("**IT**") and client resources. The wide-ranging collaboration between the Bank and BoCom enables the Bank to better serve its customers to capture merging business opportunities in Hong Kong, Mainland China and overseas markets. In 2020, the Bank had 44 outlets (including 37 BComBEST Services Centres, seven Business Services Centres) and one private banking centre in Hong Kong.

The Bank leverages on BoCom's profound experience in financial services and strong network in both Mainland China and Hong Kong. The Bank offers diversified wealth management products and services through close collaboration with its Hong Kong affiliates, such as BoCom Hong Kong Branch, BOCOM International, China BOCOM Insurance and BOCOM Trustee.

Competitive Strengths

- The Bank continues to benefit from the growth opportunities in the Hong Kong banking sector.
- The Bank enjoys a unique market position and good reputation.
- The Bank possesses strong business capabilities.
- The Bank operates on sound risk management systems.
- The Bank maintains ample capital support.

- The Bank shares advanced information system and technologies within BoCom Group.

- The Bank is managed by an experienced management team.

Strategies

- Develop a modularised business model and maximise future growth potential.

- Improve synergies through cross-selling of different business.

- Expand the retail customer base and highlight "BComBEST Services".

- Further build up network and distinctive brand.

THE OFFERING

The following is a brief summary of certain terms of this Offering. For a more detailed description of the terms of the Bonds, see "Terms and Conditions of the Bonds". Capitalised terms used herein and not defined have the meanings given to them in "Terms and Conditions of the Bonds".

The Issuer	Bank of Communications (Hong Kong) Limited, a company incorporated with limited liability in Hong Kong.
Description	U.S.$1,000,000,000 2.304 per cent. Subordinated Tier 2 Bonds due 2031.
Issue Date	8 July 2021.
Maturity Date	8 July 2031.
Issue Price	100 per cent.
Status and Subordination of the Bonds	The Bonds constitute direct, unconditional, unsecured and subordinated obligations of the Issuer ranking *pari passu* without any preference among themselves. The rights and claims of the Bondholders are subordinated in the manner described in the Conditions. Subject to the insolvency laws of Hong Kong and other applicable laws, in the event of a Winding-Up (as defined below) of the Issuer (other than pursuant to a Permitted Reorganisation (as defined below)), the rights and claims of the Bondholders in respect of or arising under the Bonds shall rank (i) subordinate and junior in right of payment to, and of all claims of, (a) all depositors and unsubordinated creditors of the Issuer, and (b) all other holders of Subordinated Indebtedness (as defined below) of the Issuer whose claims are stated to rank senior to the Bonds or rank senior to the Bonds by operation of law or contract; (ii) *pari passu* in right of payment to and of all claims of the holders of Parity Obligations; and (iii) senior in right of payment to, and of all claims of, the holders of Junior Obligations (as defined below), in each case, present and future. "**Directors**" means the Board of Directors from time to time of the Issuer and "**Director**" means any one of them. "**Junior Obligation**" means all classes of share capital, any Tier 1 Capital Instruments, and any instrument or other obligation (including without limitation any preference shares) issued, entered into, or guaranteed by the Issuer that ranks or is expressed to rank junior to the Bonds by operation of law or contract.

"**Parity Obligation**" means any instrument or other obligation issued or entered into by the Issuer that qualifies as a Tier 2 Capital Instrument (or its equivalent) under applicable Capital Regulations or any instrument or other obligation issued, entered into, or guaranteed by the Issuer that ranks or is expressed to rank *pari passu* with the Bonds by operation of law or contract, which excludes any Junior Obligations of the Issuer.

"**Permitted Reorganisation**" means a solvent reconstruction, amalgamation, reorganisation, merger or consolidation whereby all or substantially all the business, undertaking and assets of the Issuer are transferred to a successor entity which assumes all the obligations of the Issuer under the Bonds.

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

"**Subsidiary**" means any company (i) in which the Issuer holds a majority of the voting rights, (ii) of which the Issuer is a member and has the right to appoint or remove a majority of the Directors or (iii) of which the Issuer is a member and controls a majority of the voting rights, and includes any company which is a Subsidiary of a Subsidiary of the Issuer.

"**Tier 1 Capital Instruments**" means any instrument or other obligation issued or entered into by the Issuer or a Subsidiary that constitutes Tier 1 capital of the Issuer pursuant to the Capital Regulations.

"**Tier 2 Capital Instruments**" means any instrument or other obligation issued or entered into by the Issuer or a Subsidiary that constitutes Tier 2 capital of the Issuer pursuant to the Capital Regulations.

"**Winding-Up**" means a final and effective order or resolution by a judicial authority in the jurisdiction of incorporation of the Issuer for the bankruptcy, insolvency, liquidation, winding-up or similar proceedings in respect of the Issuer.

No Set-off

Subject to applicable law, no Bondholder may exercise, claim or plead any right of set-off, counter-claim or retention in respect of any amount owed to it by the Issuer arising under or in connection with the Bonds and each Bondholder shall, by virtue of being the Bondholder of any Bond be deemed to have waived all such rights of such set-off, counter-claim or retention.

	See "*Terms and Conditions of the Bonds — Status and Subordination of the Bonds — Set-off*" for further information.
Interest	The Bonds bear interest on their outstanding principal amount (subject to adjustments following the occurrence of a Non-Viability Event in accordance with Condition 5 (*Non-Viability Loss Absorption*) from, and including, 8 July 2021 (the "**Issue Date**") at the applicable Interest Rate (as defined below), payable semi-annually in arrear on 8 January and 8 July in each year in equal instalments.
Interest Rate	The rate of interest (the "**Interest Rate**") applicable to the Bonds shall be: (a) in respect of the period from, and including, the Issue Date to, but excluding, 8 July 2026 (the "**First Call Date**"), 2.304 per cent. per annum; and (b) in respect of the period from, and including, the First Call Date to, but excluding, the Maturity Date, the Reset Interest Rate. "**Reset Interest Rate**" means a fixed rate per annum (expressed as a percentage) equal to the aggregate of (a) the then-prevailing U.S. Treasury Rate (as determined as set out in Condition 4.2 (*Interest Rate*)) and (b) the Spread (as set out in Condition 4.2 (*Interest Rate*)).
Non-Viability Loss Absorption	If a Non-Viability Event occurs and is continuing, the Issuer shall, on or prior to the provision of a Non-Viability Event Notice, irrevocably (without the need for the consent of the Bondholders) reduce the then principal amount of, and cancel any accrued but unpaid interest in respect of, each Bond (in each case in whole or in part) by an amount equal to the Non-Viability Event Write-off Amount per Bond (such reduction and cancellation, and the reduction and cancellation or conversion of any other Subordinated Capital Securities so reduced and cancelled or converted upon the occurrence of a Non-Viability Event, where applicable, being referred to herein as the "**Write-off**", and "**Written-off**" shall be construed accordingly). "**Hong Kong Business Day**" means a day (other than a Saturday or Sunday) on which commercial banks and foreign exchange markets are open for general business in Hong Kong. "**Loss Absorption Effective Date**" means the date that will be specified as such in the applicable Non-Viability Event Notice as directed or approved by the Monetary Authority.

"**Non-Viability Event**" means the earlier of:

(a) the Monetary Authority notifying the Issuer in writing that the Monetary Authority is of the opinion that a Write-off or conversion is necessary, without which the Issuer would become non-viable; and

(b) the Monetary Authority notifying the Issuer in writing that a decision has been made by the government body, a government officer or other relevant regulatory body with the authority to make such a decision, that a public sector injection of capital or equivalent support is necessary, without which the Issuer would become non-viable.

"**Non-Viability Event Notice**" means the notice which shall be given by the Issuer not more than two Hong Kong Business Days after the occurrence of a Non-Viability Event, to the Bondholders, in accordance with Condition 14 (*Notices*), and to the Fiscal Agent in writing and which shall state:

(a) in reasonable detail the nature of the relevant Non-Viability Event; and

(b) the Non-Viability Event Write-off Amount for (i) each Bond; (ii) each other Subordinated Capital Securities on the Loss Absorption Effective Date in accordance with its terms and (iii) specifying the Loss Absorption Effective Date.

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

(a) the full amount of the Bonds will be Written-off in full in the event that the amount Written-off is not sufficient for the Non-Viability Event to cease to continue and (b)in the case of an event falling within paragraph

(b) of the definition of Non-Viability Event, the Write-off will be effected in full before any public sector injection of capital or equivalent support.

Further, the Non-Viability Event Write-off Amount in respect of each Bond will be calculated based on a percentage of the principal amount of that Bond.

"**Subordinated Capital Securities**" means any Junior Obligation or Parity Obligation which contains provisions relating to a write-down or conversion into ordinary shares in respect of its outstanding principal amount on the occurrence, or as a result, of a Non-Viability Event and in respect of which the conditions (if any) to the operation of such provisions are (or with the giving of any certificate or notice which is capable of being given by the Issuer, would be) satisfied.

Consequence of Non-Viability Loss Absorption

Once the outstanding principal amount of, and any accrued but unpaid interest under, the Bonds has been Written-off, the relevant amount(s) Written-off will not be restored in any circumstances including where the relevant Non-Viability Event ceases to continue. No Bondholder may exercise, claim or plead any right to any amount that has been Written-off, and each Bondholder shall, by virtue of his holding of any Bonds, be deemed to have waived all such rights to such amount that has been Written-off.

Hong Kong Resolution Authority Power

Notwithstanding any other term of the Bonds, including without limitation Condition 5 *(Non-Viability Loss Absorption)*, or any other agreement or arrangement, each Bondholder shall be subject, and shall be deemed to agree, be bound by and acknowledge that they are each subject, to having the Bonds held by such Bondholder being written off, cancelled, converted or modified, or to having the form of the Bonds changed, in the exercise of any Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority without prior notice and which may include (without limitation) and result in any of the following or some combination thereof:

(a) the reduction or cancellation of all or a part of the outstanding principal amount of, or interest on, the Bonds;

(b) the conversion of all or a part of the outstanding principal amount of, or interest on, the Bonds into shares or other securities or other obligations of the Issuer or another person (and the issue to or conferral on the holder of such shares, securities or obligations), including by means of an amendment, modification or variation of the terms of the Bonds; and

(c) the amendment or alteration of the maturity of the Bonds or amendment or alteration of the amount of interest payable on the Bonds, or the date on which the interest becomes payable, including by suspending payment for a temporary period, or any other amendment or alteration of the Conditions.

With respect to (a), (b) and (c) above, references to principal and interest shall include payments of principal and interest that have become due and payable (including principal that has become due and payable at the redemption date), but which have not been paid, prior to the exercise of any Hong Kong Resolution Authority Power. The rights of the Bondholders under the Bonds and the Conditions are subject to, and will be amended and varied, if necessary, solely to give effect to, the exercise of any Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority.

No repayment of the outstanding principal amount of the Bonds or payment of interest on the Bonds shall become due and payable or be paid after the exercise of any Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority unless, at the time that such repayment or payment, respectively, is scheduled to become due, such repayment or payment would be permitted to be made by the Issuer under the laws and regulations applicable to the Issuer and the Group.

Upon the exercise of any Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority with respect to the Bonds, the Issuer shall provide a written notice not more than two Hong Kong Business Days after the occurrence of such exercise regarding such exercise of the Hong Kong Resolution Authority Power to the Bondholders in accordance with Condition 14 (*Notices*).

Neither the reduction or cancellation, in part or in full, of the outstanding principal amount of, or interest on the Bonds, the conversion thereof into another share, security or obligation of the Issuer or another person, or any other amendment or alteration of the Conditions as a result of the exercise of any Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority with respect to the Issuer nor the exercise of the Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority with respect to the Bonds shall constitute an Event of Default under Condition 11.1 (*Events of Default and Winding-up Proceedings*).

"**Group**" means the Issuer and its Subsidiaries taken as a whole.

	"**Hong Kong Resolution Authority Power**" means any power which may exist from time to time under the Financial Institutions (Resolution) Ordinance relating to financial institutions, including licensed banks, deposit-taking companies, restricted licence banks, banking group companies, insurance companies and/or investment firms incorporated in or authorised, designated, recognised or licensed to conduct regulated financial activities in Hong Kong in effect and applicable in Hong Kong to the Issuer or other members of the Group (including, for the avoidance of doubt, powers under Part 4 and Part 5 of the Financial Institutions (Resolution) Ordinance) or any other laws, regulations, rules or requirements relating thereto, as the same may be amended from time to time (whether pursuant to the Financial Institutions (Resolution) Ordinance or otherwise), and pursuant to which obligations of a licensed bank, deposit-taking company, restricted licence bank, banking group company, insurance company or investment firm or any of its affiliates can be reduced, cancelled, transferred, modified and/or converted into shares or other securities or obligations of the obligor or any other person. "**relevant Hong Kong Resolution Authority**" means any authority with the ability to exercise a Hong Kong Resolution Authority Power in relation to the Issuer from time to time.
Use of Proceeds	The Bonds are intended to qualify as "Tier 2 Capital Instruments" of the Bank for the purposes of capital adequacy under the Banking (Capital) Rules (Cap. 155L). The issuance of the Bonds will strengthen the Bank's capital base and fund the growth of the Bank's business development.
Redemption for Tax Reasons	Subject to Condition 8.5 (*Conditions for Redemption and Purchase in respect of the Bonds*), the Bonds then outstanding may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days' notice to the Fiscal Agent and, in accordance with Condition 14 (*Notices*), the Bondholders (which notice shall be irrevocable), if (i) on the occasion of the next payment due under the Bonds, the Issuer has or will become obliged to pay additional amounts as provided or referred to in the Conditions as a result of any change in, or amendment to, the laws or regulations of Hong Kong or any political subdivision or any authority thereof or therein having power to tax, or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after 29 June 2021; and (ii) such obligation will apply on the occasion of the next payment due in respect of the Bonds and cannot be avoided by the Issuer taking reasonable measures available to it. See "*Terms and Conditions of the Bonds — Redemption and Purchase — Redemption for Tax Reasons*" for further information.

Redemption for Regulatory Reasons	Subject to Condition 8.5 (*Conditions for Redemption and Purchase in respect of the Bonds*), the Bonds may be redeemed at the option of the Issuer in whole, but not in part, at any time on giving not less than 30 nor more than 60 days' notice to the Fiscal Agent and, in accordance with Condition 14 (*Notices*), the Bondholders (which notice shall be irrevocable following the occurrence of a Capital Event). A "**Capital Event**" occurs if the Bonds, after having qualified as such, will no longer qualify (in whole or in part) as Tier 2 capital (or equivalent) of the Issuer as a result of any changes or amendments in (or any change in the application or official interpretation of) the relevant provisions of the Banking Ordinance (Cap. 155) of Hong Kong, the Banking (Capital) Rules (Cap. 155L) of Hong Kong or any successor legislation or regulations made thereunder, or any supervisory guidance issued by the Monetary Authority in relation thereto, in each case, as amended or modified from time to time (other than as a result of any discounting or amortisation requirements as to the eligibility of the Bonds for such inclusion pursuant to the relevant legislation and relevant guidelines in force from time to time), provided, however, that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which it is determined that a Capital Event will take effect. See "*Terms and Conditions of the Bonds — Redemption and Purchase — Redemption of the Bonds for Regulatory Reasons*" for further information.
Redemption at the Option of the Issuer (Issuer Call)	Subject to Condition 8.5 (*Conditions for Redemption and Purchase in respect of the Bonds*), the Issuer may, having given (a) not less than 15 nor more than 30 days' notice to the Bondholders in accordance with Condition 14 (*Notices*); and (b) not less than 15 days before the giving of the notice referred to in (a) above, notice to the Fiscal Agent and the Registrar; (which notices shall be irrevocable and shall specify the date fixed for redemption), redeem the Bonds then outstanding in whole, but not in part, on the First Call Date, at their outstanding principal amount together with interest accrued to (but excluding) the date of redemption, subject to adjustments following the occurrence of a Non-Viability Event in accordance with Condition 5 (*Non-Viability Loss Absorption*).

Conditions for Redemption and Purchase in respect of Bonds	Notwithstanding any other provision in the Conditions, the Issuer shall not redeem any of the Bonds (other than pursuant to Condition 11.1 (*Events of Default and Winding-up Proceedings*)), and neither the Issuer nor any affiliates of the Issuer over which the Issuer exercises control or significant influence shall purchase any of the Bonds, unless the prior written consent of the Monetary Authority thereto shall have been obtained, to the extent such consent is required under the Banking Ordinance (Cap. 155) of Hong Kong, the Banking (Capital) Rules (Cap. 155L) of Hong Kong or any successor legislation or regulations made thereunder, or any supervisory guidance issued by the Monetary Authority in relation thereto.
Events of Default	If default is made in the payment of any amount of principal in respect of the Bonds within seven days after the due date for payment thereof or of any amount of interest in respect of the Bonds within 14 days after the due date for payment thereof (each, an "**Event of Default**") then in order to enforce the obligations of the Issuer, any holder of a Bonds may institute a Winding-Up Proceeding against the Issuer. For the avoidance of doubt, any Write-off pursuant to Condition 5 (*Non-Viability Loss Absorption*) will not constitute an Event of Default under the Bonds. See "*Terms and Conditions of the Bonds — Events of Default and Enforcement — Events of Default and Winding-up Proceedings*" for further information.
Fiscal Agent and Calculation Agent	Bank of Communications Co., Ltd. Hong Kong Branch.
Registrar and Transfer Agent	Bank of Communications Co., Ltd. Hong Kong Branch.
Form and Denomination	The Bonds will be issued in registered form in the denomination of U.S.$250,000 each and integral multiples of U.S.$1,000 in excess thereof. The Bonds will initially be represented by the Global Certificate, in registered form, deposited on or about the Issue Date with, and registered in the name of a nominee of, a common depositary for Euroclear and Clearstream. Beneficial interests in the Global Certificate will be shown on, and transfer thereof will be effected only through the records maintained by Euroclear and Clearstream and their respective accountholders. Except as described herein, definitive certificates of Bonds will not be issued in exchange for beneficial interests in the Global Certificate. See "*The Global Certificate — Change of Registration of Title*".

Payments	All payments of principal and interest in respect of the Bonds by or on behalf of the Issuer shall be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature ("**Taxes**") imposed or levied by or on behalf of Hong Kong or any political subdivision or any authority thereof or therein having power to tax, unless the withholding or deduction of the Taxes is required by law. In the event that any such deduction is made, the Issuer will, save in certain limited circumstances provided in Condition 9 (*Taxation*), be required to pay such additional amounts as shall result in receipt by the Bondholders of such amounts as would have been received by them had no such withholding or deduction been required.
Ratings	The Bonds are expected to be rated "BBB+" by Fitch and "BBB" by S&P. A rating is not a recommendation to buy, sell or hold any security, does not address the likelihood or timing of payment of the Bonds and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.
Governing Law	The Fiscal Agency Agreement (as defined in the Conditions), the Bonds and any non-contractual obligations arising out of or in connection with the Bonds are governed by, and shall be construed in accordance with, English law, except that the subordination provisions set out in Condition 3.2 (*Subordination*) shall be governed by and construed in accordance with the laws of Hong Kong.
Jurisdiction	The courts of England are to have jurisdiction to settle any disputes that may arise out of or in connection with the Bonds and accordingly any legal action or proceedings arising out of or in connection with any Bonds may be brought in such courts.
Capital Treatment	The Bonds are intended to qualify as Tier 2 capital under the Capital Regulations. "**Authorized Institution**" has the meaning given to that term in the Banking Ordinance (Cap. 155) of Hong Kong as amended or superseded from time to time. "**Capital Regulations**" means the Banking (Capital) Rules (Cap. 155L) of Hong Kong as amended or superseded from time to time, or any other capital regulations from time to time applicable to the regulatory capital of Authorized Institutions incorporated in Hong Kong issued or implemented by the Monetary Authority. "**Monetary Authority**" means the Monetary Authority appointed under section 5A of the Exchange Fund Ordinance (Cap. 66) of Hong Kong or any successor thereto.

Listing	Application will be made for the listing of the Bonds on the Hong Kong Stock Exchange by way of debt issues to Professional Investors only.
Clearing Systems	Euroclear Bank SA/NV and Clearstream Banking S.A.
Selling Restrictions	There are restrictions on the distribution of this Offering Circular and the making of solicitations pursuant thereto in certain jurisdictions, including, among others, the United States, the UK, the EEA, Hong Kong, Singapore and Japan. See "*Subscription and Sale*".
Legal Entity Identifier of the Issuer	254900BIDL79UKUMX541.
ISIN	XS2357352702.
Common Code	235735270.

SUMMARY FINANCIAL AND OTHER INFORMATION

The following tables set forth the summary information and other selected financial data of the Bank as at and for the periods indicated. The summary historical financial data as at and for the years ended 31 December 2018, 2019 and 2020 set forth below are derived from the Bank's audited financial statements as at and for the years ended 31 December 2019 (the "**Bank's 2019 Financial Statements**") and 31 December 2020 (the "**Bank's 2020 Financial Statements**", and together with the Bank's 2019 Financial Statements, the "**Bank's Financial Statements**"), respectively, including the notes thereto.

The Bank's Financial Statements have been audited by PricewaterhouseCoopers, the Bank's independent auditor, in accordance with Hong Kong Standards on Auditing, and are included elsewhere in this Offering Circular. The Bank's Financial Statements are prepared in accordance with the HKFRS and have been properly prepared in compliance with the Companies Ordinance.

The Bank has adopted HKFRS 16 from 1 January 2019, but has not restated comparatives for the year ended 31 December 2018, as permitted under the specific transitional provisions in HKFRS 16. The reclassifications and the adjustments arising from the new leasing rules are therefore recognised in the opening consolidated statement of financial position on 1 January 2019. The impact of the adoption of HKFRS 16 are disclosed in Note 2.2.1 to the 2019 Annual Financial Statements. Therefore, the financial statements of the Bank as of and for the year ended 31 December 2018 may not be directly comparable to the financial statements of the Bank after 1 January 2019. Potential investors must therefore exercise caution when making comparisons of such data and when evaluating the financial condition and results of operations of the Bank. Investors should consult their own independent financial advisers for professional advice.

Potential investors should exercise caution when using such information to evaluate the Bank's financial condition and results of operations. In addition, the Bank's historical financial information should not be taken as an indication of its future financial performance.

The summary financial statements as set forth below should be read in conjunction with, and is qualified in their entirety by reference to, the Bank's Financial Statements and the notes thereto included elsewhere in this Offering Circular.

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	For the year ended 31 December		
	2018	**2019**	**2020**
	(audited)	*(audited)*	*(audited)*
		(HK$'000)	
Interest income	4,814,092	6,076,016	5,324,947
Interest expense	(2,957,265)	(3,154,847)	(3,046,807)
Net interest income	1,856,827	2,921,169	2,278,140
Fee and commission income	777,684	746,623	814,846
Fee and commission expense	(45,028)	(56,536)	(56,634)
Net fee and commission income	732,656	690,087	758,212
Net gains arising from trading activities	366,822	76,413	544,990
Net gains arising from financial investments	(9,851)	425,804	165,906
Dividend income	700	35	35
Other operating income	20,982	21,541	15,080
Change in expected credit losses	(212,589)	(159,988)	(470,324)
Other operating expenses	(1,503,772)	(1,546,227)	(1,544,103)
Profit before tax	1,251,775	2,428,834	1,747,936
Income tax expenses	(268,758)	(366,160)	(297,567)
Net profit for the year	983,017	2,062,674	1,450,369
Other comprehensive income for the period, net of tax			
Item that will not be reclassified subsequently to profit or loss			
Equity investments at fair value through other comprehensive income — net change in fair value	1,816	(25)	(268)
Items that may be reclassified to profit or loss:			
Net gains arising from cash flow hedge			
Changes in fair value recorded in equity	(529)	—	—
Debt investments at fair value through other comprehensive income			
Net gains recorded in equity	221,146	890,277	920,285
Net gains reclassified from equity to profit or loss	(19,367)	(496,062)	(138,532)
Other comprehensive income for the year	203,066	394,190	781,485
Total comprehensive income for the year	1,186,083	2,456,864	2,231,854

STATEMENT OF FINANCIAL POSITION

	As at 31 December		
	2018	2019	2020
	(audited)	*(audited)*	*(audited)*
		(HK$'000)	
Assets			
Cash and balances with central bank	2,353,780	1,094,956	8,438,950
Due from banks and other financial institutions	25,082,437	17,667,908	20,094,736
Financial assets at fair value through profit or loss	1,855,354	1,064,926	905,433
Financial assets at fair value through other comprehensive income	109,315,062	122,242,273	201,947,823
Loans and advances to customers	67,688,719	79,201,615	137,514,670
Property and equipment	67,418	53,476	55,792
Current tax assets	—	—	50,290
Right-of-use assets	—	298,409	234,130
Deferred income tax assets	10,978	—	—
Other assets	1,502,974	5,489,437	3,722,018
Total assets	207,876,722	227,113,000	372,963,842
Liabilities			
Due to banks and other financial institutions	21,126,951	28,736,570	71,659,676
Due to customers	162,074,683	170,755,289	245,749,909
Financial liabilities at fair value through profit or loss	467,764	1,168,798	2,783,985
Current tax liabilities	151,997	534,932	—
Deferred income tax liabilities	—	46,906	163,500
Lease liabilities	—	301,488	238,333
Other liabilities	5,422,094	4,483,009	5,251,296
Total liabilities	189,243,489	206,026,992	325,846,699
Equity			
Share capital	17,900,000	17,900,000	37,900,000
Additional equity instrument	—	—	3,871,450
Other reserves	86,974	481,164	1,262,649
Retained earnings	646,259	2,704,844	4,083,044
Total equity	18,633,233	21,086,008	47,117,143

TIER I AND TIER II CAPITAL BASE

Capital adequacy ratios ("**CAR**") comply with the Banking (Capital) Rules (Cap. 155L) of the laws of Hong Kong issued by the Monetary Authority.

	As at 31 December 2018	As at 31 December 2019	As at 31 December 2020
	(HK$'000)	*(HK$'000)*	*(HK$'000)*
Common Equity Tier 1 ("CET1") capital: instruments and reserves			
Directly issued qualifying CET1 capital instruments plus any related share premium	17,900,000	17,900,000	37,900,000
Retained earnings	646,259	2,704,844	4,083,044
Disclosed reserves	86,974	481,164	1,262,649
CET1 capital before regulatory deductions	18,633,233	21,086,008	43,245,693
CET1 capital: regulatory deductions			
Other intangible assets (net of associated deferred tax liabilities)	1,495	10,185	16,132
Deferred tax assets (net of associated deferred tax liabilities)	10,978	—	—
Gains and losses due to changes in own credit risk on fair valued liabilities	4,220	20,259	33,139
Insignificant LAC investments in CET1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold)	—	—	—
Regulatory reserve for general banking risks	794,919	891,005	749,460
Total regulatory deductions to CET1 capital	811,612	921,449	798,731
CET1 capital	17,821,621	20,164,559	42,446,962
Additional Tier 1 capital	—	—	3,871,450
Tier 1 capital	17,821,621	20,164,559	46,318,412
Tier 2 capital: instruments and provisions			
Qualifying Tier 2 capital instruments plus any related share premium	2,000,000	2,000,000	2,000,000
Collective provisions and regulatory reserve for general banking risks eligible for inclusion in Tier 2 capital	1,023,412	1,206,411	1,316,605
Tier 2 capital before regulatory deductions	3,023,412	3,206,411	3,316,605
Tier 2 capital: regulatory deductions			
Insignificant LAC investments in Tier 2 capital instruments issued by, and non-capital LAC liabilities of, financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold and, where applicable, 5% threshold)	—	—	—
Tier 2 capital	3,023,412	3,206,411	3,316,605
Total regulatory capital	20,845,033	23,370,970	49,635,017

INVESTMENT CONSIDERATIONS

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

INVESTMENT CONSIDERATIONS RELATING TO THE BANK

The financial disclosure made by the Bank in this Offering Circular and its comparability with prior periods is limited due to its limited operation history and the transfer of businesses from BoCom Hong Kong Branch to the Bank in January 2018.

The Bank commenced business in 2018 and its personal banking business was transferred from the retail banking business and private banking business (including corporate banking business which relates wholly to private banking business and retail banking business) of BoCom Hong Kong Branch to the Bank on 29 January 2018 following the promulgation of the Bank of Communications (Hong Kong) Limited (Merger) Ordinance (Cap 1182) of the laws of Hong Kong.

The transfer of personal banking business from BoCom Hong Kong Branch to the Bank is a recapitalisation of a business and does not result in any changes in business substance, management nor the ultimate controlling shareholder. Accordingly, the assets and liabilities of the Transferred Business have been presented using their carrying value in the records of BoCom Hong Kong Branch. Certain assets and liabilities of BoCom Hong Kong Branch's corporate banking business have not been transferred to the Bank (the "**Excluded Business**"). Accordingly, the statement of financial position and the statement of comprehensive income of the Bank includes the net assets and results of the Excluded Business up to 28 January 2018 because the results of the Excluded Business cannot be clearly distinguished from that of the Transferred Business. The Excluded Business have been accounted for as a deduction from equity upon completion of the business transfer on 29 January 2018. The effects of all transactions between the Bank and the BoCom Hong Kong Branch before the recapitalisation are eliminated in preparing the financial statements.

Given the Bank's short operation history, its comparative historical financial information is limited and its financial statements do not provide a complete overview of the assets and liabilities of the Bank and should not be unduly relied upon by investors as an indication of future financial performance. For instance, the Bank has received HK$10 billion capital and HK$2 billion in the form of subordinated loan from BoCom in 2018 and the Bank has further received HK$20 billion in the form of capital injection from BoCom in 2020. Its CAR has been maintained at a sufficient level throughout the year of 2020, however there can be no assurance that the Bank will receive capital injection from BoCom on a regular basis and potential investors should exercise caution to evaluate the Bank's CAR and other indicators of the Bank's financial conditions.

Any adverse change in Hong Kong's and the global social and economic environment could have an adverse impact on the Bank's business and financial condition.

The Bank conducts most of its operations and generates most of its revenue in Hong Kong. The Bank's performance and the quality and growth of its assets are necessarily dependent on the overall economy and the local social and political stability in Hong Kong. As a result, any downturn in the Hong Kong economy or any instability in the local social and political landscape of Hong Kong may adversely affect the Bank's business, financial condition and the results of its operations.

Civil unrest and an uncertain political environment may impact the Hong Kong economy and result in an economic slowdown. Protests, demonstrations or rioting causing disruption to businesses, commercial activities and transportation systems, such as the anti-extradition bill protests in Hong Kong, may adversely impact investor confidence, dampen consumer spending and affect overall business activities, which in turn may have a negative impact on our banking business in Hong Kong. Moreover, prolonged civil unrest and an uncertain political environment may impact the Hong Kong economy and result in an economic slowdown. Any significant economic environment or political arrangements in Hong Kong may result in declines in the Bank's profitability and materially affect its business, financial condition, results of operations and the price of the Bonds traded in the secondary market.

Since 2018, the United States has announced a series of additional tariffs on imported goods from China. Although the "phase one" trade deal was signed in January 2020, any further change in the U.S. global trade policy against China, including tightening regulatory restrictions, industry specific quotas, tariffs, non-tariff barriers and taxes may have an adverse effect on China's economy. Also, any Sino-U.S. trade friction, or a rise in global trade protectionism, will negatively impact the trade-dependent economies in Hong Kong and Asia, which may have an adverse impact on the Bank's cost of funding, business, operations, financial condition and properties.

On 14 July 2020, the U.S. President signed into law the Hong Kong Autonomy Act (the "**Autonomy Act**") and issued The President's Executive Order on Hong Kong Normalization ("**EO 13936**"). Under EO 13936, among other things, existing license exceptions and preferential status for Hong Kong under relevant U.S. export control laws and regulations are revoked. As a result, exports to Hong Kong of certain U.S. controlled software, commodities, and technology are subject to the enhanced requirements applicable to exports to the PRC. Any economic sanctions imposed under the Autonomy Act or EO 13936, trade-related restrictions under EO 13936, and other sanctions may have an impact on the Bank's business, financial condition and results of operations.

In addition, uncertainties and instability in global market conditions could adversely affect the Hong Kong economy, which may in turn adversely affect the Bank's business, financial condition and results of operations. Since the second half of 2008, the global credit markets have experienced, and may continue to experience, significant dislocations and liquidity disruptions which have originated from liquidity disruptions in the United States and the European Union ("**EU**") credit and sub-prime residential mortgage markets. In particular, the sovereign debt crisis in some European countries (including Greece, Ireland, Italy, Spain, Portugal and Cyprus) since early 2010 and the downgrading of the credit rating of the United States' sovereign debt in August 2011 have contributed to an economic slowdown in most economies around the world, substantial volatility in financial markets globally and the tightening of liquidity in global financial markets.

In addition, the UK withdrew from the EU on 31 January 2020 ("**Brexit**") but continued to participate in certain EU organizations (such as the customs union) during a transition period that ended on 31 December 2020. With Brexit taking full effect, there remains uncertainty about the future relationship between the UK and the EU. Although a new trade and cooperation agreement between the UK and EU was agreed upon on 24 December 2020 and applied on a provisional basis for a limited time until 30 April 2021, the extent Brexit may influence future operations of the global financial market remains unpredictable. Brexit may also have an uncertain impact upon the rates of foreign currency exchange, i.e. euro, pound and U.S. dollar, which could increase the funding costs or cause additional expenses for cross-border settlement. If there is any renewed economic downturn or slowdown in global economic recovery, there can be no assurance that the Hong Kong economy or the Bank's business, financial condition and results of operations will not be adversely affected.

Any future occurrence of natural disasters or outbreaks of contagious diseases in Asia may have a material adverse effect on the Bank's business operations, financial condition and results of operations.

Concerns about the spread of the novel coronavirus (COVID-19) and H7N9 strain of flu (Avian Flu) and outbreaks of the H1N1 virus (Swine Flu) in North America, Europe and Asia in the past have caused governments to take measures to prevent spread of the virus. The outbreak of communicable diseases such as the ones listed above on a global scale may affect investment sentiment and result in sporadic volatility in global capital markets or adversely affect PRC and other economies.

In particular, the outbreak of novel coronavirus (COVID-19) in 2020 has resulted in many countries, including China, Japan, the United States, members of the EU, the UK and India, declaring a state of emergency and imposing extensive business and travel restrictions with a view to containing the pandemic. Widespread reductions in consumption, industrial production and business activities arising from the novel coronavirus (COVID-19) pandemic has significantly disrupted the global economy and global markets and has led to result in a global economic recession. In addition, novel coronavirus (COVID-19) has led to significant volatility in the global markets across all asset classes, including stocks, bonds, oil and other commodities and this volatility may persist for some time. In early 2021, vaccination programmes have been rolled out in various countries in response to the COVID-19 pandemic, including the United States, China, the EU and UK. However, the effect of such vaccination programmes remains uncertain, and many countries, including India, are experiencing another wave of the COVID-19 pandemic, and in some cases new variants of COVID-19 which could be more contagious. As the COVID-19 pandemic continues to adversely affect business activities globally, governments and central banks across the world have introduced and continued to introduce fiscal and monetary stimulus measures including direct subsidies, tax cuts, interest rates cuts, quantitative easing programmes and suspension or relaxation of prudential bank capital requirements. These measures aim to contain the economic impact of the COVID-19 pandemic, stabilise the capital markets and provide liquidity easing to the markets. Accordingly, the Bank has revisited its stress test economic scenarios, completed various thematic reviews in response to COVID-19, and re-evaluated probability weightings in calculating expected credit loss. However, there remains significant uncertainties in assessing the duration of the COVID-19 pandemic and its impact. A continued period of significantly reduced economic activity resulting from the COVID-19 pandemic could have a material adverse effect on the Bank's business, financial conditions and result of operations.

In addition, for example, past occurrences of epidemics such as SARS have caused different degrees of damage to the national and local economies in China. If any of our employees are identified as a possible source of spreading novel coronavirus (COVID-19), Swine Flu, Avian Flu or any other similar epidemic, the Bank may be required to quarantine employees that are suspected of being infected, as well as others that have come into contact with those employees. The Bank may also be required to disinfect our affected premises, which could cause a temporary suspension of our business capacity, thus adversely affecting our operations. A recurrence of an outbreak of coronavirus (COVID-19), Swine Flu, SARS, Avian Flu, or other similar epidemic could restrict the level of economic activities generally and/or slow down or disrupt our business activities including, but not limited to, a decline in demand for residential mortgage advances, a reduction in the number of customers visiting the Bank's branches and an adverse impact on asset quality due to a weakened economy and higher unemployment rate which could in turn adversely affect the Bank's results of operations. There can be no assurance that the Bank's business, financial condition and result of operations would not be adversely affected if another outbreak of the novel coronavirus (COVID-19), Swine Flu, SARS, Avian Flu or another highly contagious disease occurs.

Intense competition in the Hong Kong banking industries could adversely affect the Bank's profitability.

The banking industry in Hong Kong is a mature market, and the Bank is subject to significant and increasing competition from many other Hong Kong-incorporated banks and Hong Kong branches of international and PRC banks, including competitors that have significantly more financial and other capital resources, higher market share and stronger brand recognition than the Bank. The international and local banks and niche players operating in Hong Kong compete for substantially the same customers as the Bank. There is a limited market, especially for retail banking products such as investment and insurance products, residential mortgage loans, credit cards and personal loans. Although the Bank could leverage on BoCom's strong network in both Mainland China and Hong Kong as well as its close collaboration with its Hong Kong affiliates such as BoCom Hong Kong Branch, BOCOM International Holdings Company Limited ("**BOCOM International**"), China BOCOM Insurance Co., Ltd. ("**China BOCOM Insurance**") and Bank of Communications Trustee Limited ("**BOCOM Trustee**"), there can be no assurance that the Bank will be able to compete effectively in the face of such competition. Intense competition may make it difficult for the Bank to increase the size of its loan portfolio and deposit base and may cause intense pricing competition. Moreover, in May 2018, the Monetary Authority published the Final Revised Guideline on the Authorisation of Virtual Banks. As at 30 April 2021, the Monetary Authority has granted virtual bank licenses to eight institutions. The emergence of virtual banks will lead to increased competition between traditional and virtual banks and the profit margin may be further squeezed. There can be no assurance that increased competition will not have a material adverse effect on the Bank's business, financial condition or results of operations.

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

- reducing the growth and quality of the Bank's loan and deposit portfolios and other products and services;
- reducing the Bank's interest income and net interest margin;
- reducing the Bank's fee and commission income;
- increasing the Bank's interest and operating expenses; and
- increasing competition for qualified managers and employees.

The Bank is subject to minimum regulatory capital and other regulatory requirements in Hong Kong, failing which may adversely affect its business and operations and further issuance of regulatory capital may adversely affect the market price of the Bonds in the secondary market.

Under the Banking Ordinance (Cap. 155) of Hong Kong (the "**Banking Ordinance**"), the Monetary Authority regulates the business activities and operations of authorized institutions and has the ability to influence banking and financial markets generally. Potential investors should be aware that regulatory requirements in Hong Kong may differ from those that prevail in other countries. Since the Bank operates in the highly regulated banking and securities industries in Hong Kong, potential investors should also be aware that the regulatory authorities have been consistently imposing higher standards and developing guidelines and regulatory requirements such as the Basel III capital standards which have been adopted in Hong Kong since January 2013.

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

The initial stage of the Basel III capital reforms has been implemented by the government of Hong Kong since the beginning of 2013, and the full implementation of the reforms will be completed by 2022.

These standards require banks to disclose key pieces of information on capital, risk exposures, risk assessment processes and hence capital adequacy. The aim of these standards is to encourage banks to demonstrate to the market participants that their risk management systems are robust and that all relevant risks have been identified and controlled.

The Monetary Authority has publicly announced its plan to implement the Basel III Liquidity standards in full following the Basel implementation schedule and transitional arrangement. The Banking (Liquidity) Rules (Cap. 155Q) of Hong Kong were enacted into local regulations in October 2014 and these rules have been in operation since 1 January 2015.

On 19 October 2018, the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements — Banking Sector) Rules (the "**LAC Rules**") was published in the gazette of the Hong Kong Special Administrative Region Government, and came into operation on 14 December 2018. The LAC Rules introduce an additional loss absorbing capacity ratio which the Bank may or may not need to maintain in addition to existing capital and liquidity. If the LAC Rules are considered applicable to the Bank in future, it may need to issue other loss absorbency capital instruments to meet the relevant requirements in the LAC Rules. There can be no assurance that the Bank will be able to obtain additional capital in a timely manner, on acceptable terms or at all. Therefore, the Bank is unable to assess the full impact of the LAC requirements on the financial system generally, the Bank's counterparties, the Bank, any of its consolidated subsidiaries, its operations and/or its financial position.

As at 31 December 2020, the Bank's Core Tier 1 CAR, Tier 1 CAR and Total CAR were 18.6 per cent., 20.3 per cent. and 21.8 per cent., respectively, which satisfy the regulation requirements. In order to strengthen its capital adequacy position or to ensure that it remains in compliance with applicable capital requirements under Hong Kong law, rules and regulations (including guidelines issued by the Monetary Authority), the Bank may from time to time raise additional capital through such means and in such manner as it may consider appropriate including, without limitation, the issue of further subordinated notes or other hybrid capital instruments, subject to any regulatory approval that may be required. There can be no assurance that such future capital raising activities will not adversely affect the market price of the Bonds in the secondary market. There can also be no assurance that the Bank will be able to obtain additional capital in a timely manner, on acceptable terms or at all.

Certain products and services provided by the Bank are regulated by other regulators including the Bonds and Futures Commission (the "**SFC**") in Hong Kong. The Bank carefully manages legal and compliance risks, including in relation to the sale of financial products and compliance with anti-money laundering and anti-terrorist financing regulations. From time to time, the regulators in Hong Kong have introduced recommendations which are intended to provide tighter control and more transparency in the Hong Kong banking sector, in particular, in relation to the selling of investment and insurance products to retail customers.

In May 2010, the Monetary Authority and the SFC each launched new investor protection measures. The Securities and Futures Ordinance (Cap. 571) of Hong Kong (the "**SFO**") and its subsidiary legislations regulate the offering and sales of securities products as defined under Schedule 1 of the SFO. In addition to the subsidiary legislations, the Monetary Authority has been introducing additional measures on sales of investment products, including non-SFO regulated investment products, which the banking industry in Hong Kong needs to comply with.

Among others, the Monetary Authority, from time to time, issues circulars in relation to the selling of investment and insurance products, which further clarified and enhanced the product due diligence process, product disclosure to customers and suitability assessment. With regards to the investment products with relatively higher risk (such as accumulators and high yield or complex bonds), the Monetary Authority also specified the regulatory standards for selling these products.

Separately, the SFC has revised their Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the "**SFC Code**") for meriting greater protection to investors, including the reform of Professional Investor Regime in March 2016 dis-applying most of the previous exemptions under the SFC Code to the Individual Professional Investors, to add a new clause into client agreement for making the intermediary's suitability obligation towards its customers as a contractual term and to further enhance disclosure of transaction related information to customers in August 2018.

Going forward, it is foreseeable that there would be further reinforcements and more stringent requirements on the regulations, particularly those in relation to suitability of selling investment and insurance products and fairness and transparency of providing banking products and services to customers. Increased regulations and the requirements for more stringent customer protections have increased its operational and compliance expenses. Any changes in regulations, governmental policies, income tax laws or rules and accounting principles, as well as international conventions and standards relating to commercial banking operations in Hong Kong, could affect the Bank's operations. There can be no assurance that the relevant regulatory authorities will not implement further regulations and that such changes will not materially increase the Bank's operational and compliance burden or adversely affect its business or operations.

The Bank may not be able to maintain sufficient portion of long-term funding and the Bank's liquidity could be adversely affected.

As at the date of this Offering Circular, the Bank has a satisfactory level of capital adequacy and it endeavours to maintain stability of its liquidity through various funding sources. As at 31 December 2020, the Bank's loan-to-deposit ratio is 56.2 per cent. As at 31 December 2020, the Bank's liquidity coverage ratio (the "**LCR**") and net stable funding ratio (the "**NSFR**") were 147.44 per cent. and 113.11 per cent, respectively. Apart from customer deposits, the Bank also meets its funding requirements through issue of certificates of deposits as well as receiving capital injection from BoCom. In 2018, the Bank received HK$10 billion capital and HK$2 billion in the form of subordinated loan from BoCom. On 10 March 2020, the shareholders meeting of BoCom approved an injection of no more than HK$30 billion in instalments to the Bank's share capital. On 21 September 2020, BoCom increased the share capital of the Bank by HK$20 billion. The Bank expects additional capital injection from BoCom in the future, however there can be no assurance that the Bank will continue to receive such capital injection or it can acquire sufficient capital through issue of debt instruments on acceptable terms and at low cost.

It is very common in most banks that a substantial portion of customer deposits will be rolled over upon maturity and these deposits in essence, can be a stable source of long-term funding. However, there can be no assurance that this pattern will apply to the Bank. If a substantial number of depositors do not roll over deposited funds upon maturity, the Bank's liquidity position would be adversely affected and the Bank may need to seek alternative sources of short-term or long-term funding to finance its operations, which may be more expensive than existing deposits.

There are many factors affecting the growth of the Bank's deposits, some of which are beyond the Bank's control, such as economic and political conditions, the availability of alternative investment choices (including but not limited to securities issued by governmental or corporate entities, unit trusts and mutual funds, investment-linked assurance schemes and structured investment products), change of government monetary policy and retail customers' changing perceptions toward savings. There can be no assurance that the Bank will be able to maintain or grow its customer deposits to support its business.

As part of its measures to maintain the liquidity of, and confidence in, the Hong Kong financial markets, the Hong Kong Deposit Protection Board enhanced the Deposit Protection Scheme with an increased protection limit of HK$500,000 and expanded coverage including deposits pledged as security, came into effect on 1 January 2011. On 24 March 2016, the Deposit Protection Scheme (Amendment) Ordinance 2016 (the "**2016 Amendment Ordinance**") came into effect. Amongst other things, a gross payout approach is adopted for the determination of compensation under the Deposit Protection Scheme in case the scheme is triggered. Under this approach, any compensation paid to depositors is determined on the basis of their aggregate protected deposits held with a failed bank (up to HK$500,000 per depositor) without deducting the amount of liabilities owed by those depositors to the same bank. The gross payout approach enables the affected depositors to have faster access to their deposits. There can be no assurance that the level of customer deposits, and therefore of the Bank's liquidity, will not be adversely affected by the withdrawal of, or any changes to, the Deposit Protection Scheme in the future.

The Monetary Authority acts as the lender of last resort to all authorized institutions in Hong Kong to provide liquidity support in the banking system generally as well as to specific institutions. Although the Hong Kong government has in the past taken measures on a case-by-case basis to maintain or restore public confidence in individual banks with an isolated liquidity crisis, there can be no assurance that the Monetary Authority will provide such assistance in the future or that it would elect to provide such assistance in the future to the Bank in the event of a liquidity crisis.

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

Volatility in interest rates could have an adverse effect on the Bank's business, financial condition, liquidity and results of operations.

As with most banks, the Bank's net interest income is a significant factor in determining its overall financial performance. For the year ended 31 December 2020, net interest income represented 60.6 per cent. of the Bank's total operating income. Interest rates in Hong Kong have remained relatively low in recent years. However, there can be no assurance that interest rates will not rise or fall or become volatile or that changes in interest rates will not be frequent. Changes in market interest rates affect the interest to be received on the Bank's interest-earning assets and the interest to be paid on the Bank's interest-bearing liabilities. The Bank realises income from the margin between income earned on its assets and interest paid on its liabilities. For the years ended 31 December 2018, 2019 and 2020, the Bank's net interest margin was approximately 0.94 per cent., 1.44 per cent. and 0.81 per cent., respectively. For the years ended 31 December 2018, 2019 and 2020, the Bank's net interest spread was 0.87 per cent., 1.29 per cent. and 0.70 per cent., respectively. As a result, volatility in interest rates could have an adverse effect on the Bank's business, financial condition, liquidity and results of operations.

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

The Bank's business operation is exposed to currency risks and may be affected by a discontinuation of or amendment to the link of the Hong Kong dollar to the U.S. dollar or revaluation of the Hong Kong dollar.

The majority of the Bank's revenue is generated in Hong Kong dollars. Although the Hong Kong dollar has been linked to the U.S. dollar since 1983, there can be no assurance that such linkage will be maintained in the future. In order to ensure continued liquidity of the Hong Kong dollar, the Monetary Authority has entered into bilateral repurchase agreements with the central banks of Australia, Mainland China, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand. In addition, the Hong Kong government has in the past expressed its commitment to maintaining exchange rate stability under the Linked Exchange Rate System, an automatic interest rate adjustment mechanism. However, there can be no assurance that the Hong Kong dollar will continue to be linked to the U.S. dollar or that, in the event of a liquidity problem affecting the Hong Kong dollar, such bilateral repurchase agreements or automatic interest rate adjustment mechanism will help to maintain adequate liquidity of the Hong Kong dollar. The Bank's business, financial condition and results of operations could be adversely affected by the impact on the Hong Kong economy of the discontinuation of the link of the Hong Kong dollar to the U.S. dollar or any revaluation of the Hong Kong dollar.

The Bank may not manage risks associated with the replacement of benchmark indices effectively.

The Financial Stability Board has observed that the decline in interbank short-term unsecured funding poses structural risks for interest rate benchmarks that reference these markets. In response, regulators and central banks in various jurisdictions have convened national working groups ("**NWGs**") to identify alternative replacement 'risk-free' rates ("**RFRs**") for these interbank offered rates ("**IBORs**") and, where appropriate, to make recommendations that would facilitate an orderly transition to these RFRs.

Following the announcement on 27 July 2017 by the United Kingdom Financial Conduct Authority ("**FCA**") where it was announced that the FCA will no longer persuade or compel banks to submit rates for the calculation of the London Interbank Offered Rate ("**LIBOR**") benchmark after 2021, the NWGs for the impacted currencies were tasked with providing guidance and support to financial and non-financial firms to help them facilitate an orderly transition of the relevant LIBORs to their chosen RFRs.

The expected discontinuation of certain key IBORs such as LIBOR, the adoption of RFRs by the market, and the development of RFR products by the Bank, introduces a number of risks for the Bank, the Bank's clients, and the financial services industry more widely. These include, but are not limited to:

- regulatory compliance, legal and conduct risk, arising from both the continued sale of products referencing IBORs, sales of products referencing RFRs and the transition of legacy contracts to alternative rates. There is a risk that the Bank is unable to meet regulatory milestones associated with the discontinuance of sale of certain IBOR products, which may result in regulatory investigations or reviews being conducted into the Bank's preparation and readiness for the replacement of IBORs with alternative reference rates. Additionally, if the Bank's sales processes are not appropriately adapted to account for the additional complexity of new products, or new RFR market conventions, additional conduct risks and regulatory actions may result and there may be a heightened risk of disputes;

- legal risks associated with the enforceability of "fall-back" provisions in IBOR contracts. There is a risk that some contracts will not be transitioned before the relevant IBOR is discontinued and the parties will need to rely on the "fall-back" provisions of those contracts. As these "fall-back" provisions do not always contemplate the permanent cessation of the relevant IBOR, there is a risk that the provisions may not work from a contractual, practical or financial perspective, potentially resulting in unintended outcomes for the Bank's clients. This also may lead to complaints, litigation and/or regulatory action taken against the Bank. While legislative solutions have been proposed in the UK, U.S. and EU, market participants will need to consider the impact of any proposals ultimately adopted; and

- financial risks resulting from the discontinuation of IBORs and the development of RFR market liquidity will affect the Bank throughout transition. The differences in IBOR and RFR interest rate levels will create a basis risk that the Bank will need to actively manage through appropriate financial hedging. Basis risk in the trading book and in the banking book may arise out of the asymmetric adoption of RFRs across assets and liabilities and across currencies and products. In addition, this may limit the Bank's ability to hedge effectively.

If any of these risks materialise, it could have a material adverse effect on the Bank's business, financial condition, results of operations, prospects and customers.

The Bank is exposed to operational risks inherent in the banking industry.

Like all other financial institutions, the Bank is exposed to many types of operational risks resulting from inadequate or failed internal processes, people and systems or from external events, including the risk of fraud, unauthorised transactions or other misconduct by employees (including the violation of regulations for the prevention of corrupt practices, and other regulations governing the Bank's business activities), unintentional or negligent failure to meet professional obligation to specific clients (including fiduciary and suitability requirements), or operational errors, including clerical or record keeping errors or errors resulting from faulty computer or telecommunications systems.

There can be no assurance that any such operational risks or operational errors will not materialise or occur in the future, or that, if such risks or errors do materialise or occur, the Bank's business, reputation, results of operations and financial conditions will not be adversely affected. The Bank is further exposed to the risk that external vendors may be unable to fulfil their contractual obligations to it (or will be subject to the same risk of fraud or operational errors by their employees).

Given the Bank's high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. In addition, the Bank's dependence upon automated systems to record and process transactions may further increase the risk of technical system flaws or employee tampering or manipulation of those systems that will result in losses that may be difficult to detect. The Bank may also be subject to disruptions of its operating systems, arising from events that are wholly or partially beyond its control (including, for example, computer viruses or electrical or telecommunication outages), which may give rise to a deterioration in customer service and to loss or liability to it. The Bank also faces the risk that the design of its controls and procedures may prove inadequate or are circumvented, thereby causing delays in detection of errors in information.

Although, like other financial institutions, the Bank maintains a system of controls designed to reduce operational risks to a reasonably low level, there can be no assurance that the Bank will not suffer material losses from operational risks in the future. The Bank's reputation could be adversely affected by the occurrence of any such events involving its employees, customers or third parties. In addition to internal factors that may affect the Bank's operations, the rapid growth and expansion of its business in recent years may have also resulted in increasing complexity in its internal and external control systems and risk management measures, which may add to its operational risks.

The Bank's business operation is subject to credit risk.

As with most banks, the Bank's banking business is exposed to credit risk arising primarily from default by its borrowers and the credit risk associates with its investments in treasury bills and debt instruments, which are recorded as financial assets designated at fair value through profit or loss.

These financial assets may also be subject to price fluctuations as a result of changes in the financial market's assessment of the relevant issuer's creditworthiness, delinquency and default rates and other factors. The Bank holds a portfolio of debt securities with different investment grades. The Bank has analysed its investments in debt securities according to the designation of external credit institutions.

Among these investments, 13.6 per cent. of them were debt instruments issued by central government or central bank such as the Hong Kong government's Exchange Fund and the United States Treasury and 34.7 per cent. of them were debt instruments issued by financial institutions which were rated BBB and above by S&P. Although the Bank adopts a relatively conservative investment strategy, there can be no assurance that the Bank will not suffer any future marked-to-market losses on its original investment amount in its portfolio of debt securities.

In addition, the Bank may not have sufficient access to resources and trading counterparties to effectively manage its credit exposure. The volatility sourced from any negative news of the relevant security issuers could be magnified, and as a result, the Bank may experience significant financial losses that could materially and adversely affect its business, financial condition and results of operations.

In addition, the Bank's loan portfolio comprises 26.4 per cent. of unsecured loans, the repayment of which is largely dependent on the cashflow of the borrower and adherence to the financial covenants contained in the loans. Long-term loans and advances to corporate and individual customers are generally secured; while revolving individual credit facilities are generally unsecured. Collaterals held as security for financial assets other than loans and advances to customers are determined by the nature of the instrument. Debt securities and treasury bonds are generally unsecured, with the exception of asset backed securities, which are secured by portfolios of financial instruments.

Although the Bank carefully assesses the repayment ability of such borrowers and closely monitors impairment indicators, loan products which are not secured by any collateral entail a higher degree of credit risk than secured loan products. If there is a downturn in the economy, the credit quality and charge-off rates experienced by the Bank may deteriorate.

The Bank relies heavily on BoCom Hong Kong Branch to provide middle-to-back office support.

The Bank commenced its personal banking business on 29 January 2018, which was transferred from the retail banking business and private banking business (including corporate banking business which relates wholly to private banking business and retail banking business) of BoCom Hong Kong Branch. The Bank's ability to sustain its development and meet future business demands depends on its ability to attract, recruit and retain suitably skilled and qualified staff. As at the date of this Offering Circular, the Bank shared 16 middle and back offices with BoCom Hong Kong Branch, such as human resources department, financial management department, risk management department, credit management department, in order to create cost synergies continuously. Those employees are employed by BoCom Hong Kong Branch and they provide relevant support to both entities. In compliance with regulatory requirements on system, data independence and security, the Bank and BoCom Hong Kong Branch share major information systems, such as 531 and Summit, to ensure the consistency on all aspects of risk management. Both the Bank and BoCom Hong Kong Branch enjoyed cost-saving benefits from such arrangement. As at 31 December 2020, all of the Bank's team head and above employees have five or more years of related work experience and 99 per cent. of them hold professional qualifications or have completed a bachelor's degree or higher. The competition for such suitably skilled and qualified staff is particularly acute in Hong Kong. Any of these factors could adversely affect the Bank's business, financial condition and results of operations.

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

The Bank's risk management policies and procedures and internal controls, as well as the risk management tools available to it, may not be adequate or effective in identifying or managing risks to which it is exposed.

The complexity of the Bank's operations and products exposes it to various risks, including market risk, credit risk, operational risk, liquidity risk, compliance risk, legal risk and other risks. The Bank has established risk management and internal control systems and procedures to manage potential risks associated with the financial services and products it offers, and it has been dedicated to continuously improving these systems and procedures. However, the design and implementation of such systems, including internal control environment, risk identification and evaluation, effectiveness of risk control and information communication, are constrained by available information, tools, models and technologies available to the Bank, and its systems may not be adequate or effective in identifying or mitigating its risk exposure in all market environments or protecting it against all types of risks. The Bank's risk management and internal control systems require constant maintenance and continual improvements. The Bank's efforts to maintain these systems may be ineffective or inadequate.

The effectiveness of the Bank's risk management and internal control systems and procedures may also be adversely affected by oversight, clerical mishandling and errors, reporting errors or its limited experience or resources in making accurate, complete, up-to-date or proper evaluations. Many of the Bank's methods for managing risk exposure are based upon observed historical market behaviour or data. Potential future risk can be significantly greater than what these methods have historically estimated. Moreover, the information and empirical data that the Bank relies on may quickly become obsolete as a result of changes in market situations and regulatory requirements, and the Bank's historical data may not be able to adequately reflect risks that may emerge from time to time in the future.

There is no assurance that the Bank's risk management and internal control systems are adequate and effective. Failure to address any internal control matters and other deficiencies in a timely and effective manner may result in investigations, disciplinary actions or even prosecution being taken against the Bank or its employees, or disruption to its risk management system, any of which may have a material adverse effect on its business, financial condition and results of operations.

The loan classification and provisioning system for Hong Kong banks is different in certain respects from that in certain other countries.

In accordance with the Guideline on Loan Classification System issued by the Monetary Authority, the Bank has established a loan credit risk classification system and performs credit risk management based on loan classification in one of five categories. The Bank classifies loans into the following five categories: normal, special-mention, substandard, doubtful and loss, of which substandard, doubtful and loss loans are regarded as non-performing loans. The Bank has a 19-level internal rating system for credit risk measurement that maps with external ratings, which comprises 18 rating levels for instruments not in default (1.1 to 1.4, 2 to 15) and one default class.

When the loans in which borrowers are displaying a definable weakness that is likely to jeopardise repayment, the Bank downgrades the loans to substandard. If loans for which collection in full is improbable and the authorized institution expects to sustain a loss of principal and/or interest, taking into account the net realisable value of collateral, the Bank classifies the loans as doubtful. Loss loans are those that are considered uncollectable after all collection options (such as the realisation of collateral or the institution of legal proceedings) have been exhausted.

The laws, regulations and guidelines governing the banking industry in Hong Kong differ from those applicable in certain other countries in certain respects and may result in particular loans being classified at a different time or being classified in a category reflecting a different degree of risk than would be required in certain other countries. In addition, the typical procedures for writing off loans in Hong Kong may result in loans being written-off later than would be the case for banks in certain other countries. Banks in Hong Kong may accrue interest on "sub-standard" loans in situations where such interest would not be accrued by banks in certain other countries.

The Bank may not be able to control the level of impaired loans in its loan portfolio, and the allowance for impairment losses on loans of the Bank may not be sufficient for covering the actual losses on its loan portfolio which may be incurred in the future.

The Bank's business could be materially and adversely affected by any deterioration in the quality of its loan portfolio or investment securities, or other assets. Risks from changes in credit quality and the recoverability of loans and amounts due from counterparties as well as risks from the Bank's investment activities are inherent in a wide range of the Bank's businesses. The Bank's non-performing loans represented approximately 0.08 per cent. of its total loans and advances to customers as at 31 December 2020. The Bank may not be able to control effectively the level of impaired loans in its current loan portfolio or the level of new loans that may become impaired in the future. In particular, the amount of the Bank's impaired loans may increase in the future due to a deterioration in the quality of its loan portfolio or a substantial increase in the amount of its new loans.

Deterioration in the quality of the Bank's loan portfolio, investment securities or other assets may occur for a variety of reasons, including factors which are beyond the Bank's control, such as a slowdown in Hong Kong, the PRC or global economies, a relapse of a global credit crisis, volatility in interest rates and market liquidity, and other adverse macroeconomic trends and financial conditions in Hong Kong, the PRC, Europe and other parts of the world. These factors may cause operational, financial and liquidity problems for the Bank's borrowers and the issuers of the Bank's investment securities which, in turn, may materially and adversely affect their ability to service their outstanding debt and fulfil their payment obligations under the securities issued.

Other factors may also cause the asset quality of the Bank's loan portfolio to deteriorate and the market value of its securities investment to decrease, including actual or perceived failure or worsening credit of counterparties (in particular, those counterparties to which the Bank has substantial exposure), declines in residential and commercial property prices, higher unemployment rates and reduced profitability of corporate borrowers.

The Bank may not be able to realise the full value of its collateral as a result of a downturn in the real estate markets, delays in bankruptcy and foreclosure proceedings, fraudulent transfers by borrowers and other factors beyond its control. Any decline in the value of the collateral securing the Bank's loans may result in an increase in its impairment allowances and a reduction in the recovery from collateral realisation, which may adversely affect its business, financial condition and results of operations.

The Bank's operations are subject to security risks and the proper functioning and maintenance of its IT systems.

As with most banks, the Bank is highly dependent on the ability of its IT systems to process accurately a large number of transactions across numerous and diverse markets and its broad range of products in a timely manner. The proper functioning of its financial control, risk management, accounting, customer service and other data processing systems, together with the communication networks between its various branches and sub-branches and its main data processing centres, are critical to its business and its ability to compete effectively. The Bank relies heavily on BoCom to develop and operate all IT systems and the relevant costs are born by BoCom, however there can be no assurance that the Bank will not incur significant costs on establishing and maintaining IT systems in the future. Although the Bank backs up the data of each system and conduct data recovery tests on a regular basis, there can be no assurance that the Bank's operations will not be materially disrupted if there is a partial or complete failure of any of these primary IT systems or communications networks. Such failures could be caused by, among other things, software bugs, computer virus attacks or conversion errors due to system upgrading. In addition, any security breach caused by unauthorised access to information or systems, loss or corruption of data and malfunction of software, hardware or other computer equipment could have a material adverse effect on the Bank's business, reputation, results of operations and financial condition.

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

The Bank's internet banking and trading services are subject to security risks.

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

The Bank's financial condition is exposed to risks relating to transactions with its related parties.

The Bank has engaged in a broad range of transactions with its related parties, such as BoCom, the Bank's directors, senior management and its fellow subsidiaries.

These transactions primarily include purchase and redemption of financial investments, deposits and loans and advances. The details of the Bank's related party transactions have been disclosed in note 33 of the Bank's 2019 Financial Statements and note 34 of the Bank's 2020 Financial Statements, respectively, included in this Offering Circular. Although such transactions with the Bank's related parties have been carried out under normal commercial terms and paid at arm's length, the Bank's related parties may have interests that are different from the interests of the Bank, which may expose the Bank to conflicts of interest and thus adversely impact the Bank's financial condition.

The Bank may not be able to detect money laundering and other illegal or improper activities in its business operations completely or on a timely basis.

The Bank is required to comply with applicable anti-money laundering laws, anti-terrorism laws and other regulations in Hong Kong, the PRC and overseas. The relevant anti-money laundering laws and regulations require financial institutions to establish sound internal control policies and procedures with respect to anti-money laundering monitoring and reporting activities. The relevant anti-terrorism regulations also require financial institutions to freeze capital or other assets of terrorist organisations and their members that have been designated by the national anti-terrorism authorities and to report to the relevant governmental authorities.

The Bank has established adequate internal control systems taking into account factors including the types of products and services offered, the category of customers and geographical locations of the parties and transactions involved for its identification of potential risks. The Bank has also implemented various ongoing control measures to manage and mitigate any potential risks arising from its business operations, ranging from senior management oversight, appointments of compliance officer and money laundering reporting officer, regular checks by its compliance and audit function teams, staff screening and training. The Bank's existing policies and procedures for the detection and prevention of money laundering activities and terrorist-financing activities through its business platform have only been adopted in recent years and may not eliminate instances in which it may have been used by other parties to engage in money laundering and other illegal or improper activities. In the event that the Bank fails to fully comply with applicable laws and regulations, the relevant government agencies may freeze its assets or impose fines or other penalties on it. There is no assurance that there will not be failures in detecting money laundering or other illegal or improper activities which may adversely affect the Bank's business reputation, financial condition and results of operations.

The Bank may be involved in legal and other proceedings arising from its operations from time to time.

The Bank offers a range of wealth management and investment products to its customers. The Bank's management of the selling process associated with the distribution of these products is important to the success of its business. The Bank is required, among other things, to assess the suitability of customers for particular investment products and to ensure that risks associated with those products are adequately disclosed to its customers before the Bank sells such products to them. The Bank may become liable to customers for damages and may be subject to regulatory enforcement actions if the sale of these products by the Bank is subsequently found to be in breach of the relevant legal or regulatory requirements, or duties owed to customers.

Litigation and claims will always be a possibility and such claims, in the aggregate, may become material to the Bank. Similarly, there can be no assurance that relevant government authorities or regulators will not seek to impose fines and/or suspend the Bank's regulated activities as a result of regulatory proceedings. Regulatory pressure to settle claims could also result in material payments by the Bank to disgruntled investors, which often does not reflect the merits of the parties' cases. Any legal or regulatory proceedings, whether substantiated or not, may result in negative publicity and a loss of customer confidence and/or goodwill, which may lead to a loss of business that may pose adverse effect on the Bank's reputation with existing and potential customers, as well as the Bank's business, financial condition or results of operations. Lastly, future legislative or regulatory restrictions may also limit the practices and ability of the Bank to sell investment products, which may have an impact on the Bank's business.

If the Bank is unsuccessful in defending any legal proceeding, or is unsuccessful in settling any legal proceeding on commercially reasonable terms, the Bank may be liable to pay damages or face penalties or sanctions that may have a material adverse impact on the Bank's business and operations. In addition, whilst the Bank has purchased to purchase liability insurance, there is no assurance by the Bank that such insurance coverage is sufficient to eliminate potential loss and damage caused by such proceedings.

As at the date of this Offering Circular, neither the Bank nor any of its subsidiaries is involved in any legal, litigation or arbitration proceedings relating to claims or amounts which are material in the context of the issue of the Bonds, nor is the Bank or any of its subsidiaries aware that any such proceedings are pending or threatened.

The Bank or the Bank's customers may engage in certain transactions in or with countries or persons that are the subject of U.S. and other sanctions.

The United States imposes a range of economic sanctions against certain foreign countries, terrorists, international narcotics traffickers, those engaged in activities related to the proliferation of weapons of mass destruction, and other persons. The U.S. sanctions are intended to advance certain U.S. foreign policy and national interests, such as discouraging certain countries or persons from acquiring weapons of mass destruction or engaging in human rights abuses. The U.S. Department of the Treasury's Office of Foreign Assets Control ("**OFAC**") is the principal government agency charged with administering and enforcing U.S. economic sanctions programmes. These economic sanctions generally apply to U.S. entities and, in certain cases, to foreign affiliates of U.S. entities, or to transactions that involve, in some manner, U.S. products or otherwise come within the jurisdiction of the United States. Other governments and international or regional organisations also administer similar economic sanctions.

The Bank operates in jurisdictions and with counterparties that may be subject to economic sanctions and other forms of trade restrictions imposed by the United States, the European Union, or other members of the international community. While the Bank is not currently engaged in any activities in violation of U.S. sanctions, the United States maintains so-called "secondary sanctions" threatening the imposition of a range of sanctions against non-U.S. entities engaging in, among other activities, targeted activities involving certain countries or sanctioned persons outside of U.S. jurisdiction. If the Bank or any of its counterparties becomes targeted by U.S. sanctions, or if the Bank engages in any prohibited transactions by any means or if it is otherwise determined that any of the Bank's transactions violated OFAC-administered or other sanctions regulations, the Bank could be subject to penalties and/or the Bank's reputation and ability to conduct future business in the United States or with U.S. entities, or in other affected jurisdictions, could be affected, which may materially and adversely affect the Bank's business, financial condition and results of operations.

Complying with the OECD's Common Reporting Standard will increase operational and compliance costs for the Bank.

The Organisation for Economic Co-operation and Development (the "**OECD**") has developed a common reporting standard (the "**CRS**") and model competent authority agreement to enable the multilateral and automatic exchange of financial account information. The CRS does not include a potential withholding element. Under the CRS, financial institutions are required to identify and report the tax residence status of customers in all the countries that have endorsed the CRS.

The adoption of the CRS in the PRC and Hong Kong became effective on 1 January 2017. PRC and Hong Kong financial institutions have begun collecting tax residency information from their account holders from 1 January 2017 for submission of information on reportable account holders in 2018. The increased due diligence of customer information and the reporting of information to the tax authorities will continue to increase operational and compliance costs for banks, including the Bank.

The Bank's ability to extend credit may be affected by BoCom's credit exposure limits, which may adversely affect its business and results of operations.

As a wholly owned subsidiary of BoCom, the Bank's ability to extend credit to a customer or counterparty of BoCom may be constrained by BoCom's overall credit exposure limits and specific credit exposure limits to such customer or counterparty. Any constraint on the Bank's ability to conduct operations in its best economic interest may make the Bank's business less competitive, as well as adversely affect its business, financial condition and results of operations.

INVESTMENT CONSIDERATIONS RELATING TO THE BONDS

The Bonds are complex and high risk financial instruments which may not be a suitable investment for all investors.

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

(a) have sufficient knowledge and experience to make a meaningful evaluation of the Bonds, the merits and risks of investing in the Bonds and the information contained or incorporated by reference in this Offering Circular or any applicable supplement;

(b) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Bonds and the impact such investment will have on its overall investment portfolio;

(c) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Bonds, including where the currency for principal or interest payments is different from the potential investor's currency;

(d) understand thoroughly the terms of the Bonds and be familiar with the behaviour of any relevant financial markets; and

(e) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic and other factors that may affect its investment and its ability to bear the applicable risks, including the likelihood and effect of the occurrence of a Non-Viability Event (as defined in the Conditions) or the exercise of any Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority (as defined in the Conditions).

The Bonds are complex and high-risk financial instruments. A potential investor must not invest in the Bonds unless it has the expertise (either alone or with the help of a financial adviser) to evaluate how the Bonds will perform under changing conditions, including the effects of inflation, the resulting effects on the value of the Bonds and the impact this investment will have on the potential investor's overall investment portfolio.

Investors have no right to require the Issuer to redeem the Bonds early.

Bondholders have no ability to require the Issuer to redeem their Bonds whereas the Issuer can redeem the Bonds in certain circumstances as described in the Conditions. However, the Issuer is under no obligation to redeem the Bonds at any time. The Bonds are intended to qualify as Tier 2 capital of the Issuer and the ability of the Issuer to redeem Bonds is subject to the Issuer obtaining the prior written consent of the Monetary Authority (if then required) to the redemption, to the extent such consent is required under the Banking Ordinance (Cap. 155) of Hong Kong, the Banking (Capital) Rules (Cap. 155L) of Hong Kong, or any successor legislation or regulations made thereunder, or any supervisory guidance issued by the Monetary Authority in relation thereto.

This means that Bondholders have no ability to cash in their investment, except if the Issuer exercises its right to redeem the Bonds or by selling their Bonds. However, there can be no guarantee that the Issuer will be able to meet the conditions for redemption of Bonds. Bondholders who wish to sell their Bonds may be unable to do so at a price at or above the amount they have paid for them, or at all, if insufficient liquidity exists in the market for the Bonds.

In addition, upon the occurrence of a Capital Event (as defined in the Conditions), the Bonds may be redeemed at the relevant redemption amount, as more particularly described in the Conditions. Also, if any Non-Viability Event occurs, as more fully described in Condition 5 *(Non-Viability Loss Absorption*) of the Conditions, Bondholders may lose up to the full principal amount of the Bonds. There can be no assurance that Bondholders will be able to reinvest the amount received upon redemption at a rate that will provide the same rate of return as their investment in the Bonds.

The Bonds may be redeemed at the Issuer's option on the First Call Date or the occurrence of certain other events.

The Bonds are redeemable at the option of the Issuer on the First Call Date (as defined in the Conditions) at their outstanding principal amount together with any interest accrued to (but excluding) the date fixed for redemption. In addition, upon the occurrence of other specified events such as an adverse withholding tax change or a Capital Event, the Bonds may be redeemed at the relevant redemption amount, as more particularly described in the Conditions.

The date on which the Issuer elects to redeem the Bonds may not accord with the preference of individual Bondholders. This may be disadvantageous to the Bondholders in light of market conditions or the individual circumstances of the Bondholder of the Bonds. In addition, an investor may not be able to reinvest the redemption proceeds in comparable securities at an effective interest rate at the same level as that of the Bonds.

The Issuer's obligations under the Bonds are subordinated.

The Bonds constitute direct, unconditional, unsecured and subordinated obligations of the Issuer ranking *pari passu* without any preference among themselves.

Subject to the insolvency laws of Hong Kong and other applicable laws, in the event of a Winding-Up (as defined in the Conditions) of the Issuer (other than pursuant to a Permitted Reorganisation (as defined in the Conditions)), the rights and claims of the Bondholders in respect of or arising under the Bonds, shall rank (i) subordinate and junior in right of payment to, and of all claims of, (a) all depositors and unsubordinated creditors of the Issuer and (b) all other holders of Subordinated Indebtedness (as defined in the Conditions) of the Issuer whose claims are stated to rank senior to the Bonds or rank senior to the Bonds by operation of law or contract; (ii) *pari passu* in right of payment to and of all claims of the holders of Parity Obligations (as defined in the Conditions); and (iii) senior in right of payment to, and to the holders of Junior Obligations (as defined in the Conditions).

In the event of a shortfall of funds on a Winding-Up, there is a risk that an investor in the Bonds will lose all or part of its investment and will not receive a full return of the principal amount or any unpaid amounts due under the Bonds. The Bonds also do not limit the Issuer's ability or the ability of any entity in the Group to incur additional indebtedness, including indebtedness that ranks senior in priority of payment to the Bonds.

The Bonds are subject to non-viability loss absorption and bank resolution provisions.

Under the Conditions, a Non-Viability Event means the earlier of (a) the Monetary Authority notifying the Issuer in writing that the Monetary Authority is of the opinion that a Write-off or conversion is necessary, without which the Issuer would become non-viable; and (b) the Monetary Authority notifying the Issuer in writing that a decision has been made by the government body, a government officer or other relevant regulatory body with the authority to make such a decision, that a public sector injection of capital or equivalent support is necessary, without which the Issuer would become non-viable.

If a Non-Viability Event occurs and is continuing, the Issuer shall, on or prior to the provision of a Non-Viability Event Notice, irrevocably (without the need for the consent of the Bondholders) reduce the then outstanding principal amount of, and cancel any accrued but unpaid interest in respect of, each Bond (in each case in whole or in part) by an amount equal to the Non-Viability Event Write-off Amount per Bond. The Conditions also provide that each Bondholder shall be subject, and shall be deemed to agree, be bound by and acknowledge that they are each subject, to having the Bonds held by such Bondholder being written off, cancelled, converted or modified, or to having the form of the Bonds changed, in the exercise of any Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority without prior notice and which may include (without limitation) and result in any of the following or some combination thereof:

(a) the reduction or cancellation of all or a part of the outstanding principal amount of, or interest on, the Bonds;

(b) the conversion of all or a part of the outstanding principal amount of, or interest on, the Bonds into shares or other securities or other obligations of the Issuer or another person (and the issue to or conferral on the holder of such shares, securities or obligations), including by means of an amendment, modification or variation of the terms of the Bonds; and

(c) the amendment or alteration of the maturity of the Bonds or amendment or alteration of the amount of interest payable on the Bonds, or the date on which the interest becomes payable, including by suspending payment for a temporary period, or any other amendment or alteration of the Conditions.

If the Hong Kong Resolution Authority Power is exercised by the relevant Hong Kong Resolution Authority, the provisions detailed in the Hong Kong Resolution Authority Power Instrument (as defined below) shall apply to the Bonds.

Although the Issuer has agreed to notify the clearing systems and the Bondholders following the occurrence of a Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power, there will be a delay between a Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power and the time that the clearing systems and the Bondholders via the clearing systems are notified of the occurrence of the relevant Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power through their clearing systems accounts or otherwise. Such delay may exceed several days during which trading and settlement in the Bonds may continue. Any such delay will not change or delay the effect of a Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power on the obligations of the Issuer under the Bonds or on the rights of the Bondholders. See "*Terms and Conditions of the Bonds — Non-Viability Loss Absorption*" and "*Terms and Conditions of the Bonds — Hong Kong Resolution Authority Power*". The notification of a Non-Viability Event is at the discretion of the Monetary Authority and the exercise of the Hong Kong Resolution Authority Power is at the discretion of the relevant Hong Kong Resolution Authority, and both are and beyond the control of the Issuer. The circumstances in which such discretion is exercised are not limited and may include concerns about the Issuer's capital, funding and/or liquidity levels.

Bondholders should note that any amount that is Written-off upon the occurrence of a Non-Viability Event in accordance with the Conditions or is subject to the exercise of the Hong Kong Resolution Authority Power is permanent and will not be restored under any circumstances, including where the relevant Non-Viability Event ceases to continue or the exercise of the Hong Kong Resolution Authority Power has ceased. In addition, a Non-Viability Event or exercise of the Hong Kong Resolution Authority Power may occur on more than one occasion and each Bond may be written down on more than one occasion. As the Interest Rate is calculated on the basis of the outstanding principal amount as adjusted following the occurrence of a Non-Viability Event or as provided for in the relevant Hong Kong Resolution Authority Power Instrument, in the event that such principal amount is permanently reduced by the relevant Write-off or the exercise of the Hong Kong Resolution Authority Power, Bondholders will receive less interest on their Bonds. In addition, upon the occurrence of a Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power, Bondholders could risk losing up to the full principal amount of the Bonds, as well as the cancellation of any accrued (and unpaid) interest, without receiving any compensation for such loss or cancellation.

Potential investors of the Bonds should have sufficient knowledge and expertise to evaluate effect or the likelihood of the occurrence of a Non-Viability Event for the Bonds which feature loss absorption or the exercise of the Hong Kong Resolution Authority Power before making their investment decisions. See "*Regulation and Supervision — The Hong Kong Resolution Regime*".

The application of a non-viability loss absorption feature similar to Condition 5 (*Non-Viability Loss Absorption*) and the exercise of the Hong Kong Resolution Authority Power as set out in Condition 6 (*Hong Kong Resolution Authority Power*) has not been tested in Hong Kong and some degree of uncertainty may exist in its application. See also "*— Regulations on non-viability loss absorption are new, untested and subject to interpretation and application by regulations in Hong Kong*".

The occurrence of a Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power may be inherently unpredictable and may depend on a number of factors which may be outside of the Group's control.

The occurrence of a Non-Viability Event is dependent on a determination by the Monetary Authority, which is the earlier of (a) the Monetary Authority notifying the Issuer in writing that the Monetary Authority is of the opinion that a Write-off or conversion is necessary, without which the Issuer would become non-viable; and (b) the Monetary Authority notifying the Issuer in writing that a decision has been made by the government body, a government officer or other relevant regulatory body with the authority to make such a decision, that a public sector injection of capital or equivalent support is necessary, without which the Issuer would become non-viable.

The exercise of the Hong Kong Resolution Authority Power is dependent on the terms of the Hong Kong Resolution Authority Power Instrument. As a result, the Monetary Authority may require or may cause a Write-off or the relevant Hong Kong Resolution Authority may exercise the Hong Kong Resolution Authority Power in circumstances that are beyond the control of the Issuer and with which the Issuer does not agree. Due to the inherent uncertainty regarding the determination of whether a Non-Viability Event exists or whether the Hong Kong Resolution Authority Power will be exercised, it will be difficult to predict when, if at all, a Write-off or the exercise of the Hong Kong Resolution Authority Power in relation to the Bonds will occur. Accordingly, the trading behaviour in respect of the Bonds is not necessarily expected to follow trading behaviour associated with other types of securities. Any indication that the Issuer is trending towards a Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power could have a material adverse effect on the market price of the Bonds.

Potential investors should consider the risk that holders of the Bonds may lose all of their investment in the Bonds, including the principal amount plus any accrued but unpaid interest, in the event that a Non-Viability Event occurs or the Hong Kong Resolution Authority Power is exercised.

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

The application of a non-viability loss absorption features similar to Condition 5 (*Non-Viability Loss Absorption*) and the exercise of the Hong Kong Resolution Authority Power as set out in Condition 6 (*Hong Kong Resolution Authority Power*) has not been tested in Hong Kong and some degree of uncertainty may exist in their application. See also "— *Regulations on non-viability loss absorption are new, untested and subject to interpretation and application by regulations in Hong Kong*".

The Bonds may be subject to a full or partial Write-off.

Investors may lose all of their investment in any Bonds upon the occurrence of a Non-Viability Event, which will lead to a full or partial Write-off. Investors may lose all of their investment in the Bonds as a result of the cancellation or modification of the Bonds pursuant to the exercise of the Hong Kong Resolution Authority Power. Upon the occurrence of a Write-off or so specified in the Hong Kong Resolution Authority Power Instrument, the principal amount and any accrued but unpaid interest of such Bonds will automatically be written down and if there is a full Write-off the principal amount and any accrued but unpaid interest may be written down completely and such Bonds will be automatically cancelled.

In addition, the subordination and set-off provisions set out in Condition 3 (*Status and Subordination of the Bonds*) are effective only upon the occurrence of any Winding-Up proceedings of the Issuer. In the event that a Non-Viability Event occurs, the rights of holders of Bonds shall be subject to Condition 8 (*Redemption and Purchase*). In the event that the Hong Kong Resolution Authority Power is exercised, the rights of the holders of the Bonds shall be subject to the provisions in the Hong Kong Resolution Authority Power Instrument. The occurrence of a Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power may not result in the same outcome for Bondholders as would otherwise occur under Condition 3 (*Status and Subordination of the Bonds*) upon the occurrence of any Winding-Up proceedings of the Issuer.

Upon the occurrence of a Write-off or if specified in the Hong Kong Resolution Authority Power Instrument, no Bondholder may exercise, claim or plead any right to any such amounts written off, and each Bondholder shall be deemed to have waived all such rights to such amounts.

Any such Write-off or exercise of the Hong Kong Resolution Authority Power will be irrevocable and the Bondholders will, upon the occurrence of a Write-off or if specified in the Hong Kong Resolution Authority Power Instrument, not receive any shares or other participation rights of the Issuer or be entitled to any other participation in the upside potential of any equity or debt securities issued by the Issuer, or be entitled to any subsequent write-up or any other compensation in the event of a potential recovery of the Issuer.

Transfers scheduled to settle through Euroclear and Clearstream (the "ICSDs") are expected to be rejected if the scheduled settlement is after any suspension by the ICSDs of clearance and settlement of the Bonds in connection with a Non-Viability Event Notice or the exercise of the Hong Kong Resolution Authority Power. Furthermore, because of time zone differences and the delay between the time when a Non-Viability Event occurs or the Hong Kong Resolution Authority Power is exercised and when the ICSDs receive and process the Non-Viability Event Notice or the notice that the Hong Kong Resolution Authority Power has been exercised, it is possible that transfers may either (i) fail to settle through the ICSDs even though such transfers were initiated prior to the Non-Viability Event or the relevant cut-off time specified in any instrument evidencing the exercise of the Hong Kong Resolution Authority Power (the "Hong Kong Resolution Authority Power Instrument") or (ii) are settled through the ICSDs even though such transfers were initiated after the Non-Viability Event or the relevant cut-off time specified in the Hong Kong Resolution Authority Power Instrument.

The ICSDs are expected to suspend all clearance and settlement of transfers of the Bonds by Bondholders after receipt of a Non-Viability Event Notice or the relevant cut-off time specified in the Hong Kong Resolution Authority Power Instrument, and any transfer of the Bonds that is scheduled to settle after commencement of such suspension is expected to be rejected by the ICSD and will not be settled within the ICSDs.

Although a Non-Viability Event Notice or notice of the exercise of the Hong Kong Resolution Authority Power will be sent by the Issuer to the ICSDs and the Bondholders via the ICSDs after the occurrence of a Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power, the records of the ICSDs will not be immediately updated to reflect the Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power, and a period of time, which may exceed several days, will be required before the clearance and settlement of transfers of the Bonds through the ICSDs are suspended. Due to such delay, it is possible that transfers that are initiated prior to such suspension and scheduled to settle on a date after the ICSDs commence such suspension will fail to settle through the ICSDs even though such transfers were initiated prior to the Non-Viability Event or the relevant cut-off time specified in the Hong Kong Resolution Authority Power Instrument. In such circumstances, transferors of the Bonds would not receive any consideration through the ICSDs in respect of such intended transfer because the ICSDs will not settle such transfer after commencement of such suspension. Similarly, it is possible that transfers that are initiated prior to such suspension and scheduled to settle on a date before the ICSDs commence such suspension will be settled through the ICSDs even though such transfers were initiated after the Non-Viability Event or the relevant cut-off time specified in the Hong Kong Resolution Authority Power Instrument. In such circumstances, transferees of the Bonds may be required to pay consideration through the ICSDs even though, upon the occurrence of a Non-Viability Event or if specified in the Hong Kong

Resolution Authority Power Instrument, no amounts under the Bonds will thereafter become due, and such transferees will have no rights whatsoever under the Bonds to take any action or enforce any rights whatsoever against the Issuer, regardless of whether they have received actual or constructive notice of such fact. The settlement of the Bonds following a Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power will be subject to procedures of the ICSDs that are in place at such time.

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

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

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

The operation of the resolution regime in Hong Kong may override the contractual terms of the Bonds.

In Hong Kong, the Financial Institutions (Resolution) Ordinance (No. 23 of 2016) (the "**FIRO**") became effective on 7 July 2017. The Monetary Authority is the relevant Hong Kong Resolution Authority in relation to banking sector entities in Hong Kong, such as the Issuer. The Monetary Authority's powers under FIRO include, but are not limited to, powers to write off or convert all or a part of the principal amount of, or interest on, the Bonds, and powers to amend or alter the contractual provisions of the Bonds. Whilst the FIRO sets out a framework of the resolution regime in Hong Kong, much of the detail is to be legislated through secondary legislation and supporting rules, and as such the impact of it on the Bonds cannot currently be fully accurately assessed. See "*Regulation and Supervision — The Hong Kong Resolution Regime*".

The operation of the resolution regime in Hong Kong may affect the rights of the Bondholders and could result in the Bondholders losing their rights in relation to accrued and future interest without compensation. See also "*— The Bonds may be subject to a full or partial Write-off*" and "*— The Bonds are subject to non-viability loss absorption and bank resolution provisions*".

If the Bank fails to complete the post-issuance filing with the NDRC in connection with the Bonds, NDRC may impose penalties or other administrative procedures on the Bank.

On 14 September 2015, the National Development and Reform Commission of the PRC (the "**NDRC**") promulgated the Circular on Promoting the Reform of the Filing and Registration System on the Issuance by Enterprises of Foreign Debt (Fa Gai Wai Zi [2015] No. 2044) (國家發展改革委關於推進企業發行外債備案登記制管理改革的通知(發改外資[2015] 2044 號)) issued by the NDRC (the "**NDRC Circular**") pursuant to which if a PRC enterprise or an offshore enterprise or a branch controlled by a PRC enterprise wishes to issue bonds or notes outside the PRC with a maturity term of one year or longer, such PRC enterprise must in advance of issuing such bonds, file certain prescribed documents with the NDRC and procure a registration certificate from the NDRC in respect of such issue. The enterprise must also report certain issuance details of the bonds to the NDRC within 10 working days after the completion of the note issue.

The NDRC Circular is silent on the legal consequences of noncompliance with the post-issue notification requirement. The Bank has undertaken to notify the NDRC of the particulars of the issue of the Bonds within the prescribed period under the NDRC Circular.

Since the NDRC Circular does not have any detailed implementation procedures, there is no assurance that the NDRC will not issue further implementation rules or notices which may require additional steps in terms of the registration or provide sanctions or other administrative procedures in case of failure to complete the post-issuance filing with the NDRC. If the Bank does not complete the post-issuance filing with respect to the Bonds within the prescribed timeframe (including as a result of reasons outside the Bank's control), the NDRC may impose sanctions or other administrative procedures on the Bank which may have a material adverse impact on the Bank's business, financial condition or results of operations.

Credit ratings of the Bonds.

The Bonds are expected to be assigned a rating of "BBB+" by Fitch and "BBB" by S&P. These ratings reflect the Issuer's ability to make timely payments of principal and interest on the Bonds. A rating is not a recommendation to buy, sell or hold any security, does not address the likelihood or timing of payment of the Bonds and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation. There is no assurance that the ratings assigned to the Bonds will remain in effect for any given period or that the ratings will not be revised by the assigning rating organisation in the future if, in its judgment, circumstances so warrant. A downgrade in ratings may affect the secondary market price of the Bonds.

Liquidity of the Bonds.

There can be no assurance as to the liquidity of the Bonds or that an active trading market will develop. If such a market were to develop, the Bonds could trade at prices that may be higher or lower than the initial issue price depending on many factors, including prevailing interest rates, the Issuer's operations and the market for similar securities. The Joint Lead Managers are not obliged to make a market for the Bonds and any such market-making, if commenced, may be discontinued at any time at the sole discretion of the Joint Lead Managers, acting together. No assurance can be given as to the liquidity of, or trading market for, the Bonds upon their listing on the Hong Kong Stock Exchange. Lack of a liquid, active trading market for the Bonds may adversely affect the price of the Bonds or may otherwise impede a Bondholder's ability to dispose of the Bonds.

There are limited remedies for non-payment under the Bonds.

Notwithstanding any of the provisions relating to non-payment defaults, the right to institute Winding-Up proceedings is limited to circumstances where payment of principal or any interest on any of the Bonds has become due and such failure continues for a period of 14 days in the case of interest or seven days in the case of principal; or where an order is made or an effective resolution passed for the Winding-Up of the Issuer. The only remedy against the Issuer available to any Bondholders for recovery of amounts in respect of the Bonds following the occurrence of a payment default after any sum becomes due in respect of the Bonds will be instituting Winding-Up proceedings and/or proving and/or claiming in Winding-Up in respect of any of the Issuer's payment obligations arising from the Bonds. In such a Winding-Up, the claims of the Bondholder will be subordinated and subject in right of payment to the prior payment in full of all claims of such senior creditors as set out in Condition 3 (*Status and Subordination of the Bonds*).

The Issuer may raise other capital which affects the price of the Bonds.

The Issuer may raise additional capital through the issue of other securities or other means. There is no restriction, contractual or otherwise, on the amount of securities or other liabilities which the Issuer may issue or incur and which rank senior to, or *pari passu* with, the Bonds, and there is no restriction on the Issuer issuing securities with or without Non-Viability Loss Absorption provisions (whether or not such provisions are similar to those of the Bonds). The issue of any such securities or the incurrence of any such other liabilities may reduce the amount (if any) recoverable by Bondholders on a dissolution or Winding-Up and/or may increase the likelihood of a cancellation of interest under the Bonds. The issue of any such securities or the incurrence of any such other liabilities might also have an adverse impact on the trading price of the Bonds and/or the ability of Bondholders to sell their Bonds.

USE OF PROCEEDS

The Bonds are intended to qualify as "Tier 2 Capital Instruments" of the Bank for the purposes of capital adequacy under the Banking (Capital) Rules (Cap. 155L). The issuance of the Bonds will strengthen the Bank's capital base and fund the growth of the Bank's business development.

CAPITALISATION AND INDEBTEDNESS

As at the date of this Offering Circular, the Bank has an issued share capital of HK$37.9 billion consisting of 37,900,000,000 ordinary shares of HK$1 each.

The following table sets out the Bank's audited capitalisation and indebtedness as at 31 December 2020 and as adjusted for the issue of the Bonds.

	As at 31 December 2020	As adjusted
	(HK$'000)	*(HK$'000)*
INDEBTEDNESS		
Due to banks and other financial institutions	71,659,676	71,659,676
Due to customers	245,749,909	245,749,909
Other liabilities	5,251,296	5,251,296
Total indebtedness	322,660,881	322,660,881
EQUITY		
Share capital	37,900,000	37,900,000
Additional equity instrument	3,871,450	3,871,450
Other reserves	1,262,649	1,262,649
Retained earnings	4,083,044	4,083,044
Bonds to be issued	—	7,764,700
Total equity	47,117,143	54,881,843
Total indebtedness and equity	369,778,024	377,542,724

There has been no material change in the capitalisation and indebtedness of the Bank since 31 December 2020.

BUSINESS OF THE BANK

Overview

Bank of Communications (Hong Kong) Limited is a leading retail and corporate bank in Hong Kong. The Bank offers a wide range of retail and corporate banking products and services through 44 outlets (including 37 BComBEST Services Centres, seven Business Services Centres) and one private banking centre across Hong Kong in 2020. The Bank's personal banking business provides conventional transactional banking services such as foreign exchange and cash services, RMB services, deposits, loans, investments, mortgage, insurance, MPF and credit cards, while its private banking business offers personalised investments, family office services, wealth management solutions and life style services. The Bank's corporate banking business provides a wide variety of products in cash management, corporate loans, trade finance, SME lending, treasury, insurance, IPO services and MPF. The Bank is a public company incorporated with limited liability in Hong Kong.

The Bank is a wholly owned subsidiary of BoCom, a leading commercial bank in Mainland China providing comprehensive range of commercial banking products and services. BoCom's principal lines of business are corporate banking, personal banking and interbank and financial market businesses. Within BoCom's primary business lines, it also offers insurance, financial leasing, asset management, trust services, fund, overseas securities and debt-to-equity conversion. BoCom's strategy is to become "the First-tier Bank with Wealth Management Characteristics and Global Competitive Capabilities in the World". In accordance with BoCom's strategy, the retail banking business and private banking business (including corporate banking business which relates wholly to private banking business and retail banking business) of BoCom Hong Kong Branch were transferred to the Bank in January 2018. As a wholly owned subsidiary of BoCom, the Bank receives extensive support from BoCom in terms of funding, settlement, IT and client resources. The wide-ranging collaboration between the Bank and BoCom enables the Bank to better serve its customers to capture merging business opportunities in Hong Kong, Mainland China and overseas markets. In 2020, the Bank had 44 outlets (including 37 BComBEST Services Centres, seven Business Services Centres) and one private banking centre in Hong Kong.

The Bank leverages on BoCom's profound experience in financial services and strong network in both Mainland China and Hong Kong. The Bank offers diversified wealth management products and services through close collaboration with its Hong Kong affiliates, such as BoCom Hong Kong Branch, BOCOM International, China BOCOM Insurance and BOCOM Trustee.

History

Established in 1934, BoCom Hong Kong Branch was the first overseas branch of BoCom. In addition to multi-currency deposits, multi-currency loans and international settlement services, BoCom Hong Kong Branch also provides non-banking services through its subsidiaries.

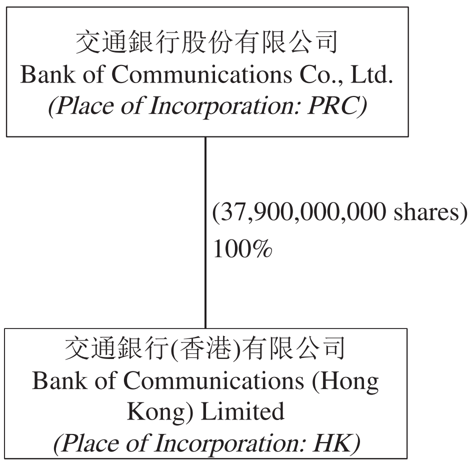
BoCom Hong Kong Branch placed an emphasis on serving personal banking customers. For corporate finance operations, it targets, among others, listed companies and large PRC state-owned enterprises. Its key/core customers in terms of amount of loans were all listed companies and their affiliates, large state-owned enterprises or customers of relatively low risk. In addition, it also actively participated in the syndicated loan market. Apart from generating interest income, it continued to focus on generating fee income. It also provided a variety of fee-based products and services.

The establishment of the Bank was approved by the China Banking Regulatory Commission (now known as the China Banking and Insurance Regulatory Commission) on 20 January 2014. The Bank obtained a full banking licence under the Banking Ordinance (Cap 155) of the laws of Hong Kong from the Monetary Authority on 29 September 2015 to operate banking business, specialising in personal banking business (including retail banking business and private banking business). In 2017, BoCom announced its investment of HK$7.9 billion in the Bank which amounted to 100 per cent. of the share of the Bank. On 29 January 2018, BoCom further announced the existing activities, assets and liabilities which constituted the retail and private banking businesses of BoCom Hong Kong Branch would be transferred to the Bank in accordance with section 4(1) of the Bank of Communications (Hong Kong) Limited (Merger) Ordinance (Cap 1182) of the laws of Hong Kong. The Bank officially commenced its business activities after the transfer. In 2018, the Bank has received HK$10 billion capital and HK$2 billion in the form of subordinated loan from BoCom. In 2020, the Bank received HK$20 billion in the form of capital injection from BoCom.

Organisation Chart

As at the date of this Offering Circular, the organisation structure of the Bank is set out below:

Organisation Chart of Bank of
Communications (Hong Kong) Limited
交通銀行(香港)有限公司



Recent Developments

Impact of the COVID-19 pandemic

The COVID-19 pandemic has created unprecedented economic and social challenges to all regions of the world. In order to limit the spread of COVID-19, different restrictions (including social distancing or lock down) have been implemented by governments over the world which resulted in a sharp decline in global economic activity during 2020. At the same time, significant fiscal and monetary stimulus measures have also been introduced by governments around the world to prevent further economic downturn and support the recovery of economies. In early 2021, vaccination programmes have been rolled out in various countries, including the United States, China, the EU and UK. However, the effect of the vaccination programmes on the COVID-19 pandemic remains uncertain, and many countries, including India, are experiencing another wave of the COVID-19 pandemic, and in some cases new variants of COVID-19 which could be more contagious.

The above development of COVID-19 pandemic and geopolitical environment changes in the year of 2020 have added complications to the estimates of the economic scenarios and caused the Bank to revisit its stress test economic scenarios, complete various thematic reviews in response to COVID-19, and re-evaluate probability weightings in calculating expected credit loss. For more details, see above "*Investment Considerations — Investment Considerations Relating to the Bank — Any future occurrence of natural disasters or outbreaks of contagious diseases in Asia may have a material adverse effect on the Bank's business operations, financial condition and results of operations.*"

Market recognition and awards

The Bank has also received further market recognition and awards and honours. In 2020, the Bank won the "Outstanding Retail Banking — Wealth Management Award" and the "Outstanding Financial Services Business in Greater Bay Area — Wealth Management Award" during the RMB Business Outstanding Awards organised by Metro Finance and Hong Kong Tai Kung Wen Wei Media Group. During the Mystery Caller Assessment Awards held by Hong Kong Call Centre Association, and the Bank received the "Mystery Caller Assessment Award — Best-in-class (Banking)", the "Inbound Contact Centre of the Year — Silver Award" and the "Offshore Contact Centre of the Year — Silver Award". The Bank also won the "Outstanding Mobile Banking Service Award" at the Banking and Finance Awards 2020 organised by Sky Post. In March 2021, the Bank received the "Gold Star Employer" at QF in Action organised by Education Bureau of Hong Kong.

KEY MILESTONES

Below sets forth the key milestones in the establishment and operation of the Bank:

2013	BoCom passed the resolution to transfer the Transferred Business from BoCom Hong Kong Branch to the Bank in March 2013.
2014	China Banking and Insurance Regulatory Commission approved of the establishment of the Bank in January 2014.
2015	The Bank was granted a banking license by the Monetary Authority in September 2015. BoCom passed the Resolution on Extending the Validity and Authorisation Period of the Resolution on the transfer proposal of BoCom Hong Kong Branch in October 2015.
2017	Bank of Communications (Hong Kong) Limited (Merger) Bill officially took effect in July 2017. The Bank was approved by the SFC for Type 1 and Type 4 regulated activities in November 2017.
2018	The Bank officially commenced its operations in January 2018.
2019	The Bank was awarded a "stable" rating outlook by Fitch, Moody's and Standard & Poor's, and enjoys the same international credit rating as BoCom. The Bank also introduced "Smart Kiosk", a one-stop self-service hub for account opening and automated teller machine ("**ATM**") card application, and launched "BOCOM HK" WeChat Official Account in 2019.
2020	The Bank received HK$20 billion in the form of capital injection from BoCom. The Bank became the first card issuer in Hong Kong to exempt all cross-network ATM cash withdrawal fee for all ATM cardholders.
2021	The Bank introduced the "Red Packet Giveaway Feature" via mobile banking fast payment service during Chinese New Year festive period.

Competitive Strengths

The Bank continues to benefit from the growth opportunities in the Hong Kong banking sector

The Bank leverages on BoCom's profound experience in financial services and strong network in both Mainland China and Hong Kong to offer excellent and diversified wealth management products and services through close collaboration with its Hong Kong affiliates, such as BoCom Hong Kong Branch, BOCOM International Holdings Company Limited, China BoCom Insurance Co., Ltd. and Bank of Communications Trustee Limited. The Bank has experienced and is expected to continue experience growth in view of RMB's internationalisation, Fintech expansion, the "Belt and Road Initiative" and the Guangdong-Hong Kong-Macao Greater Bay Area Plan.

The "Belt and Road Initiative" and Guangdong-Hong Kong-Macao Greater Bay Area Plan emphasise on deepening interconnection between the Mainland-Chinese market and overseas market and developing overseas markets vigorously to ensure the impetus for continuous economic growth in the future. As a well-established and long-standing Hong Kong Chinese bank, the Bank possesses the geographic advantages to offer innovative and diversified cross-border structured products to meet customers' different demands.

To capture the opportunities brought by the internationalisation of Renminbi and Fintech development, the Monetary Authority has been collaborating with Mainland Chinese regulators in further opening up two RMB markets. In 2018, the Monetary Authority published the Final Revised Guideline on the Authorization of Virtual Banks and launched the RMB500 million "Technology Talent Scheme" to attract, train and nurture technology talents. In November 2020, the Bank supported the pilot run of phase I of the cross-border collaboration between the People's Bank of China Trade Finance Platform and eTradeConnect. It aims to provide importers and exporters in both Mainland China and Hong Kong with more convenient trade finance services. The connection facilitates the automation of trade processes, enhances the service quality of cross-border trade and the efficiency of trade finance for corporations. The Bank is committed to the application of technology in financial services, including cross-border trade transactions. The Bank believes along with the transfer of technologies from BoCom and its current wealth management offerings, it is well placed to capture the growth opportunities for Chinese banks' business in Hong Kong.

The Bank enjoys a unique market position and good reputation

BoCom has a long-standing history of over 110 years and plays an important role in China's financial system. BoCom Hong Kong Branch has been serving the Hong Kong community for 87 years. The Bank now enjoys an effective local network, backed by extensive reach in Mainland China, and has inherited the long history of operation and ample experience of BoCom to serve a large customer base across the border. The Bank is also placed as the strategic leader for the international expansion strategy carried by BoCom. Since its establishment, the Bank has received various recognitions and awards for its practice in the market. The Bank was awarded the "Outstanding Retail Banking — Wealth Management Award" for three consecutive years since 2018 and the "Outstanding Financial Services Business in Greater Bay Area — Wealth Management Award" in 2020 during the RMB Business Outstanding Awards organised by Metro Finance and Hong Kong Tai Kung Wen Wei Media Group. During the Mystery Caller Assessment Awards held by Hong Kong Call Centre Association, and the Bank received the "GCCA Service Excellence Recognition" in 2018, the "Mystery Caller Assessment Award — Gold Award" in 2018 and 2019, the "Mystery Caller Assessment Award — Best-in-class (Banking)" in 2019 and 2020, the "Inbound Contact Centre of the Year — Gold Award" in 2018 and 2019, "Inbound Contact Centre of the Year — Silver Award" in 2020 and the "Offshore Contact Centre of the Year — Silver Award" between 2018 and 2020. In addition, the Bank was awarded the "Renminbi Deposit Service Award" during the Sing Tao Service Awards in 2019, the "Best of Online Trading Platform" during the E-Brand Awards organised by e-zone magazine in 2018 and 2019, the "Outstanding Mobile Securities Trading App for Personal Banking" during the Hong Kong Digital Brand Awards organised by Metro Broadcast and The Chamber of Hong Kong Computer Industry in 2018 and 2019, the "Outstanding Mobile Banking Service Award" during the Banking & Finance Awards organised by Sky Post in 2019 and 2020 and the "Gold Star Employer" in at QF in Action organised by Education Bureau of Hong Kong in 2021.

The Bank possesses strong business capabilities

The Bank has built up its strong capabilities via comprehensive and integrated cross-border wealth management services, extensive network and enabling strategic partners in key areas. In 2020, the Bank had 44 outlets (including 37 BComBEST Services Centres, seven Business Services Centres) and one private banking centre spread across Hong Kong Island, Kowloon and New Territories in Hong Kong.

With a specific focus on Mainland China and Hong Kong cross-border wealth management services, the Bank offers instant cross border transfers in Hong Kong or in Mainland China via mobile banking or internet banking. In addition, it offers dual currency credit cards which reduce the impact of commission fees and exchange rate fluctuation. Properties in Mainland China may also be used to apply for collateralised loans. The Bank also assists customers in Mainland China by providing services such as overseas guarantees along with overseas financial products hedging and cross-border receipt and payment of corporate funds. Furthermore, on 2 November 2020, the Bank became a member of the interbank foreign currency market of China Foreign Exchange Trade System, which allows the Bank to conduct foreign currency lending, foreign currency repurchase and interbank deposit of foreign currency.

The Bank establishes strategic partnerships across its various business and services including insurance, MPF, ATM, Card and wealth management and investment products. It collaborates with China Life (Overseas) Company Limited ("**China Life**") and FWD Life Insurance Company (Bermuda) Limited ("**FWD**") in its life insurance businesses and China BOCOM Insurance and BOC Insurance in general insurance businesses. The Bank is also a licensed intermediary for MPF funds in Hong Kong offering "BoCom Joyful Retirement MPF Scheme", a comprehensive MPF scheme operated by BOCOM Trustee. The Bank further enhances its presence by collaborating with Jecto, UnionPay in ATM business across Hong Kong to offer self-served banking services. For its card business, the Bank offers co-branded credit cards with FWD and Yan Chai Hospital and bank card / credit card issue with support from Jetco, VISA and UnionPay. Through strategic collaborations with other financial institutions, the Bank is able to provide multiple fund products and structure products.

The Bank operates on sound risk management systems

The Bank has established a risk management framework based on Basel III with its Board of Directors (the "**Board**"), comprising a risk management committee acting as the centre of control, its senior management monitoring risks through the Comprehensive Risk Management Committee and risk management units. Risk management culture was promoted through various policies and programmes within the Bank.

The Bank has set up an independent Risk Management Department to lead the implementation of comprehensive risk management measures and three lines of defence consisting of front office, risk management units and an Internal Audit Department with all risk management teams embed into business lines. It has also established a market risk management system to monitor key parameters of market risk and pioneered regular stress tests on concentration risk, interest rate risk and liquidity risk.

The continued improvement of the Bank's risk management capability has enabled the Bank to effectively handle the challenges brought on by the recent economic downturn and manage its overall risks. As at 31 December 2019 and 2020, the Bank's NPL ratio was 0.08 per cent. and 0.08 per cent., respectively, whereas its NPL coverage ratio was 530 per cent. and 543 per cent., respectively. For the years ended 31 December 2019 and 2020, the Bank's market funds/tangible assets ratio was 12.3 per cent. and 19.4 per cent., respectively, whereas its liquidity banking assets/tangible assets ratio was 62.2 per cent. and 61.8 per cent., respectively.

The Bank maintains ample capital support

As at 31 December 2018, 2019 and 2020, the Bank's total assets were HK$208 billion, HK$227 billion and HK$373 billion, respectively; the Bank's total liabilities were HK$189 billion, HK$206 billion and HK$326 billion, respectively; the Bank's loans (equal to the sum of its total loans and advances to customers before expected credit loss allowance) were HK$68 billion, HK$80 billion and HK$138 billion, respectively; the Bank's deposits were HK$162 billion, HK$171 billion and HK$246 billion, respectively. As at 31 December 2020, the Bank's loan-to-deposit ratio and cost-to-income ratio were 56.2 per cent. and 41.0 per cent., respectively, representing significant growth potential. In addition to accelerating the development of its deposit business, the Bank also intends to further diversify its financing channels including issuing certificate of deposits and establishing medium term note programmes in the future to diversify its source of funding.

The Bank has maintained its business collaboration with BoCom Hong Kong Branch by undertaking the development share of BoCom Hong Kong Branch's business on the premise of controlling NSFR and CAR within a resilient range. As the strategic pinpoint for BoCom's global expansion strategy, the Bank may receive further capital injections from BoCom as a source of capital support. For example, on 10 March 2020, the shareholders meeting of BoCom approved an injection of no more than HK$30 billion in instalments to the Bank's share capital, following which BoCom increased the share capital of the Bank by HK$20 billion on 21 September 2020.

The Bank's CET1 capital ratio, tier 1 capital ratio and total capital ratio as at 31 December 2020 were 18.6 per cent., 20.3 per cent. and 21.8 per cent., respectively, which were higher than the Monetary Authority's requirements.

The Bank shares advanced information system and technologies within BoCom Group

In line with the trend which features electronic accounts and online transactions, the Bank receives strong support from BoCom in accelerating the development of financial technologies, optimising the functions of electronic channels and reducing development cost. The Bank has launched various projects in recent years to cater for the emerging demands from both internal and external customers, by adopting omni-channel strategies, creating seamless cross-border experience, and extending the digital banking services beyond the Bank through external partnership. Hundreds of innovations were delivered to evolve overall online experience with their Mobile First digital strategy and award-winning mobile and Internet banking platforms. The Bank launched a number of initiatives, including but not limited to (i) eKYC remote account opening powered by biometric recognition; (ii) full suite of online wealth management products and tools such as digital currency-linked deposit, mobile foreign exchange margin trading, mutual funds and securities selector, and intelligent profit and loss calculator; (iii) Wechat banking powered by social media platform; and (iv) introduction of higher transaction limit, biometric credentials and various transaction capability uplifts enabled by robust cybersecurity capabilities to fit increasing demand of online services and safety.

The Bank has also been developing its system software, middleware, database and software tool in providing more effective customer data protection and backup internally. The Bank formulated its "Customer Data Protection Regulations" and "Guidelines on Application System Data Backup" to strengthen the protection of customer data, and expressly prescribed the reporting and handling procedures for events concerning customer data loss or leakage. The Bank also formulated its own "Data Borrowing Procedure" and "Firewall Security Setting Guidelines" and adopted security mechanisms such as password management to protect data in the systems and prevent unauthorised access. The data of important systems is synchronised from production data centre to disaster recovery backup centre in real time. The Bank backs up the data of each system and conducts data recovery tests on a regular basis.

As at 31 December 2020, the Bank had approximately 159,000 online personal banking customers with banking accounts and 11,000 online corporate banking customers representing 47 per cent. and 34 per cent., respectively, of its total personal banking customers and corporate banking customers, respectively.

The Bank is managed by an experienced management team

The Bank has one of the most experienced management teams in Hong Kong's banking industry, with rich experience in managing leading Chinese financial enterprises professionally, making important contributions to the fast growth of the Bank. The key members of the Bank's senior management have an average of approximately 20 years of management experience in the banking sector in both Hong Kong and Mainland China. In particular, the Bank's chairman has held various major leadership positions in the financial industry.

As at 31 December 2020, among employees who are team heads or more senior, 80 per cent. of them had over five or more years of work experience with BoCom Hong Kong Branch or the Bank, 100 per cent. of them had five or more years of related banking work experience and 99 per cent. of them had professional qualifications or hold a bachelor's or higher level degree.

The Bank's Strategies

Develop a modularised business model and maximise future growth potential

The Bank has a clear strategy which identifies the key components in the operation of the Bank, including local corporates in Hong Kong and offshore branches of Mainland China corporates and sets major goals including the development of its wealth management business, in order to maximise its future growth potential through collaborative referrals among the domestic and overseas subsidiaries within the BoCom Group. The Bank intends to provide all-round wealth management services to target customer segments through its private banking, personal banking and corporate banking, under the brands of "BComBEST Services", "BOCOM FORTUNE Services" and "BComEASY Business Credit Services".

Improve synergies through cross-selling of different business

The Bank inherited the corporate banking business which was ancillary to the personal banking businesses previously. The Bank aims to develop its services in providing comprehensive solutions for individual business owners and SMEs. Its targeted marketing to mid-to-high-end SMEs to enable cross-selling cash management, credit facilities and wealth management services.

Expand the retail customer base and highlight "BComBEST Services"

The Bank aims to expand its retail customer base with continuous enhancements on the "BComBEST Services" and "BOCOM FORTUNE Services". As at 31 December 2020, the Bank had approximately 30,000 BComBEST Services customers constituting 9 per cent. of the Bank's total retail customers. It provides personalised services with access to professional wealth management team, exclusive BComBest Services Centres and priority counters. The Bank provides BComBEST Floating Overdraft Facility Service, diversified investment products and comprehensive RMB products and services for its wealth management customers. These BComBEST Services customers also enjoy exclusive privileges including accessing to regular seminars, wide range of investment products, exchange rate discount, fee waivers on specific banking services and perpetual waiver on credit card annual fees.

As at 31 December 2020, the Bank had approximately 42,000 BOCOM FORTUNE Services customers constituting approximately 12 per cent. of its total retail customers. BOCOM FORTUNE Services customers enjoy comprehensive financial services with one-stop banking and wealth management services. They also have access to a specially designed BOCOM FORTUNE card that can be used at any JETCO ATM machines in Hong Kong and 24-hour internet and mobile banking services to manage their account conveniently.

Further build up network and distinctive brand

The Bank aims to continue to optimise its geographic network. As at 31 December 2020, the Bank operated a retail network of 44 outlets across Hong Kong Island, Kowloon and the New Territories. It has also developed multiple retail channels including ATM network, internet banking, phone banking, mobile banking to enhance services efficiency and expand client reach. In 2020, the Bank won the "Outstanding Retail Banking — Wealth Management Award" and the "Outstanding Financial Services Business in Greater Bay Area — Wealth Management Award" during the RMB Business Outstanding Awards organised by Metro Finance and Hong Kong Tai Kung Wen Wei Media Group. During the Mystery Caller Assessment Awards held by Hong Kong Call Centre Association, and the Bank received the "Mystery Caller Assessment Award — Best-in-class (Banking)", the "Inbound Contact Centre of the Year — Silver Award" and the "Offshore Contact Centre of the Year — Silver Award". The Bank also won the "Outstanding Mobile Banking Service Award" at the Banking and Finance Awards 2020 organised by Sky Post. In March 2021, the Bank received the "Gold Star Employer" at QF in Action organised by Education Bureau of Hong Kong. The Bank aims to further strengthen its e-banking channels to expand its networks and to improve its current retail channels to provide better banking experiences for its customers.

The Bank's Principal Business Activities

The Bank's principal lines of business consist of corporate banking business, personal banking business, interbank and financial market business and other business. The Bank also provides multi-currency lending and deposit-taking services, foreign exchange trading, international settlement services and certain non-banking financial services including, among others, services of the Bank's securities and brokerage businesses, insurance business, trust business and leasing business.

Corporate Banking Business

Overview

For the year ended 31 December 2020, the total operating income from the Bank's corporate banking business was HK$560 million, representing 14.9 per cent. of the Bank's total operating income for the same period. The Bank offers a broad range of products and services to corporations, enterprises, financial institutions, and other entities. The Bank's corporate finance products include, among others, corporate loans, corporate deposits, bill discounting, clearance and settlement, trade finance, asset custodian services, corporate wealth management, investment banking, syndicated loans, cash management, medium, small and micro enterprises business and other corporate intermediary services. The Bank also delivers its corporate finance products and services through a combination of its branch network, service centres and internet banking platform. As at 31 December 2019 and 2020, the Bank's corporate deposit balance was HK$17.5 billion and HK$40.3 billion, respectively, whereas corporate loan balance was HK$44.2 billion and HK$94.1 billion, respectively.

Corporate Loans

Corporate loans have historically constituted a large component of the Bank's loan portfolio. The Bank's corporate loans consist of short-term loans and medium- and long-term loans. As at 31 December 2019 and 2020, the Bank had HK$44.2 billion and HK$94.1 billion of corporate loans outstanding, respectively, representing 55.9 per cent. and 68.4 per cent. of its total gross loans and advances to customers, respectively.

Cash Management

The Bank offers four principal deposit products to its corporate customers including current deposits, time deposits, savings deposits and club deposits. Demand deposits pays accrued interest on a quarterly basis, and account holders may withdraw their funds at any time. Time deposits require that the customer maintain a deposit for a fixed term, during which interest accrues at a fixed rate. Account holders may withdraw funds prior to maturity with interest payments calculated based on the demand deposit interest rate. The Bank's additional deposit products include deposit agreements, negotiated deposits and call deposits.

Sales and Distribution of Treasury Products

The Bank offers services include foreign exchange forward contracts, non-deliverable forward ("**NDF**") contracts, structured investments deposits, bonds, and certificate of deposits. Under its foreign exchange forward contracts segment, the Bank offers a range of major currencies. NDF contracts offered by the Bank help companies to hedge related currency risk where there is no physical settlement of principal upon entering into the NDF contract. The Bank also offers interest rate-linked deposits and currency-linked deposits with various tenors. The Bank offers debt instrument products denominated in a wide range of currencies, where its customers can buy or sell in the secondary market prior to maturity with flexible tenor.

Insurance

The Bank offers a comprehensive range of insurance products including employee protection, cargo insurance, business protection and construction protection in cooperation with various partners in Hong Kong. Under its employee protection scheme, the Bank offers employee compensation and accident insurance underwritten by China BOCOM Insurance and key man life insurance and employee group medical insurance underwritten by FWD and China Life, respectively. The Bank's cargo insurance covers sea, air, land transits which is also underwritten by China BOCOM Insurance. The Bank's business protection insurance includes business package insurance, public liability insurance, money insurance, burglary insurance, machinery breakdown insurance and business interruption insurance which are all underwritten by China BOCOM Insurance. The Bank's construction protection includes Erection All Risks Insurance and Contractors All Risk Insurance, which all both underwritten by China BOCOM Insurance.

SME Lending

The Banks participates in the SME Financing Guarantee Scheme of The Hong Kong Mortgage Corporation Limited ("**HKMC**") in order to assist local SMEs to obtain loans. It offers a maximum loan amount of up to HK$18,000,000 to help SMEs to tide over their liquidity problems where HKMC will provide guarantee coverage from 50 per cent. to 90 per cent. The Bank also offers export financing supported by credit insurance policies of the Hong Kong Export Credit Insurance Corporation ("**ECIC**"). It allows its customers to receive cash advance against account receivable to improve cash flow situation. The ECIC export finance has features including low financing requirements, preferential rates and relaxed application criteria. The Bank also offers corporate tax loan to ease tax payment pressure on the SMEs. Features of the corporate tax loan offers include preferential interest rate, flexible repayment plans and relaxed collateral requirements.

Trade Finance

The Bank provides trade finance services to its customers. The Bank's trade finance primarily involves financing services for companies engaging in the procurement of commodities or sale of goods, or operating import and export businesses. The Bank's trade finance products and services include, among others, issuing letter of credit, invoice financing, inward bills for collection and import loan, shipping guarantee, trust receipt, letter of credit ("**LC**") advising, outward bills collection/purchase under documents against acceptance ("**DA**") and documents against payment

("**DP**"), outward bills under LC for collection/negotiation, transfer of LC, packing loan purchase of receivables, back-to-back LC and forfaiting. The Bank actively utilised international factoring to help small and medium-sized foreign trade enterprises to avoid the risks from exported exchange collections and provide financing facilities.

Initial Public Offering Services

The Bank provides IPO related services to its customers. The Bank's IPO services primarily involve the Bank acting as the main receiving bank of the IPO processes, including handling account opening for the applicant for public listing, liaising with the assigned share registrar for the refund cheque specimen and signing arrangement, acting upon the instruction from the listed company and its underwriters, performing all duties of receiving bank such as distributing application forms and prospectuses, collecting completed forms and applications monies, process completed forms and application monies, recycling application monies in the inter-bank money market and arranging refund of the application monies and providing IPO financing services.

MPF

The Bank is a registered principal intermediary in providing MPF services. The BCOM Joyful Retirement MPF scheme established in 2014 is a product of BOCOM Trustee. It provides a variety of constituent funds in different risk levels for employers, employees, self-employed persons and personal account member's selection to satisfy various investment needs.

Personal Banking Business

Overview

For the year ended 31 December 2020, the total operating income from the Bank's personal banking operations was HK$2,497 million, accounting for approximately 66.4 per cent. of the Bank's total operating income for the same period. The Bank offers a full range of personal finance products and services to personal customers, consisting mainly of individual deposits, personal loans, card services and personal wealth management services. In recent years, the Bank has introduced new products to meet the needs of the personal finance market and have gradually formed five product series, including (1) liability products, such as club deposits and time deposits, (2) DreamCash personal loans, (3) resold products, including primarily insurance and MPF, (4) personal wealth management products and (5) the Bank's co-branded bank card series.

To market and deliver these products, the Bank employs multiple distribution channels, including automated service machines, internet banking and phone banking. As at 31 December 2019 and 2020, the balance of retail deposits of the Bank was HK$153.2 billion and HK$205.5 billion, respectively. As at 31 December 2019 and 2020, the balance of retail loans of the Bank was HK$35.0 billion and HK$43.4 billion, respectively.

The Bank provides professional and comprehensive Renminbi services in Hong Kong for both Hong Kong and non-Hong Kong residents. It includes deposit, investment, exchange, card, transfer and remittance, loans, insurance and cross-border services. It offers flexible and convenient channels for Renminbi financial management.

Deposits and Related Banking Services

Personal Deposits

The Bank offers four principal personal deposit products to its personal banking customers including current deposits, savings deposits, time deposits and club deposits. In order to satisfy the customers' needs for transactions in different currencies, the Bank offers Hong Kong dollar, Renminbi and U.S. dollar current accounts, and offers Hong Kong dollar and multi-currency savings accounts. The Bank also offers time deposit services in multiple currencies in various combinations within a low minimum deposit amount to provide its customers with full financial flexibilities. The club deposit offered by the bank is a deposit product designed with the planned savings concept. Customers can put in an agreed amount by instalment over an arranged period, with the aim of reaching the customers' saving targets upon the maturity date.

In addition, the Bank also launched the "Bo Asset+" programme as a one-stop solution for wealth management services and extra-curricular activities for customers and their children to develop good saving habits, concept of wealth management and other various events to foster the healthy development of their children.

Transfer Services

Ancillary to the Bank's deposit services, the Bank provides transfer services including intrabank transfer, local transfer, remittance and auto-pay services. It provides a fast and cost-efficient channel for its customers to move its funds into or outside of Hong Kong.

Loan Services

Personal Loans

The Bank's personal loan programme of "DreamCash Personal Loan" offers unsecured advances to individuals up to an amount of HK$2,000,000 or 12 times of an individual's monthly salary (whichever is lower) with a flexible tenor of up to 60 months for an annual interest rate of as low as 2.22 per cent. The "DreamCash Personal Loan" programme offers customers greater cash arrangement efficiency and assist them to achieve better financial planning.

In addition, the Bank offers "DreamCash Balance Transfer" programme which consolidates a customer's outstanding credit card and personal loan balances to a single account for better financial management. It offers a loan amount of up to HK$2,000,000 or 21 times of an individual's monthly salary (whichever is lower) with a flexible tenor of up to 72 months. The "DreamCash Balance Transfer" programme provides features of fixed monthly repayment for better budget planning and the entire repayment period can be shortened on demand.

Mortgage

The Bank offers home mortgage plans for potential owners of both local private residential properties and properties offered by the government and public sectors for self-occupation purpose.

The Bank's Residential Mortgage Plans includes HIBOR Mortgage Plan, which is based on the HIBOR to enable the customers to capture a lower interest rate and protects them from fluctuation of Hong Kong Dollar Prime Rate, and Investment Property Mortgage Plan, which is applicable to properties under personal or shell-company account and provides preferential mortgage interest rate for investors to achieve higher financial returns. The Bank also provides Mortgage Income Account services which provide greater flexibility for customers in managing their wealth, and Mortgage Insurance Plan which allows loan amount of up to 90 per cent. of the property purchase price or appraised property value.

The Bank's Government Housing Scheme Mortgage Plans includes Home Ownership Scheme, which allows a loan amount of up to 95 per cent. of the purchase price or the appraised property value, and Tenants Purchase Scheme which allows a loan amount of up to 100 per cent. of the purchase price or the appraised property value. Both schemes offer privileges including preferential mortgage interest rates, cash rebates, extended repayment period up to 25 years and are applicable to both primary market and secondary market properties and available in both fixed repayment period or fixed repayment amount plans.

Investments

In addition to the range of traditional banking products and services offered by the Bank to its customers, the Bank also provides investment services for various types of products, including but not limited to securities trading, securities margin trading, China connect securities, investment fund, bond investment, certificate of deposit, foreign exchange, deposit extra investment, equity linked investment, FX margin trading. The Bank also provides financial information, investment products risk level analysis to help its customers in making financial decisions.

Credit Card Products

The Bank offers a comprehensive range of credit card products in Hong Kong with a total of 88 tactical promotion programmes as at 31 December 2020, catering for both personal and co-brand FWD and Yan Chai Hospital markets. As at 31 December 2020, the Bank had approximately 184,265 credit cards in issue and its total credit card receivables amounted to approximately HK$109,921,484. Year round local and overseas merchant promotions and reward programmes such as travel reward, cash rebates and bonus points programmes have further contributed to the continued growth of the Bank's credit card services. The Bank aims to further enhance its credit and business by leverage BoCom's resources and engage in greater joint marketing promotions with its partners.

Private Banking

The private banking business of the Bank aims to provide its customers with a unique and personalised investment solution by utilising the Bank's capabilities via its onshore and offshore platform to maximise its customers' asset value. In addition to privileged ordinary bank services, the Bank also provides a wide range of investment vehicles such as public / private mutual funds, equity IPO, private placement, cornerstone and anchor investments, RMB bond and certificate of deposit, global bond trading, FX margin trading, tailor-made structured products through the Bank's open-ended investment platform. The Bank's private banking business also offers a wide range of family office services including family wealth management, will drafting, custodian services and setting up family trust and other types of trusts to allowing the continuity and growth of its customers' wealth. The Bank's private banking customers can also enjoy professional consultancy services on overseas emigration, medical and healthcare services and education in Hong Kong, and overseas property investment and management. There is also a professional investment advisory team to provide specified independent advices to assist with customers' need in developing their businesses.

Insurance

The Bank offers a comprehensive range of insurances under its personal banking segment in cooperation with various partners in Hong Kong. The Banks's motor, fire, foreign domestic helper, home, accidental, China medical card and travel insurances are underwritten by BoCom Insurance. Health and life insurance products are underwritten by FWD Life Insurance and China Life (overseas). The Bank acts as a selling agent of these insurance products of the respective insurance companies.

Interbank and Financial Market

The Bank's interbank and financial market business offers services primarily including sales and trading, liquidity, hedging strategies and competitive pricing to institutional clients. For the year ended 31 December 2020, the total operating income from the Bank's interbank and financial market business was HK$705.1 million, accounting for approximately 18.7 per cent. of the Bank's total operating income for the same period.

Others

The Bank's other businesses include operations of the back office departments, financial management, human resources and other various support departments. For the year ended 31 December 2020, the total operating income from the Bank's other businesses was HK$0.3 million.

E-Banking Distribution Channels

The Bank's e-banking distribution channels, such as self-service centres, internet banking, phone banking and mobile banking, provides its customers with around-the-clock, diversified e-banking services. The Bank realises its e-banking business revenue mainly through transaction service fees, commission fees and interest income.

Internet Banking

Through the Bank's internet banking platform, the Bank's corporate customers are able to conduct account inquiry, corporate payment and cash management, among others, and its personal banking customers are able to conduct account inquiry, transfer of funds, credit card payment, funds transactions and foreign currency trading activities, among others. Since its launch, the Bank's internet banking services business has grown rapidly. As at 31 December 2020, the number of corporate e-banking customers was approximately 11,000, while the number of corporate e-banking transactions was approximately 280,000 with a transaction amount of approximately HK$150 billion for the year ended 31 December 2020. As at 31 December 2020, the number of personal e-banking customers was approximately 180,000, and the number of personal e-banking transactions (excluding mobile banking transactions) was approximately 980,000 with a transaction amount of approximately HK$180 billion for the year ended 31 December 2020.

Mobile Banking

The Bank's mobile banking system provides services through its mobile banking applications named "BOCOM(HK) Mobile App" and "BOCOM(HK) Securities Mobile App", respectively. The Bank's mobile banking applications are designed to enhance transaction efficiency and data transmission security. The Bank's customers can perform various types transactions through the mobile banking system, including account inquiry, fund transfer, investment products trading and foreign currency exchange. Financial information regarding, among others, foreign exchange rates, stocks and securities are also accessible through the Bank's mobile banking applications. As at 31 December 2020, the total number of "BOCOM(HK) Mobile App" and "BOCOM(HK) Securities Mobile App" downloads were approximately 150,000 and for the year ended 31 December 2020, the number of mobile banking transactions made was 800,000 with a transaction amount of approximately HK$66 billion.

Relationship Manager

The Bank continued the construction of relationship manager team and enhanced the education and training of relationship managers. As at 31 December 2020, the Bank had a total number of 222 relationship managers in its branches, accounting for 26 per cent. of its total number of employees.

The Bank is committed to strengthening consumer rights protection by conducting inspection tours and organising special competitions on consumer protection service to improve the quality of customer service.

Marketing

The Bank develops specific marketing strategies for both corporate and personal banking clients in line with those adopted by BoCom. BoCom's head office organises bank-wide marketing strategies and provides supporting resources for local marketing efforts formulated and coordinated by the Bank. The Bank's branches are responsible for the implementation of local marketing plans. The Bank will be responsible for the specific strategies designated to its branches in Hong Kong.

The Bank has carried out marketing strategies designed by BoCom based on geographical region, customer size and product type. The Bank focuses its advertising spending on television advertising, outdoor billboards, and to a lesser extent, internet, print and radio advertising. The Bank also develops marketing strategies based on customer segmentation and it intends to continue to strengthen branding efforts for the specific products it offers. For example, the Bank intends to further promote its customised and comprehensive wealth management solutions and product combinations under the brands of "BComBEST Services", "BOCOM FORTUNE Services" and "BComEASY Business Credit Services" and gradually position its brand as the "wealth management bank".

Information Technology

BoCom's IT systems which are also utilised by the Bank, are integral to many aspects of the Bank's business operations, including customer services, transaction processing, risk management and financial management. The Bank believes that the establishment of advanced IT systems that complement its overall business strategies will greatly improve its efficiency, the quality of its customer service, as well as risk and financial management. The Bank has invested and continues to invest heavily in its IT systems.

The Bank intends to continue to leverage on such IT systems to develop its business in the future. In addition to the upgrades and improvements the Bank has made in recent years to its IT systems, the Bank is expected continue to upgrade and integrate its information technology systems to facilitate operational efficiency, risk management and business development. The Bank will continue to benefit from the abovementioned investments and upgrades to the IT system.

Employees

As at 31 December 2020, the Bank had a total of 868 employees, of which 59 per cent. possess a bachelor's degree and 12 per cent. possess a master's degree or higher qualification.

As at the date of this Offering Circular, the Bank has not experienced any strikes, work stoppages, labour disputes or actions which would have a material adverse effect on its overall business, financial condition or results of operations.

Intellectual Property

The Bank conducts business under the name of Bank of Communications (Hong Kong) Limited. The trademarks of logos of Bank of Communications and others have been registered under the name of Bank of Communications Co., Ltd. acting through BoCom Hong Kong Branch at the Trade Marks Registry, Intellectual Property Department of Hong Kong. The Bank is also the registered owner of the domain name "www.hk.bankcomm.com".

Legal and Regulatory Proceedings

As at the date of this Offering Circular, neither the Bank nor any of its subsidiaries is involved in any legal, litigation or arbitration proceedings relating to claims or amounts which are material in the context of the issue of the Bonds, nor is the Bank or any of its subsidiaries aware that any such proceedings are pending or threatened.

Properties

The address of the Bank's principal office is Unit B B/F & G/F, Unit C G/F, 1-3/F, 16/F Rm01 & 18/F Wheelock House, 20 Pedder Street, Central, Hong Kong. In 2020, the Bank had 44 outlets in Hong Kong (including 37 outlets offering BComBEST Services wealth management service centres, seven Business Services Centres) and one private banking centre in Hong Kong.

RISK MANAGEMENT

The Bank's activities expose it to a variety of financial risks and those activities involve analysis, evaluation, acceptance and management of a certain degree of risks or a portfolio of risks. The Bank's aim is to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Bank's financial performance. The Bank's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Bank regularly reviews its risk management policies and systems to reflect changes in markets, products and the latest best practices. The Board sets out strategies and risk preferences for overall risk management strategy and decides the risk tolerance level. The senior management establishes related risk management policies and procedures under the strategy approved by the Board. Business units act as the first line of defence in risk management while the Risk Management Department undertakes the main risk management operational functions of the Bank. In addition, the Internal Audit Department is responsible for the independent review of risk management and the control environment. The main types of financial risks of the Bank are credit risk, liquidity risk, market risk and operational risk, etc. Market risk also includes foreign exchange risk, interest rate risk and other price risk.

Credit Risk

Credit risk, the risk that a borrower or counterparty of the Bank will be unable or unwilling to honour a repayment obligation, is one of the key risks encountered by the Bank. As the Bank's main business is still dominated by credit business such as lending, billing and stock financing. If credit deterioration or default occurs, it will cause certain losses and affect the Bank's business stability. Therefore, the risks must be strictly monitored. Starting with quality of business, the monitoring approach includes not only rigorous credit review but also ongoing post-lending monitoring. This ensures that the non-performing loan ratio is less than risk tolerance and there is sufficient provision for coverage. The Bank manages and controls the overall credit risk in a prudent manner and reports regularly to the senior management and the Board.

The Bank's credit risk management is assumed by major functions including Corporate Business Management Department, Retail Business Management Department, Credit Card Centre, Credit Management Department, Risk Management Department and Financial Management Department, which are responsible for the standardised management for corporate and retail credit businesses in terms of credit investment, credit investigation and report, credit approval, loan granting, post-loan monitoring and non-performing loan management.

Market Risk

The Bank takes on exposure to market risks, which is initiated by the fluctuation of the fair value of or future cash flow of financial instruments as a result of the changes of the market prices. Market risks arise from open positions in interest rates and exchange rates products, all of which are exposed to market fluctuations and changes in interest rates and foreign exchange rates.

The Bank established a management model of "large and small middle offices" for its market risk management, which is a centralised control framework led by the Board and senior management of the Bank. With the establishment of segregation of different duties, the Risk Management Department formulates market risk policies and ensures the Bank's exposure are within the risk appetite of the Board, while the Global Markets Department is the execution unit of market risk management. The

Internal Audit Department is responsible for independent verification of the market risk management system policies and processes.

The Bank monitors market risk separately in respect of trading portfolios and non-trading portfolios. The trading account consists of financial instruments held either for trading intent or economic hedging for other elements of the trading account. The banking account consists of the investments purchased by the Bank with excess funds and other financial instruments that are not captured in the trading account.

With regard to the exchange rate risks and the interest rate risks of trading book, the Bank established an effective limit management system by implementing net position, risk sensitivity, Value at Risk ("**VaR**") and other indicators. Net interest income sensitivity analysis, interest rate repricing gap analysis and foreign exchange risk concentration analysis are the major tools used by the Bank to monitor the market risk of its overall businesses. In addition, through adequate pricing management and asset allocation, the Bank strives to maximise its rate of return while keeping its risks under control.

The Bank has continuously improved the management system of market risks. The Bank conducted stress tests on historical scenarios and hypothetical scenarios in the consideration of the Bank's major market risk factors. The Bank has implemented daily automatic collection of trading data and market data in the system. The Bank also conducted the management of risk capital and VaR quota and formulated the quota allocation plans.

As part of its market risk management, the Bank enters into interest rate swaps to match the interest rate risk associated with the structured deposits and fix-rate long-term debt securities.

(a) Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the market value of a financial instrument will fluctuate because of changes in market interest rates. The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. The interest rate repricing risk for foreign currency denominated debt securities and the remaining part of the financial guarantees and credit commitments businesses which are not based upon these basic interest rates is not expected to be significant.

The table below summarise the Bank's exposures to interest rate risks in thousands of Hong Kong Dollar. The table show the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

	As at 31 December 2020						
	Up to 1 month	**1 – 3 months**	**3 – 12 months**	**1 – 5 years**	**Over 5 years**	**Non-interest bearing**	**Total**
Assets							
Cash and balances with central bank	—	—	—	—	—	8,438,950	8,438,950
Due from banks and other financial institutions	18,627,299	1,312,750	154,687	—	—	—	20,094,736
Financial assets at fair value through profit or loss	—	—	—	—	—	905,433	905,433
Financial assets at fair value through other comprehensive income	27,695,463	51,620,765	13,574,987	69,398,885	39,648,026	9,697	201,947,823
Loans and advances to customers	123,037,458	10,559,020	1,532,412	267,350	2,118,430	—	137,514,670
Other financial assets	—	—	—	—	—	3,650,086	3,650,086
Total financial assets	169,360,220	63,492,535	15,262,086	69,666,235	41,766,456	13,004,166	372,551,698
Liabilities							
Due to banks and other financial institutions	21,031,885	32,892,562	17,473,034	—	—	262,195	71,659,676
Due to customers	145,064,190	71,038,353	26,728,791	2,490	—	2,916,085	245,749,909
Financial liabilities at fair value through profit or loss	—	—	—	—	—	2,783,985	2,783,985
Lease liabilities	14,086	28,230	82,565	111,740	1,712	—	238,333
Other financial liabilities	—	—	—	—	—	5,135,147	5,135,147
Total financial liabilities	166,110,161	103,959,145	44,284,390	114,230	1,712	11,097,412	325,567,050
Total interest sensitivity gap	3,250,059	(40,466,610)	(29,022,304)	69,552,005	41,764,744	1,906,754	46,984,648

(b) Foreign exchange risk

The Bank conducts the majority of its businesses in Hong Kong Dollars, with certain foreign transactions in U.S.$, RMB and other currencies. The Bank takes on exposure to the effects of fluctuations in the prevailing foreign exchange rates and changes on its financial position and cash flows. The senior management sets limits on the level of exposure in exchange rate risk and monitors the exposure regularly. The table below summarise the Bank's exposure to foreign exchange risk at the end of the year. The table shows the Bank's total assets and liabilities at carrying amounts in Hong Kong Dollars, categorised by the original currency.

	As at 31 December 2020				
		RMB	**U.S.$**	**Others**	**Total**
	(HK$'000)	*(HK$'000 Equivalent)*	*(HK$'000 Equivalent)*	*(HK$'000 Equivalent)*	*(HK$'000)*
Assets					
Cash and balances with central bank	8,030,743	22,900	373,343	11,964	8,438,950
Due from banks and other financial institutions	4,059,565	161,938	11,111,474	4,761,759	20,094,736
Financial assets at fair value through profit or loss	706,909	180	198,292	52	905,433
Financial assets at fair value through other comprehensive income	7,625,263	23,604,208	139,985,459	30,732,893	201,947,823
Loans and advances to customers	110,453,320	251,672	26,792,069	17,609	137,514,670
Other financial assets	1,776,343	332,782	1,404,820	136,141	3,650,086
Total financial assets	132,652,143	24,373,680	179,865,457	35,660,418	372,551,698
Liabilities					
Due to banks and other financial institutions	3,893,807	439,709	61,587,129	5,739,031	71,659,676
Due to customers	171,793,292	24,091,111	42,656,866	7,208,640	245,749,909
Financial liabilities at fair value through profit or loss	1,125,543	123	1,658,319	—	2,783,985
Lease liabilities	238,333	—	—	—	238,333
Other financial liabilities	3,553,950	149,745	1,293,370	138,082	5,135,147
Total financial liabilities	180,604,925	24,680,688	107,195,684	13,085,753	325,567,050
Net position	(47,952,782)	(307,008)	72,669,773	22,574,665	46,984,648

Liquidity Risk

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations associated with its financial liabilities when they fall due and other current liquidity needs. The consequence may be the failure to meet obligations to repay depositors and fulfil loan commitments for lending. The Bank's objective in liquidity management is to ensure the availability of adequate funding to meet the demands of fund deposit withdrawals and other liabilities as they fall due and to ensure that it is able to meet its obligations to fund loan originations and commitments and to take advantage of new investment opportunities.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, matured deposits, loan drawdowns, guarantees and from margin and other calls on cash settled derivatives. The Bank set limits on the minimum proportion of funds to meet such calls and on the minimum level of interbank and other borrowing facilities that should be in place to cover different levels of unexpected withdrawals.

Funding liquidity risk relates to the Bank's ability to fulfill its obligations arising from financial liabilities as they fall due, or its ability to fulfill maturing funding needs, which subsequently affects the Bank's capacity to support deposit withdrawal or drawdown on loan commitments. Effective liquidity risk management helps to sustain the expansion of the Bank's business with liquidity cost and risk under control. The Bank has established and implemented its own liquidity risk management policy per local regulatory requirements in order to fulfil its liquidity risk management. The Asset and Liability Management Committee of the Bank is the decision-making body in balance sheet management and is responsible for coordinating and overseeing all related strategies, including risk management framework and risk appetite. The Financial Management Department is responsible for analysing and monitoring activities related to liquidity risk. The Global Markets Department is responsible for managing daily liquidity position and related executions. The Internal Audit Department is responsible for conducting periodic reviews to ensure liquidity risk management framework is effectively implemented.

The cornerstone of the Bank's funding sources is customer deposits. The Bank strives to build up core deposits while diversifying funding sources via various funding channels to enhance its financing capacity. Regarding its liquidity arrangement with BoCom, the Bank performs regular funding transfer with BoCom to preserve prompt intragroup backup funding supply if necessary. Monitoring and control on intragroup funding transactions are in line with those of third parties. Moreover, BoCom has set up groupwide internal limits to control the Bank's reliance on BoCom's funding.

The majority of the liquidity risk of the Bank arises from maturity mismatch of assets and liabilities. Therefore, regular cash flow analysis and projections on both on- and off-balance sheet items falling within different maturity buckets is performed to ensure funding need. Moreover, the Bank closely monitors off-balance sheet funding obligations (such as commitments or letters of guarantee) and assesses their impact to the Bank's liquidity capacity. Furthermore, the Bank strives to maintain high marketability of the asset portfolio to allow prompt monetisation in case of unforeseeable liquidity crunch in the market.

The Bank has in place various limits and indicators for liquidity risk, including liquidity coverage ratio, loan-to-deposit ratio, concentration limits on customer deposits, interbank borrowing utilisation ratio, etc. for effective identification and control of liquidity risk. The Bank utilises relevant management information systems to perform daily liquidity risk management functions. Moreover, the Bank performs daily cash flow analysis to assess liquidity in normal circumstances and performs regular stress test (at least monthly) to evaluate the Bank's resilience under significant stress conditions. The stress test scenarios are designed with reference to the Monetary Authority's Supervisory Policy Manuals, and also historical liquidity stress scenarios. The Bank's stress test takes into account the impact of all assets, liabilities and off-balance sheet positions and estimates possible funding short-fall with historical data and plausible stress conditions. The results will be scrutinised, and appropriate measures will be taken if necessary.

The Bank has set up an early warning indicator system, and movement of relevant indicators is closely monitored on a regular basis. In case of any liquidity crisis, the Bank's Crisis Management Committee will be formed to formulate appropriate contingency funding plan to resolve the crisis. The Bank also performs regular drills in order to ensure prompt actions and feasibility of contingency funding plan under crisis.

To cope with unpredictable liquidity needs, the Bank has set up liquidity buffer to maintain sufficient highly liquid assets. The buffer portfolio contains cash, exchange fund bills/notes¸ unencumbered sovereign bonds and other high-quality bonds, which is managed by the Financial Management Department and operated by the Global Markets Department on a daily basis.

Fair value of financial assets and liabilities

Certain financial assets and liabilities of the Bank are measured at fair value or with fair value disclosed for financial reporting purposes. The fair value has been determined using appropriate valuation techniques and inputs for fair value measurements. The appropriateness of the valuation techniques and the inputs to the fair value measurements are reviewed periodically.

Fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

Level 1: The fair value of financial instruments traded in active markets is based on quoted (unadjusted) market prices at the end of the reporting period. The quoted market price used for financial assets held by the Bank is the current bid price. These instruments are included in level 1.

Level 2: The fair value of financial instruments that are not traded in an active market is determined using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

Level 3: If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

Specific valuation techniques used to value for Level 2 financial instruments include:

- the use of quoted market prices or dealer quotes for similar instruments;
- calculation of the present value of the estimated future cash flows based on observable yield curves for interest rate swap;
- the fair value of foreign currency forwards is determined using forward exchange rates at the balance sheet date; and
- the fair value of the remaining financial instruments is determined using discounted cash flow analysis.

Offsetting financial assets and financial liabilities

Certain financial assets and financial liabilities of the Bank are subject to enforceable master netting arrangements or similar agreements. The agreement between the Bank and the counterparty generally allows for net settlement of the relevant financial assets and financial liabilities when both elect to settle on a net basis. In the absence of such a mutual consent, financial assets and financial liabilities will be settled on a gross basis. However, each party to the master netting arrangements or similar agreements will have the option to settle all such amounts on a net basis in the event of default of the other party. These financial assets and financial liabilities of the Bank are not offset in accordance with the HKFRS.

Capital Management

The Bank's objectives in managing "capital", which is a broader concept than the "shareholder equity" on the statement of financial position, are:

- to comply with the capital requirements set by the regulators of the markets where the Bank operates;

- to ensure the Bank's ability to maintain a stable operation so as to continue to provide returns for shareholders and benefits for other stakeholders; and

- to maintain a strong capital base to support the development of its business.

Consistent with industry practice, the Bank monitors its capital structure on the basis of the CAR and there have been no material changes in the Bank's policy on the management of capital during the year. The Bank has complied with all externally imposed capital requirements during 2020.

BOARD OF DIRECTORS AND SENIOR MANAGEMENT

General

The Board of Directors of the Bank (the "**Board**") currently (as at 25 June 2021) comprises ten members including four Executive Directors, two Non-executive Directors and four Independent Non-executive Directors. Members of the Board are appointed by BoCom, the Bank's sole shareholder.

Directors

The following table sets forth certain information concerning the directors of the Bank.

Name	Position
Mr. WANG Feng	Executive Director and Chairman
Ms. WU Ye	Executive Director, Deputy Chairman and Chief Executive
Mr. ZHU Bin	Executive Director and Deputy Chief Executive
Mr. FAN Chaorong	Executive Director and Deputy Chief Executive
Ms. ZHU Chen	Non-executive Director
Mr. MA Zequan	Non-executive Director
Mr. CHAN Ka Lok	Independent Non-executive Director
Mr. TANG Kwai Chang	Independent Non-executive Director
Ms. CHAN Ching Har Eliza	Independent Non-executive Director
Mr. LAM Yim Nam	Independent Non-executive Director

Executive Directors

Mr. WANG Feng, Chairman of the Board and Executive Director of the Bank since February 2019. Mr. Wang has been Chief Executive of the BoCom Hong Kong Branch since August 2017; Chairman of China BOCOM Insurance since August 2019. He also serves as the Chief Expert of BoCom. He successively served as General Manager of BoCom Shandong Branch from 2010 to 2017; General Manager of BoCom Shanxi (Taiyuan) Branch from 2005 to 2010; Deputy General Manager of BoCom Zhengzhou Branch from 2000 to 2005; Deputy General Manager of BoCom Zijingshan Sub-branch, Deputy General Manager and General Manager of BoCom Wenhua Road Sub-branch and General Manager of BoCom Baihua Road Sub-branch of Zhengzhou Branch from 1994 to 2000. He is a Senior Economist. Mr. Wang obtained DSc of Fundamental Mathematics from Zhengzhou University.

Ms. WU Ye, Chief Executive and Executive Director of the Bank since April 2021 and Deputy Chairman of the Bank since May 2021. Ms. Wu also serves as Deputy Chief Executive of BoCom Hong Kong Branch since January 2021. She worked successively as Deputy President and President of BoCom Macau Branch from April 2013 to January 2021; Assistant General Manager and Deputy General Manager of Corporate Culture Department of BoCom Head Office from December 2006 to April 2013; Assistant Head of Offices of BoCom Head Office from September 2005 to December 2006; various positions in International Banking Department of BoCom Head Office with last held position as Senior Manager from July 1995 to September 2005. Ms. Wu obtained Doctor of Business Administration from Macau University of Science & Technology, and Master of Economics from Fudan University.

Mr. ZHU Bin, Executive Director of the Bank since April 2021 and Deputy Chief Executive of the Bank since October 2020. Mr. Zhu also serves as Chairman and Non-Executive Director of BOCOM Trustee since June 2021; Director of Bank of Communications (Nominee) Company Limited since June 2021; Director of BOCOM MPF & Financial Services Company Limited since June 2021; Deputy Chief Executive of BoCom Hong Kong Branch since October 2020. He worked successively as Assistant President and Vice President of BoCom Guangdong Provincial Branch from October 2012 to October 2020; Deputy Senior Manager and Senior Manager of Human Resources Department of BoCom Guangdong Provincial Branch from April 2009 to October 2012; Assistant Senior Manager of Human Resources Department of BoCom Guangzhou Branch from August 2008 to April 2009; Manager of Human Resources Department and Assistant President of BoCom Zhuhai Branch from March 2007 to August 2008; various positions in BoCom Zhuhai Branch Gongbei Office and Qiaoguang Sub-branch from March 1993 to March 2007. Mr. Zhu obtained EMBA from Jiangxi University of Finance and Economics.

Mr. FAN Chaorong, Executive Director of the Bank since September 2019 and Deputy Chief Executive of the Bank since July 2018. Mr. Fan also serves as Deputy Chief Executive of BoCom Hong Kong Branch since July 2018. He worked successively as Deputy General Manager of Information & Technology Management Department of BoCom Head Office and Deputy Chief Engineer of Chief Engineer Office (Application and System Architecture Department) from July 2017 to June 2018; Deputy General Manager of BoCom Software Development Centre and General Manager of Development Centre (Shenzhen) from April 2015 to June 2017; Deputy General Manager of BoCom Development Centre (Shenzhen) from April 2012 to March 2015; worked for IT Department of BoCom Shanghai Pudong Sub-branch, IT Department of BoCom Hong Kong Branch and Information and Technology Management Department of BoCom Head Office from January 1991 to March 2012. He is a Senior Engineer. Mr. Fan obtained B.E. in Automation from East China Institute of Chemical Technology.

Non-Executive Directors

Ms. ZHU Chen, Non-executive Director of the Bank since June 2018. Ms. Zhu also serves as General Manager of the International Banking Department of BoCom Head Office. She worked successively as Deputy General Manager and General Manager of BoCom Taipei Branch from November 2012 to July 2017; various positions in International Banking Department of BoCom Head Office from 1993 to 2012 with last held position as Deputy General Manager. Ms. Zhu obtained Bachelor Degree of Science from Fudan University.

Mr. MA Zequan, Non-executive Director of the Bank since May 2021. Mr. Ma also serves as Deputy General Manager of Risk Management Department and Deputy Director of Internal Control and Case Prevention Office of BoCom Head Office. He worked successively as Deputy Director of Case Prevention and Control Office of Supervision Bureau of BoCom Head Office from July 2018 to February 2019; Secretary of Commission for Discipline Inspection of BoCom Henan Provincial Branch from September 2017 to July 2018; Secretary of Commission for Discipline Inspection and Vice President of BoCom Qingdao Branch from January 2015 to September 2017; Deputy Senior Manager and Senior Manager of Asset and Liability Management Department of BoCom Jiangsu Provincial Branch from August 2010 to January 2015; Vice President of BoCom Lianyungang Branch from November 2006 to August 2010; various positions in BoCom Nanjing Branch from August 1995 to November 2006. Mr. Ma obtained Bachelor Degree of Finance from Hangzhou University.

Independent Non-Executive Directors

Mr. CHAN Ka Lok, Independent Non-executive Director of the Bank since April 2017. Mr. Chan is Wei Lun Professor of Finance of The Chinese University of Hong Kong. He also serves as Director of COSCO SHIPPING Ports Limited, FTLife Insurance Company Limited, Hang Seng Qianhai Fund Management Company Limited, and International Review of Finance Limited. He was the Dean of The Chinese University of Hong Kong Business School from 2014 to 2019 and Professor of Finance of Hong Kong University of Science and Technology from January 1996 to October 2014. Mr. Chan obtained Ph.D. in Finance from Ohio State University.

Mr. TANG Kwai Chang, Independent Non-executive Director of the Bank since April 2017. Mr. Tang serves as Director of Alfred K. C. Tang & Company Limited, HKR International Ltd., Tsit Wing International Holdings Ltd., Baosteel Resources Company Limited, Baosteel Resources International Company Ltd., BCOM Finance (Hong Kong) Limited, Cusworth Company Limited, Foxconn Interconnect Technology Limited, HKBU R&D Licensing Limited, and Hong Kong Baptist University Century Club Limited. He worked successively in Deloitte Touche Tohmatsu from January 1982 to May 2013 and his last position there was Partner. He obtained Diploma in Accounting (Distinction) from Hong Kong Baptist University.

Ms. CHAN Ching Har Eliza, Independent Non-executive Director of the Bank since September 2019. Ms. Chan serves as Senior Advisor of Deloitte Touche Tohmatsu and Senior Consultant (Founder) of Yang Chan & Jamison since 2019. She also serves as Vice-President of Friends of Hong Kong Association Limited, Director of We Like Hong Kong Limited, Concord International Investment Limited, Tong Ren Tang Technologies Co. Ltd. and China Electronics Optics Valley Union Holding Co. Ltd. Ms. Chan obtained LL.D (Hon) and LL.B. from University of Victoria and B.Sc from University of Victoria. She is a member of the National CPPCC and has previously served as Chairman of Hong Kong CPPCC (Provincial) Members Association and in different government appointed positions, notably as a member of Hong Kong Hospital Authority, Board of Education, Hong Kong Examinations and Assessment Authority, Hong Kong Science & Technology Parks Corporation and Public Service Commission.

Mr. LAM Yim Nam, Independent Non-executive Director of the Bank since December 2019. Mr Lam serves as Director of SH Group (Holdings) Limited, Director of Hong Kong Chi Tung Association and Honorary Advisor of The Hong Kong Institute of Bankers. He worked successively as Independent Director of Shenzhen Rural Commercial Bank from 2012 to 2018 and Deputy Chief Executive of Bank of China (Hong Kong) Limited from 2001 to 2011. Mr Lam obtained Master and Bachelor Degree of Business Administration from The Chinese University of Hong Kong.

Senior Management

The senior management of the Bank comprises six members currently (as at 9 June 2021).

The following table sets forth certain information concerning members of the senior management of the Bank.

Name	Position
Mr. WANG Feng	Chairman of the Board
Ms. WU Ye	Deputy Chairman of the Board and Chief Executive
Mr. LIU Wang Kit Alan	Alternate Chief Executive and Deputy Chief Executive
Mr. ZHU Bin	Deputy Chief Executive
Mr. FAN Chaorong	Deputy Chief Executive
Mr. IP Tsz Kin	Deputy Chief Executive and Chief Risk Officer

Mr. WANG Feng, please refer to details in "*Executive Directors*".

Ms. WU Ye, please refer to details in "*Executive Directors*".

Mr. LIU Wang Kit Alan, Alternate Chief Executive and Deputy Chief Executive of the Bank since September 2018 and March 2018 respectively. Mr. Liu also serves as Alternate Chief Executive and Deputy Chief Executive of BoCom Hong Kong Branch since November 2015 and September 2006 respectively; Director and Alternate Chief Executive of BCOM Finance (Hong Kong) Limited since July 2007 and August 2007, respectively. He successively worked as Financial Director of American Express from January 2004 to September 2006; worked for KPMG Peat Marwick and Standard Chartered Bank from July 1989 to January 2004. He is a HKICPA Fellow Member and ICAEW Associate. Mr. Liu obtained Bachelor of Laws from Tsinghua University and Master of Business Administration from The University of Hong Kong.

Mr. ZHU Bin, please refer to details in "*Executive Directors*".

Mr. FAN Chaorong, please refer to details in "*Executive Directors*".

Mr. IP Tsz Kin, Deputy Chief Executive of the Bank and of BoCom Hong Kong Branch since November 2018. He also serves as Chief Risk Officer of the Bank and of BoCom Hong Kong Branch since January 2019. He successively worked as Deputy Head of Credit Management Department, Branch Manager of Shatin Sub-branch, Deputy Head and Head of Commercial Banking Department, Head of Business Department, Head of Corporate Business Management Department and joint Head of Global Banking and Business Banking of BoCom Hong Kong Branch from May 2001 to November 2018. He also held temporary positions in Corporate Business Management Department of BoCom Head Office from February 2003 to June 2004; worked for General Affairs Department of BoCom Hong Kong Branch from January 1994 to May 2001. Mr. Ip obtained Master of Accounting and MBA from Open University of Hong Kong.

Board Committees

The Bank has established a corporate governance structure comprising BoCom, the Board, specialised committees, management-level committee and senior management, with clearly defined authorities and responsibilities, balanced equilibrium, and coordinated and independent operation. The Board delegates certain responsibilities to various committees. The Board has set up five specialised committees, namely the management committee, since June 2021, the audit committee, the nomination committee, the remuneration committee and the risk management committee, since June 2017, which are delegated with different responsibilities to assist the Board in performing its duties. The committees report to the Board of Directors assisting it in performing its duties according to authorization from the board of directors. As at the date of this Offering Circular, the Bank shares the middle-and-back-office facilities and management services of 16 units with BoCom Hong Kong Branch, in order to create cost synergies continuously.

The Management Committee

The main duties of the management committee are to manage and control daily operation and business of the Bank in accordance with the policies and procedures adopted by the Bank from time to time and the power authorised by the Board; to discuss and review policies which may have a significant impact on the Bank; to ensure that senior management have the opportunities to receive regular training so as to maintain and enhance their professional capabilities, keeping them abreast of the latest industry and regulatory development relating to their duties; to act in accordance with the instructions and requirements of the Board from time to time; and to review and update the terms of reference of the management committee regularly, and submit any necessary amendments to the Board for approval. According to the terms of reference of the management committee, the management committee shall be chaired by Chairman of the Board, and the majority of members shall be Deputy Chairman of the Board and Chief Executive, all Deputy Chief Executives, as well as any person who is deemed appropriate and necessary according to the Board.

As at 23 June 2021, members of the management committee were Mr. Wang Feng (chairman of the management committee), Ms. Wu Ye, Mr. Liu Wang Kit Alan, Mr. Zhu Bin, Mr. Fan Chaorong and Mr. Ip Tsz Kin.

The Audit Committee

The audit committee is mainly responsible for monitoring the effectiveness of the Bank's internal audit function and work performed by external auditors. The main duties of the audit committee include drawing up, reviewing and updating periodically the terms of reference of the audit committee for the Board's approval; establishing the responsibility and independence of the internal audit function and providing guidance to the audit department of the Bank; approving audit charter drawn up and updated periodically by the audit department; approving the annual audit plan and the related manpower and financial resources required after identifying the areas of risk within the Bank's operations to be covered; assessing all major aspects of the internal audit function periodically and making suggestions for improvement on its effectiveness; receiving audit reports and reviewing significant recommendations and implementation plans and ensuring senior management has taken timely remedial actions as necessary to tackle the internal control weaknesses, the areas of non-compliance with laws, regulations and policies and issues identified by external auditors; reviewing ad-hoc non-compliance incident reports and Monetary Authority on-site examination reports; recommending to the Board with regard to the appointment, remuneration and termination of external auditors, considering their audit work plans and reviewing their audit conclusions and significant recommendations; reviewing accounting policies, financial conditions and financial reporting process and providing opportunities for external and internal auditors to meet and discuss their respective findings. According to the terms of reference of the audit committee, all audit committee members should be Non-executive Directors appointed by the Board. Additionally, the majority of whom (including the chairman of the audit committee) should be Independent Non-executive Directors.

As at 31 December 2020, the chairman of the audit committee was Mr. Tang Kwai Chang and the other members were Mr. Chan Ka Lok and Ms. Chan Ching Har Eliza, and all of them were Independent Non-executive Directors. There were four audit committee meetings held in 2020.

The Nomination Committee

The nomination committee's main duties are to identify individuals suitably qualified to become members of the Board or of senior management, and to select, or to make recommendations to the Board on the selection of, individuals nominated for directorships and senior management positions; to ensure objectivity and independence in the selection process for Board members and senior management; to make recommendations to the Board on the appointment or re-appointment of directors and succession planning for directors; to review the independence of the Independent Non-executive Directors; to undertake regular assessments of the Board performance to assist the Board in reviewing the efficiency and effectiveness of the functioning of the Board; and to undertake regular assessments of the ongoing suitability of each Board member. The nomination committee comprises at least three members. The committee shall be chaired by an Independent Non-executive Director, and the majority of members shall be Independent Non-executive Directors.

As at 31 December 2020, members of the nomination committee were Ms. Chan Ching Har Eliza (chairman of the nomination committee), Mr. Chan Ka Lok and Mr. Lam Yim Nam. There have been four nomination committee meetings held in 2020. Major works performed during 2020 include consideration of the matters relating to the adjustment and appointment of directors; review of the terms of reference of the nomination committee; review of policies related to the succession and appointment of directors and senior management; and evaluation of the independence of the Independent Non-executive Directors, performance of the Board, its specialized committees and the Board members.

The Remuneration Committee

The remuneration committee's main duties are to make recommendations to the Board on the Bank's remuneration policy and structure for all directors, chief executive (including alternate chief executives), senior management and key personnel and on the establishment of a formal and transparent procedure for developing a remuneration policy; to make recommendations to the Board on the remuneration by reference to corporate goals and objectives resolved by the Board, and on the remuneration packages of directors, chief executive, senior management and key personnel; to make recommendations in respect of remuneration policy and practices to the Board, and to ensure that the remuneration policy is consistent with the principles set out in the Supervisory Policy Manual Module, CG-5 "Guideline on a Sound Remuneration System" of the Monetary Authority and any other legal or regulatory requirements; to develop and promote a sound bank culture according to the "Bank Culture Reform" guidance issued by the Monetary Authority, to support prudent risk management and to contribute towards promoting proper staff behaviour leading to positive customer outcomes and high ethical standards in the banking industry; to lay down the Bank's ethical standards and promote them to all levels of staff; to review and approve the proposed amendment of the code of conduct; to ensure the Bank has adequate systems to enforce the code of conduct; to resolve complex ethical dilemmas; to exercise competent and independent judgement on remuneration policies and practices, as well as the incentives thereby created for managing risk, capital and liquidity; to work closely with other relevant board committees and consulting compliance function in the evaluation of the incentives created by the remuneration system; and to ensure that a regular review of the Bank's remuneration system and its operation, either internally conducted or externally commissioned, is carried out independently of management and the result is submitted to the Monetary Authority. The remuneration committee comprises at least three members. The committee shall be chaired by an Independent Non-executive Director, and the majority of members shall be Independent Non-executive Directors.

As at 31 December 2020, members of the remuneration committee were Mr. Chan Ka Lok (chairman of the remuneration committee), Mr. Tang Kwai Chang and Ms. Zhu Chen. The remuneration committee held three meetings in 2020. Major works performed during 2020 include review of remuneration policies; review of the terms of reference of the remuneration committee; review and amendment to the staff code of conduct; consideration of the proposal on staff bonus for 2019 and of the proposal on salary adjustment for 2020; consideration of the report on independent compliance review of the CG-5 "Guideline on a Sound Remuneration System" of the Monetary Authority prepared by a consultancy firm; listening to the report of the annual audit review on remuneration policies; and listening to the implementation report on bank culture reform.

The Risk Management Committee

The risk management committee's main duties are to establish the risk appetite and the strategy in risk management, judge the risk level in each kind of risk; to identify, assess, and manage different kind of risk faced by the Bank; to review and access the risk management process of the Bank, and the adequacy of system and internal control; to review and monitor the compliance of risk management policies, procedures, system and internal control; and to conduct annual review on the Internal Capital Adequacy Assessment Process procedure and report to ensure the Bank has adequate capital to cater for major risk by assessing the business and risk strategy.

As at 31 December 2020, members of the risk management committee were Mr. Lam Yim Nam (chairman of the risk management committee), Mr. Tang Kwai Chang, Ms. Chan Ching Har Eliza and Mr. Fan Chaorong. In 2020, five risk management committee meetings were held. The major task completed by risk management committee included reviewing and recommending risk management strategy and risk level/appetite that could be accepted by the Bank for Board approval; reviewing and accessing whether the risk management structure and policies are able to identify, measure, monitor and control the risk faced by the Bank and whether the risk management structure and policies function effectively; reviewing the report from comprehensive risk management committee about the risk exposures and risk management activities; reviewing and approving high level risk policies and measures; approving various risk management limits; and reviewing and recommending the recovery plan for Board approval.

PRINCIPAL SHAREHOLDERS

The following table sets forth information with regard to the beneficial ownership of the Bank's ordinary shares as at the date of this Offering Circular:

Principal shareholder	Capacity	Share Capital (HK$)	Percentage of issued share capital
Bank of Communications Co., Ltd.	Beneficial owner[1]	37,900,000,000	100%

Note:

(1) Beneficial ownership is determined by and includes the power to direct the voting or the disposition of the securities or to receive the economic benefit of the ownership of the securities.

(2) On 10 March 2020, the shareholders meeting of BoCom approved an injection of no more than HK$30 billion in instalments to the Bank's share capital, following which BoCom increased the share capital of the Bank by HK$20 billion on 21 September 2020.

The banking sector in Hong Kong is regulated by and subject to the provisions of the Banking Ordinance and to the powers and functions ascribed by the Banking Ordinance to the Monetary Authority. The Banking Ordinance provides that only authorized institutions (that is, banks which have been granted a banking licence ("**licence**") by the Monetary Authority may carry on banking business (as defined in the Banking Ordinance) in Hong Kong and contains controls and restrictions on such banks ("**authorized institutions**").

Supervision of Authorized Institutions in Hong Kong

The provisions of the Banking Ordinance are implemented by the Monetary Authority, the principal function of which is to promote the general stability and effectiveness of the banking system, especially in the area of supervising compliance with the provisions of the Banking Ordinance. The Monetary Authority supervises authorized institutions through, *inter alia*, a regular information gathering process, the main features of which are as follows:

(1) each authorized institution must submit a monthly return to the Monetary Authority setting out the assets and liabilities of its operations in Hong Kong and a further comprehensive quarterly return relating to its principal place of business in Hong Kong and all local branches, although the Monetary Authority has the right to allow returns to be made at less frequent intervals;

(2) the Monetary Authority may order an authorized institution, any of its subsidiaries, its holding company or any subsidiaries of its holding company to provide such further information (either specifically or periodically) as it may reasonably require for the exercise of its functions under the Banking Ordinance or as it may consider necessary to be submitted in the interests of the depositors or potential depositors of the authorized institution concerned. Such information shall be submitted within such period and in such manner as the Monetary Authority may require. The Monetary Authority may in certain circumstances also require such information or any return submitted to it to be accompanied by a certificate of the authorized institution's auditors (approved by the Monetary Authority for the purpose of preparing the report) confirming compliance with Banking Ordinance and certain matters;

(3) authorized institutions may be required to provide information to the Monetary Authority regarding companies in which they have an aggregate 20 per cent. or more direct or indirect shareholding or with which they have common directors or managers (as defined in the Banking Ordinance), the same controller, a common name or a concert party arrangement to promote the authorized institution's business;

(4) in addition, authorized institutions are obliged to report to the Monetary Authority immediately of their likelihood of becoming unable to meet their obligations or of the commencement of material civil proceedings applicable only to authorized institutions incorporated in Hong Kong;

(5) the Monetary Authority may direct an authorized institution to appoint an auditor to report to the Monetary Authority on the state of affairs and/or profit and loss of the authorized institution or the adequacy of the systems of control of the authorized institution or other matters as the Monetary Authority may reasonably require;

(6) the Monetary Authority may, at any time, with or without prior notice, examine the books, accounts and transactions of any authorized institution, and in the case of an authorized institution incorporated in Hong Kong, any local branch, overseas branch, overseas representative office or subsidiary, whether local or overseas, of such institution; such inspections are carried out by the Monetary Authority on a regular basis; and

(7) authorized institutions are required to give written notice to the Monetary Authority immediately of any proposal to remove an auditor before the expiration of his term of office or replace an auditor at the expiration of his term of office.

Exercise of Powers over Authorized Institution

The Monetary Authority may, after consultation with the Financial Secretary, exercise certain powers over the conduct of authorized institutions in any of the following circumstances:

(1) when an authorized institution informs the Monetary Authority that it is likely to become unable to meet its obligations, that it is insolvent, or that it is about to suspend payment;

(2) when an authorized institution becomes unable to meet its obligations or suspends payment;

(3) if after an examination or investigation, the Monetary Authority is of the opinion that an authorized institution:

  (i) is carrying on its business in a manner detrimental to the interests of its depositors or potential depositors or of its creditors or of holders or potential holders of multi-purpose cards issued by it or the issue of which is facilitated by it;

  (ii) is insolvent or is likely to become unable to meet its obligations or is about to suspend payment;

  (iii) has contravened or failed to comply with any of the provisions of the Hong Kong Banking Ordinance; or

  (iv) has contravened or failed to comply with any condition attached to its licence or certain conditions in the Banking Ordinance; and

(4) where the Financial Secretary advises the Monetary Authority that he considers it in the public interest to do so.

In any of the circumstances described above, the Monetary Authority, after consultation with the Financial Secretary, may exercise any of the following powers:

(1) to require the authorized institution, by notice in writing served on it, forthwith to take any action or to do any act or thing whatsoever in relation to its business and property as the Monetary Authority may consider necessary;

(2) to direct the authorized institution to seek advice on the management of its affairs, business and property from an adviser approved by the Monetary Authority;

(3) to assume control of and carry on the business of the authorized institution, or direct some other person to assume control of and carry on the business of the authorized institution; or

(4) to report to the Chief Executive in Council in certain circumstances (in which case the Chief Executive in Council may exercise a number of powers including directing the Financial Secretary to present a petition to the Court of First Instance for the winding-up of the authorized institution).

Revocation and Suspension of Banking Licence

The Monetary Authority also has powers to recommend the revocation or suspension of a licence. Both powers are exercisable after consultation with the Financial Secretary and with a right of appeal of the authorized institution concerned except in the event of temporary suspension in urgent cases. The grounds for suspension or revocation include the following:

(1) the authorized institution no longer fulfils the criteria for authorisation and the requirements for registration;

(2) the authorized institution is likely to be unable to meet its obligations or to suspend payment or proposes to make, or has made, any arrangement with its creditors or is insolvent;

(3) the authorized institution has failed to provide material information required under the Hong Kong Banking Ordinance or has provided false information;

(4) the authorized institution has breached a condition attached to its licence;

(5) a person has become or continues to be a controller or chief executive or director of the authorized institution after the Monetary Authority has made an objection;

(6) the interests of the depositors require that the licence be revoked; or

(7) the authorized institution is engaging in practices likely to prejudice Hong Kong as an international financial centre or in practices (specified in the Monetary Authority guidelines) which should not be engaged in.

Revocation or suspension of a licence means that the authorized institution can no longer conduct banking business (for the specified period in the case of a suspension).

Principal Obligations of Authorized Institutions

The obligations of an authorized institution under the Hong Kong Banking Ordinance, which are enforced by the Monetary Authority through the system described above, include, but are not limited to, the following:

Capital Adequacy

An authorized institution incorporated in Hong Kong must at all times maintain a total CAR of at least 8.0 per cent., calculated as the ratio (expressed as a percentage) of its capital base to its risk-weighted assets as more fully described below. In relation to an authorized institution with subsidiaries, the Monetary Authority may require the ratio to be calculated on a consolidated basis, or on both a consolidated and an unconsolidated basis, or on a consolidated basis only in respect of such subsidiaries of the authorized institution as may be specified by the Monetary Authority. The Monetary Authority may, after consultation with the authorized institution concerned, increase the ratio for any particular authorized institution. An authorized institution is under a duty to inform the Monetary Authority immediately of a failure to maintain the required CAR and to provide the Monetary Authority with such particulars as it may require. It is an indictable offence not to do so, and the Monetary Authority is entitled to prescribe remedial action.

The capital base of an authorized institution is, broadly speaking but not limited to, all its paid-up capital and reserves, its profit and loss account including its current year's profit or loss, together with perpetual and term subordinated debt meeting prescribed conditions, general provisions against doubtful debts subject to certain limitations and a portion of its latent reserves arising from the revaluation of long-term holdings of specified equity securities or its reserves on the revaluation of real property.

The risk-weighted exposure is determined by:

(1) multiplying risk-weight factors to the book value of various categories of assets (including but not limited to notes and coins, Hong Kong government certificates of indebtedness and cash items in the course of collection);

(2) multiplying the credit conversion factors to various off-balance sheet items (including but not limited to direct credit substitutes, transaction-related contingencies, repurchase contracts, note issuance facilities and exchange rate contracts) to determine their credit equivalent amount;

(3) aggregating the amounts determined pursuant to (1) and (2); and

(4) subtracting from the amount determined pursuant to (3) the value of general provisions not included in the capital base of the authorized institution.

The capital adequacy standards described above are commonly known as Basel II, and there are four approaches under Basel II to calculate credit risks, namely the basic approach, the standardised approach, foundation internal rating-based approach and the advanced internal ratings-based approach. Authorized institutions in Hong Kong under Basel II can choose either one out of the four approaches, with the foundation internal rating-based approach and advanced internal rating-based approach requiring approval from the Monetary Authority.

In December 2010 and January 2011, the Basel Committee issued further capital requirements designed to raise the quality, consistency and transparency of banks' capital base and new global liquidity standards. These requirements are collectively known as Basel III. Among other things, Basel III will increase the minimum CAR requirements in relation to risk-weighted amounts, with the common equity requirement rising from 2 per cent. to 4.5 per cent. and the Tier 1 capital requirements rising from 4 per cent. to 6 per cent. The total minimum capital requirement remains unchanged at 8 per cent. (excluding buffers). The Basel Committee expects its member jurisdictions to begin the implementation of Basel III from 1 January 2013, with full implementation by 1 January 2019. The Monetary Authority has taken steps to implement Basel III in Hong Kong in accordance with the timetable of the Basel Committee and to effect the first phase of Basel III implementation starting January 2013.

The Banking Ordinance was amended in 2012 to facilitate the implementation of the Basel III capital and disclosure requirements in Hong Kong. More specifically, the amendments made to the Banking Ordinance empowered the Monetary Authority to:

(a) prescribe capital requirements for authorized institutions incorporated in Hong Kong or elsewhere; and

(b) issue and approve codes of practice for the purpose of providing guidance in respect of the requirements.

The Banking (Capital) (Amendment) Rules 2012 came into effect on 1 January 2013, with the requirements being phased in over six years to achieve full implementation by 1 January 2019. These include:

- the imposition of three minimum risk-weighted capital ratios, namely CET1 capital ratio, Tier 1 capital ratio and total CAR, with gradual phasing in of the minimum capital requirements over three years commencing 1 January 2013;
- the introduction of two capital buffers, namely the capital conservation buffers and countercyclical capital buffer, to be phased in sequentially from 1 January 2016 to 1 January 2019;
- the introduction of capital requirement for counterparty risk effect from 1 January 2013; and
- capital instruments issued on or after 1 January 2013 must meet all of the Basel III criteria to qualify as regulatory capital. Capital instruments prior to this date that no longer qualify for inclusion in capital base will be phased out during the 10-year period commencing 1 January 2013.

With effect from 30 June 2013, the Banking (Disclosure) Rules have been amended to implement Basel III capital and disclosure standards. The Monetary Authority has conducted further consultation on implementing the Basel III liquidity standards. For example, the Monetary Authority has issued a consultation paper to consult on the proposed approach to implementing the Basel III final reform package on 6 November 2020.

The Hong Kong "Resolution Regime"

In early 2014, the Hong Kong government launched the initial stage of a public consultation on establishing a "resolution regime" for authorized institutions and other financial institutions in Hong Kong. A second consultation was launched in early 2015. The Response Paper published concluded the two consultations and summarised the key comments received and the authorities' responses and proposals in relation to those comments. The Response Paper also discusses certain further issues which remain under development internationally. The Financial Institutions (Resolution) Ordinance (No. 23 of 2016) came into effect on 7 July 2017.

The resolution regime seeks to provide the relevant resolution authorities with administrative powers to bring about timely and orderly resolution in order to stabilise and secure continuity for a failing financial institution in Hong Kong. In particular, it has been envisaged that subject to certain safeguards, the relevant resolution authority would be provided with powers to affect contractual and property rights as well as payments (including in respect of any priority of payment) that creditors would receive in resolution. These may include but are not limited to, powers to write off or convert all or a part of the principal amount of, or interest on, the Bonds, which may, *inter alia*, be in addition to any write off pursuant to the contractual provisions relating to loss absorption of the Bonds, and powers to amend or alter the contractual provisions of the Bonds. Holders are subject to and bound by the Financial Institutions (Resolution) Ordinance.

Liquidity

Liquidity of an authorized institution is its ability to meet payment obligations as they fall due. Banks must maintain sufficient liquidity to handle daily operational activities such as cash withdrawal from depositors, interbank clearing, repayment of debts, etc. The liquidity requirements applicable to authorized institutions are provided mainly in the Banking (Liquidity) Rules ("**BLR**") issued by the Monetary Authority under section 97H(1) of the Banking Ordinance.

Under the BLR, authorized institutions designated by the Monetary Authority as "category 1 institutions" are required to comply with the requirements relating to the LCR and the NSFR. Usually category 1 institutions are either having significant international exposures or being significant to the general stability of the local banking sector having regard to their size or complexity of business operations. Category 1 institutions are required to maintain an LCR not less than 100 per cent. and an NSFR not less than 100 per cent.

Other authorized institutions are regarded as "category 2 institutions", which must comply with the requirements relating to the local liquidity maintenance ratio ("**LMR**"). Category 2A institutions in category 2 institutions must also comply with the requirements relating to the local core funding ratio ("**CFR**"). The designation of category 2A institutions are based on the business size and the liquidity risk associated with the institution. Category 2 institutions are required to maintain an LMR not less than 25 per cent., whereas Category 2A institutions are required to maintain an LMR not less than 25 per cent. and an CFR of not less than 75 per cent.

Financial Exposure to Any One Customer

The financial exposure of an authorized institution incorporated in Hong Kong to any one person or group of connected persons must not (subject to certain exceptions) exceed 25.0 per cent. of the capital base of the authorized institution. Subject to certain exclusions, the authorized institution's financial exposure to any one person or group of connected persons is taken to be the aggregate of:

(1) all advances, loans and credit facilities granted to that person or group;

(2) the value of the authorized institution's holdings of shares, debentures and other debt securities issued by that person or group; and

(3) the principal amount, multiplied by a factor to be specified by the Monetary Authority, for off-balance sheet items resulting from transactions between the authorized institution and that person or group.

For these purposes, persons shall be treated as connected if one company is the subsidiary of another, they have a common holding company, they have a common controller (not being a company) or if one (not being a company) is a controller of another (being a company).

The calculation of financial exposure does not include financial exposure to the Hong Kong government or authorized institutions or financial exposure generally to the extent it is secured by a cash deposit, a guarantee, an undertaking, certain specified securities or a letter of comfort accepted by the Monetary Authority.

If a person or a company to whom an authorized institution is financially exposed is a trustee of more than one trust, the Monetary Authority may, by notice in writing, extend the limit of the authorized institution's financial exposure to that person or company.

Other Restrictions on Lending

The Banking Ordinance also provides that the amount of the facilities which a Hong Kong incorporated authorized institution may make available on an unsecured basis to its controllers, its directors, their relatives or certain of its employees and persons associated with any of them shall be subject to the restrictions set out therein.

The Banking (Exposure Limits) Rules (the "**BELR**") also provides that:

(1) authorized institutions may not provide a financial facility against the security of their own shares, capital-in-nature instrument or non-capital LAC debt instruments (or, except with the approval of the Monetary Authority, that of their respective holding companies, subsidiaries or fellow subsidiaries of such holding companies); and

(2) authorized institutions may not, except with the written consent of the Monetary Authority, provide to any one of their employees any unsecured facility of an amount in excess of that employee's salary for one year.

Restrictions on Investments in Land

Under the BELR, an authorized institution must at all times maintain a land exposure ratio (as defined in the BELR) not exceeding 50 per cent. and an adjusted land exposure ratio (as defined in the BELR) not exceeding 25 per cent.. The Monetary Authority may, by written notice served on an authorized institution, vary any or both of the limits under the BELR for the authorized institution if the Monetary Authority, after taking into account the considerations, including the risks associated with the level or concentration of the authorized institution's holding of interests in land, any risk mitigation measures taken by the authorized institution to manage those risks and any other factors that the Monetary Authority considers relevant, is satisfied on reasonable grounds that it is prudent to make the variation.

Equity Exposures in Other Companies

An authorized institution incorporated in Hong Kong may not acquire or hold the aggregate equity exposures which exceed 25.0 per cent. of the authorized institution's Tier 1 capital base except for shares held by way of security for facilities and by virtue of acquisitions in satisfaction of debts due to it (which must, however, be disposed of at the earliest suitable opportunity and not later than 18 months after their acquisition unless the Monetary Authority agrees to a longer period). Shares held by virtue of underwriting and sub-underwriting commitments are, nevertheless, permitted provided the relevant shares are disposed of within seven working days or such longer period as the Monetary Authority may agree.

There are other exemptions for any holding of equity exposures approved by the Monetary Authority in other banks and companies carrying on nominee, executor, trustee or other functions related to banking business, the business of deposit taking, insurance, investments or other financial services.

Charges

An authorized institution incorporated in Hong Kong is not permitted to create any charges over its assets if either the aggregate value of all charges existing over its total assets is 5.0 per cent. or more of the value of those total assets or creating that charge would cause the aggregate value of all charges over its total assets to be more than 5.0 per cent. of the value of those total assets.

Restrictions on Overseas Activities

An authorized institution which is incorporated in Hong Kong is subject to a condition that it shall not establish or maintain any overseas branch or overseas representative office without the approval of the Monetary Authority. The Monetary Authority is empowered by the Banking Ordinance to require financial and other information regarding any such overseas branch to be supplied to it.

Further, an authorized institution incorporated in Hong Kong or its Hong Kong incorporated holding company may not without the consent of the Monetary Authority owns a company incorporated outside of Hong Kong which may (whether or not in or outside of Hong Kong) lawfully take deposits from the public. The Monetary Authority may at any time attach in respect of any such approved overseas companies any conditions as the Monetary Authority may think proper.

Shareholders, Chief Executives and Directors

Limitations on Shareholders

The Monetary Authority has the power to object, on certain specified grounds, to persons becoming or being "controllers" of authorized institutions incorporated in Hong Kong. "Controller" in this context means:

(1) a person who, either alone or with any associate(s), is entitled to exercise or control the exercise of, 10.0 per cent. or more, but not more than 50.0 per cent., of the voting power at any general meeting of the authorized institution or of another company of which it is a subsidiary; or

(2) a person who, either alone or with any associate(s), is entitled to exercise, or control the exercise of, more than 50.0 per cent. of the voting power at any general meeting of the authorized institution or of another company of which it is a subsidiary; or

(3) a person in accordance with whose directions or instructions the directors of the authorized institution or of another company of which it is a subsidiary are accustomed to act (but does not include any professional advisors or managers appointed by the Monetary Authority to manage the authorized institution).

A person may not become a controller of an authorized institution incorporated in Hong Kong unless he has served a written notice on the Monetary Authority of his proposal to that effect and the Monetary Authority consents to his becoming such a controller or does not object within three months.

Within the three-month period, the Monetary Authority may object to the applicant's proposal, unless it is satisfied that the applicant is a fit and proper person to become a controller; that depositors' or potential depositors' interests will not be threatened by that person being such a controller; and having regard to the applicant's likely influence on that institution as a controller, the authorized institution is likely to continue to conduct its business prudently or that the applicant is likely to undertake adequate remedial action to ensure that the authorized institution will conduct its business prudently. The Monetary Authority may also object to the continuation of a person as a controller on similar grounds as in respect of new controllers.

Where a person becomes a controller (by virtue of being able to exercise or control the exercise of certain voting power in an authorized institution) after a notice of objection has been served on him or otherwise in the contravention of the procedure prescribed by the Banking Ordinance, the Monetary Authority may notify the controller that until further notice any specified shares are subject to one or more of the following restrictions:

(1) any transfer of the shares or, in the case of unissued shares, any transfer of the right to be issued with them, and any issue of such shares, shall be void;

(2) voting rights in respect of those shares shall not be exercisable;

(3) no further shares in right or pursuant to any offer made to the shareholder shall be issued; or

(4) except in a liquidation, no payments of any sums due from the authorized institution on the shares shall be paid.

In addition, the Monetary Authority may apply to court for an order that the shares be sold. Once the shares are sold, the proceeds (less the costs of sale) shall be paid into court and held for the benefit of the persons beneficially interested in them.

In the case of an indirect controller who does not have the approval of the Monetary Authority, the person concerned is prohibited from giving directions or instructions to the directors of the authorized institution or of another company of which it is a subsidiary.

Limitations on Persons Becoming Chief Executives or Directors

All authorized institutions must have a chief executive ordinarily resident in Hong Kong. A person requires the written consent of the Monetary Authority before becoming a chief executive and alternate chief executive.

The consent of the Monetary Authority is also required for a person to become a director of a Hong Kong incorporated authorized institution.

Supervision of Securities Business

The SFO, which came into operation in April 2003, introduced a substantial change to the conduct of securities business by banks. Banks are no longer exempted from the relevant regulations when they engage in securities business. Instead they are required to apply for registration with the SFC, which means they will have to meet the Fit and Proper Criteria set by the SFC. Likewise, staff engaged by banks in securities business will have to meet the Fit and Proper Criteria applicable to staff of brokerage firms. It is a statutory condition of registration for banks that each member of staff engaged by them in securities business is a fit and proper person. Banks will also have to comply with the various regulatory requirements set by the SFC in relation to their securities business, including the subsidiary legislation and the business conduct codes. Under the SFO, banks and their securities staff will be subject to the same range of disciplinary actions that are applicable to brokers and their staff in case they are guilty of misconduct or otherwise not fit and proper.

With the introduction of a new licensing regime under the SFO, corresponding changes have been made to the Hong Kong Banking Ordinance by way of the introduction of the Banking (Amendment) Ordinance 2002. Such ordinance came into operation simultaneously with the SFO and has enabled the Monetary Authority to enhance their regulatory functions in relation to the securities businesses of banks and other authorized institutions that are registered under the SFO.

Supervision of Insurance Business

The main source of statutory regulation of the insurance market and insurance businesses in Hong Kong is the Hong Kong Insurance Ordinance ("**HKIO**") and its subsidiary regulations, which set out requirements for the authorisation, ongoing compliance and reporting obligations of insurers and insurance intermediaries. Pursuant to the HKIO, a person must not carry on a regulated activity, or hold out that the person is carrying on a regulated activity, in the course of the person's business or employment, or for reward, unless the person is a licensed insurance intermediary or is exempt under the HKIO.

While The Hong Kong Insurance Authority ("**HKIA**") is the regulatory body that administers the HKIO, the HKIA has delegated its inspection powers and investigation powers under the HKIO to the Monetary Authority in relation to business of regulated activities carried by the authorized institutions.

An authorized institution that intends to carry on regulated activities must apply to the authorized institution for an insurance intermediary licence. The Monetary Authority normally will require the authorized institution to provide an Independent Assurance Report on the authorized institution's fitness and propriety and whether the authorized institution is competent to carry on regulated activities with reference to the relevant statutory requirements as well as regulatory requirements issued by the HKIA and the Monetary Authority. To facilitate planning, authorized institutions should notify the Monetary Authority of their intended application in advance.

The Monetary Authority also requires all authorized institutions to comply with all relevant legislation, rules and regulations, and conduct their businesses including the businesses of regulated activities in a responsible, honest and business-like manner, and with integrity, prudence and the appropriate degree of professional competence. To this end, senior management should ensure that appropriate policies and procedures, management oversight, internal controls and staff training are in place. Failure to comply with any applicable legal and regulatory requirements will call into question whether the authorized institution or the licensed technical representative of the authorized institution is a fit and proper person to remain licensed, and may lead to disciplinary actions.

TERMS AND CONDITIONS OF THE BONDS

The following is the text of the Terms and Conditions of the Bonds which (subject to completion and modification and excluding italicised text) will be endorsed on each definitive certificate evidencing the Bonds.

The U.S.$1,000,000 2.304 per cent. Tier 2 Subordinated Bonds due 2031 (the "**Bonds**") of Bank of Communications (Hong Kong) Limited (the "**Issuer**") were authorised by the board of directors of the Issuer. A fiscal agency agreement dated 8 July 2021 (as amended or supplemented from time to time, the "**Fiscal Agency Agreement**") between the Issuer, Bank of Communications Co., Ltd. Hong Kong Branch as fiscal agent (the "**Fiscal Agent**", which expression includes any successor fiscal agent appointed from time to time in connection with the Bonds), Bank of Communications Co., Ltd. Hong Kong Branch as registrar (the "**Registrar**", which expression includes any successor registrar appointed from time to time in connection with the Bonds), the transfer agent named therein (the "**Transfer Agent**", which expression includes any successor or additional transfer agent appointed from time to time in connection with the Bonds), the paying agents named therein (together with the Fiscal Agent, the "**Paying Agents**", which expression includes any successor or additional paying agents appointed from time to time in connection with the Bonds) and Bank of Communications Co., Ltd. Hong Kong Branch as calculation agent (the "**Calculation Agent**", which expression includes any successor or additional calculation agents appointed from time to time in connection with the Bonds). The Bonds have the benefit of a deed of covenant dated 8 July 2021 (as amended or supplemented from time to time, the "**Deed of Covenant**") entered into by the Issuer. References herein to the "**Agents**" are to the Registrar, the Fiscal Agent, the Transfer Agent, the Paying Agents and the Calculation Agent and any reference to an "**Agent**" is to any one of them. Certain provisions of these terms and conditions (the "**Conditions**") are summaries of the Fiscal Agency Agreement and the Deed of Covenant and subject to their detailed provisions. The Bondholders (as defined below) are bound by, and are deemed to have notice of, all the provisions of the Fiscal Agency Agreement and the Deed of Covenant applicable to them. Copies of the Fiscal Agency Agreement and the Deed of Covenant are available for inspection by Holders (as defined below) with prior written notice during normal business hours at the principal office for the time being of the Fiscal Agent, being at the date hereof 20 Pedder Street, Central, Hong Kong and at the Specified Offices (as defined in the Fiscal Agency Agreement) of each of the Agents, the initial Specified Offices of which are set out below.

Any reference to "**Bondholders**" or "**Holders**" in relation to any Bonds shall mean the persons in whose name the Bonds are registered.

1 FORM, DENOMINATION AND TITLE

The Bonds are issued in registered form in denominations of U.S.$250,000 each and integral multiples of U.S.$1,000 in excess thereof.

A certificate (each a "**Certificate**") will be issued to each Bondholder in respect of its registered holding of Bonds. Each Certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the register of Bondholders which the Issuer will procure to be kept by the Registrar in accordance with the provisions of the Fiscal Agency Agreement.

Title to the Bonds passes only by registration in the register of Bondholders. The Bondholder of any Bond will (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any interest or any writing on, or the theft or loss of, the Certificate issued in respect of it) and no person will be liable for so treating the Bondholder.

*Upon issue, the Bonds will be represented by a Global Certificate (the "**Global Certificate**") deposited with a nominee of a common depositary for Euroclear Bank SA/NV ("**Euroclear**") and Clearstream Banking S.A. ("**Clearstream**"). The Conditions are modified by certain provisions contained in the Global Certificate. The Bonds are not issuable in bearer form.*

2 TRANSFERS OF THE BONDS

2.1 Transfers of interests in Bonds

One or more Bonds may be transferred upon the surrender (at the specified office of the Registrar or any Transfer Agent) of the Certificate representing such Bonds to be transferred, together with the form of transfer endorsed on such Certificate, (or another form of transfer substantially in the same form and containing the same representations and certifications (if any), unless otherwise agreed by the Issuer), duly completed and executed and any other evidence as the Registrar or Transfer Agent may reasonably require to prove the title of the transferor and the authority of the individuals that have executed the form of transfer. In the case of a transfer of part only of a holding of Bonds represented by one Certificate, a new Certificate shall be issued to the transferee in respect of the part transferred and a further new Certificate in respect of the balance of the holding not transferred shall be issued to the transferor. All transfers of Bonds and entries on the Register will be made in accordance with these Conditions and subject to the detailed regulations concerning transfers of Bonds set out in the Fiscal Agency Agreement. The regulations may be changed by the Issuer, with the prior written approval of the Registrar and the Fiscal Agent. A copy of the current regulations will be made available for inspection by the Registrar or any Transfer Agent to any Bondholder following prior written request and satisfactory proof of holding.

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

2.2 Partial Write-off in Respect of Bonds

In the case of a partial Write-off (as defined below), or partial cancellation, modification, conversion and/or change in form pursuant to Condition 6 (*Hong Kong Resolution Authority Power*), of a holding of Bonds represented by a single Certificate, a new Certificate shall be issued to the holder in respect of the balance of the holding not Written-off or not subject to cancellation, modification, conversion and/or change in form pursuant to Condition 6 (*Hong Kong Resolution Authority Power*). New Certificates shall only be issued against surrender of the existing Certificates to the Registrar or the Transfer Agent.

2.3 Delivery of New Certificates

Each new Certificate to be issued pursuant to Condition 2.1 (*Transfers of interests in Bonds*) shall be available for delivery within seven business days of receipt of the form of transfer and surrender of the Certificate for exchange. Delivery of the new Certificate(s) shall be made at the specified office of the Registrar or any Transfer Agent (as the case may be) to whom delivery or surrender of such form of transfer or Certificate shall have been made or, at the option of the holder making such delivery or surrender as aforesaid and as specified in the relevant form of transfer or otherwise in writing, be mailed by uninsured post at the risk of the holder entitled to the new Certificate to such address as may be so specified, unless such holder requests otherwise and pays in advance to the Registrar or, as the case may be, such Transfer Agent the costs of such other method of delivery and/or such insurance as it may specify. In this Condition 2.3 (*Delivery of New Certificates*), "**business day**" means a day, other than a Saturday or Sunday, on which banks are open for business in the place of the specified office of the Registrar or the relevant Transfer Agent (as the case may be).

Except in the limited circumstances described in the Global Certificate, owners of interest in the Bonds will not be entitled to receive physical delivery of definitive Certificates.

2.4 Cost of Registration

Transfers of Bonds and Certificates on registration or transfer shall be effected without charge by or on behalf of the Issuer, the Registrar or the Transfer Agents, but upon (i) payment of any tax, duty or other governmental charges that may be imposed in relation to such transfer (or the giving of such indemnity and/or security and/or pre-funding as the Registrar or the Transfer Agent may require) (ii) the Registrar or the Transfer Agent (as the case may be) being satisfied in its absolute discretion with the documents of title or identity of the person making the application and (iii) the Registrar or the Transfer Agent (as the case may be) being satisfied that the regulations concerning transfers of Bonds have been complied with.

2.5 Closed Periods

No Bondholder may require the transfer of a Bond to be registered (i) during the period of 15 days ending on (and including) the due date for redemption of, or payment of any principal or interest in respect of the Bonds or (ii) during the period commencing on the date of a Non-Viability Event Notice (as defined in Condition 5 (*Non-Viability Loss Absorption*) below) and ending on (and including) the close of business in Hong Kong on the effective date of the related Write-off.

*So long as Bond are represented by a Global Certificate and such Global Certificate is held on behalf of Euroclear or Clearstream or any other clearing system, no holder may require the transfer of a Bond to be registered during the period of five Clearing System Business Days (or such other period as the relevant clearing systems shall determine in accordance with their rules and procedures) commencing on the Clearing System Business Day immediately following the date on which the Non-Viability Event Notice has been received by the relevant clearing systems (the "**Suspension Period**"). "**Clearing System Business Day**" means a weekday (Monday to Friday, inclusive except 25 December and 1 January).*

3 STATUS AND SUBORDINATION OF THE BONDS

3.1 Status of the Bonds

The Bonds constitute direct, unconditional, unsecured and subordinated obligations of the Issuer ranking *pari passu* without any preference among themselves. The rights and claims of the Bondholders are subordinated in the manner described below.

3.2 Subordination

Subject to the insolvency laws of Hong Kong and other applicable laws, in the event of a Winding-Up (as defined below) of the Issuer (other than pursuant to a Permitted Reorganisation (as defined below)), the rights and claims of the Bondholders in respect of or arising under the Bonds, shall rank (i) subordinate and junior in right of payment to, and of all claims of, (a) all depositors and unsubordinated creditors of the Issuer and (b) all other holders of Subordinated Indebtedness of the Issuer whose claims are stated to rank senior to the Bonds or rank senior to the Bonds by operation of law or contract; (ii) *pari passu* in right of payment to and of all claims of the holders of Parity Obligations; and (iii) senior in right of payment to, and of all claims of, the holders of Junior Obligations, in each case, present and future.

3.3 Qualification of the Bonds

The Bonds are intended to qualify as Tier 2 capital under the Capital Regulations.

For the purposes of these Conditions:

"**Authorized Institution**" has the meaning given to that term in the Banking Ordinance (Cap. 155) of Hong Kong as amended or superseded from time to time.

"**Capital Regulations**" means the Banking (Capital) Rules (Cap. 155L) of Hong Kong as amended or superseded from time to time, or any other capital regulations from time to time applicable to the regulatory capital of Authorized Institutions incorporated in Hong Kong issued or implemented by the Monetary Authority.

"**Directors**" means the Board of Directors from time to time of the Issuer and "**Director**" means any one of them.

"**Group**" means the Issuer and its Subsidiaries taken as a whole.

"**Junior Obligation**" means all classes of share capital of the Issuer, any Tier 1 Capital Instruments, and any instrument or other obligation (including without limitation any preference shares) issued, entered into, or guaranteed by the Issuer that ranks or is expressed to rank junior to the Bonds by operation of law or contract.

"**Monetary Authority**" means the Monetary Authority appointed under section 5A of the Exchange Fund Ordinance (Cap. 66) of Hong Kong or any successor thereto.

"**Parity Obligation**" means any instrument or other obligation issued or entered into by the Issuer that qualifies as a Tier 2 Capital Instrument (or its equivalent) under applicable Capital Regulations or any instrument or other obligation issued, entered into, or guaranteed by the Issuer that ranks or is expressed to rank *pari passu* with the Bonds by operation of law or contract, which excludes any Junior Obligations of the Issuer.

"**Permitted Reorganisation**" means a solvent reconstruction, amalgamation, reorganisation, merger or consolidation whereby all or substantially all the business, undertaking and assets of the Issuer are transferred to a successor entity which assumes all the obligations of the Issuer under the Bonds.

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

"**Subsidiary**" means any company (i) in which the Issuer holds a majority of the voting rights, (ii) of which the Issuer is a member and has the right to appoint or remove a majority of the Directors or (iii) of which the Issuer is a member and controls a majority of the voting rights, and includes any company which is a Subsidiary of a Subsidiary of the Issuer.

"**Tier 1 Capital Instruments**" means any instrument or other obligation issued or entered into by the Issuer or a Subsidiary that constitutes Tier 1 capital of the Issuer pursuant to the Capital Regulations.

"**Tier 2 Capital Instruments**" means any instrument or other obligation issued or entered into by the Issuer or a Subsidiary that constitutes Tier 2 capital of the Issuer pursuant to the Capital Regulations.

"**Winding-Up**" means a final and effective order or resolution by a judicial authority in the jurisdiction of incorporation of the Issuer for the bankruptcy, insolvency, liquidation, winding-up or similar proceedings in respect of the Issuer.

3.4 Set-off

Subject to applicable law, no Bondholder may exercise, claim or plead any right of set-off, counter-claim or retention in respect of any amount owed to it by the Issuer arising under or in connection with the Bonds and each Bondholder shall, by virtue of being the Bondholder of any Bond be deemed to have waived all such rights of such set-off, counter-claim or retention.

Notwithstanding the preceding sentence, if any of the amounts owing to any Bondholder by the Issuer in respect of, or arising under or in connection with the Bonds is discharged by set-off, counterclaim or retention, such Bondholder shall, subject to applicable law, immediately pay an amount equal to the amount of such payment or discharge to the Issuer (or, in the event of its Winding-Up, the liquidator or, as appropriate, administrator of the Issuer) and, until such time as payment is made, shall hold an amount equal to such amount in trust for the Issuer (or the liquidator or, as appropriate, administrator of the Issuer (as the case may be)) and accordingly any such discharge shall be deemed not to have taken place and each Bondholder, by virtue of becoming a Bondholder of any Bond, shall be deemed to have so agreed and undertaken with and to the Issuer and all depositors and other unsubordinated creditors of the Issuer for good consideration.

4 INTEREST

4.1 Interest Payments

The Bonds bear interest on their outstanding principal amount (subject to adjustments following the occurrence of a Non-Viability Event in accordance with Condition 5 (*Non-Viability Loss Absorption*)) from, and including, 8 July 2021 (the "**Issue Date**") at the applicable Interest Rate, payable semi-annually in arrear on 8 January and 8 July in each year in equal instalments (each a "**Interest Payment Date**"), provided that and in respect of the first Interest Payment Date on 8 January 2022 and each Interest Payment Date thereafter up to the First Call Date, the Interest payable shall be equal to U.S.$11.52 per Calculation Amount.

Unless otherwise provided in these Conditions, each Bond will cease to confer the right to receive any interest from the due date for redemption unless, upon surrender of the Certificate representing such Bond, payment of principal is improperly withheld or refused. In such event, interest shall continue to accrue at such rate (both before and after judgment) until whichever is the earlier of (a) the date on which all amounts due in respect of such Bond have been paid; and (b) seven days after the date on which the full amount of moneys payable in respect of such Bond has been received by the Fiscal Agent and notice to that effect has been given to the Bondholders in accordance with Condition 14 (*Notices*).

4.2 Interest Rate

The rate of interest (the "**Interest Rate**") applicable to the Bonds shall be:

(i) in respect of the period from, and including, the Issue Date to, but excluding, 8 July 2026 (the "**First Call Date**"), 2.304 per cent. per annum; and

(ii) in respect of the period from, and including, the First Call Date to, but excluding, 8 July 2031 (the "**Maturity Date**"), the Reset Interest Rate.

For the purposes of these Conditions:

"**Calculation Business Day**" means any day, excluding a Saturday and a Sunday, on which banks are open for general business (including dealings in foreign currencies) in New York City and Hong Kong.

"**Calculation Date**" means the third Calculation Business Day immediately preceding the First Call Date.

"**Comparable Treasury Issue**" means the U.S. Treasury security selected by the Calculation Agent as having a maturity of five years that would be utilised, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities with a maturity of five years.

"**Comparable Treasury Price**" means, with respect to any Calculation Date, the average of three Reference Treasury Dealer Quotations for such Calculation Date.

"**Reference Treasury Dealer**" means each of the three nationally recognised investment banking firms selected by the Issuer that are primary U.S. Government securities dealers.

"**Reference Treasury Dealer Quotations**" means with respect to each Reference Treasury Dealer and any Calculation Date, the average, as determined by the Calculation Agent, of the bid and asked prices for the Comparable Treasury Issue, expressed in each case as a percentage of its principal amount, quoted in writing to the Calculation Agent by such Reference Treasury Dealer at 5.00 p.m. (New York City time), on such Calculation Date.

"**Reset Interest Rate**" means a fixed rate per annum (expressed as a percentage) equal to the aggregate of (a) the then-prevailing U.S. Treasury Rate (as determined as set out below) and (b) the Spread.

"**Spread**" means 1.4 per cent. per annum.

"**U.S. Treasury Rate**" means the rate in percentage per annum as notified by the Calculation Agent to the Issuer and the Fiscal Agent equal to the yield on U.S. Treasury securities having a maturity of five years as set forth in H.15 under the caption "Treasury constant maturities", as displayed on Reuters page "FRBCMT" (or any successor page or service displaying yields on U.S. Treasury securities as agreed between the Issuer and the Calculation Agent), at 5.00 p.m. (New York time) on the Calculation Date.

If such page (or any successor page or service) does not display the relevant yield at 5.00 p.m. (New York time) on the Calculation Date, "**U.S. Treasury Rate**" shall mean the rate in percentage per annum equal to the semi-annual equivalent yield to maturity of the Comparable Treasury Issue, calculated using a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for the Calculation Date.

If there is no Comparable Treasury Price on the Calculation Date for whatever reason, "**U.S. Treasury Rate**" means the rate in per cent. per annum as notified by the Calculation Agent to the Issuer and the Fiscal Agent equal to the yield on U.S. Treasury securities having a maturity of five years as set forth in H.15 under the caption "Treasury constant maturities", as was displayed on Reuters page "FRBCMT" (or any successor page or service displaying yields on

U.S. Treasury securities as agreed between the Issuer and the Calculation Agent), at 5.00 p.m. (New York time) on the last available date preceding the Calculation Date on which such rate was displayed on Reuters page "FRBCMT" (or any successor page or service displaying yields on U.S. Treasury securities as agreed between the Issuer and the Calculation Agent).

4.3 Calculation of Interest and Reset Interest Rate

The Calculation Agent will calculate the amount of interest in respect of any period by applying the applicable Interest Rate to the Calculation Amount. If interest is required to be paid in respect of a Bond on any date other than the Interest Payment Date, it shall be calculated by applying the applicable Interest Rate to the Calculation Amount, multiplying the product by the relevant Day Count Fraction, rounding the resulting figure to the nearest cent (half a cent being rounded upwards) and multiplying such rounded figure by a fraction equal to the principal amount of such Bond divided by the Calculation Amount, where "**Calculation Amount**" means U.S.$1,000, subject to adjustments following occurrence of a Non-Viability Event, and "**Day Count Fraction**" means, in respect of any period, the number of days in the relevant period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with twelve 30-day months).

The Calculation Agent will, on the Calculation Date, calculate the Reset Interest Rate payable in respect of each Bond. The Calculation Agent will cause the Interest Rate and the Reset Interest Rate determined by it to be promptly notified to the Issuer, the Fiscal Agent and the Registrar.

All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of Condition 4.1 (*Interest Payments*) by the Calculation Agent will (in the absence of manifest error) be binding on the Issuer, the Fiscal Agent and the Bondholders and (subject as aforesaid) no liability to any such person will attach to the Calculation Agent in connection with the exercise or non-exercise by it of its powers, duties and discretions for such purposes.

4.4 Publication of Reset Interest Rate

The Issuer shall cause notice of the then applicable Reset Interest Rate to be notified to the Bondholders as soon as practicable in accordance with Condition 14 (*Notices*) after determination thereof.

4.5 Determination or Calculation by Successor Calculation Agent

If the Calculation Agent does not at any time for any reason so determine the Reset Interest Rate, the Issuer shall as soon as practicable appoint a reputable financial institution of good standing as a successor calculation agent to do so and such determination or calculation shall be deemed to have been made by the Calculation Agent. In doing so, the successor calculation agent shall apply the foregoing provisions of this Condition 4.1 (*Interest Payments*), with any necessary consequential amendments, to the extent that, in the opinion of the successor calculation agent, it can do so and, in all other respects it shall do so in such manner as it shall deem fair and reasonable in all the circumstances.

5 NON-VIABILITY LOSS ABSORPTION

The ability to operationally effect any Write-off of any Bonds under this Condition 5 (Non-Viability Loss Absorption) with respect to the clearing and/or settlement of any Bonds in or through the relevant clearing system(s) is subject to the availability of procedures to effect any such Write-off in such clearing system(s). However, any Write-off of any Bonds with respect to the Issuer under this Condition 5 (Non-Viability Loss Absorption) will be effective upon the date that the Issuer specifies in the Non-Viability Event Notice notwithstanding any inability to operationally effect any such Write-off in the relevant clearing system(s).

If a Non-Viability Event occurs and is continuing, the Issuer shall, on or prior to the provision of a Non-Viability Event Notice, irrevocably (without the need for the consent of the Bondholders) reduce the then outstanding principal amount of, and cancel any accrued but unpaid interest in respect of, each Bond (in each case in whole or in part) by an amount equal to the Non-Viability Event Write-off Amount per Bond (such reduction and cancellation, and the reduction and cancellation or conversion of any other Subordinated Capital Securities so reduced and cancelled or converted upon the occurrence of a Non-Viability Event, where applicable, being referred to herein as the "**Write-off**", and "**Written-off**" shall be construed accordingly).

Concurrently with the giving of the Non-Viability Event Notice, the Issuer shall procure (unless otherwise directed by the Monetary Authority) that a similar notice be given in respect of other Subordinated Capital Securities in accordance with their terms.

For the avoidance of doubt, any Write-off pursuant to this provision will not constitute an Event of Default under the Bonds.

Any Bond may be subject to one or more Write-offs in part (as the case may be), except where such Bond has been Written-off in its entirety.

Any references in these Conditions to principal in respect of the Bonds shall thereafter refer to the outstanding principal amount of the Bonds reduced by any applicable Write-off(s). In the case of a partial Write-off, a new Certificate shall be issued thereafter to each Bondholder in respect of the balance of the holding of Bonds not Written-off.

Once the outstanding principal amount of, and any accrued but unpaid interest under, the Bonds has been Written-off, the relevant amount(s) Written-off will not be restored in any circumstances including where the relevant Non-Viability Event ceases to continue. No Bondholder may exercise, claim or plead any right to any amount that has been Written-off, and each Bondholder shall, by virtue of his holding of any Bonds, be deemed to have waived all such rights to such amount that has been Written-off.

For the purposes of these Conditions:

"**Hong Kong Business Day**" means a day (other than a Saturday or Sunday) on which commercial banks and foreign exchange markets are open for general business in Hong Kong.

"**Loss Absorption Effective Date**" means the date that will be specified as such in the applicable Non-Viability Event Notice as directed or approved by the Monetary Authority.

"**Non-Viability Event**" means the earlier of:

(a) the Monetary Authority notifying the Issuer in writing that the Monetary Authority is of the opinion that a Write-off or conversion is necessary, without which the Issuer would become non-viable; and

(b) the Monetary Authority notifying the Issuer in writing that a decision has been made by the government body, a government officer or other relevant regulatory body with the authority to make such a decision, that a public sector injection of capital or equivalent support is necessary, without which the Issuer would become non-viable.

"**Non-Viability Event Notice**" means the notice which shall be given by the Issuer not more than two Hong Kong Business Days after the occurrence of a Non-Viability Event, to the Bondholders in accordance with Condition 14 (*Notices*), and to the Fiscal Agent in writing and which shall state:

(a) in reasonable detail the nature of the relevant Non-Viability Event; and

(b) the Non-Viability Event Write-off Amount for (i) each Bond; (ii) each other Subordinated Capital Securities on the Loss Absorption Effective Date in accordance with its terms and (iii) specifying the Loss Absorption Effective Date.

*Following the receipt of a Non-Viability Event Notice by Euroclear and/or Clearstream and the commencement of the Suspension Period, Euroclear and/or Clearstream shall suspend all clearance and settlement of the Bonds. As a result, Bondholders will not be able to settle the transfer of any Bonds from the commencement of the Suspension Period, and any sale or other transfer of the Bonds that a Bondholder may have initiated prior to the commencement of the Suspension Period that is scheduled to settle during the Suspension Period will be rejected by Euroclear and/or Clearstream and will not be settled within Euroclear and/or Clearstream. See "Investment Considerations — Considerations Relating to the Bonds — Transfers scheduled to settle through Euroclear and Clearstream (the "**ICSDs**") are expected to be rejected if the scheduled settlement is after any suspension by the ICSDs of clearance and settlement of the Bonds in connection with a Non-Viability Event Notice or the exercise of the Hong Kong Resolution Authority Power. Furthermore, because of time zone differences and the delay between the time when a Non-Viability Event occurs or the Hong Kong Resolution Authority Power is exercised and when the ICSDs receive and process the Non-Viability Event Notice or the notice that the Hong Kong Resolution Authority Power has been exercised, it is possible that transfers may either (i) fail to settle through the ICSDs even though such transfers were initiated prior to the Non-Viability Event or the relevant cut-off time specified in any instrument evidencing the exercise of the Hong Kong Resolution Authority Power (the "**Hong Kong Resolution Authority Power Instrument**") or (ii) are settled through the ICSDs even though such transfers were initiated after the Non-Viability Event or the relevant cut-off time specified in the Hong Kong Resolution Authority Power Instrument".*

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

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

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

Further, the Non-Viability Event Write-off Amount in respect of each Bond will be calculated based on a percentage of the outstanding principal amount of that Bond.

"**Subordinated Capital Securities**" means any Junior Obligation or Parity Obligation which contains provisions relating to a write-down or conversion into ordinary shares in respect of its outstanding principal amount on the occurrence, or as a result, of a Non-Viability Event and in respect of which the conditions (if any) to the operation of such provisions are (or with the giving of any certificate or notice which is capable of being given by the Issuer, would be) satisfied.

6 HONG KONG RESOLUTION AUTHORITY POWER

Notwithstanding any other term of the Bonds, including without limitation Condition 5 (*Non-Viability Loss Absorption*), or any other agreement or arrangement, each Bondholder shall be subject, and shall be deemed to agree, be bound by and acknowledge that they are each subject, to having the Bonds held by such Bondholder being written off, cancelled, converted or modified, or to having the form of the Bonds changed, in the exercise of any Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority without prior notice and which may include (without limitation) and result in any of the following or some combination thereof:

(a) the reduction or cancellation of all or a part of the outstanding principal amount of, or interest on, the Bonds;

(b) the conversion of all or a part of the outstanding principal amount of, or interest on, the Bonds into shares or other securities or other obligations of the Issuer or another person (and the issue to or conferral on the holder of such shares, securities or obligations), including by means of an amendment, modification or variation of the terms of the Bonds; and

(c) the amendment or alteration of the maturity of the Bonds or amendment or alteration of the amount of interest payable on the Bonds, or the date on which the interest becomes payable, including by suspending payment for a temporary period, or any other amendment or alteration of these Conditions.

With respect to (a), (b) and (c) above of this Condition 6 (*Hong Kong Resolution Authority Power*), references to principal and interest shall include payments of principal and interest that have become due and payable (including principal that has become due and payable at the redemption date), but which have not been paid, prior to the exercise of any Hong Kong Resolution Authority Power. The rights of the Bondholders under the Bonds and these Conditions are subject to, and will be amended and varied, if necessary, solely to give effect to, the exercise of any Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority.

No repayment of the outstanding principal amount of the Bonds or payment of interest on the Bonds shall become due and payable or be paid after the exercise of any Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority unless, at the time that such repayment or payment, respectively, is scheduled to become due, such repayment or payment would be permitted to be made by the Issuer under the laws and regulations applicable to the Issuer and the Group.

Upon the exercise of any Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority with respect to the Bonds, the Issuer shall provide a written notice not more than two Hong Kong Business Days after the occurrence of such exercise regarding such exercise of the Hong Kong Resolution Authority Power to the Bondholders in accordance with Condition 14 (*Notices*).

Neither the reduction or cancellation, in part or in full, of the outstanding principal amount of, or interest on the Bonds, the conversion thereof into another share, security or other obligation of the Issuer or another person, or any other amendment or alteration of these Conditions as a result of the exercise of any Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority with respect to the Issuer nor the exercise of the Hong Kong Resolution Authority Power by the relevant Hong Kong Resolution Authority with respect to the Bonds shall constitute an Event of Default under Condition 11.1 (*Events of Default and Winding-up Proceedings*).

*The Financial Institutions (Resolution) Ordinance (Cap. 628) of Hong Kong as amended or superseded from time to time (the "**Financial Institutions (Resolution) Ordinance**") was passed by the Legislative Council of Hong Kong and published in the gazette of the Hong Kong Special Administrative Region Government (the "**HKSAR Government**") in June 2016. The Financial Institutions (Resolution) Ordinance became effective on 7 July 2017 and all licensed banks in Hong Kong are subject to the Financial Institutions (Resolution) Ordinance.*

For the purposes of these Conditions:

"**Hong Kong Resolution Authority Power**" means any power which may exist from time to time under the Financial Institutions (Resolution) Ordinance relating to financial institutions, including licensed banks, deposit-taking companies, restricted licence banks, banking group companies, insurance companies and/or investment firms incorporated in or authorised, designated, recognised or licensed to conduct regulated financial activities in Hong Kong in effect and applicable in Hong Kong to the Issuer or other members of the Group (including, for the avoidance of doubt, powers under Part 4 and Part 5 of the Financial Institutions (Resolution) Ordinance) or any other laws, regulations, rules or requirements relating thereto, as the same may be amended from time to time (whether pursuant to the Financial Institutions (Resolution) Ordinance or otherwise), and pursuant to which obligations of a licensed bank, deposit-taking company, restricted licence bank, banking group company, insurance company or investment firm or any of its affiliates can be reduced, cancelled, transferred, modified and/or converted into shares or other securities or obligations of the obligor or any other person.

"**relevant Hong Kong Resolution Authority**" means any authority with the ability to exercise a Hong Kong Resolution Authority Power in relation to the Issuer from time to time.

Please see the investment consideration relating to the Bonds entitled "The resolution regime in Hong Kong may override the contractual terms of the Bonds" for further information.

7 PAYMENTS

7.1 Payments in Respect of the Bonds

(i) Payments of principal in respect of Bonds shall be made in United States dollars against presentation and surrender of the relevant Certificates at the specified office of the Transfer Agent or of the Registrar and in the like manner provided in Condition 7.1(ii) (*Payments in Respect of the Bonds*) in respect of payments of interest.

(ii) Interest shall be paid to the person shown on the Register at the close of business on the fifteenth day before the due date for payment thereof (the "**Record Date**"). Payments of interest in respect of each Bond shall be made in United States dollars by wire transfer in immediately available funds to the holder (or to the first named of joint holders) of such Bond at its address appearing in the Register. Upon application by the holder to the specified office of the Registrar or the Transfer Agent before the Record Date, such payment of interest may be made by transfer to an account in United States dollars maintained by the payee with a bank in New York City.

(iii) Bondholders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due on a Bond if the due date is not a Payment Business Day or if the Bondholder is late in surrendering or cannot surrender its Certificate (if required to do so).

7.2 Payments subject to Fiscal Laws

Payments will be subject in all cases, to (i) any fiscal or other laws and regulations applicable thereto, but without prejudice to the provisions of Condition 9 (*Taxation*), in the place of payment, and (ii) any withholding or deduction required pursuant to an agreement described in Section 1471(b) of the U.S. Internal Revenue Code of 1986 (the "**Internal Revenue Code**") or otherwise imposed pursuant to Sections 1471 through 1474 of the Internal Revenue Code, any regulations or agreements thereunder, any official interpretations thereof, or (without prejudice to the provisions of Condition 9 (*Taxation*)) any law implementing an intergovernmental approach thereto.

7.3 Non-Payment Business Days

If any date for payment in respect of any Bond is not a Payment Business Day, the holder shall not be entitled to payment until the next following Payment Business Day nor to any interest or other sum in respect of such postponed payment. In this Condition 7 (*Payments*), "**Payment Business Day**" means a day (other than a Saturday, a Sunday or a public holiday) on which banks and foreign exchange markets are open for business in the relevant place of presentation (if presentation and/or surrender of such Bond is required) in London, New York City and Hong Kong, and where payment is to be made by transfer to an account maintained with a bank in U.S. dollars, on which foreign exchange transactions may be carried on in U.S. dollars in London, New York City and Hong Kong.

8 REDEMPTION AND PURCHASE

8.1 Redemption at Maturity

Unless previously redeemed or purchased and cancelled as provided below, the Issuer will redeem the Bonds at their outstanding principal amount together with interest accrued to (but excluding) the Maturity Date, subject to adjustments following the occurrence of a Non-Viability Event in accordance with Condition 5 (*Non-Viability Loss Absorption*). The Bonds may not be redeemed at the option of the Issuer other than in accordance with this Condition 8 (*Redemption and Purchase*).

8.2 Redemption for Tax Reasons

Subject to Condition 8.5 (*Conditions for Redemption and Purchase in respect of the Bonds*), the Bonds then outstanding may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days' notice to the Fiscal Agent and in accordance with Condition 14 (*Notices*), the Bondholders (which notice shall be irrevocable), if:

(i) on the occasion of the next payment due under the Bonds, the Issuer has or will become obliged to pay additional amounts as provided or referred to in the Conditions as a result of any change in, or amendment to, the laws or regulations of Hong Kong or any political subdivision or any authority thereof or therein having power to tax, or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after 29 June 2021; and

(ii) such obligation will apply on the occasion of the next payment due in respect of the Bonds and cannot be avoided by the Issuer taking reasonable measures available to it;

provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would be obliged to pay such additional amounts or give effect to such treatment, as the case may be, were a payment in respect of the Bonds then due.

Prior to giving any such notice of redemption, the Issuer shall deliver to the Fiscal Agent (i) a certificate signed by one Director of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer to redeem have occurred, and an opinion of independent legal or tax advisers of recognised standing to the effect that the Issuer has or will become obliged to pay such additional amounts as a result of such change or amendment and (ii) a copy of the written consent of the Monetary Authority; and the Fiscal Agent shall be entitled to accept the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on the Bondholders.

Bonds so redeemed will be redeemed at their outstanding principal amount together with interest accrued to (but excluding) the date of redemption, subject to adjustments following the occurrence of a Non-Viability Event in accordance with Condition 5 (*Non-Viability Loss Absorption*).

8.3 Redemption of the Bonds for Regulatory Reasons

Subject to Condition 8.5 (C*onditions for Redemption and Purchase in respect of the Bonds*), the Bonds may be redeemed at the option of the Issuer in whole, but not in part, at any time on giving not less than 30 nor more than 60 days' notice to the Fiscal Agent and in accordance with Condition 14 (*Notices*), the Bondholders (which notice shall be irrevocable following the occurrence of a Capital Event). For the purposes of these Conditions, "**Capital Event**" occurs if the Bonds, after having qualified as such, will no longer qualify (in whole or in part) as Tier 2 capital (or equivalent) of the Issuer as a result of any changes or amendments in (or any change in the application or official interpretation of) the relevant provisions of the Banking Ordinance (Cap. 155) of Hong Kong, the Banking (Capital) Rules (Cap. 155L) of Hong Kong or any successor legislation or regulations made thereunder, or any supervisory guidance issued by the Monetary Authority in relation thereto, in each case, as amended or modified from time to time (other than as a result of any discounting or amortisation requirements as to the eligibility of the Bonds for such inclusion pursuant to the relevant legislation and relevant guidelines in force from time to time), provided, however, that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which it is determined that a Capital Event will take effect.

Prior to giving any such notice of redemption pursuant to this Condition 8.3 (*Redemption of the Bonds for Regulatory Reasons*), the Issuer shall deliver to the Fiscal Agent (i) a certificate signed by one Director of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer to redeem have occurred, (ii) an opinion of independent legal or auditors of recognised standing to the effect that a Capital Event has or occurred or will occur and (iii) a copy of the written consent of the Monetary Authority as referred to in Condition 8.5 (*Conditions for Redemption and Purchase in respect of the Bonds*); and the Fiscal Agent shall be entitled to accept the certificate and consent as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on the Bondholders.

Bonds so redeemed will be redeemed at their outstanding principal amount together with interest accrued to (but excluding) the date of redemption, subject to adjustments following the occurrence of a Non-Viability Event in accordance with Condition 5 (*Non-Viability Loss Absorption*).

8.4 Redemption at the option of the Issuer (Issuer Call)

Subject to Condition 8.5 (*Conditions for Redemption and Purchase in respect of the Bonds*), the Issuer may, having given:

(a) not less than 15 nor more than 30 days' notice to the Bondholders in accordance with Condition 14 (*Notices*); and

(b) not less than 15 days before the giving of the notice referred to in (a) above, notice to the Fiscal Agent and the Registrar;

(which notices shall be irrevocable and shall specify the date fixed for redemption), redeem the Bonds then outstanding in whole, but not in part, on the First Call Date, at their outstanding principal amount together with interest accrued to (but excluding) the date of redemption, subject to adjustments following the occurrence of a Non-Viability Event in accordance with Condition 5 (*Non-Viability Loss Absorption*).

For the avoidance of doubt, the Issuer does not provide any undertaking that it will call the Bonds at any time.

8.5 Conditions for Redemption and Purchase in respect of the Bonds

Notwithstanding any other provision in these Conditions, the Issuer shall not redeem any of the Bonds (other than pursuant to Condition 11.1 (*Events of Default and Winding-up Proceedings*)), and neither the Issuer nor any affiliates of the Issuer over which the Issuer exercises control or significant influence shall purchase any of the Bonds, unless the prior written consent of the Monetary Authority thereto shall have been obtained, to the extent such consent is required under the Banking Ordinance (Cap. 155) of Hong Kong, the Banking (Capital) Rules (Cap. 155L) of Hong Kong or any successor legislation or regulations made thereunder, or any supervisory guidance issued by the Monetary Authority in relation thereto.

8.6 Purchase and Cancellation

Any Bonds so purchased in accordance with Condition 8.5 (*Conditions for Redemption and Purchase in respect of the Bonds*) (which may be in the open market or otherwise and at any price), while held by or on behalf of the Issuer or any affiliates of the Issuer over which the Issuer exercises control or significant influence, shall not entitle the holder to vote at any meetings of the Capital Bondholders and shall not be deemed to be outstanding for, among other things, the purposes of calculating quorums at meetings of the Bondholders or for the purposes of Condition 11.1 (*Events of Default and Winding-up Proceedings*).

All Certificates representing Bondholders purchased by or on behalf of the Issuer shall be surrendered for cancellation to the Transfer Agent or Registrar and upon surrender thereof, all such Bonds shall be cancelled forthwith. Any Certificates so surrendered for cancellation may not be reissued or resold and the obligations of the Issuer in respect of any such Bonds shall be discharged.

For the avoidance of doubt, this provision shall not apply to the Issuer or any affiliates of the Issuer over which the Issuer exercises control or significant influence holding the Bonds in a purely nominee capacity.

9 TAXATION

All payments of principal and interest in respect of the Bonds by or on behalf of the Issuer shall be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature ("**Taxes**") imposed or levied by or on behalf of Hong Kong or any political subdivision or any authority thereof or therein having power to tax, unless the withholding or deduction of the Taxes is required by law. In that event, the Issuer will pay such additional amounts ("**Additional Tax Amounts**") as shall be necessary in order that the net amounts received by the holders of the Bonds after such withholding or deduction shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of the Bonds in the absence of the withholding or deduction; except that no such Additional Tax Amounts shall be payable with respect to any Bond:

(a) presented for payment by or on behalf of, a holder who is liable to the Taxes in respect of such Bond by reason of his having some connection with Hong Kong other than the mere holding of such Bond; or

(b) presented for payment more than 30 days after the Relevant Date except to the extent that a holder would have been entitled to such Additional Tax Amounts on presenting the same for payment on the last day of the period of 30 days.

As used in these Conditions, "**Relevant Date**" means the date on which the payment first becomes due but, if the full amount of the money payable has not been received by the Fiscal Agent or the Registrar, as the case may be, on or before the due date, it means the date on which, the full amount of the money having been so received, notice to that effect is duly given to the Bondholders by the Issuer in accordance with Condition 14 (*Notices*).

10 PRESCRIPTION

Claims against the Issuer for payment in respect of the Bonds will become void unless made within a period of 10 years (in the case of principal) and five years (in the case of interest) after the Relevant Date (as defined in Condition 9 (*Taxation*)) therefor.

11 EVENTS OF DEFAULT AND ENFORCEMENT

11.1 Events of Default and Winding-up Proceedings

If default is made in the payment of any amount of principal in respect of the Bonds within seven days after the due date for payment thereof or of any amount of interest in respect of the Bonds within 14 days after the due date for payment thereof (each, an "**Event of Default**") then in order to enforce the obligations of the Issuer, any holder of a Bonds may institute a Winding-Up Proceeding against the Issuer. For the avoidance of doubt, any Write-off pursuant to Condition 5 (*Non-Viability Loss Absorption*) will not constitute an Event of Default under the Bonds.

If an order is made or an effective resolution is passed for the Winding-Up of the Issuer (whether or not an Event of Default has occurred and is continuing) then any holder of a Bond may, by written notice to the Issuer at the specified office of the Fiscal Agent, effective upon the date of receipt there by the Fiscal Agent, declare any Bond held by it to be forthwith due and payable whereupon the same shall become forthwith due and payable at its outstanding principal amount together with interest accrued to (but excluding) the date of repayment, subject to adjustments following the occurrence of a Non-Viability Event in accordance with Condition 5 (*Non-Viability Loss Absorption*), without further action or formality.

In these Conditions:

"**Winding-Up Proceedings**" shall mean, with respect to the Issuer, proceedings in Hong Kong in respect of the Issuer for the bankruptcy, insolvency, liquidation, winding-up or similar proceedings in respect of the Issuer.

11.2 Enforcement

Subject to applicable laws, no remedy (including the exercise of any right of set-off or analogous event) other than those provided for in Condition 11.1 (*Events of Default and Winding-up Proceedings*) above will be available to the Bondholders, provided that any Bondholder may without further notice to the Issuer institute such proceedings against the Issuer as it may think fit to enforce any term or condition binding on the Issuer under the Bonds (including any payment obligation due under or arising from the Bonds, including, without limitation, payment of any principal or interest in respect of the Bonds and any damages awarded for breach of any obligations but excluding any right to declare the Bonds immediately due and payable prior to the Winding-Up of the Issuer) and in no event shall the Issuer be obliged to pay any sum or sums, in cash or otherwise, sooner than the same would otherwise have been payable by it.

12 REPLACEMENT OF BONDS

Should any Certificate be lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Registrar or the Transfer Agent upon payment by the claimant of such costs and expenses as may be incurred in connection therewith and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

13 AGENTS

The Fiscal Agent, the Paying Agent, the Registrar, the Transfer Agent and the Calculation Agent and any Calculation Agent appointed from time to time in respect of any Bonds (save in the case of the Issuer) act solely as agents of the Issuer and do not assume any obligation or relationship of agency or trust for or with any Bondholder. The Issuer reserves the right at any time to vary or terminate the appointment of the Paying Agent, any other Paying Agent, any Registrar, any Transfer Agent or any Calculation Agent and to appoint additional or other Paying Agents or Transfer Agents, in each case, provided that the Issuer shall at all times maintain (i) a Fiscal Agent, (ii) a Registrar, (iii) a Transfer Agent, and (iv) a Calculation Agent.

Notice of any such change or any change of any specified office shall promptly be given by the Issuer to the Bondholders in accordance with Condition 14 (*Notices*).

14 NOTICES

Notices to the holders of the Bonds shall be mailed to them at their respective addresses in the Register and deemed to have been given on the fourth weekday (being a day other than a Saturday or a Sunday) after the date of mailing and, so long as the Bonds are listed on a stock exchange or admitted to trading by another relevant authority and the rules of that exchange or a relevant authority so require, published in a daily newspaper having general circulation in the place or places required by those rules. If any such publication is not practicable, notice shall be validly given if published in another leading daily English language newspaper with general circulation in Asia. Any such notice shall be deemed to have been given on the date of such publication or, if published more than once or on different dates, on the first date on which publication is made, as provided above.

So long as the Bonds are represented by a Global Certificate and such Global Certificate is held on behalf of Euroclear or Clearstream or any other clearing system, notices to the holders of the Bonds may be given by delivery of the relevant notice to that clearing system for communication by it to entitled accountholders in substitution for publication as required by the Conditions.

15 MEETINGS OF BONDHOLDERS AND MODIFICATIONS

15.1 Meetings of Bondholders

The Fiscal Agency Agreement contains provisions for convening meetings of Bondholders to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution (as defined in the Fiscal Agency Agreement) of a modification of any of these Conditions. Such a meeting may be convened by Bondholders holding not less than 10 per cent. in nominal amount of the Bonds for the time being outstanding. The quorum for any meeting convened to consider an Extraordinary Resolution shall be one or more persons holding or representing not less than 50 per cent. in nominal amount of the Bonds for the time being outstanding, or at any adjourned meeting one or more persons being or representing Bondholders whatever the nominal amount of the Bonds held or represented, unless the business of such meeting includes consideration of proposals, inter alia, (i) to change any date scheduled for payment of principal or interest in respect of the Bonds, to reduce or cancel the amount of principal or interest payable on any date in respect of the Bonds, or to alter the method of calculating the amount of any payment in respect of the Bonds on redemption or the date for any such payment, (ii) to effect the exchange, conversion or substitution of the Bonds for, or the conversion of the Bonds into, shares, bonds or other obligations or securities of the Issuer or any other person or body corporate formed or to be formed, (iii) to change the currency of payments under the Bonds, (iv) to amend any provision of Condition 3 (*Status and Subordination of the Bonds*), Condition 5 (*Non-Viability Loss Absorption*) or Condition 6 (*Hong Kong Resolution Authority Power*) or (v) to modify the provisions concerning the quorum required at any meeting of Bondholders or the majority required to pass the Extraordinary Resolution, in which case the necessary quorum shall be one or more persons holding or representing not less than 75 per cent., or at any adjourned meeting not less than 25 per cent., in nominal amount of the Bonds for the time being outstanding. Any Extraordinary Resolution duly passed shall be binding on all Bondholders (whether or not they were present at the meeting at which such resolution was passed).

15.2 Modifications and Waivers

The Issuer may agree, without the consent of the Bondholders, to any modification of any of these Conditions or any of the provisions of the Fiscal Agency Agreement for the purpose of curing any ambiguity or of curing, correcting or supplementing any manifest or proven error or any other defective provision contained herein or therein or, in the case of the Fiscal Agency Agreement only, in any other manner which is not materially prejudicial to the interests of the Bondholders. Any determination with regards to material prejudice to the interests of the Bondholders shall be made by the Issuer and none of the Agents shall have any responsibility or liability whatsoever with respect to such determinations. Any modification shall be binding on the Bondholders and shall be notified by the Issuer to the Bondholders as soon as practicable thereafter in accordance with Condition 14 (*Notices*).

16 CURRENCY INDEMNITY

U.S. dollars is the sole currency of account and payment for all sums payable by the Issuer under or in connection with the Bonds, including damages. Any amount received or recovered in a currency other than U.S. dollars (whether as a result of, or of the enforcement of, a judgment or order of a court of any jurisdiction, in the insolvency, winding-up or dissolution of the Issuer or otherwise) by any Bondholder in respect of any sum expressed to be due to it from the Issuer shall only constitute a discharge to the Issuer to the extent of the U.S. dollar amount which the recipient is able to purchase with the amount so received or recovered in that other currency on the date of that receipt or recovery (or, if it is not practicable to make that purchase on that date, on the first date on which it is practicable to do so). If that U.S. dollar amount is less than the U.S. dollar amount expressed to be due to the recipient under any Bond, the Issuer shall indemnify it against any loss sustained by it as a result. In any event, the Issuer shall indemnify the recipient against the cost of making any such purchase. For the purposes of this Condition 16 (*Currency Indemnity*), it will be sufficient for the Bondholder to demonstrate that it would have suffered a loss had an actual purchase been made. These indemnities constitute a separate and independent obligation from the Issuer's other obligations, shall give rise to a separate and independent cause of action, shall apply irrespective of any indulgence granted by any Bondholder and shall continue in full force and effect despite any other judgment, order, claim or proof for a liquidated amount in respect of any sum due under any Bond or any other judgment or order.

17 CONTRACTS (RIGHTS OF THIRD PARTIES) ACTS 1999

No person shall have any right to enforce any term or condition of the Bonds under the Contracts (Rights of Third Parties) Act 1999.

18 GOVERNING LAW

18.1 Governing law

The Fiscal Agency Agreement, the Bonds and any non-contractual obligations arising out of or in connection with the Bonds are governed by, and shall be construed in accordance with, English law, except that the subordination provisions set out in Condition 3.2 (*Subordination*) shall be governed by, and construed in accordance with, the laws of Hong Kong.

18.2 Jurisdiction

The courts of England are to have jurisdiction to settle any disputes that may arise out of or in connection with the Bonds and accordingly any legal action or proceedings arising out of or in connection with any Bonds ("**Proceedings**") may be brought in such courts. The Issuer irrevocably submits to the jurisdiction of such courts and waives any objection to Proceedings in any such courts whether on the ground of venue or on the ground that the Proceedings have been brought in an inconvenient forum. This submission is made for the benefit of each of the Bondholders and shall not limit the right of any of them to take Proceedings in any other court of competent jurisdiction nor shall the taking of Proceedings in one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction (whether concurrently or not).

18.3 Appointment of Process Agent

The Issuer has irrevocably appointed Hackwood Secretaries Limited at its registered office for the time being in England, currently at One Silk Street, London EC2Y, 8HQ, United Kingdom as its agent for service of process in any proceedings before the English courts in relation to any Dispute, and agrees that, in the event of such agent being unable or unwilling for any reason so to act, it will forthwith appoint another person as its agent for service of process in England in respect of any Dispute and will notify the Bondholders in accordance with Condition 14 (*Notices*) of such appointment. Nothing herein shall affect the right to serve process in any other manner permitted by law.

SUMMARY OF PROVISIONS RELATING TO THE BONDS IN GLOBAL FORM

The Global Certificate contains the following provisions which apply to the Bonds whilst they are represented by the Global Certificate, some of which modify the effect of the Conditions. Terms defined in the Conditions have the same meaning as set out in paragraphs 1 to 11 below.

1 Accountholders

For so long as all of the Bonds are represented by the Global Certificate and the Global Certificate is held on behalf of a clearing system, each person (other than another clearing system) who is for the time being shown in the records of Euroclear or Clearstream (as the case may be) as the holder of a particular aggregate principal amount of such Bonds (each an "**Accountholder**") (in which regard any certificate or other document issued by Euroclear or Clearstream (as the case may be) as to the aggregate principal amount of such Bonds standing to the account of any person shall, in the absence of manifest error, be conclusive and binding for all purposes) shall be treated as the holder of such aggregate principal amount of such Bonds (and the expression "**Bondholders**" and references to "holding of Bonds" and to "holder of Bonds" shall be construed accordingly) for all purposes other than with respect to payments on such Bonds, the right to which shall be vested, as against the Issuer, solely in the nominee for the relevant clearing system (the "**Relevant Nominee**") in accordance with and subject to the terms of the Global Certificate. Each Accountholder must look solely to Euroclear or Clearstream, as the case may be, for its share of each payment made to the Relevant Nominee.

2 Cancellation

Cancellation of any Bond following its redemption or purchase by the Issuer will be effected by reduction in the aggregate principal amount of the Bonds in the register of Bondholders and by the annotation of the appropriate schedule to the Global Certificate.

3 Payments

Payments of principal and interest in respect of Bonds represented by the Global Certificate will be made upon presentation or, if no further payment falls to be made in respect of the Bonds, against presentation and surrender of the Global Certificate to or to the order of the Registrar or such other Agent as shall have been notified to the holder of the Global Certificate for such purpose. Interests of amounts with respect to book-entry interests in the Bonds held through Euroclear or Clearstream will be credited, to the extent received by the Issuing and Paying Agent, to the cash accounts of Euroclear or Clearstream participants in accordance with the relevant system's rules and procedures.

A record of each payment made will be endorsed on the appropriate schedule to the Global Certificate by or on behalf of the Registrar and shall be prima facie evidence that payment has been made.

4 Payment Record Date

Each payment in respect of the Global Certificate will be made to the person shown as the Bondholder in the register of Bondholders at the close of business (in the relevant clearing system) on the Clearing System Business Day before the due date for such payment (the "**Record Date**") where "**Clearing System Business Day**" means a weekday (Monday to Friday, inclusive, except 25 December and 1 January).

5 Failure to Pay

If principal in respect of any Bonds is not paid when due and payable (but subject as provided below), the relevant Accountholders of the Global Certificate may from time to time elect that Direct Rights under the provisions of Global Certificate shall come into effect. Such election shall be made by notice to the Fiscal Agent and presentation of this Global Certificate to or to the order of the Fiscal Agent for reduction of the principal amount of Bonds represented by the Global Certificate by such figure as shall be specified in the notice and endorsement in the schedule of such principal amount of Bonds formerly represented as the principal amount of Bonds in respect of which Direct Rights have arisen under Global Certificate. Upon such notice being given the appropriate Direct Rights shall take effect.

No such election may however be made on or before an Exchange Date, being a day falling not less than 30 days after that on which the notice requiring exchange is given, fixed in accordance with the Global Certificate with respect to the Bonds to which that Exchange Date relates unless the holder elects in such notice that the exchange in question shall no longer take place.

6 Exchange

Owners of interests in the Bonds in respect of which the Global Certificate is issued will be entitled to have title to the Bonds registered in their names and to receive individual definitive Certificates if either Euroclear or Clearstream or any other clearing system (an "**Alternative Clearing System**") is closed for business for a continuous period of 14 days (other than by reason of holidays, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so or upon or following any failure to pay any amount in respect of the Bonds. In such circumstances, the Issuer will as soon as practicable cause sufficient individual definitive Certificates to be executed and delivered to the Registrar (or its agents on its behalf) for completion, authentication and dispatch to the relevant Bondholders. A person with an interest in the Bonds in respect of which the Global Certificate is issued must provide the Registrar not less than 30 days' notice at its specified office of such holder's intention to effect such transfer.

7 Notices

Notwithstanding Condition 14 (*Notices*), so long as all the Bonds are represented by the Global Certificate and the Global Certificate is held on behalf of a clearing system, notices to Bondholders may be given by delivery of the relevant notice to that clearing system for communication by it to entitled Accountholders in substitution for notification as required by the Conditions. Any such notice shall be deemed to have been given to the Bondholders on the day after the day on which such notice is delivered to Euroclear, Clearstream, or such other clearing system, as the case may be. The Issuer shall also ensure that notices are duly given in a manner which complies with the rules and regulations of any stock exchange on which the Bonds are for the time being listed.

8 Meetings

For the purposes of any meeting of Bondholders, the holder of the Bonds represented by the Global Certificate shall (unless the Global Certificate represents only one Bond) be treated as two persons for the purposes of any quorum requirements of a meeting of Bondholders and as being entitled to one vote in respect of each U.S.$1,000 in principal amount of Bonds for which the Global Certificate is issued.

9 Issuer's Redemption

Subject to Condition 8.5 (*Conditions for Redemption and Purchase in respect of the Bonds*), the option of the Issuer provided for in Condition 8.2 (*Redemption for Tax Reasons*), Condition 8.3 (*Redemption of the Bonds for Regulatory Reasons*) and Condition 8.4 (*Redemption at the option of the Issuer*) shall be exercised by the Issuer giving notice to the Bondholders within the time limits set out in and containing the information required by the Conditions.

10 Transfers

Transfers of book-entry interests in the Bonds will be effected through the records of Euroclear and Clearstream and their respective participants in accordance with the rules and procedures of Euroclear and Clearstream and their respective direct and indirect participants.

11 Write-off

If a Write-off occurs at such time as the Bonds are represented by the Global Certificate, such Write-off will be reflected as a reduction in the aggregate principal amount of such Global Certificate and, unless the Issuer determines otherwise (acting in good faith and having regard to the rules and procedures of Euroclear or Clearstream or any Alternative Clearing System, as the case may be), the principal amount standing to the account of each Accountholder shall be correspondingly be reduced on a pro rata basis to the extent practicable. Any excess portion of the principal amount held thereafter by an Accountholder that is not wholly divisible into the then adjusted Calculation Amount shall, for the purposes of determining a Bondholder's rights in a Winding-Up, be disregarded.

TAXATION

The statements herein regarding taxation are based on the laws in force as at the date of this Offering Circular and are subject to any changes in law occurring after such date, which changes could be made on a retroactive basis. The following summary does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase, own or dispose of the Bonds and does not purport to deal with the tax consequences applicable to all categories of investors, some of which (such as dealers or certain professional investors) may be subject to special rules. Persons considering the purchase of the Bonds should consult their own tax advisers concerning the application of Hong Kong tax laws to their particular situations as well as any consequences of the purchase, ownership and disposition of the Bonds arising under the laws of any other tax jurisdiction.

Hong Kong

Withholding Tax

No withholding tax is payable in Hong Kong in respect of payments of principal or interest on the Bonds or in respect of any capital gains arising from the sale of the Bonds.

Profits Tax

Hong Kong profits tax is chargeable on every person carrying on a trade, profession or business in Hong Kong in respect of profits arising in or derived from Hong Kong from such trade, profession or business (excluding profits arising from the sale of capital assets).

Interest on the Bonds may be deemed to be profits arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong in the following circumstances:

(i) interest on the Bonds is derived from Hong Kong and is received by or accrues to a corporation carrying on a trade, profession or business in Hong Kong;

(ii) interest on the Bonds is derived from Hong Kong and is received by or accrues to a person, other than a corporation, carrying on a trade, profession or business in Hong Kong and is in respect of the funds of that trade, profession or business;

(iii) interest on the Bonds is received by or accrues to a financial institution (as defined in the Inland Revenue Ordinance (Cap. 112) of Hong Kong (the "**IRO**")) and arises through or from the carrying on by the financial institution of its business in Hong Kong; or

(iv) interest on the Bonds is received by or accrues to a corporation, other than a financial institution, and arises through or from the carrying on in Hong Kong by the corporation of its intra-group financing business (within the meaning of section 16(3) of the IRO).

Pursuant to the Exemption from Profits Tax (Interest Income) Order, interest income accruing to a person other than a financial institution, on deposits (denominated in any currency and whether or not the deposit is evidenced by a certificate of deposit) placed with, *inter alia*, an authorized institution in Hong Kong (within the meaning of section 2 of the Banking Ordinance (Cap. 155) of Hong Kong) is exempt from the payment of Hong Kong profits tax. This exemption does not apply, however, to deposits that are used to secure or guarantee money borrowed in certain circumstances. Provided no prospectus involving the issue of Bonds is registered under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) of Hong Kong, (the "**C(WUMP)O"**) the issue of the Bonds by the Issuer is expected to constitute a deposit to which the above exemption from payment will apply.

Sums received by or accrued to a financial institution by way of gains or profits arising through or from the carrying on by the financial institution of its business in Hong Kong from the sale, disposal and redemption of Bonds will be subject to Hong Kong profits tax. Sums received by or accrued to a corporation, other than a financial institution, by way of gains or profits arising through or from the carrying on in Hong Kong by the corporation of its intra-group financing business (within the meaning of section 16(3) of the IRO) from the sale, disposal or other redemption of Bonds will be subject to Hong Kong profits tax.

Sums derived from the sale, disposal or redemption of Bonds will be subject to Hong Kong profits tax where received by or accrued to a person, other than a financial institution, who carries on a trade, profession or business in Hong Kong and the sum has a Hong Kong source unless otherwise exempted. The source of such sums will generally be determined by having regard to the manner in which the Bonds are acquired and disposed of.

In certain circumstances, Hong Kong profits tax exemptions (such as concessionary tax rates) may be available. Investors are advised to consult their own tax advisors to ascertain the applicability of any exemptions to their individual position.

Stamp Duty

As the Bonds are treated as regulatory capital securities for the purpose of the Stamp Duty Ordinance (Cap. 117), no Hong Kong stamp duty will be chargeable upon the issue or transfer of the Bonds.

Foreign Account Tax Compliance Act

Pursuant to certain provisions of the U.S. Internal Revenue Code of 1986, commonly known as FATCA, a "foreign financial institution" (as defined by FATCA) may be required to withhold on certain payments it makes ("**foreign passthru payments**") to persons that fail to meet certain certification, reporting or related requirements. The Issuer is a foreign financial institution for these purposes. A number of jurisdictions (including Hong Kong) have entered into, or have agreed in substance to, intergovernmental agreements with the United States to implement FATCA ("**IGAs**"), which modify the way in which FATCA applies in their jurisdictions. Under the provisions of IGAs as currently in effect, a foreign financial institution in an IGA jurisdiction would generally not be required to withhold under FATCA or an IGA from payments that it makes. Certain aspects of the application of the FATCA provisions and IGAs to instruments such as the Bonds, including whether withholding would ever be required pursuant to FATCA or an IGA with respect to payments on instruments such as the Bonds, are uncertain and may be subject to change. Even if withholding would be required pursuant to FATCA or an IGA with respect to payments on instruments such as the Bonds, such withholding would not apply prior to the date that is two years after the date on which final regulations defining foreign passthru payments are published in the U.S. Federal Register and the Bonds characterised as debt (or which are not otherwise characterised as equity and have a fixed term) for U.S. federal tax purposes that are issued on or prior to the date that is six months after the date on which final regulations defining "foreign passthru payments" are filed with the U.S. Federal Register generally would be "grandfathered" for purposes of FATCA withholding unless materially modified after such date. Bondholders should consult their own tax advisers regarding how these rules may apply to their investment in the Bonds.

SUBSCRIPTION AND SALE

Each of Bank of Communications Co., Ltd. Hong Kong Branch, BOCOM International Securities Limited, Citigroup Global Markets Limited, The Hongkong and Shanghai Banking Corporation Limited, Agricultural Bank of China Limited Hong Kong Branch, Bank of China Limited, China CITIC Bank International Limited, China Everbright Bank Co., Ltd., Hong Kong Branch, China International Capital Corporation Hong Kong Securities Limited, China Minsheng Banking Corp., Ltd., Hong Kong Branch, CMBC Securities Company Limited, China Securities (International) Finance Holding Company Limited, CLSA Limited, CMB International Capital Limited, Crédit Agricole Corporate and Investment Bank, Guotai Junan Securities (Hong Kong) Limited, Haitong International Securities Company Limited, Huarong International Securities Limited, ICBC International Securities Limited, Industrial and Commercial Bank of China (Asia) Limited, J.P. Morgan Securities PLC, Shanghai Pudong Development Bank Co., Ltd., Hong Kong Branch, SPDB International Capital Limited and Standard Chartered Bank (together the "**Joint Lead Managers**") has, pursuant to a subscription agreement dated 29 June 2021 (the "**Subscription Agreement**"), severally agreed with the Issuer, subject to the satisfaction of certain conditions, to subscribe and pay for, or to procure subscribers to subscribe and pay for, the principal amount of the Bonds set out opposite its name below:

Joint Lead Manager	**Principal amount of the Bonds to be subscribed**
	(U.S.$)
Bank of Communications Co., Ltd. Hong Kong Branch	350,000,000
BOCOM International Securities Limited	150,000,000
Citigroup Global Markets Limited	150,000,000
The Hongkong and Shanghai Banking Corporation Limited	150,000,000
Agricultural Bank of China Limited Hong Kong Branch	10,000,000
Bank of China Limited	10,000,000
China CITIC Bank International Limited	10,000,000
China Everbright Bank Co., Ltd., Hong Kong Branch	10,000,000
China International Capital Corporation Hong Kong Securities Limited	10,000,000
China Minsheng Banking Corp., Ltd., Hong Kong Branch	10,000,000
CMBC Securities Company Limited	10,000,000
China Securities (International) Finance Holding Company Limited	10,000,000
CLSA Limited	10,000,000
CMB International Capital Limited	10,000,000
Crédit Agricole Corporate and Investment Bank	10,000,000
Guotai Junan Securities (Hong Kong) Limited	10,000,000
Haitong International Securities Company Limited	10,000,000
Huarong International Securities Limited	10,000,000
ICBC International Securities Limited	10,000,000
Industrial and Commercial Bank of China (Asia) Limited	10,000,000
J.P. Morgan Securities PLC	10,000,000
Shanghai Pudong Development Bank Co., Ltd., Hong Kong Branch	10,000,000
SPDB International Capital Limited	10,000,000
Standard Chartered Bank	10,000,000
Total	**1,000,000,000**

The Issuer has agreed to indemnify the Joint Lead Managers against certain liabilities incurred in connection with the issue of the Bonds. The Subscription Agreement provides that the obligations of the Joint Lead Managers are subject to certain conditions precedent, and entitles the Joint Lead Managers to terminate the Subscription Agreement in certain circumstances at any time up to the time when subscription moneys have been received and the Bonds issued.

The Joint Lead Managers and their affiliates are full service financial institutions engaged in various activities that may include securities trading, commercial and investment banking, financial advisory, investment management, principal investment, hedging, financing and brokerage activities ("**Banking Services and/or Transactions**"). The Joint Lead Managers and their respective affiliates may have, from time to time, performed, and may in the future perform, various Banking Services and/or Transactions with the Issuer for which they have received, or will receive, fees and expenses.

In connection with the issue of the Bonds, any of the Joint Lead Managers appointed or acting as stabilisation manager (the "**Stabilisation Manager**") or any person acting on behalf of the Stabilisation Manager may, to the extent permitted by applicable laws and directives, over-allot the Bonds or effect transactions with a view to supporting the price of the Bonds at a level higher than that which might otherwise prevail, but in so doing, the Stabilisation Manager or any person acting on behalf of the Stabilisation Manager shall act as principal and not as agent of the Issuer. However, there is no assurance that the Stabilisation Manager or any person acting on behalf of the Stabilisation Manager will undertake Stabilisation action. Any loss or profit sustained as a consequence of any such overallotment or stabilisation shall be for the account of the Joint Lead Managers.

In connection with the offering of the Bonds, the Joint Lead Managers and/or their respective affiliates, or affiliates of the Issuer, may act as investors and place orders, receive allocations and trade the Bonds for their own account and such orders, allocations or trade of the Bonds may be material. Such entities may hold or sell such Bonds or purchase further Bonds for their own account in the secondary market or deal in any other securities of the Issuer, and therefore, they may offer or sell the Bonds or other securities otherwise than in connection with the offering of the Bonds. Accordingly, references herein to the offering of the Bonds should be read as including any offering of the Bonds to the Joint Lead Managers and/or their respective affiliates, or affiliates of the Issuer as investors for their own account. Such entities are not expected to disclose such transactions or the extent of any such investment, otherwise than in accordance with any applicable legal or regulatory requirements. If such transactions occur, the trading price and liquidity of the Bonds may be impacted.

Furthermore, it is possible that a significant proportion of the Bonds may be initially allocated to, and subsequently held by, a limited number of investors. If this is the case, the trading price and liquidity of trading in the Bonds may be constrained. The Issuer and the Joint Lead Managers are under no obligation to disclose the extent of the distribution of the Bonds among individual investors, otherwise than in accordance with any applicable legal or regulatory requirements.

In the ordinary course of their various business activities, the Joint Lead Managers and their respective affiliates make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers, and may at any time hold long and short positions in such securities and instruments. Such investment and securities activities may involve securities and instruments of the Issuer, including the Bonds, and could adversely affect the trading price and liquidity of the Bonds. The Joint Lead Managers and their affiliates may make investment recommendations and/or publish or express independent research views (positive or negative) in respect of the Bonds or other financial instruments of the Issuer, and may recommend to their clients that they acquire long and/or short positions in the Bonds or other financial instruments of the Issuer.

If a jurisdiction requires that such offering be made by a licensed broker or dealer and the underwriters or any affiliate of the underwriters is a licensed broker or dealer in that jurisdiction, such offering shall be deemed to be made by the underwriters or such affiliate on behalf of the Issuer in such jurisdiction.

General

None of the Issuer or the Joint Lead Managers makes any representation that any action will be taken in any jurisdiction by the Joint Lead Managers or the Issuer that would permit a public offering of the Bonds, or possession or distribution of this Offering Circular (in preliminary, proof or final form) or any amendment or supplement thereto any other offering or publicity material relating to the Bonds, in any country or jurisdiction where action for that purpose is required. The Issuer will not have any responsibility for, and the Joint Lead Managers will obtain any consent, approval or permission required by them for, the acquisition, offer, sale or delivery by them of Bonds under the laws and regulations in force in any jurisdiction to which they are subject or in or from which they make any acquisition, offer, sale or delivery. The Joint Lead Managers are not authorised to make any representation or use any information in connection with the issue, subscription and sale of the Bonds other than as contained in, or which is consistent with, this Offering Circular or any amendment or supplement to it.

United States

The Bonds have not been and will not be registered under the U.S. Securities Act of 1933 (the "**Securities Act**") or the securities laws of any state or other jurisdiction of the United States and may not be offered or sold within the United States except in certain transactions exempt from or not subject to, the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

Accordingly, the Bonds are being offered and sold outside of the United States in offshore transactions in reliance on, and in compliance with, Regulation S.

Until 40 days after the commencement of the offering of the Bonds, an offer or sale of the Bonds within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with an available exemption from registration under the Securities Act.

United Kingdom

Each Joint Lead Manager has represented, warranted and agreed that:

(1) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 (the "**FSMA**")) received by it in connection with the issue or sale of any Bonds in circumstances in which section 21(1) of the FSMA does not apply to the Issuer; and

(2) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Bonds in, from or otherwise involving the UK.

Prohibition of sales to EEA Retail Investors

Each Joint Lead Manager has represented and agreed that it has not offered, sold or otherwise made available and will not offer, sell or otherwise make available any Bonds which are the subject of the offering contemplated by this Offering Circular in relation thereto to any retail investor in the EEA. For the purposes of this provision:

(1) the expression "**retail investor**" means a person who is one (or more) of the following:

    (i) a retail client as defined in point (11) of Article 4(1) of Directive 2014/65/EU (as amended, "**MiFID II**"); or

    (ii) a customer within the meaning of Directive (EU) 2016/97 (the "**Insurance Distribution Directive**"), where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; or

(2) the expression an "**offer**" includes the communication in any form and by any means of sufficient information on the terms of the offer and the Bonds to be offered so as to enable an investor to decide to purchase or subscribe for the Bonds.

Prohibition of sales to UK Retail Investors

Each Joint Lead Manager has represented and agreed that it has not offered, sold or otherwise made available and will not offer, sell or otherwise make available any Bonds which are the subject of the offering contemplated by this Offering Circular in relation thereto to any retail investor in the United Kingdom. For the purposes of this provision:

(1) the expression "**retail investor**" means a person who is one (or more) of the following:

   (i) a retail client, as defined in point (8) of Article 2 of Regulation (EU) No 2017/565 as it forms part of domestic law by virtue of the European Union (Withdrawal) Act 2018 ("**EUWA**"); or

   (ii) a customer within the meaning of the provisions of the Financial Services and Markets Act 2000 (the "**FSMA**") and any rules or regulations made under the FSMA to implement Directive (EU) 2016/97, where that customer would not qualify as a professional client, as defined in point (8) of Article 2(1) of Regulation (EU) No 600/2014 as it forms part of domestic law by virtue of the EUWA; or

(2) the expression an "**offer**" includes the communication in any form and by any means of sufficient information on the terms of the offer and the Bonds to be offered so as to enable an investor to decide to purchase or subscribe for the Bonds.

Hong Kong

Each Joint Lead Manager has represented and agreed that:

(1) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any Bonds other than (a) to "professional investors" as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong (the "**SFO**") and any rules made under the SFO; or (b) in other circumstances which do not result in the document being a "prospectus" as defined in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) of Hong Kong (the "**C(WUMP)O**") or which do not constitute an offer to the public within the meaning of the C(WUMP)O; and

(2) it has not issued or had in its possession for the purposes of issue, and will not issue or have in its possession for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the Bonds, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to Bonds which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" as defined in the SFO and any rules made under the SFO.

Singapore

Each Joint Lead Manager has acknowledged that this Offering Circular has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, each Joint Lead Manager has represented, warranted and agreed that it has not offered or sold any Bonds or caused the Bonds to be made the subject of an invitation for subscription or purchase and will not offer or sell any Bonds or cause the Bonds to be made the subject of an invitation for subscription or purchase, and has not circulated or distributed, nor will it circulate or distribute, this Offering Circular or any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the Bonds, whether directly or indirectly, to any person in Singapore other than (i) to an institutional investor (as defined in Section 4A of the Securities and Futures Act (Chapter 289) of Singapore, as modified or amended from time to time (the "**SFA**")) pursuant to Section 274 of the SFA, (ii) to a relevant person (as defined in Section 275(2) of the SFA) pursuant to Section 275(1) of the SFA, or any person pursuant to Section 275(1A) of the SFA, and in accordance with the conditions specified in Section 275 of the SFA, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

Where the Bonds are subscribed or purchased under Section 275 of the SFA by a relevant person which is:

(1) a corporation (which is not an accredited investor (as defined in Section 4A of the SFA)) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or

(2) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor,

securities or securities-based derivatives contracts (each term as defined in Section 2(1) of the SFA) of that corporation or the beneficiaries' rights and interest (howsoever described) in that trust shall not be transferred within six months after that corporation or that trust has acquired the Bonds pursuant to an offer made under Section 275 of the SFA, except:

(1) to an institutional investor or to a relevant person or to any person arising from an offer referred to in Section 275(1A) or Section 276(4)(i)(B) of the SFA;

(2) where no consideration is or will be given for the transfer;

(3) where the transfer is by operation of law;

(4) as specified in Section 276(7) of the SFA; or

(5) as specified in Regulation 37A of the Securities and Futures (Offers of Investments) (Securities and Securities-based Derivatives Contracts) Regulations 2018.

*Notification under Section 309B(1)(c) of the SFA — In connection with Section 309B of the SFA and the Securities and Futures (Capital Markets Products) Regulations 2018 of Singapore (the "**CMP Regulations 2018**"), the Issuer has determined, and hereby notifies all relevant persons (as defined in Section 309(A)(1) of the SFA), that the Bonds are "prescribed capital markets products" (as defined in the CMP Regulations 2018) and Excluded Investment Products (as defined in MAS Notice SFA 04-N12: Notice on the Sale of Investment Products and MAS Notice FAA-N16: Notice on Recommendations on Investment Products).*

Japan

The Bonds have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (Act No. 25 of 1948, as amended) (the "**Financial Instruments and Exchange Act**") and, accordingly, each Joint Lead Manager has represented, warranted and undertaken that it has not, directly or indirectly, offered or sold and will not, directly or indirectly, offer or sell any Bonds in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan) or to others for re-offering or re-sale, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Financial Instruments and Exchange Act and other relevant laws and regulations of Japan.

GENERAL INFORMATION

1. **Clearing Systems**: The Bonds have been accepted for clearance through Euroclear and Clearstream with the Common Code of 235735270 and ISIN of XS2357352702.

2. **Legal Entity Identifier of the Issuer**: The Issuer's Legal Entity Identifier is 254900BIDL79UKUMX541.

3. **Listing of Bonds**: Application will be made to the Hong Kong Stock Exchange for the listing of the Bonds by way of debt issues to Professional Investors (as defined in Chapter 37 of the Rules Governing the Listing of Bonds on the Hong Kong Stock Exchange) ("**Professional Investors**") only. It is expected that dealing in, and listing of, the Bonds on the Hong Kong Stock Exchange will commence on 9 July 2021. This Offering Circular is for distribution to Professional Investors only.

4. **Litigation**: Neither the Issuer nor any of its subsidiaries is involved in any legal, litigation or arbitration proceedings relating to claims or amounts which are material in the context of the issue of the Bonds, nor is the Issuer or any of its subsidiaries aware that any such proceedings are pending or threatened.

5. **Authorisations**: The Issuer has obtained all necessary consents, approvals and authorisations as may be required in connection with the issue and performance of the Bonds, including, but not limited to, approval by the Monetary Authority. The issue of the Bonds was authorised by a resolution of the Board of Directors of the Issuer passed on 4 June 2021. Listing of the Bonds on the Hong Kong Stock Exchange is conditional upon satisfaction of the requirements of that exchange, including execution of the Fiscal Agency Agreement relating to the Bonds. The Bonds will be issued in accordance with the annual foreign debt issuance quota granted by the NDRC to BoCom.

6. **No Material Adverse Change**: There has been no material adverse change, or any development or event likely to involve a prospective change, in the condition (financial or other), prospects, results of operations or, general affairs of the Issuer since 31 December 2020.

7. **Available Documents**: For so long as any of the Bonds is outstanding, copies of the following documents may be inspected at a specified office of the Fiscal Agent at 20 Pedder Street, Central, Hong Kong:

   (a) the Articles of Association of the Issuer;

   (b) a copy of the independent auditor's reports of PricewaterhouseCoopers, and the audited financial statements of the Issuer as at and for the years ended 31 December 2019 and 2020;

   (c) copies of the most recent annual and interim reports (including the financial statements) published by the Issuer; and

   (d) the Fiscal Agency Agreement, to be dated on or about 8 July 2021.

Copies of the independent auditor's reports, the audited financial statements and the most recent annual and interim reports (including the financial statements) published by the Issuer referred to above, will be made available free of charge at the specified office of the Fiscal Agent at 20 Pedder Street, Central, Hong Kong.

8. **Independent Auditors**: The financial statements of the Issuer as at and for the years ended 31 December 2019 and 2020 are included in this Offering Circular and have been audited by PricewaterhouseCoopers, Certified Public Accountants, the Issuer's independent auditor, as stated in the independent auditor's reports contained herein.

INDEX TO THE FINANCIAL STATEMENTS

Notes:

(1) The audited consolidated financial statements set out herein have been reproduced from the annual reports for the years ended 31 December 2019 and 2020, and page references to pages set forth in such annual report.

Independent Auditor’s Report

TO THE MEMBER OF BANK OF COMMUNICATIONS (HONG KONG) LIMITED
(incorporated in Hong Kong with limited liability)

Opinion

What we have audited

The financial statements of Bank of Communications (Hong Kong) Limited (the “Company”) set out on pages 7 to 99, which comprise:

- the statement of financial position as at 31 December 2019;
- the statement of profit or loss and other comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Our opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Company as at 31 December 2019, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards (“HKFRSs”) issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”) and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing (“HKSAs”) issued by the HKICPA. Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Company in accordance with the HKICPA’s Code of Ethics for Professional Accountants (“the Code”), and we have fulfilled our other ethical responsibilities in accordance with the Code.

Other Information

The directors are responsible for the other information. The other information comprises the information included in the annual report, but does not include the financial statements and our auditor's report thereon.

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Directors and the Audit Committee for the Financial Statements

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

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

The Audit Committee is responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. We report our opinion solely to you, as a body, in accordance with Section 405 of the Hong Kong Companies Ordinance and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

Auditor's Responsibilities for the Audit of the Financial Statements *(Continued)*

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 8 April 2020

Statement of Profit or Loss and Other Comprehensive Income

(All amounts expressed in thousands of HK$ unless otherwise stated)

		Year ended 31 December	
		2019	2018
	Notes		
Interest income		**6,076,016**	4,814,092
Interest expense		**(3,154,847)**	(2,957,265)
Net interest income	4	**2,921,169**	1,856,827
Fee and commission income	5	**746,623**	777,684
Fee and commission expense	6	**(56,536)**	(45,028)
Net fee and commission income		**690,087**	732,656
Net gains arising from trading activities	8	**76,413**	366,822
Net gains/(losses) arising from financial investments		**425,804**	(9,851)
Dividend income	7	**35**	700
Other operating income	9	**21,541**	20,982
Change in expected credit losses	10	**(159,988)**	(212,589)
Other operating expenses	11	**(1,546,227)**	(1,503,772)
Profit before tax		**2,428,834**	1,251,775
Income tax expenses	14	**(366,160)**	(268,758)
Net profit for the year		**2,062,674**	983,017
Other comprehensive income for the year, net of tax			
Item that will not be reclassified subsequently to profit or loss			
Equity investments at fair value through other comprehensive income – net change in fair value		**(25)**	1,816
Items that may be reclassified to profit or loss:			
Net gain arising from cash flow hedge			
Changes in fair value recorded in equity		**–**	(529)
Debt investments at fair value through other comprehensive income			
Net gains recorded in equity		**890,277**	221,146
Net gains reclassified from equity to profit or loss		**(496,062)**	(19,367)
Other comprehensive income for the year		**394,190**	203,066
Total comprehensive income for the year		**2,456,864**	1,186,083

The accompanying notes form a part of these financial statements.

Statement of Financial Position

(All amounts expressed in thousands of HK$ unless otherwise stated)

	Notes	As at 31 December 2019	2018
ASSETS			
Cash and balances with central bank	15	**1,094,956**	2,353,780
Due from banks and other financial institutions	16	**17,667,908**	25,082,437
Financial assets at fair value through profit or loss	17	**1,064,926**	1,855,354
Financial assets at fair value through other comprehensive income	20	**122,242,273**	109,315,062
Loans and advances to customers	19	**79,201,615**	67,688,719
Property and equipment	21	**53,476**	67,418
Deferred income tax assets	22	**–**	10,978
Right-of-use assets	23	**298,409**	–
Other assets	24	**5,489,437**	1,502,974
Total assets		**227,113,000**	207,876,722
LIABILITIES			
Due to banks and other financial institutions	25	**28,736,570**	21,126,951
Due to customers	26	**170,755,289**	162,074,683
Financial liabilities at fair value through profit or loss	27	**1,168,798**	467,764
Current tax liabilities		**534,932**	151,997
Deferred income tax liabilities	22	**46,906**	–
Lease liabilities		**301,488**	–
Other liabilities	28	**4,483,009**	5,422,094
Total liabilities		**206,026,992**	189,243,489
EQUITY			
Share capital	29	**17,900,000**	17,900,000
Other reserves		**481,164**	86,974
Retained earnings		**2,704,844**	646,259
Total equity		**21,086,008**	18,633,233
Total equity and liabilities		**227,113,000**	207,876,722

The financial statements were approved and authorized for issuance by the Board of Directors on 8 April 2020 and signed on its behalf by:

Wang Feng, Chairman

Chan Ha Fong, Nancy, Chief Executive

The accompanying notes form a part of these financial statements.

Statement of Changes in Equity

(All amounts expressed in thousands of HK$ unless otherwise stated)

	Attributable to the shareholder of the Company					
	Head office account	Share capital	Revaluation reserve	Cash flow hedge reserve (Note 18)	Retained earnings (Note (a))	Total
At 1 January 2019	**–**	**17,900,000**	**86,974**	**–**	**646,259**	**18,633,233**
Change in accounting policy	**–**	**–**	**–**	**–**	**(4,089)**	**(4,089)**
Restated balance at 1 January 2019	**–**	**17,900,000**	**86,974**	**–**	**642,170**	**18,629,144**
Net profit for the year	**–**	**–**	**–**	**–**	**2,062,674**	**2,062,674**
Other comprehensive income	**–**	**–**	**394,190**	**–**	**–**	**394,190**
At 31 December 2019	**–**	**17,900,000**	**481,164**	**–**	**2,704,844**	**21,086,008**
At 1 January 2018	–	300,000	–	–	(7,512)	292,488
Effect of recapitalization of a business	18,380,966	–	940,348	(9,299)	17,539,428	36,851,443
	18,380,966	300,000	940,348	(9,299)	17,531,916	37,143,931
Change in accounting policy	–	–	54,957	–	(101,009)	(46,052)
Restated balance at 1 January 2018	18,380,966	300,000	995,305	(9,299)	17,430,907	37,097,879
Net profit for the year	–	–	–	–	983,017	983,017
Other comprehensive income	–	–	203,595	(529)	–	203,066
Repayment to Head office	(18,380,966)	–	–	–	–	(18,380,966)
Issuance of share capital	–	17,600,000	–	–	–	17,600,000
Transfer of Excluded Business to Bank of Communications Co., Ltd. Hong Kong Branch ("HKBR") (Note 2)	–	–	(1,111,926)	9,828	(17,767,665)	(18,869,763)
At 31 December 2018	–	17,900,000	86,974	–	646,259	18,633,233

Note (a):

In accordance with the requirements of the Hong Kong Monetary Authority (the"HKMA"), the regulatory reserve is set aside for general banking risks, including future losses or other unforeseeable risks. The regulatory reserve is set up in compliance with the HKMA's requirements and is distributable to shareholder of the Company subject to consultation with the HKMA. As at 31 December 2019, HK$891,005,000 (2018: HK$794,919,000) was earmarked as the regulatory reserve from the retained earnings.

The accompanying notes form a part of these financial statements.

Statement of Cash Flows

(All amounts expressed in thousands of HK$ unless otherwise stated)

	Notes	2019	2018
		Year ended 31 December	
Cash flows from operating activities:			
Profit before tax		**2,428,834**	1,251,775
Adjustments for:			
Change in expected credit losses		**159,988**	212,589
Depreciation and amortization		**30,365**	33,154
Depreciation of right-of-use assets		**166,890**	–
Finance costs – lease interest expense		**4,820**	–
Loss on disposal of property and equipment		**25**	2,183
Interest income from financial investments		**(3,531,136)**	(2,200,059)
Fair value (gains)/losses		**(38,828)**	11,788
Dividend income		**(35)**	(700)
Withholding tax		**–**	59,363
Net (gains)/losses arising from financial investments		**(425,804)**	9,851
Interest expenses on certificates of deposit issued and debt securities issued		**–**	119,347
Operating cash flows before movements in operating assets and liabilities		**(1,204,881)**	(500,709)
Net decrease in due from banks and other financial institutions		**3,000,205**	16,117,318
Net decrease in financial assets at fair value through profit or loss		**829,256**	1,159,657
Net increase in loans and advances to customers		**(11,605,133)**	(13,904,519)
Net increase in other assets		**(3,966,740)**	(8,744,712)
Net increase in due to banks and other financial institutions		**7,609,619**	205,313,139
Net increase in financial liabilities at fair value through profit or loss		**701,034**	2,037,834
Net increase in due to customers		**8,680,606**	22,324,403
Net (decrease)/increase in other liabilities		**(942,931)**	97,482,278
Income tax paid		**–**	(997,878)
Net cash inflows from operating activities		**3,101,035**	320,286,811

Statement of Cash Flows

(All amounts expressed in thousands of HK$ unless otherwise stated)

	Notes	Year ended 31 December 2019	2018
Cash flows from investing activities:			
Purchase of financial investments		**(155,694,231)**	(211,897,275)
Disposal or redemption of financial investments		**143,601,346**	38,076,566
Dividend received		**35**	700
Interest received from financial investments		**3,520,322**	2,545,279
Purchase of property and equipment		**(15,037)**	(26,135)
Purchase of intangible assets		**(12,114)**	(1,523)
Net cash outflows from investing activities		**(8,599,679)**	(171,302,388)
Cash flows from financing activities:			
Proceeds from debt securities and certificate of deposits issued		**–**	567,236
Repayment of debt securities and certificate of deposits issued		**–**	(6,039,343)
Repayment to Head office		**–**	(18,380,966)
Principal elements of lease payments		**(166,931)**	–
Interest paid for lease		**(4,820)**	–
Interest paid for certificates of deposit issued and debt securities issued		**–**	(305,432)
Proceeds from issuance of share capital		**–**	17,600,000
Net cash outflows from financing activities		**(171,751)**	(6,558,505)
Net (decrease)/increase in cash and cash equivalents		**(5,670,395)**	142,425,918
Transfer of cash and cash equivalents in relation to the Transfer of Excluded Business to HKBR	2	**–**	(171,312,689)
Cash and cash equivalents at the beginning of the year		**11,704,990**	40,591,761
Cash and cash equivalents at the end of the year	31	**6,034,595**	11,704,990
Net cash flows from operating activities include:			
Interest received		**2,471,431**	3,161,720
Interest paid		**(3,267,520)**	(2,945,396)

The accompanying notes form a part of these financial statements.

1 GENERAL

As at 31 December 2019, Bank of Communications (Hong Kong) Limited ("the Company") was a private company incorporated and domiciled in Hong Kong. The address of its registered office is 20 Pedder Street, Central, Hong Kong and principal place of business is Unit B B/F & G/F, Unit C G/F, 1-3/F, 16/F Rm01 & 18/F Wheelock House, 20 Pedder Street, Central, Hong Kong. Its ultimate holding company is Bank of Communications Co., Ltd., which is incorporated in the People's Republic of China.

On 29 September 2015, the Hong Kong Monetary Authority granted the Company a banking licence under the Banking Ordinance.

On 29 January 2018 (the "Appointed Day"), the Bank of Communications (Hong Kong) Limited (Merger) Ordinance (Chapter 1182 of the laws of Hong Kong) (the "Ordinance") has become effective. Pursuant to the Ordinance, certain activities, assets and liabilities which constitute the retail banking business and private banking business ("Transferred Business") of Bank of Communications Co., Ltd. Hong Kong Branch ("HKBR") have been transferred to the Company in accordance with section 4(1) of the Ordinance. Accordingly, the Company commenced its retail banking business and private banking business on the Appointed Day.

On 6 January 2020, the Company has altered its articles of association and the Company's status has been changed from a private company to a public company with effect from 6 January 2020 .

These financial statements are presented in thousands of Hong Kong Dollars (HK$), unless otherwise stated.

The regulatory disclosure information required under the Banking (Disclosure) Rules is available in the Regulatory Disclosure Section of our website www.hk.bankcomm.com.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ('HKFRSs') and the requirements of the Hong Kong Companies Ordinance (Cap. 622). The financial statements have been prepared on the historical cost basis except for certain financial instruments which are measured at fair value.

The Company adopts the going concern basis in preparing its financial statements.

On 29 January 2018, the transfer of retail bank business and private banking business from HKBR to the Company was a recapitalization of a business and did not result in any changes in business substance, management nor the ultimate controlling shareholder. Accordingly, the assets and liabilities of the Transferred Business have been presented using their carrying value in the records of HKBR.

Certain assets and liabilities of HKBR's corporate banking business have not been transferred to the Company (the "Excluded Business"). Accordingly, the statement of financial position and the statement of profit or loss and other comprehensive income of the Company includes the net assets and results of the Excluded Business up to 28 January 2018 because the results of this business cannot be clearly distinguished from that of the Transferred Business. The Excluded Business have been accounted for as a deduction from equity upon completion of the business transfer at 29 January 2018.

The effects of all transactions for the year ended 31 December 2018 between the Company and the Transferred Business of HKBR before the recapitalization were eliminated in preparing the financial statements.

(All amounts expressed in thousands of HK$ unless otherwise stated)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.1 Basis of preparation *(continued)*

2.1.1 New and revised HKFRSs effective by 1 January 2019 applied by the Company

HKFRIC 23	Uncertainty over income tax
HKFRS 16	Leases
Amendments to HKFRS 9	Prepayment Features with Negative Compensation and Modifications of Financial Liabilities

The Company had to change its accounting policies as a result of adopting HKFRS 16. The Company elected to adopt the new rules retrospectively but recognized the cumulative effect of initially applying the new standard on 1 January 2019. This is disclosed in note 2.2.1 below. The other amendments listed above did not have any impact on the amounts recognized in prior periods and are not expected to significantly affect the current or future periods.

2.1.2 Standards and amendments that are not yet effective and have not been adopted by the Company

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2019 reporting periods and have not been early adopted by the Company. These standards are not expected to have a material impact on the entity in the current or future reporting periods and on foreseeable future transactions.

2.2 Changes in accounting policies

This note explains the impact of the adoption of HKFRS 16 Leases on the Company's financial statements and discloses the new accounting policies that have been applied from 1 January 2019 in note 2.2.1 below.

The Company has adopted HKFRS 16 retrospectively from 1 January 2019, but has not restated comparatives for the 2018 reporting period, as permitted under the specific transitional provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognized in the opening statement of financial position on 1 January 2019.

2.2.1 HKFRS 16 Leases – Impact of adoption

Adjustments recognized on adoption of HKFRS 16

On adoption of HKFRS 16, the Company recognized lease liabilities in relation to leases which had previously been classified as 'operating leases' under the principles of HKAS 17 Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of 1 January 2019. The weighted average lessee's incremental borrowing rate applied to the lease liabilities on 1 January 2019 was 1.3%.

Practical expedients applied
In applying HKFRS 16 for the first time, the Company has used the following practical expedients permitted by the standard:

- applying a single discount rate to a portfolio of leases with reasonably similar characteristics;
- relying on previous assessments on whether leases are onerous as an alternative to performing an impairment review – there were no onerous contracts as at 1 January 2019;
- accounting for operating leases with a remaining lease term of less than 12 months as at 1 January 2019 as short-term leases;
- excluding initial direct costs for the measurement of the right-of-use asset at the date of initial application; and
- using hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

The Company has also elected not to reassess whether a contract is, or contains a lease at the date of initial application. Instead, for contracts entered into before the transition date the Company relied on its assessment made applying HKAS 17 and HKFRIC 4 Determining whether an Arrangement contains a Lease.

(All amounts expressed in thousands of HK$ unless otherwise stated)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Changes in accounting policies *(continued)*

2.2.1 HKFRS 16 Leases – Impact of adoption (continued)

Adjustments recognized on adoption of HKFRS 16 (continued)

	2019
Operating lease commitments disclosed as at 31 December 2018 (Note (a))	–
Add: New lease liability recognized as at 1 January 2019	**207,291**
Lease liability recognized as at 1 January 2019	**207,291**

Note (a):

As at 31 December 2018, certain lease agreements have been signed by HKBR which the lease are used by the Company. The Company does not have any commitment with respect to these operating lease commitment.

The right-of-use assets were measured on a retrospective basis as if the new rules had always been applied. There were no onerous lease contracts that would have required an adjustment to the right-of-use assets at the date of initial application.

The recognized right-of-use assets relate to the following types of assets:

	31 December 2019	**1 January 2019**
Properties	289,945	188,374
Equipment	8,328	15,198
Others	136	70
Total right-of-use assets	298,409	203,642

The change in accounting policy affected the following items in the statement of financial position on 1 January 2019:

- right-of-use assets – increased by HK$203,642,000;
- prepayments – decreased by HK$440,000; and
- lease liabilities – increased by HK$207,291,000.

The net impact on retained earnings on 1 January 2019 was a decrease of HK$4,089,000.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies

2.3.1 Interest income and expense

Interest income and expense are recognized in profit or loss for interest-bearing financial instruments using the effective interest method.

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (including a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant periods. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Company estimates cash flows considering all contractual terms of the financial instrument (but does not consider future credit losses). The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Interest income on an impaired financial asset or a group of impaired similar financial assets is recognized using the original interest rate which was used to discount the future cash flows for the purpose of measuring the impairment loss.

2.3.2 Fee and commission income

The Company earns fee and commission income from a diverse range of services it provides to its customers. For those services that are over a period of time, fee and commission income are accrued over that period when the services are rendered. For other services, fee and commission income are recognized when the services are rendered.

2.3.3 Dividend income

Dividends are recognized when the right to receive the dividends is established.

2.3.4 Financial assets and liabilities

Measurement methods

Initial recognition and measurement

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognized on trade-date, the date on which the Company commits to purchase or sell the asset.

At initial recognition, the Company measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability, such as fees and commissions. Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss are expensed in profit or loss. Immediately after initial recognition, an expected credit loss allowance (ECL) is recognized for financial assets measured at amortized cost and investments in debt instruments measured at FVOCI, which results in an accounting loss being recognized in profit or loss when an asset is newly originated.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.4 Financial assets and liabilities (continued)

Measurement methods (continued)

Initial recognition and measurement (continued)

When the fair value of financial assets and liabilities differs from the transaction price on initial recognition, the Company recognizes the difference as follows:

(a) When the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e. a Level 1 input) or based on a valuation technique that uses only data from observable markets, the difference is recognized as a gain or loss.

(b) In all other cases, the difference is deferred and the timing of recognition of deferred day one profit or loss is determined individually. It is either amortized over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or realized through settlement.

Amortized cost and effective interest rate

The amortized cost is the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset (i.e. its amortized cost before any impairment allowance) or to the amortized cost of a financial liability. The calculation does not consider expected credit losses and includes transaction costs, premiums or discounts and fees and points paid or received that are integral to the effective interest rate, such as origination fees. For purchased or originated credit-impaired ('POCI') financial assets – assets that are credit-impaired (see definition on note 3.1.2.2) at initial recognition – the Company calculates the credit-adjusted effective interest rate, which is calculated based on the amortized cost of the financial asset instead of its gross carrying amount and incorporates the impact of expected credit losses in estimated future cash flows.

When the Company revises the estimates of future cash flows, the carrying amount of the respective financial assets or financial liability is adjusted to reflect the new estimate discounted cash flows using the original effective interest rate. Any changes are recognized in profit or loss.

Interest income

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for:

(a) POCI financial assets, for which the original credit-adjusted effective interest rate is applied to the amortized cost of the financial asset.

(b) Financial assets that are not 'POCI' but have subsequently become credit-impaired (or 'stage 3'), for which interest revenue is calculated by applying the effective interest rate to their amortized cost (i.e. net of the expected credit loss provision).

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.4 Financial assets and liabilities (continued)

2.3.4.1 Financial assets

(i) Classification and subsequent measurement

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

- Fair value through profit or loss;
- Fair value through other comprehensive income; or
- Amortized cost.

The classification requirements for debt and equity instruments are described below:

Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds.

Classification and subsequent measurement of debt instruments depend on:

(i) The Company's business model for managing the asset; and

(ii) The cash flow characteristics of the asset.

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

- Amortized 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 fair value through profit or loss, are measured at amortized cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognized and measured from these financial assets. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

- Fair value through other comprehensive income: 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 fair value through profit or loss, 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 gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortized cost which are recognized in profit or loss. When the financial asset is derecognized, the cumulative gain or loss previously recognized in other comprehensive income is reclassified from equity to profit or loss and recognized in 'Net gains/losses arising from financial investment'. Interest income from these financial assets is recognized in profit or loss and included in 'Interest income' using the effective interest rate method.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.4 Financial assets and liabilities (continued)

2.3.4.1 Financial assets (continued)

(i) Classification and subsequent measurement (continued)

Debt instruments *(continued)*

- Fair value through profit or loss: Assets that do not meet the criteria for amortized cost or fair value through other comprehensive income are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognized in profit or loss and recognized in the profit or loss within 'Net gains/losses arising from trading activities' in the period in which it arises.

Business model: the business model reflects how the Company manages the assets in order to generate cash flows. That is, whether the Company'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 (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'other' business model and measured at fair value through profit or loss. Factors considered by the Company in determining the business model for a Company of assets include past experience on how the cash flows for these assets were 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 Company assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Company 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. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

Financial assets with embedded derivatives are considered in their entirely when determining whether their cash flows are solely payment of principal and interest.

The Company reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.4 Financial assets and liabilities (continued)

2.3.4.1 Financial assets (continued)

(i) Classification and subsequent measurement (continued)

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. Examples of equity instruments include basic ordinary shares.

The Company subsequently measures all equity investments at fair value through profit or loss, except where the Company's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Company's policy is to designate equity investments as fair value through other comprehensive income when those investments are held for purposes other than to sell. When this election is used, fair value gains and losses are recognized in other comprehensive income and are not subsequently reclassified to profit or loss, including on disposal. Dividends, when representing a return on such investments, continue to be recognized in profit or loss as 'Dividend income' when the Company's right to receive payments is established.

Gains and losses on equity investments at fair value through profit or loss are recognized in the profit or loss as 'Net gains/ losses arising from trading activities'.

(ii) Impairment

The Company assesses on a forward-looking basis the ECL associated with its debt instrument assets carried at amortized cost and fair value through other comprehensive income and with the exposure arising from loan commitments and financial guarantee contracts. The Company recognizes a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Regarding these judgment and estimates, refer to Credit Risk management in Note 3.1. Note 3.1.2 provides details of how the ECL allowance is measured.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.4 Financial assets and liabilities (continued)

2.3.4.1 Financial assets (continued)

(iii) Modification of loans

The Company sometimes renegotiates or otherwise modifies the contractual cash flows of loans to customers. When this happens, the Company assesses whether or not the new terms are substantially different to the original terms. The Company does this by considering, among others, the following factors:

- If the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay.
- Whether any substantial new terms are introduced, such as a profit share/equity-based return that substantially affects the risk profile of the loan.
- Significant extension of the loan term when the borrower is not in financial difficulty.
- Significant change in the interest rate.
- Change in the currency the loan is denominated in.
- Insertion of collateral, other security or credit enhancements that significantly affect the credit risk associated with the loan.

If the terms are substantially different, the Company derecognizes the original financial asset and recognizes a 'new' asset at fair value and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Company also assesses whether the new financial asset recognized is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognized in profit or loss as a gain or loss on derecognition.

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Company recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognizes a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets).

(iv) Derecognition other than on a modification

Financial assets, or a portion thereof, are derecognized when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either (i) the Company transfers substantially all the risks and rewards of ownership, or (ii) the Company neither transfers nor retains substantially all the risks and rewards of ownership and the Company has not retained control.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.4 Financial assets and liabilities (continued)

2.3.4.1 Financial assets (continued)

(iv) Derecognition other than on a modification (continued)

The Company enters into transactions where it retains the contractual rights to receive cash flows from assets but assumes a contractual obligation to pay those cash flows to other entities and transfers substantially all of the risks and rewards. These transactions are accounted for as 'pass through' transfers that result in derecognition if the Company:

(i) Has no obligation to make payments unless it collects equivalent amounts from the assets;

(ii) Is prohibited from selling or pledging the assets; and

(iii) Has an obligation to remit any cash it collects from the assets without material delay.

Collateral (shares and bonds) furnished by the Company under standard repurchase agreements and securities lending and borrowing transactions are not derecognized because the Company retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met. This also applies to certain securitization transactions in which the Company retains a subordinated residual interest.

When the contractual rights to receive the cash flows from the assets have been transferred, and the Company neither transfers nor retains substantially all the risks and rewards of ownership, and the Company has retained control of the transferred assets, the Company applies continuing involvement approach. Under this approach, the Company continues to recognize the transferred asset to the extent of its continuing involvement and recognize the associated liability, to reflect the rights and obligations retained by the Company. The net carrying amount of the transferred asset and associated liability is: (a) the amortized cost of the rights and obligations retained by the Company, if the transferred asset is measured at amortized cost; or (b) equal to the fair value of the rights and obligations retained by the Company when measured on a stand-alone basis, if the transferred asset is measured at fair value.

2.3.4.2 Financial liabilities

(i) Classification and subsequent measurement

In both the current and prior period, financial liabilities are classified as liabilities measured at amortized cost, except for:

- Financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading (e.g. short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in profit or loss;

- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition or when the continuing involvement approach applies. When the transfer of financial asset did not qualify for derecognition, a financial liability is recognized for the consideration received for the transfer. In subsequent periods, the Company recognizes any expense incurred on the financial liability; when continuing involvement approach applies, see note 2.3.4.1(iv); and

- Financial guarantee contracts and loan commitments (see note 2.3.5).

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.4 Financial assets and liabilities (continued)

2.3.4.2 Financial liabilities (continued)

(ii) Derecognition

Financial liabilities are derecognized when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

The exchange between the Company and its original lenders of debt instruments with substantially different terms, as well as substantial modifications of the terms of existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is more than 10% different from the discounted present value of the remaining cash flows of the original financial liability. In addition, other qualitative factors, such as the currency that the instrument is denominated in, changes in the type of interest rate, new conversion features attached to the instrument and change in covenants are also taken into consideration. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognized as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortized over the remaining term of the modified liability.

2.3.5 Financial guarantee contracts and loan commitments

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and others on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of:

- The amount of the loss allowance; and

- The premium received on initial recognition less income recognized in accordance with the principles of HKFRS 15.

Loan commitments provided by the Company are measured as the amount of the loss allowance. The Company has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

For loan commitments and financial guarantee contracts, the loss allowance is recognized as provision. However, for contracts that include both a loan and an undrawn commitment and the Company cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component, the expected credit losses on the undrawn commitment are recognized together with the loss allowance for the loan. To the extent that the combined expected credit losses exceed the gross carrying amount of the loan, the expected credit losses are recognized as a provision.

2.3.6 Derivatives and hedging activities

The Company has elected to apply the hedge accounting requirements of HKFRS 9.

The Company has not provided comparative information for periods before the date of initial application of HKFRS 9 for the new disclosures introduced by HKFRS 9 as a consequential amendment to HKFRS 7, as permitted by HKFRS 7 paragraph 44Z.

Derivatives are initially recognized at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Certain derivatives are embedded in hybrid contracts, such as the conversion option in a convertible bond. If the hybrid contract contains a host that is a financial asset, then the Company assesses the entire contract as described in the financial assets section above for classification and measurement purposes. Otherwise, the embedded derivatives are treated as separate derivatives when:

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.6 Derivatives and hedging activities (continued)

(i) Their economic characteristics and risks are not closely related to those of the host contract;

(ii) A separate instrument with the same terms would meet the definition of a derivative; and

(iii) The hybrid contract is not measured at fair value through profit or loss.

These embedded derivatives are separately accounted for at fair value, with changes in fair value recognized in the statement of profit or loss unless the Company chooses to designate the hybrid contracts at fair value through profit or loss.

The method of recognizing the resulting fair value gain or loss depends on whether the derivative is designated and qualifies as a hedging instrument, and if so, the nature of the item being hedged. The Company designates certain derivatives as either:

(a) Hedges of the fair value of recognized assets or liabilities or a firm commitment (fair value hedges); or

(b) Hedges of highly probable future cash flows attributable to a recognized asset or liability (cash flow hedges).

At the inception of the hedging, the Company documents the economic relationship between hedging instruments and hedged items. The Company documents its risk management objective and strategy for undertaking its hedge transactions. The Company also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair values of derivative financial instruments designated in hedge relationships are disclosed in note 18. Movements in the hedging reserve in shareholder's equity are shown in statement of changes in equity.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the statement of profit or loss, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortized to profit or loss over the period to maturity and recorded as net interest income.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in other comprehensive income. The gain or loss relating to the ineffective portion is recognized immediately in the statement of profit or loss.

Amounts accumulated in equity are recycled to the statement of profit or loss in the periods when the hedged item affects profit or loss. They are recorded in the income or expense lines in which the revenue or expense associated with the related hedged item is reported.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.6 Derivatives and hedging activities (continued)

Cash flow hedge (continued)

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognized in the periods when the hedged item affects profit or loss. When a forecast transaction is no longer expected to occur (for example, the recognized hedged asset is disposed of), the cumulative gain or loss previously recognized in other comprehensive income is immediately reclassified to the statement of profit or loss.

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognized immediately in profit or loss and are included in gains/(losses) from trading activities.

2.3.7 Assets transferred under repurchase agreements

Financial assets sold subject to agreements with a commitment to repurchase at a specific future date at a fixed or determinable price are not derecognized in the statement of financial position. The proceeds from selling such assets are presented under "due to banks and other financial institutions" in the statement of financial position. The difference between the selling price and repurchasing price is recognized as interest expense during the term of the agreement using the effective interest method.

2.3.8 Property and equipment

The Company's property and equipment mainly comprise buildings, equipment, transportation equipment and property improvement.

The assets purchased are initially measured at acquisition cost.

Subsequent expenditures incurred for the property and equipment are included in the cost of the property and equipment if it is probable that economic benefits associated with the asset will flow to the Company and the subsequent expenditures can be measured reliably. Meanwhile the carrying amount of the replaced part is derecognized. Other subsequent expenditures are recognized in profit or loss in the period in which they are incurred.

Depreciation is calculated on the straight-line method to write down the cost of such assets over their estimated useful lives. The useful lives of assets are reviewed, and adjusted if appropriate, at each financial reporting date.

Buildings comprise primarily branch office premises and office premises. The estimated useful lives and depreciation rate of buildings, equipment, transportation equipment and property improvement are as follows:

Type of assets	Estimated useful lives
Buildings	50 years
Equipment	5 years
Transportation equipment (excluding equipment under operating leases)	3 years
Property improvement	Over the shorter of the economic useful lives and remaining lease terms

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.9 Repossessed assets

Repossessed assets are initially recognized at lower of fair value less cost to sell or amortized cost of the corresponding debt at the date of repossession and included in other assets. At each reporting date, repossessed assets are subsequently measured at lower of fair value less cost to sell and the carrying amount. When the fair value less cost to sell is lower than the carrying amount, an impairment loss is recognized in profit or loss.

When a repossessed asset is disposed, the difference between the disposal proceeds and the carrying amount is recognized in profit or loss.

2.3.10 Investment property

Investment property is a property held to earn rentals or for capital appreciation or both and initially measured at cost.

As there is an active property market in the location in which the Company's investment property is situated, and the Company can obtain the market price and other relevant information regarding the same or similar type of property from the property market so as to reasonably estimate the fair value of the investment property; therefore, the Company uses the fair value model for subsequent measurement of the investment property, with changes in the fair value included in profit or loss for the period in which they arise.

When an investment property is sold, transferred, retired or damaged, the Company recognizes the amount of any proceeds on disposal net of the carrying amount and related taxes in profit or loss for the period.

2.3.11 Intangible assets

An intangible asset is measured initially at cost. When an intangible asset with a finite useful life is available for use, its original cost is amortized over its estimated useful life using the straight-line method. An intangible asset with an indefinite useful life is not amortized.

For an intangible asset with a finite useful life, the Company reviews the useful life and amortization method at the end of each reporting period, and makes adjustments when necessary.

An intangible asset is derecognized on disposal, or when no future economic benefits are expected from use or disposal. Gains and losses arising from de-recognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognized in profit or loss when the asset is derecognized.

2.3.12 Impairment of non-financial assets

At the end of the reporting period or whenever there is an indication that the non-financial assets are impaired, the Company reviews the carrying amounts of its tangible and intangible assets with finite useful lives to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized in profit or loss immediately.

Intangible assets with indefinite useful life are tested for impairment annually, irrespective of whether there is any indication that the assets may be impaired.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but the increased carrying amount should not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is recognized in profit or loss immediately.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.13 Leases

2.3.13.1 Accounting policy effective from 1 January 2019

As explained in note 2.2 above, the Company has changed its accounting policy for leases where the Company is the lessee. The new policy is described below and the impact of the change in note 2.2.

For the year ended 31 December 2018, leases in which a significant portion of the risks and rewards of ownership were not transferred to the Company as lessee were classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) were charged to profit or loss on a straight-line basis over the period of the lease.

From 1 January 2019, leases are recognized as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Company.

Contracts may contain both lease and non-lease components. The Company allocates the consideration in the contract to the lease and non-lease components based on their relative stand-alone prices.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable; and

- amounts expected to be payable by the Company under residual value guarantees.

Lease payments to be made under reasonably certain extension options are also included in the measurement of the liability.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be readily determined, which is generally the case for leases in the Company, the lessee's incremental borrowing rate is used, being the rate that the individual lessee would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions.

To determine the incremental borrowing rate, the Company:

- where possible, uses recent third-party financing received by the individual lessee as a starting point, adjusted to reflect changes in financing conditions since third party financing was received, and

- makes adjustments specific to the lease, e.g. term, country, currency and security.

Lease payments are allocated between principal and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability;

- any lease payments made at or before the commencement date less any lease incentives received;

- any initial direct costs; and

- restoration costs.

Right-of-use assets are generally depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. If the Company is reasonably certain to exercise a purchase option, the right-of-use asset is depreciated over the underlying asset's useful life.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.14 Cash and cash equivalents

Cash and cash equivalents are assets with a maturity of less than 3 months from the date of acquisition or highly liquid assets with an original maturity of less than three months, which are readily convertible into known amounts of cash and subject to an insignificant risk of changes in value.

2.3.15 Provisions

Provisions are recognized when the Company has a present obligation related to a contingency, it is probable that an outflow of economic benefits will be required to settle the obligation, and the amount of the obligation can be measured reliably.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account factors pertaining to a contingency such as the risks, uncertainties and time value of money. Where the effect of the time value of money is material, the amount of the provision is determined by discounting the related future cash outflows.

Where all or some of the expenditure required to settle a provision is expected to be reimbursed by a third party, the reimbursement is recognized as a separate asset only when it is virtually certain that reimbursement will be received, and the amount of reimbursement recognized does not exceed the carrying amount of the provision.

2.3.16 Current and deferred income taxes

Income tax expense represents the sum of the tax currently payable and deferred tax.

(a) Current income tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the statement of profit or loss and other comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.16 Current and deferred income taxes (continued)

(b) Deferred income tax

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax base used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary difference to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Such deferred tax assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at the end of the reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset is realized, based on tax rate (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. Current and deferred tax is recognized in profit or loss, except when it relates to items that are recognized in other comprehensive income, in which case the current and deferred tax are also recognized in other comprehensive income.

For the purposes of measuring deferred tax liabilities or deferred tax assets for investment properties that are measured using the fair value model, the carrying amounts of such properties are presumed to be recovered entirely through sale, unless the presumption is rebutted. The presumption is rebutted when the investment property is depreciable and is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale.

2.3.17 Contingent liabilities and contingencies

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

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

2.3.18 Fiduciary activities

In activities where the Company acts in a fiduciary capacity such as trustee, custodian or agent, the assets and income arising from the transaction together with the related undertakings to return the assets to customers are excluded from the Company's financial statements.

2.3.19 Acceptances

Acceptances comprise the Company's commitments on payment for bills that are issued to customers. Acceptances are accounted for as financial guarantees and credit related commitments and are disclosed as contingent liabilities and commitments.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Significant Accounting Policies *(continued)*

2.3.20 Employee benefits

(i) Employee leave entitlements

Liabilities for wages and salaries, including non-monetary benefits and accumulating sick leave that are expected to be settled wholly within 12 months after the end of the period in which the employees render the related service are recognized in respect of employees' services up to the end of the reporting period and are measured at the amounts expected to be paid when the liabilities are settled.

(ii) Retirement benefit schemes

The Company contributes to defined contribution schemes under either recognized Occupational Retirement Schemes Ordinance (ORSO) Schemes or Mandatory Provident Fund (MPF) Schemes that are available to the Company's employees. Contributions to the schemes by the Company and employees are calculated as a percentage of employees' basic salaries for the ORSO schemes and in accordance with the MPF rules for MPF schemes. When an employee leaves the Company prior to his/her interest in the Company's employer non-mandatory contributions vesting with the employee, the ongoing contributions payable by the Company may be reduced by the relevant amount of forfeited contributions.

The assets of the schemes are held in independently-administered funds separate from those of the Company.

2.3.21 Offset financial assets and liabilities

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the assets and settle the liability simultaneously.

2.3.22 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker is the person or Company that allocates resources to and assesses the performance of the operating segments of an entity. The Company has determined the senior management team represented by the governor as its chief operating decision maker.

An operating segment is a component of the Company with all of the following conditions are satisfied: (1) that component can earn revenues and incur expenses from ordinary activities; (2) the component's operating results are regularly reviewed by the chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and (3) discrete financial information for the component is available to the Company. If two or more operating segments have similar economic characteristics, and certain conditions are satisfied, they may be aggregated into a single operating segment.

Intra-segment income and expenses are eliminated. Income and expenses directly associated with each segment are considered in determining segment performance.

2.3.23 Foreign currency translation

HK$ is the currency of the primary economic environment in which the Company operates. Therefore, the Company chooses HK$ as their functional currency and adopts HK$ to prepare its financial statements.

In preparing the financial statements, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in the respective functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions.

At the reporting date, foreign currency monetary items are translated into HK$ using the spot exchange rates at the reporting date. Exchange differences arising from the differences between the spot exchange rates prevailing at the reporting date and those on initial recognition or at the previous reporting date are recognized in profit or loss for the period except that (1) exchange differences related to hedging instruments for the purpose of hedging against foreign exchange risks are accounted for using hedge accounting and (2) exchange differences arising from available-for-sale non-monetary items denominated in foreign currencies and changes in the carrying amounts (other than the amortized cost) of available-for-sale monetary items are recognized as other comprehensive income.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.4 Critical accounting estimates and judgements in applying accounting policies

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense.

In preparing these financial statements, the significant judgements made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were as follow:

(a) Measurement of the expected credit loss ("ECL") allowance

The measurement of the expected credit loss allowance for financial assets measured at amortized cost and fair value through other comprehensive income is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behavior (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 note 3.1.2 and 3.1.3, which also sets out key sensitivities of the ECL to changes in these elements.

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 group of similar financial assets for the purposes of measuring ECL.

Detailed information about the judgements and estimates made by the Company in the above areas is set out in note 3.1.2.

(b) Fair value of financial instruments

The fair values of financial instruments that are not quoted in active markets are determined by using valuation techniques (e.g. discounted cash flow model). To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty's), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

(c) Determination of lease term

In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. Extension options (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated).

For leases of retail stores, the following factors are normally the most relevant:

- If any leasehold improvements are expected to have significant remaining value, the Company is typically reasonably certain to extend (or not terminate).
- Otherwise, the Company considers other factors including historical leases durations and the costs and business disruption required to replace the leased asset.

The lease term is reassessed if an option is actually exercised (or not exercised) or the Company becomes obliged to exercise (or not exercise) it. The assessment of reasonable certainty is only revised if a significant event or a significant change in circumstances occurs, which affects this assessment, and that is within the control of the lessee.

3 FINANCIAL RISK MANAGEMENT

The Company's activities expose it to a variety of financial risks and those activities involve analysis, evaluation, acceptance and management of a certain degree of risks or a portfolio of risks. The Company's aim is to achieve an appropriate balance between risk and return and minimize potential adverse effects on the Company's financial performance.

The Company's risk management policies are designed to identify and analyze these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Company regularly reviews its risk management policies and systems to reflect changes in markets, products and the latest best practice.

The Board of Directors sets out strategies and risk preference for overall risk management strategy and decides the risk tolerance level. The senior management establishes related risk management policies and procedures under the strategy approved by the Board of Directors. Business Units act as the first line of defense in risk management while the Risk Management Department undertakes the main risk management operational functions of the Company. In addition, internal audit department is responsible for the independent review of risk management and the control environment.

The main types of financial risks of the Company are credit risk, liquidity risk, market risk and operational risk, etc. Market risk also includes foreign exchange risk, interest rate risk and other price risk.

3.1 Credit risk

Credit risk, the risk that a borrower or counterparty of the Company will be unable or unwilling to honor a repayment obligation, is one of the key risks encountered by the Company as the Company's main business is still dominated by credit business such as lending, billing and stock financing. If credit deterioration or default occurs, it will cause certain losses and affect the Company's business stability. Therefore, the risks must be strictly monitored. Starting with quality of business, the monitoring approach includes not only rigorous credit review but also ongoing post-lending monitoring. This ensures that the non-performing loan ratio is less than risk tolerance and there is sufficient provision for coverage. The Company manages and controls the overall credit risk in a prudent manner and reports regularly to the senior management and the Board of Directors of the Company.

3.1.1 Credit risk management

The Company's credit risk management is assumed by major functions including Corporate Business Management Department, Retail Business Management Department, Credit Card Centre, Credit Management Department, Risk Management Department, and Finance Department, which are responsible for the standardized management for corporate and retail credit businesses in terms of credit investment, credit investigation and report, credit approval, loan granting, post-loan monitoring and non-performing loan management.

(a) Loans and advances to customers

As for corporate loans, the Company's relationship managers are responsible for receiving application files submitted by the applicants, conducting pre-loan investigation, assessing the credit risk suffered by applicants and relevant businesses, and completing initial internal rating. The Company adopts the hierarchical approval system based on the credit approval authority. Credit line is determined by taking into account the credit record, financial position, collaterals and guarantees of the applicant, overall credit risk of the credit portfolio, macroeconomic regulation and control policies and relevant laws and regulations. The Company keeps a close eye on the economic and financial trend and credit risk profile in the industry and provides more guidance on credit investment by formulating guidance for different industries. It strengthens daily risk pre-warning, monitoring and specific risk investigation to identify customers under major risks and material potential risk points. With improvements in post-loan management, the Company enhanced the refinement of post-loan management in a practical manner. The independent Credit Management Department shall review the compliance, completeness and effectiveness of relevant credit files before loan granting according to the applications for drawdown of credit line. The Company's relationship manger is the person primarily responsible for post-loan management. The Company adopts a series of tools and approaches, such as risk filtering, list management, risk warning and risk investigation, in daily risk monitoring of corporate loans. To minimize the losses arising from credit risks, the Company manages NPLs mainly through (1) collection; (2) restructuring; (3) disposal of collaterals or recourse to the guarantor; (4) litigation or arbitration; and (5) write-off pursuant to regulations and requirements.

For retail credit assets, the Company adopts categorized management for retail credit assets on the basis of overdue ageing and guarantee mode. With regard to retail credit customers with overdue loans, different approaches are adopted to collect such loans based on their overdue days. Retail credit businesses overdue by a certain period shall be managed as impaired assets and relevant impairment allowance shall be provided for such assets.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.1 Credit risk management (continued)

(a) Loans and advances to customers (continued)

Credit Card Centre accounted for independently by the Company is in charge of the operation and management of credit card business. Credit Card Centre of the Company adopts various supervisory and preventive measures simultaneously. It reinforces data cross-validation to enhance risk prevention in the approval process, tightens credit line on high risk customers through secondary credit investigation to enter into the collection process earlier than scheduled, deploys collection strength in a proper manner to significantly enhance collection efficiency, and optimizes data analytic system to further propel the refined management of credit card business.

(b) Treasury business

For treasury business, the Company chooses banks and other financial institutions prudently and balances the credit risk and return rate of investments. By making reference to internal and external credit rating information, the Company adopts hierarchical credit and uses an appropriate credit limit management system to review and adjust credit lines, aiming to manage the credit risk exposed to the treasury business.

For debt investments, internal and external ratings (such as Standard and Poor's) are used by the Company when available for managing the credit risk exposed to debt investments and bills. The investment in those debts and bills is to have better credit quality assets while maintaining readily available funding sources. The bond issuers involved with the Company are subject to the credit granting review and approval of the Global Market Department, Credit Management Department and credit limits are placed on such issuers.

As for derivative instruments, the Company maintains strict limits on net open derivative investment positions (i.e., the difference between long and short contracts), by both amount and maturity. At any time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Company (i.e., assets where their fair value is positive), which, in relation to derivative instruments, is only a fraction of the contract's notional amount used to express the amount outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market fluctuations. Collateral or other security is not usually obtained for credit risk exposures on these instruments, except when the Company requires margin deposits from counterparties. The management has set limits of these contracts according to counterparty, and regularly monitor and control the actual credit risk when the Company concludes foreign exchange and interest rate contracts with other financial institutions and clients.

The Company manages the credit quality of due from and placements with banks and other financial institutions by considering the size, financial position and the external credit rating of the banks and financial institutions. The Risk Management Department monitors and reviews the credit risk of due from and placements with banks and other financial institutions by counterparties periodically. Limits are placed on different counterparties.

(c) Credit-related commitments

Credit risk exposures to financial guarantees are the same as that of loans. However, commercial letters of credit are usually pledged by the relevant shipped goods, and therefore is subject to lower risk compared with direct loans. Credit related commitments are included in the management of overall credit line granted to the applicant. For customers with transactions beyond the credit limit or infrequent transactions, the applicant shall be requested to provide relevant guarantee in order to reduce credit risk exposures.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.1 Credit risk management *(continued)*

(d) Credit risk quality

In accordance with the Guideline on Loan Classification System issued by the HKMA, the Company has established a loan credit risk classification system and performs credit risk management based on loan classification in one of five categories. The Company classifies loans into the following five categories: normal, special-mention, substandard, doubtful and loss, of which substandard, doubtful and loss loans are regarded as non-performing loans.

The five categories of loan classification into which the Company classifies its loans and advances to customers are set out below:

Pass:	Loans for which borrowers are current in meeting commitments and for which the full repayment of interest and principal is not in doubt.
Special-mention:	Loans with which borrowers are experiencing difficulties and which may threaten the authorized institution's position.
Substandard:	Loans in which borrowers are displaying a definable weakness that is likely to jeopardise repayment.
Doubtful:	Loans for which collection in full is improbable and the authorized institution expects to sustain a loss of principal and/or interest, taking into account the net realizable value of collateral.
Loss:	Loans that are considered uncollectable after all collection options (such as the realization of collateral or the institution of legal proceedings) have been exhausted.

Regarding risk, the treasury business is classified into five categories based on five categories of loan classification.

(e) Credit risk measurement

The Company has established an internal rating system to measure credit risk arising from default events.

The credit risk internal rating system considers the "probability of default" by debtors (or debts). This is similar to the approach used for the purposes of measuring Expected Credit Loss ("ECL") under HKFRS 9. Please refer to note 3.1.2 for more details.

Probability of default is the probability of occurrence of default event in a given period of time in future.

Exposure at default represents the total amount of on-balance sheet and off-balance sheet exposure at the time of default by debtor, reflecting the total amount of possible losses to be incurred. In general, this includes the utilized credit limit, interest receivable, the anticipated usage of unused credit facilities as well as the related expenses to be incurred.

Loss given default represents the percentage of amount of loss to be occurred in the event of default to the total risk exposure. It is expressed as the loss percentage per unit of exposure which typically varies by nature of debtor, type and seniority of claim and the availability of collaterals or other credit enhancements.

The Company summarized a series of financial and other related factors to build the internal credit rating model to measure the probability of default, which is based on historical data collection, data statistics and data analysis on the characteristics of risks of the clients/debts before the default occurs. Internal rating model applies the principle of regression to forecast the probability of default and then matches the probability of default with relevant rank of default risk which is used for determination of the borrower's credit ranking within the internal rating system. In order to improve the model's accuracy and stability, the Company performs evaluation of the model every three months and monitors the results by performing back testing and comparing the results from model using the default from customers.

The above credit risk factors are considered for the measurement of possible credit losses to be incurred, and applied in the daily operations of the Company.

For retail business, the assets are categorized and credit risk is measured by aging analysis.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.1 Credit risk management (continued)

(e) Credit risk measurement (continued)

For corporate business, the rating is determined at the borrower level. A relationship manager will incorporate any updated or new information/credit assessments into the credit system on an ongoing basis. In addition, the relationship manager will also update information about the creditworthiness of the borrower every year from sources such as public financial statements. This will determine the updated internal credit rating and the probability of default.

For debt securities in the Treasury portfolio, external rating agency credit grades are mapped onto the master scale. These published grades are continuously monitored and updated. The mapping to the master scale will determine the updated internal credit rating and the probability of default.

The Company's rating method comprises 18 rating levels for instruments not in default (1.1 to 1.4, 2 to 15) and one default class. The master scale assigns each rating category a specific range of probabilities of default, which is stable over time. The rating methods are subject to annual validation and recalibration so that they reflect the latest projections in light of all actual observed defaults.

The Company's internal rating scale and mapping of external ratings are set out below:

Internal Rating	PD Range	Corresponding Rating (S&P)	Description of Grade
1.1 – 4	0.03% – 0.53%	AAA to BBB–	Investment Grade
5 – 11	0.53% – 14.07%	BB+ to B–	Standard Monitoring
12 – 15	14.07% – 99.99%	CCC+ to C	Special Monitoring
Default	100.00%	D	Default

3.1.2 Expected credit loss measurement

HKFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarized below:

If the credit risk on a financial instrument has not increased significantly since initial recognition, the financial instrument is classified in 'Stage 1' and has its credit risk continuously monitored by the Company.

If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. Please refer to note 3.1.2.1 for a description of how the Company determines when a significant increase in credit risk has occurred.

If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Please refer to note 3.1.2.2 for a description of how the Company defined credit-impaired and default.

Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis. Please refer to note 3.1.2.3 for a description of inputs, assumptions and estimation techniques used in measuring the ECL.

A pervasive concept in measuring ECL in accordance with HKFRS 9 is that it should consider forward-looking information. Note 3.1.2.4 includes an explanation of how the Company has incorporated this in its ECL models.

Purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired on initial recognition. Their ECL is always measured on a lifetime basis.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement *(continued)*

The following diagram summaries the impairment requirements under HKFRS 9 (other than purchased or originated credit-impaired financial assets):

Stage 1	**Stage 2**	**Stage 3**
(Initial recognition)	(Significant increase in credit risk since initial recognition)	(Credit-impaired assets)
12- month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses

The key judgements and assumptions adopted at the Company in addressing the requirements of the standards are addressed below.

3.1.2.1 Significant increase in credit risk (SICR)

The criteria for the determination of "a significant increase in credit risk" includes but is not limited to the following factors:

(a) Notch difference

For investment securities, significant increase in credit risk is assessed based on the notch difference threshold by comparing ratings at measurement date and initial recognition date.

Internal Rating	**Notch Difference**
1.1 – 1.3	4
1.4 – 4	3
5 – 8	2
9 – 15	1

(b) Day past due

Different levels of day past due are considered as significant credit deterioration criteria for different portfolios.

(c) Watch list

Qualitative and forward-looking information, e.g. industry outlook of obligor, future organization, restructure plan of obligor, are considered as criteria of adding to the watch list, which is considered as significant increase in credit risk. For investment securities, significant decrease in market price and external rating are considered as significant increase in credit risk.

(d) HKMA ratings

Under HKMA's Guideline on Loan Classification System, the Special Mention grade is considered as threshold for retail loan, corporate loan and credit card portfolio.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement (continued)

3.1.2.1 Significant increase in credit risk (SICR) (continued)

(e) Other risk alarm indicators imply growing potential risk, and could cause losses of financial assets to the Company.

The financial assets are moveable between stages. For instance, financial instruments originally classified at stage 1 should be downgraded to stage 2 if events occur such as a significant increase in credit risk. Financial instruments at stage 2 could be upgraded to stage 1 if credit risk decreases and the criteria for the determination of "a significant increase in credit risk" are no longer met.

The assessment of significant increase in credit risk incorporates forward-looking information (refer to note 3.1.2.4 for further information) and is performed on a periodic basis at a counterparty level for all financial instruments held by the Company.

3.1.2.2 Definition of default and credit-impaired assets

The Company defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

- The borrower is more than 90 days past due on its contractual payments (with the sole exception of credit card where a borrower only needs to be 60 days past due to be considered in default).

- The borrower has been classified as Substandard, Doubtful or Loss under the HKMA classification system.

- The loan has been placed on individual assessment list (applicable only to loans).

The credit impairment definition has been applied consistently to model the probability of default, exposure at default and loss given default throughout the Company's expected loss calculations.

3.1.2.3 Measuring ECL – Explanation of inputs, assumptions and estimation techniques

The ECL is measured on either a 12-month or lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

- The PD represents the likelihood of a borrower defaulting on its financial obligation (as per "Definition of credit-impaired" above), either over the next 12 months (12M PD), or over the remaining lifetime (Lifetime PD) of the obligation.

- EAD is based on the amounts the Company expects to be owed at the time of default. For example, for a revolving commitment, the Company includes the current drawn balance plus any further amount that is expected to be drawn up to the current contractual limit by the time of default, should it occur.

- LGD represents the Company's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type and seniority of claim and availability of collateral or other credit support. LGD is expressed as a percentage loss per unit of exposure at the time of default (EAD).

The ECL is determined by projecting the PD, LGD and EAD for each future year and for each individual exposure. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has not prepaid or defaulted in an earlier year). This effectively calculates an ECL for each future year, which is then discounted back to the reporting date and summed. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

The Lifetime PD is developed by using forecasted macroeconomic factor to calculate a forecasted 12M PD for the 2nd to 5th year. For the years after the fifth year, it is assumed that the PD will remain the same.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement *(continued)*

3.1.2.3 Measuring ECL – Explanation of inputs, assumptions and estimation techniques (continued)

EAD represents the total amount of on-balance sheet and off-balance sheet exposure at the time of default by debtor, reflecting the total amount of possible losses to be incurred. In general, this includes the utilized credit limit, interest receivable, the anticipated usage of unused credit facilities as well as the related expenses to be incurred.

LGDs are determined based on the factors which impact the recoveries made post default. These vary by product type.

- For secured products, this is primarily based on collateral type and projected collateral values, historical discounts to market/book values due to forced sales, time to repossession and recovery costs observed.
- For unsecured products, LGD's are typically set at product level due to the limited differentiation in recoveries achieved across different borrowers. These LGD's are influenced by collection strategies, including contracted debt sales and price.

3.1.2.4 Forward-looking information incorporated in the ECL models

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. The Company 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 judgment has also been applied in this process. Forecasts of these economic variables (the "base economic scenario") over the next five years are gathered from economics team of the Bank of Communications Co. Ltd., HKBR's Development Strategy Team and the International Monetary Fund (IMF). After five years, economic variables are assumed to remain stable and the last available forecast is used. The impact of these economic variables on the PD, EAD and LGD has been determined by performing statistical regression analysis to understand the impact changes in these variables have had historically on default rates and on the components of LGD and EAD.

In addition to the base economic scenario, the Company's Risk Management Department and Development Strategy Team have also considered other economic scenarios which are calculated using historical data, along with weightings for each of the scenarios. The number of other scenarios used is set based on the analysis of each major product type to ensure non-linearities are captured. The number of scenarios and their attributes are reassessed at each reporting date. At 31 December 2018 and 31 December 2019, the Company concluded that three scenarios appropriately captured non-linearities. The scenario weightings are determined by a combination of statistical analysis and expert credit judgement, taking account of the range of possible outcomes each chosen scenario is representative of.

Following this assessment, The Company then measures ECL as either a probability weighted 12 month ECL (Stage 1), or a probability weighted lifetime ECL (Stages 2 and 3). These probability-weighted ECLs are determined by running each scenario through the relevant ECL model and multiplying it by the appropriate scenario weighting (as opposed to weighting the inputs).

As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The Company considers these forecasts to represent its best estimate of the possible outcomes and has analyzed the non-linearities and asymmetries within the Company's different portfolios to establish that the chosen scenarios are appropriately representative of the range of possible scenarios. The proposed macroeconomic forecasts and probability weightings are subject to management review.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement (continued)

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

Economic variable assumptions

The scenarios "base", "upside" and "downside" were used for all portfolios. The most significant period-end assumptions used for the ECL estimate as at 31 December 2019 are set out below.

		2020	2021	2022	2023	2024
Hong Kong CPI	Base	2.50%	2.50%	2.50%	2.50%	2.50%
	Upside	6.32%	5.84%	2.86%	-4.02%	-3.69%
	Downside	-1.66%	-3.06%	-2.50%	-0.45%	0.90%
Hong Kong Unemployment rate	Base	3.70%	4.00%	4.30%	4.50%	4.50%
	Upside	2.77%	2.20%	4.70%	6.25%	4.95%
	Downside	5.09%	7.32%	7.94%	6.81%	5.59%
China Real GDP (first difference)	Base	-0.10%	0.00%	-0.20%	-0.10%	-0.10%
	Upside	-1.08%	-0.65%	-1.58%	-0.03%	0.75%
	Downside	-0.10%	0.67%	0.98%	0.13%	1.15%
US Real GDP (first difference)	Base	-0.26%	-0.34%	-0.19%	0.02%	0.04%
	Upside	1.08%	0.69%	-0.04%	0.24%	-0.59%
	Downside	-3.12%	0.81%	1.02%	0.98%	-0.44%

The weightings assigned to each economic scenario as at 31 December 2019 were as follows:

Upside	Base	Downside
20%	65%	15%

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement (continued)

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

Economic variable assumptions (continued)

The most significant period-end assumptions used for the ECL estimate as at 31 December 2018 are set out below.

		2019	2020	2021	2022	2023
Hong Kong CPI	Base	1.50%	1.50%	1.50%	1.50%	1.50%
	Upside	6.32%	5.84%	2.86%	-4.02%	–3.69%
	Downside	-1.66%	–3.06%	–2.50%	–0.45%	0.90%
Hong Kong Unemployment rate	Base	3.20%	3.30%	3.40%	3.50%	3.50%
	Upside	2.77%	2.20%	4.70%	6.25%	4.95%
	Downside	5.09%	7.32%	7.94%	6.81%	5.59%
China Real GDP (first difference)	Base	-0.20%	0.00%	–0.10%	–0.10%	–0.10%
	Upside	-1.08%	–0.65%	–1.58%	–0.03%	0.75%
	Downside	-0.10%	0.67%	0.98%	0.13%	1.15%
US Real GDP (first difference)	Base	-0.34%	–0.73%	–0.09%	–0.24%	–0.11%
	Upside	1.08%	0.69%	-0.04%	0.24%	–0.59%
	Downside	-3.12%	0.81%	1.02%	0.98%	–0.44%

The weightings assigned to each economic scenario as at 31 December 2018 were as follows:

Upside	Base	Downside
25%	60%	15%

Other forward-looking considerations not otherwise incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have also been considered, but are not deemed to have a material impact and therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness on a quarterly basis.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement (continued)

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

Sensitivity analysis

The following table presents the base ECL scenario compared to the probability-weighted ECL derived from using three ECL scenarios. The difference reflects the impact of deriving multiple scenarios around the base ECL and resultant change in ECL due to non-linearity and sensitivity to using macroeconomic forecasts.

Change from Base to Probability-weighted ECL	**As at 31 December 2019**	As at 31 December 2018
Probability-weighted ECL	**477,417**	324,147
Base ECL	**480,756**	291,262
Difference in amount	**(3,339)**	32,885
Difference in percentage	**(0.7%)**	10.1%

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure

3.1.3.1 Maximum exposure to credit risk – Financial instruments subject to impairment

The following tables contain an analysis of the credit risk exposure of financial instruments for when an ECL allowance is recognized.

The gross carrying amount of financial assets below also represents the company's maximum exposure of credit risk on these assets.

	2019			
	Stage 1	**Stage 2**	**Stage 3**	
Corporate Loan	**12 month ECL**	**Lifetime ECL**	**Lifetime ECL**	**Total**
Investment Grade	**10,474,278**	**–**	**–**	**10,474,278**
Standard Monitoring	**15,201,423**	**108,155**	**–**	**15,309,578**
Special Monitoring	**13,529**	**181,967**	**–**	**195,496**
Defaults	**–**	**–**	**32,605**	**32,605**
Unrated	**18,333,628**	**34,338**	**–**	**18,367,966**
Gross carrying amount	**44,022,858**	**324,460**	**32,605**	**44,379,923**
Loss allowance	**(138,330)**	**(16,797)**	**(14,316)**	**(169,443)**
Carrying amount	**43,884,528**	**307,663**	**18,289**	**44,210,480**

	2018			
	Stage 1	Stage 2	Stage 3	
Corporate Loan	12 month ECL	Lifetime ECL	Lifetime ECL	Total
Investment Grade	12,460,563	–	–	12,460,563
Standard Monitoring	9,131,492	10,358	–	9,141,850
Special Monitoring	–	50,606	–	50,606
Defaults	–	–	17,900	17,900
Unrated	17,943,052	18,597	–	17,961,649
Gross carrying amount	39,535,107	79,561	17,900	39,632,568
Loss allowance	(141,821)	(8,578)	(8,236)	(158,635)
Carrying amount	39,393,286	70,983	9,664	39,473,933

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure (continued)

3.1.3.1 Maximum exposure to credit risk – Financial instruments subject to impairment (continued)

	2019			
	Stage 1	**Stage 2**	**Stage 3**	
Retail loan	**12 month ECL**	**Lifetime ECL**	**Lifetime ECL**	**Total**
Investment Grade	**34,672,630**	**22,340**	**–**	**34,694,970**
Standard Monitoring	**158,575**	**204,003**	**–**	**362,578**
Special Monitoring	**–**	**20,337**	**–**	**20,337**
Defaults	**–**	**–**	**29,783**	**29,783**
Gross carrying amount	**34,831,205**	**246,680**	**29,783**	**35,107,668**
Loss allowance	**(90,033)**	**(43,605)**	**(14,329)**	**(147,967)**
Carrying amount	**34,741,172**	**203,075**	**15,454**	**34,959,701**

	2018			
	Stage 1	Stage 2	Stage 3	
Retail loan	12 month ECL	Lifetime ECL	Lifetime ECL	Total
Investment Grade	27,871,785	6,467	–	27,878,252
Standard Monitoring	168,877	165,443	182	334,502
Special Monitoring	–	29,377	208	29,585
Defaults	–	–	46,026	46,026
Gross carrying amount	28,040,662	201,287	46,416	28,288,365
Loss allowance	(34,877)	(23,384)	(15,318)	(73,579)
Carrying amount	28,005,785	177,903	31,098	28,214,786

	2019			
	Stage 1	**Stage 2**	**Stage 3**	
Due from banks and other financial institutions	**12 month ECL**	**Lifetime ECL**	**Lifetime ECL**	**Total**
Investment Grade	**17,676,217**	**–**	**–**	**17,676,217**
Gross carrying amount	**17,676,217**	**–**	**–**	**17,676,217**
Loss allowance	**(8,309)**	**–**	**–**	**(8,309)**
Carrying amount	**17,667,908**	**–**	**–**	**17,667,908**

	2018			
	Stage 1	Stage 2	Stage 3	
Due from banks and other financial institutions	12 month ECL	Lifetime ECL	Lifetime ECL	Total
Investment Grade	25,088,522	–	–	25,088,522
Gross carrying amount	25,088,522	–	–	25,088,522
Loss allowance	(6,085)	–	–	(6,085)
Carrying amount	25,082,437	–	–	25,082,437

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure (continued)

3.1.3.1 Maximum exposure to credit risk – Financial instruments subject to impairment (continued)

	2019			
	Stage 1	**Stage 2**	**Stage 3**	
Debt securities at fair value through other comprehensive income	**12 month ECL**	**Lifetime ECL**	**Lifetime ECL**	**Total**
Investment Grade	**83,818,392**	**–**	**–**	**83,818,392**
Unrated	**38,413,916**	**–**	**–**	**38,413,916**
Gross carrying amount	**122,232,308**	**–**	**–**	**122,232,308**
Loss allowance	**(121,331)**	**–**	**–**	**(121,331)**
Carrying amount	**122,110,977**	**–**	**–**	**122,110,977**

	2018			
	Stage 1	Stage 2	Stage 3	
Debt securities at fair value through other comprehensive income (restated)	12 month ECL	Lifetime ECL	Lifetime ECL	Total
Investment Grade	103,793,107	–	–	103,793,107
Unrated	5,511,965	–	–	5,511,965
Gross carrying amount	109,305,072	–	–	109,305,072
Loss allowance	(61,089)	–	–	(61,089)
Carrying amount	109,243,983	–	–	109,243,983

Information on how the Expected Credit Loss (ECL) is measured and how the three stages above are determined is included in notes 3.1.2.

3.1.3.2 Maximum exposure to credit risk – Financial instruments

The following table contains an analysis of the maximum credit risk exposure from financial assets not subject to impairment:

	Maximum exposure to credit risk	
	2019	2018
Financial assets at fair value through profit or loss		
Derivative financial instruments	**874,964**	1,290,050
Government bonds	**189,962**	544,483
Other debt securities	**–**	20,821
Total	**1,064,926**	1,855,354

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure (continued)

3.1.3.3 Collateral and other credit enhancements

The Company manages limits and controls concentrations of credit risk wherever they are identified, in particular, to individual counterparties, company and groups and geographical regions.

The Company structures the levels of credit risk it undertakes by placing limits in relation to one borrower, or group of borrowers. Such risks are monitored on a regular basis and subject to annual or more frequent review, whenever necessary.

The exposure to any single borrower including banks and brokers is further restricted by sub-limits covering on-balance and off-balance sheet exposures, and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored daily.

Exposure to credit risk is also managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations and by changing their lending limits where appropriate.

Some other specific control and risk mitigation measures are outlined below:

(a) Collaterals

The Company employs a range of policies and practices to mitigate credit risk. The most useful practice is to accept collaterals. The Company implements guidelines on the acceptability of specific classes of collaterals. The principal types of collaterals for loans and advances to customers are:

- Residential properties;
- Business assets such as premises, inventory and accounts receivable; and
- Financial instruments such as debt securities and stocks.

Long-term loans and advances to corporate and individual customers are generally secured; while revolving individual credit facilities are generally unsecured. In addition, in order to minimize the credit loss the Company will seek additional collaterals from the counterparties as soon as impairment indicators are noted for the relevant individual loans and advances.

For loans guaranteed by a third-party guarantor, the Company will assess the financial condition, credit history and ability to meet obligations of the guarantor.

Collaterals held as security for financial assets other than loans and advances to customers are determined by the nature of the instrument. Debt securities and treasury bonds are generally unsecured, with the exception of asset backed securities, which are secured by portfolios of financial instruments.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure (continued)

3.1.3.3 Collateral and other credit enhancements (continued)

(a) Collaterals (continued)

The Company closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Company will take possession of collateral to mitigate potential credit losses. The fair value is capped at lower of carrying amount and fair value. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

As at 31 December 2019:

	Gross exposure	**ECL allowance**	**Carrying amount**	**Fair value of collateral held**
Loans to individuals	**29,783**	**(14,329)**	**15,454**	**13,687**
Loans to corporate entities	**32,605**	**(14,316)**	**18,289**	**10,560**
	62,388	**(28,645)**	**33,743**	**24,247**

As at 31 December 2018:

	Gross exposure	ECL allowance	Carrying amount	Fair value of collateral held
Loans to individuals	46,416	(15,318)	31,098	29,241
Loans to corporate entities	17,900	(8,236)	9,664	9,664
	64,316	(23,554)	40,762	38,905

(b) Master netting arrangements

The Company further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of assets and liabilities in the statement of financial position, as transactions are usually settled on a gross basis. However, the credit risk associated with favourable contracts is reduced by a master netting arrangement to the extent that if a default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Company's overall exposure to credit risk on derivative instruments subject to master netting arrangements can change substantially within a short period, as each transaction subject to the arrangement affects credit risk.

3.1.4 Movements of gross carrying amount and ECL allowance

The loss allowance recognized in the period is impacted by a variety of factors, such as:

- Transfers between Stage 1 and Stages 2 or 3 due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit-impaired in the period, and the consequent step up (or step down) between 12-month and Lifetime ECL;

- Additional allowances for new financial instruments recognized during the period, as well as releases for financial instruments derecognized in the period;

- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular refreshing of inputs to models;

- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis; and

- Financial assets derecognized during the period and write-offs of allowances related to assets that were written off during the period (see note 3.1.5).

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

The following tables explain the changes in the loss allowance between the beginning and the end of the annual period due to these factors:

Movement of gross amount – Corporate Loan

Corporate loan	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Gross carrying amount as at 1 January 2019	**39,535,107**	**79,561**	**17,900**	**39,632,568**
Transfers:				
Transfer from Stage 1 to Stage 2	**(124,257)**	**124,257**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(12,789)**	**–**	**12,789**	**–**
Transfer from Stage 2 to Stage 1	**21,431**	**(21,431)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(2,390)**	**2,390**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**4,648,945**	**144,463**	**(452)**	**4,792,956**
Foreign Exchange and other movements	**(45,579)**	**–**	**(22)**	**(45,601)**
Gross carrying amount as at 31 December 2019	**44,022,858**	**324,460**	**32,605**	**44,379,923**

Corporate Loan	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Gross carrying amount as at 1 January 2018	225,391,235	3,074,621	534,753	229,000,609
Transfer of Excluded Business to HKBR (Note 2)	(200,702,708)	(2,566,843)	(448,179)	(203,717,730)
Transfers:				
Transfer from Stage 1 to Stage 2	(83,975)	83,975	–	–
Transfer from Stage 1 to Stage 3	(5,683)	–	5,683	–
New financial assets originated or purchased, assets derecognized, repayments and further lending	14,936,160	(512,190)	(74,357)	14,349,613
Foreign exchange and other movements	78	(2)	–	76
Gross carrying amount as at 31 December 2018	39,535,107	79,561	17,900	39,632,568

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of ECL allowance – Corporate Loan

Corporate Loan	**Stage 1 12-month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
Loss allowance as at 1 January 2019	**141,821**	**8,578**	**8,236**	**158,635**
Transfers:				
Transfer from Stage 1 to Stage 2	**(941)**	**941**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(107)**	**–**	**107**	**–**
Transfer from Stage 2 to Stage 1	**2,317**	**(2,317)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(374)**	**374**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**17,600**	**3,534**	**1,705**	**22,839**
Changes in PDs/LGDs/EADs	**(22,040)**	**6,274**	**3,799**	**(11,967)**
Unwind of discount (Note a)	**–**	**203**	**–**	**203**
Foreign Exchange and other movements	**(320)**	**(42)**	**95**	**(267)**
Loss allowance amount as at 31 December 2019	**138,330**	**16,797**	**14,316**	**169,443**

Corporate Loan	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Loss allowance as at 1 January 2018	875,665	34,744	264,855	1,175,264
Transfer of Excluded Business to HKBR (Note 2)	(856,478)	(34,654)	(242,222)	(1,133,354)
Transfers:				
Transfer from Stage 1 to Stage 2	(738)	738	–	–
Transfer from Stage 1 to Stage 3	(10)	–	10	–
New financial assets originated or purchased, assets derecognized, repayments and further lending	173,404	(12)	(17,896)	155,496
Changes in PDs/LGDs/EADs	(26,084)	7,735	272	(18,077)
Foreign Exchange and other movements	(23,938)	27	3,217	(20,694)
Loss allowance amount as at 31 December 2018	141,821	8,578	8,236	158,635

Note a: The unwind of discount on Stage 3 financial assets is reported within 'interest income' so that interest income is recognized on the amortized cost (after deducting the ECL allowance).

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance *(continued)*

Movement of gross amount – Retail Loan

Retail Loan	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Gross carrying amount as at 1 January 2019	**28,040,662**	**201,287**	**46,416**	**28,288,365**
Transfers:				
Transfer from Stage 1 to Stage 2	**(185,428)**	**185,428**	–	**–**
Transfer from Stage 1 to Stage 3	**(18,522)**	–	**18,522**	**–**
Transfer from Stage 2 to Stage 1	**89,474**	**(89,474)**	–	**–**
Transfer from Stage 2 to Stage 3	–	**(1,357)**	**1,357**	**–**
Transfer from Stage 3 to Stage 1	**74**	–	**(74)**	**–**
Transfer from Stage 3 to Stage 2	–	**495**	**(495)**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**6,910,503**	**(49,586)**	**(29,148)**	**6,831,769**
Write-offs	**–**	**–**	**(6,794)**	**(6,794)**
Foreign exchange and other movements	**(5,558)**	**(113)**	**(1)**	**(5,672)**
Gross carrying amount as at 31 December 2019	**34,831,205**	**246,680**	**29,783**	**35,107,668**

Retail Loan	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Gross carrying amount as at 1 January 2018	28,553,939	188,847	22,149	28,764,935
Transfers:				
Transfer from Stage 1 to Stage 2	(171,510)	171,510	–	–
Transfer from Stage 1 to Stage 3	(28,322)	–	28,322	–
Transfer from Stage 2 to Stage 1	117,476	(117,476)	–	–
Transfer from Stage 2 to Stage 3	–	(263)	263	–
Transfer from Stage 3 to Stage 1	2	–	(2)	–
New financial assets originated or purchased, assets derecognized, repayments and further lending	(432,580)	(41,337)	2,090	(471,827)
Write-offs	–	–	(6,405)	(6,405)
Foreign exchange and other movements	1,657	6	(1)	1,662
Gross carrying amount as at 31 December 2018	28,040,662	201,287	46,416	28,288,365

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of ECL allowance – Retail Loan

Retail Loan	**Stage 1 12-month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
Loss allowance amount as at 1 January 2019	**34,877**	**23,384**	**15,318**	**73,579**
Transfers:				
Transfer from Stage 1 to Stage 2	**(409)**	**409**	–	**–**
Transfer from Stage 1 to Stage 3	**(44)**	–	**44**	**–**
Transfer from Stage 2 to Stage 1	**15,529**	**(15,529)**	–	**–**
Transfer from Stage 2 to Stage 3	–	**(266)**	**266**	**–**
Transfer from Stage 3 to Stage 1	**13**	–	**(13)**	**–**
Transfer from Stage 3 to Stage 2	**–**	**506**	**(506)**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**22,116**	**1,482**	**(845)**	**22,753**
Unwind of discount (Note a)	**–**	**558**	**–**	**558**
Changes in PDs/LGDs/EADs	**18,127**	**33,178**	**6,546**	**57,851**
Write-offs	**–**	**–**	**(6,794)**	**(6,794)**
Foreign Exchange and other movements	**(176)**	**(117)**	**313**	**20**
Loss allowance amount as at 31 December 2019	**90,033**	**43,605**	**14,329**	**147,967**

Retail Loan	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Loss allowance amount as at 1 January 2018	45,526	28,937	22,332	96,795
Transfers:				
Transfer from Stage 1 to Stage 2	(347)	347	–	–
Transfer from Stage 1 to Stage 3	(47)	–	47	–
Transfer from Stage 2 to Stage 1	23,292	(23,292)	–	–
Transfer from Stage 2 to Stage 3	–	(84)	84	–
Transfer from Stage 3 to Stage 1	6	–	(6)	–
New financial assets originated or purchased, assets derecognized, repayments and further lending	(2,239)	(375)	57	(2,557)
Unwind of discount (Note a)	–	454	–	454
Changes in PDs/LGDs/EADs	(33,865)	17,395	6,064	(10,406)
Write-offs	–	–	(6,405)	(6,405)
Foreign Exchange and other movements	2,551	2	(6,855)	(4,302)
Loss allowance amount as at 31 December 2018	34,877	23,384	15,318	73,579

Note a: The unwind of discount on Stage 3 financial assets is reported within 'interest income' so that interest income is recognized on the amortized cost (after deducting the ECL allowance).

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance *(continued)*

Movement of ECL allowance – loans and advances to customers

Loans and advances to customers	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Loss allowance amount as at 1 January 2019	**176,698**	**31,962**	**23,554**	**232,214**
Transfers:				
Transfer from Stage 1 to Stage 2	**(1,350)**	**1,350**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(151)**	**–**	**151**	**–**
Transfer from Stage 2 to Stage 1	**17,846**	**(17,846)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(640)**	**640**	**–**
Transfer from Stage 3 to Stage 1	**13**	**–**	**(13)**	**–**
Transfer from Stage 3 to Stage 2	**–**	**506**	**(506)**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**39,716**	**5,016**	**860**	**45,592**
Changes in PDs/LGDs/EADs	**(3,913)**	**39,452**	**10,345**	**45,884**
Unwind of discount (Note a)	**–**	**761**	**–**	**761**
Write-offs	**–**	**–**	**(6,794)**	**(6,794)**
Foreign Exchange and other movements	**(496)**	**(159)**	**408**	**(247)**
Loss allowance amount as at 31 December 2019	**228,363**	**60,402**	**28,645**	**317,410**

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Loss allowance amount as at 1 January 2018	921,191	63,681	287,187	1,272,059
Transfer of Excluded Business to HKBR (Note 2)	(856,478)	(34,654)	(242,222)	(1,133,354)
Transfers:				
Transfer from Stage 1 to Stage 2	(1,085)	1,085	–	–
Transfer from Stage 1 to Stage 3	(57)	–	57	–
Transfer from Stage 2 to Stage 1	23,292	(23,292)	–	–
Transfer from Stage 2 to Stage 3	–	(84)	84	–
Transfer from Stage 3 to Stage 1	6	–	(6)	–
New financial assets originated or purchased, assets derecognized, repayments and further lending	171,165	(387)	(17,839)	152,939
Changes in PDs/LGDs/EADs	(59,949)	25,130	6,336	(28,483)
Unwind of discount (Note a)	–	454	–	454
Write-offs	–	–	(6,405)	(6,405)
Foreign Exchange and other movements	(21,387)	29	(3,638)	(24,996)
Loss allowance amount as at 31 December 2018	176,698	31,962	23,554	232,214

Note a: The unwind of discount on Stage 3 financial assets is reported within 'interest income' so that interest income is recognized on the amortized cost (after deducting the ECL allowance).

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of gross carrying amount – Due from banks and other financial institutions

Due from banks and other financial institutions	**Stage 1** **12-month ECL allowance**	**Stage 2** **Lifetime ECL allowance**	**Stage 3** **Lifetime ECL allowance**	**Total**
Gross carrying amount as at 1 January 2019	**25,088,522**	**–**	**–**	**25,088,522**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**(7,412,305)**	**–**	**–**	**(7,412,305)**
Gross carrying amount as at 31 December 2019	**17,676,217**	**–**	**–**	**17,676,217**

Due from banks and other financial institutions	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
Gross carrying amount as at 1 January 2018	105,855,209	–	–	105,855,209
Transfer of Excluded Business to HKBR (Note 2)	(164,809,851)	–	–	(164,809,851)
New financial assets originated or purchased, assets derecognized, repayments and further lending	84,043,164	–	–	84,043,164
Gross carrying amount as at 31 December 2018	25,088,522	–	–	25,088,522

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of ECL allowance – Due from banks and other financial institutions

Due from banks and other financial institutions	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Loss allowance amount as at 1 January 2019	**6,085**	**–**	**–**	**6,085**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**1,868**	**–**	**–**	**1,868**
Change in PDs/LGDs/EADs	**356**	**–**	**–**	**356**
Foreign exchange and other movements	**–**	**–**	**–**	**–**
Loss allowance amount as at 31 December 2019	**8,309**	**–**	**–**	**8,309**

Due from banks and other financial institutions	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
Loss allowance amount as at 1 January 2018	28,284	–	–	28,284
Transfer of Excluded Business to HKBR (Note 2)	(33,777)	–	–	(33,777)
New financial assets originated or purchased, assets derecognized, repayments and further lending	11,586	–	–	11,586
Foreign exchange and other movements	(8)	–	–	(8)
Loss allowance amount as at 31 December 2018	6,085	–	–	6,085

Movement of gross amount – Debt securities at fair value through other comprehensive income

Debt securities at fair value through other comprehensive income	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2019	**109,305,072**	**–**	**–**	**109,305,072**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**13,396,487**	**–**	**–**	**13,396,487**
Foreign exchange and other movements	**(469,251)**	**–**	**–**	**(469,251)**
Gross carrying amount as at 31 December 2019	**122,232,308**	**–**	**–**	**122,232,308**

Debt securities at fair value through other comprehensive income	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2018	185,586,498	727,049	–	186,313,547
Transfer of Excluded Business to HKBR (Note 2)	(245,146,574)	(727,049)	–	(245,873,623)
New financial assets originated or purchased, assets derecognized, repayments and further lending	168,865,148	–	–	168,865,148
Gross carrying amount as at 31 December 2018	109,305,072	–	–	109,305,072

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of ECL allowance – Debt securities at fair value through other comprehensive income

Debt securities at fair value through other comprehensive income	**Stage 1 12-month ECL allowance**	**Stage 2 Lifetime ECL allowance**	**Stage 3 Lifetime ECL allowance**	**Total**
Loss allowance amount as at 1 January 2019	**61,089**	**–**	**–**	**61,089**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**52,428**	**–**	**–**	**52,428**
Changes in PDs/LGDs/EADs	**7,814**	**–**	**–**	**7,814**
Loss allowance amount as at 31 December 2019	**121,331**	**–**	**–**	**121,331**

Debt securities at fair value through other comprehensive income	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
Loss allowance amount as at 1 January 2018	91,858	414	–	92,272
Transfer of Excluded Business to HKBR (Note 2)	(98,668)	(414)	–	(99,082)
New financial assets originated or purchased, assets derecognized, repayments and further lending	67,899	–	–	67,899
Loss allowance amount as at 31 December 2018	61,089	–	–	61,089

Financial guarantee and credit related commitment	**Stage 1 12-month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
Gross carrying amount as at 31 December 2019	**11,780,758**	**9,303**	**–**	**11,790,061**
Gross carrying amount as at 31 December 2018	**12,082,761**	**38,937**	**–**	**12,121,698**

Financial guarantees and credit related commitment	**Stage 1 12-month ECL**	**Stage 2 Lifetime ECL**	**Stage 3 Lifetime ECL**	**Total**
Loss allowance amount as at 31 December 2019	**12,780**	**2,092**	**–**	**14,872**
Loss allowance amount as at 31 December 2018	**9,588**	**1,353**	**–**	**10,941**

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.5 Write-off policy

The Company writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include but is not limited to (i) ceasing enforcement activity and (ii) where the Company'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.

The Company may write-off financial assets that are still subject to enforcement activity. The Company still seeks to recover amounts it is legally owed in full, but which have been partially written off due to no reasonable expectation of full recovery.

3.1.6 Modification of Financial Assets

The amortized cost of financial assets that were modified during the year ended 31 December 2019 was HK$5.1 million (31 December 2018: HK$2.6 million) before modification, with insignificant modification gain or loss. As of 31 December, 2019, there have been no significant modified assets for which the loss allowance has changed from lifetime to twelve month expected credit loss.

3.1.7 Derivative instruments

The Company undertakes its transactions in foreign exchange, interest rate derivative contracts and others with other financial institutions and customers. The management has established limits for these contracts based on counterparties, industry sectors and countries. Actual credit exposures and limits are regularly monitored and controlled by management.

Settlement risk arises mainly from foreign exchange transactions with counterparties and also from derivatives transactions in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily settlement limits are established for each counterparty or customer to cover all settlement risk arising from the Company's market transactions on any single day.

3.1.8 Repossessed assets

Repossessed assets are collateral of the outstanding indebtedness that the Company takes possession of the collateral assets thorough court proceedings or voluntary delivery actions by the borrower. It will be sold as soon as practicable with the proceeds used to repay the outstanding indebtedness.

As at 31 December 2019 and 2018 , there was no repossessed asset that being held by the Company.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.9 Concentration risk analysis for loans and advances to customers with credit risk exposure

The Company mainly manages concentration risk for loans and advances to customers by geographical sectors. The following tables are the geographical analysis of gross loans and advances to customers:

Geographical sectors

	2019	2018
Mainland China	**10,630,761**	12,793,225
Hong Kong	**68,517,199**	54,913,438
Others	**371,065**	214,270
	79,519,025	67,920,933

3.2 Market risk

3.2.1 Overview

The Company takes on exposure to market risks, which is initiated by the fluctuation of the fair value of or future cash flow of financial instruments as a result of the changes of the market prices. Market risks arise from open positions in interest rates, exchange rates and equity products, all of which are exposed to market fluctuations and changes in interest rates, foreign exchange rates and equity products.

The Company established a management model of "large and small middle offices" for its market risk management, which is a centralized control framework led by Board of Directors and senior management. With the establishment of segregation of different duties, the Risk Management Department formulates market risk policies and ensures the Company's exposure are within risk appetite of the Board of Directors, while Global Markets Department is the execution unit of market risk management. The Internal Audit Department is responsible for independent verification of the market risk management system policies and processes.

The Company monitors market risk separately in respect of trading portfolios and non-trading portfolios. The trading account consists of financial instruments held either for trading intent or economic hedging for other elements of the account. The non-trading account consists of the investments purchased by the Company with excess funds and other financial instruments that are not captured in the trading account.

With regard to the exchange rate risks and the interest rate risks of trading book, the Company established an effective limit management system by implementing Net Position, Risk Sensitivity, Value at Risk ("VaR") and other indicators. Net interest income sensitivity analysis, interest rate repricing gap analysis and foreign exchange risk concentration analysis are the major tools used by the Company to monitor the market risk of its overall businesses. In addition, through adequate pricing management and asset allocation, the Company strived to maximize its rate of return while keeping its risks under control.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.1 Overview (continued)

The Company has continuously improved the management system of market risk. The Company conducted stress tests on historical scenarios and hypothetical scenarios in the consideration of the Company's major market risk factors. The Company has implemented daily automatic collection of trading data and market data in the system. The Company conducted the management of risk capital and VaR quota, and formulated the quota allocation plans.

As part of market risk management, the Company enters into interest rate swaps to match the interest rate risk associated with the structured deposits and fix-rate long-term debt securities.

The major measurement techniques used to measure and control market risk are outlined below:

3.2.2 VaR

VaR refers to the maximum loss that an investment portfolio may incur at a given confidence level and holding period caused by the changes in market price factors such as interest rates and exchange rates etc. The Company adopted the historical simulation method to calculate daily VaR (99% confidence interval, the holding period of one day).

A summary of VaR by risk type of the Company's portfolios is as follows:

	For the year ended 31 December 2019			
Items	**31 December 2019**	**Average**	**Maximum**	**Minimum**
VaR	**1,422**	**1,071**	**3,324**	**182**
– Interest rate risk	**1,519**	**1,465**	**2,360**	**4**
– Foreign exchange risk	**2,111**	**1,797**	**4,182**	**732**

	For the year ended 31 December 2018			
Items	31 December 2018	Average	Maximum	Minimum
VaR	1,188	2,438	24,085	387
– Interest rate risk	369	1,615	21,444	–
– Foreign exchange risk	1,312	3,327	35,902	387

3.2.3 Sensitivity tests

Interest rate sensitivity test

The Company performs interest rate sensitivity analysis on net interest income for the Company by measuring the impact of a change in net interest income of financial assets and liabilities, not taking customer behaviour and repayment option into consideration.

On an assumption of a parallel shift of 100 basis points in RMB, USD and HKD interest rates, the Company calculates the changes in net interest income for the year on a monthly basis.

The table below illustrates the impact to net interest income of the coming year of the Company based on the structure of interest bearing assets and liabilities as at 31 December 2019 and 31 December 2018, caused by a parallel shift of 100 basis points of RMB, USD and HKD interest rates.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.3 Sensitivity tests (continued)

Interest rate sensitivity test (continued)

	Expected changes in net interest income	
	As at 31 December 2019	As at 31 December 2018
+100 basis points parallel shift in yield curves	**(174,814)**	71,935
-100 basis points parallel shift in yield curves	**174,814**	(71,935)

The results of the interest rate sensitivity tests set out in the table above are illustrative only and are based on simplified scenarios. The figures represent the projected impact to the net interest income caused by the projected movement of current interest risk structure yield curves. This effect, however, does not take into account actions that would be taken by the Company to mitigate the impact of interest rate changes. The projections above also assume that interest rates of all maturities excluding demand deposits move by the same amount and, therefore, do not reflect the potential impact on net interest income due to changes in certain rates while others remain unchanged. The projections make other simplifying assumptions as well, including that all positions are to be held to maturity. There will be changes to the projection if positions are not held to maturity but it is not expected that the changes would be material.

Foreign exchange sensitivity test

The Company performs exchange rate sensitivity analysis on net profit and equity for the Company by measuring the impact of a change in exchange rate on financial assets and liabilities denominated in different currencies. Since HK$ is pegged to USD under linked exchange rate system, no sensitivity analysis against USD is presented. On an assumption of an appreciation or depreciation of RMB spot and forward rates against HK$ by 5%, the Company calculates the changes in net profit and other comprehensive income for the year on a monthly basis.

The table below illustrates the impact of an appreciation or depreciation of RMB spot and forward rates against HK$ by 5% on the Company's net profit and equity:

	Expected changes in net profit and equity	
	As at 31 December 2019	As at 31 December 2018
5% appreciation of RMB	**(796,224)**	1,098,095
5% depreciation of RMB	**796,224**	(1,098,095)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.4 Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the market value of a financial instrument will fluctuate because of changes in market interest rates.

The Company takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows.

The interest rate repricing risk for foreign currency denominated debt securities and the remaining part of the financial guarantees and credit commitments businesses which are not based upon these basic interest rates is not expected to be significant.

The tables below summarize the Company's exposures to interest rate risks. The tables show the Company's assets and liabilities at carrying amounts, categorized by the earlier of contractual repricing or maturity dates.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.4 Interest rate risk (continued)

	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Non-interest bearing	Total
As at 31 December 2019							
Assets							
Cash and balances with central bank	–	–	–	–	–	1,094,956	1,094,956
Due from banks and other financial institutions	6,675,582	10,992,326	–	–	–	–	17,667,908
Financial assets at fair value through profit or loss	–	155,478	34,484	–	–	874,964	1,064,926
Financial assets at fair value through other comprehensive income	21,797,930	51,856,957	11,323,189	24,118,908	13,135,324	9,965	122,242,273
Loans and advances to customers	71,775,867	4,803,560	384,790	337,202	1,900,196	–	79,201,615
Other financial assets	–	–	–	–	–	5,418,372	5,418,372
Total financial assets	100,249,379	67,808,321	11,742,463	24,456,110	15,035,520	7,398,257	226,690,050
Liabilities							
Due to banks and other financial institutions	7,102,118	20,060,545	1,556,264	–	–	17,643	28,736,570
Due to customers	104,042,804	48,076,879	16,294,765	1,819	–	2,339,022	170,755,289
Financial liabilities at fair value through profit or loss	–	–	–	–	–	1,168,798	1,168,798
Lease liabilities	15,241	29,375	103,545	152,287	1,040	–	301,488
Other financial liabilities	–	–	–	–	–	4,378,083	4,378,083
Total financial liabilities	111,160,163	68,166,799	17,954,574	154,106	1,040	7,903,546	205,340,228
Total interest sensitivity gap	(10,910,784)	(358,478)	(6,212,111)	24,302,004	15,034,480	(505,289)	21,349,822

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.4 Interest rate risk (continued)

	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Non-interest bearing	Total
As at 31 December 2018							
Assets							
Cash and balances with central bank	–	–	–	–	–	2,353,780	2,353,780
Due from banks and other financial institutions	14,626,550	10,075,887	380,000	–	–	–	25,082,437
Financial assets at fair value through profit or loss	–	20,821	544,483	–	–	1,290,050	1,855,354
Financial assets at fair value through other comprehensive income	20,030,202	31,765,511	42,112,452	13,165,599	2,231,308	9,990	109,315,062
Loans and advances to customers	56,489,616	7,140,491	1,117,481	1,147,727	1,793,404	–	67,688,719
Other financial assets	–	–	–	–	–	1,429,059	1,429,059
Total financial assets	91,146,368	49,002,710	44,154,416	14,313,326	4,024,712	5,082,879	207,724,411
Liabilities							
Due to banks and other financial institutions	13,035,005	8,077,074	–	–	–	14,872	21,126,951
Due to customers	78,186,275	28,167,636	53,131,413	2,645	–	2,586,714	162,074,683
Financial liabilities at fair value through profit or loss	–	–	–	–	–	467,764	467,764
Other financial liabilities	–	–	–	–	–	5,280,872	5,280,872
Total financial liabilities	91,221,280	36,244,710	53,131,413	2,645	–	8,350,222	188,950,270
Total interest sensitivity gap	(74,912)	12,758,000	(8,976,997)	14,310,681	4,024,712	(3,267,343)	18,774,141

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.5 Foreign exchange risk

The Company conducts the majority of its businesses in HK$, with certain foreign transactions in USD, RMB and other currencies. The Company takes on exposure to the effects of fluctuations in the prevailing foreign exchange rates and changes on its financial position and cash flows. The senior management sets limits on the level of exposure in exchange rate risk and monitors the exposure regularly. The tables below summarize the Company's exposure to foreign exchange risk at the end of the year. The tables show the Company's total assets and liabilities in carrying amounts in HK$, are categorized by the original currency.

	HK$	RMB (HK$ Equivalent)	USD (HK$ Equivalent)	Others (HK$ Equivalent)	Total
As at 31 December 2019					
Assets					
Cash and balances with central bank	**1,053,928**	**24,047**	**9,960**	**7,021**	**1,094,956**
Due from banks and other financial institutions	**14,400,318**	**231,532**	**694,820**	**2,341,238**	**17,667,908**
Financial assets at fair value through profit or loss	**771,072**	**189,970**	**103,826**	**58**	**1,064,926**
Financial assets at fair value through other comprehensive income	**9,868,713**	**11,696,443**	**73,939,649**	**26,737,468**	**122,242,273**
Loans and advances to customers	**68,270,613**	**276,087**	**10,637,366**	**17,549**	**79,201,615**
Other financial assets	**4,424,277**	**133,769**	**789,592**	**70,734**	**5,418,372**
Total financial assets	**98,788,921**	**12,551,848**	**86,175,213**	**29,174,068**	**226,690,050**
Liabilities					
Due to banks and other financial institutions	**6,246,364**	**24,006**	**22,336,912**	**129,288**	**28,736,570**
Due to customers	**101,926,676**	**26,899,726**	**34,250,657**	**7,678,230**	**170,755,289**
Financial liabilities at fair value through profit or loss	**973,920**	**–**	**194,862**	**16**	**1,168,798**
Lease liabilities	**301,488**	**–**	**–**	**–**	**301,488**
Other financial liabilities	**1,983,634**	**1,552,595**	**756,883**	**84,971**	**4,378,083**
Total financial liabilities	**111,432,082**	**28,476,327**	**57,539,314**	**7,892,505**	**205,340,228**
Net position	**(12,643,161)**	**(15,924,479)**	**28,635,899**	**21,281,563**	**21,349,822**

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.5 Foreign exchange risk (continued)

	HK$	RMB (HK$ Equivalent)	USD (HK$ Equivalent)	Others (HK$ Equivalent)	Total
As at 31 December 2018					
Assets					
Cash and balances with central bank	2,298,318	37,534	12,390	5,538	2,353,780
Due from banks and other financial institutions	11,956,572	2,771,471	8,095,903	2,258,491	25,082,437
Financial assets at fair value through profit or loss	1,291,511	559,903	3,940	–	1,855,354
Financial assets at fair value through other comprehensive income	10,358,704	51,101,942	32,422,542	15,431,874	109,315,062
Loans and advances to customers	56,280,306	952,986	10,448,190	7,237	67,688,719
Other financial assets	801,818	318,023	223,887	85,331	1,429,059
Total financial assets	82,987,229	55,741,859	51,206,852	17,788,471	207,724,411
Liabilities					
Due to banks and other financial institutions	3,643,886	11,793,287	5,650,743	39,035	21,126,951
Due to customers	96,528,813	21,630,426	35,937,504	7,977,940	162,074,683
Financial liabilities at fair value through profit or loss	438,633	12	29,119	–	467,764
Other financial liabilities	2,143,432	356,231	2,684,968	96,241	5,280,872
Total financial liabilities	102,754,764	33,779,956	44,302,334	8,113,216	188,950,270
Net position	(19,767,535)	21,961,903	6,904,518	9,675,255	18,774,141

3.2.6 Other price risk

The Company is exposed to other price risk arising from financial assets such as equity investments and derivatives linked to commodity price. The Company considers the exposure to the other price risk to be insignificant.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk

3.3.1 Overview

Liquidity risk is the risk that the Company will be unable to meet its payment obligations associated with its financial liabilities when they fall due and other current liquidity needs. The consequence may be the failure to meet obligations to repay depositors and fulfill loan commitments for lending. The Company's objective in liquidity management is to ensure the availability of adequate funding to meet the demands of fund deposit withdrawals and other liabilities as they fall due and to ensure that it is able to meet its obligations to fund loan originations and commitments and to take advantage of new investment opportunities.

The Company is exposed to daily calls on its available cash resources from overnight deposits, current accounts, matured deposits, loan drawdowns, guarantees and from margin and other calls on cash settled derivatives. The Company set limits on the minimum proportion of funds to meet such calls and on the minimum level of interbank and other borrowing facilities that should be in place to cover different levels of unexpected withdrawals.

3.3.2 Liquidity risk management process

Funding liquidity risk relates to the Company's ability to fulfill its obligations arising from financial liabilities as they fall due, or its ability to fulfill maturing funding needs, which subsequently affects the Company's capacity to support deposit withdrawal or drawdown on loan commitments. Effective liquidity risk management helps to sustain the expansion of the Company's business with liquidity cost and risk under control. The Company has established and implemented its own liquidity risk management policy per local regulatory requirements in order to fulfill its liquidity risk management. The Asset and Liability Management Committee (ALCO) of the Company is the decision-making body in balance sheet management and is responsible for coordinating and overseeing all related strategies, including risk management framework and risk appetite. Asset and Liability Management Department is responsible for analyzing and monitoring activities related to liquidity risk. Global Markets Department is responsible for managing daily liquidity position and related executions. Internal Audit Department is responsible for conducting periodic review to ensure liquidity risk management framework is effectively implemented.

The cornerstone of the Company's funding sources is customer deposit. The Company strives to build up core deposits while diversifying funding sources via various funding channels to enhance financing capacity. Regarding liquidity arrangement with parent bank, the Company performs regular funding transfer with parent bank to preserve prompt intragroup backup funding supply if necessary. Monitoring and control on intragroup funding transactions are in line with those of third parties. Moreover, parent bank has set up groupwide internal limits to control the Company's reliance on parent bank's funding.

The majority of the liquidity risk of the Company arises from maturity mismatch of assets and liabilities. Therefore, regular cash flow analysis and projections on both on- and off-balance sheet items falling within different maturity buckets is performed to ensure funding need. Moreover, the Company closely monitors off-balance sheet funding obligations (such as commitments or letters of guarantee) and assesses their impact to our liquidity capacity. Furthermore, the Company strives to maintain high marketability of the asset portfolio to allow prompt monetization in case of unforeseeable liquidity crunch in the market.

The Company has in place various limits and indicators for liquidity risk, including liquidity coverage ratio, loan-to-deposit ratio, concentration limits on customer deposits, interbank borrowing utilization ratio, etc. for effective identification and control of liquidity risk. The Company utilizes relevant management information systems to perform daily liquidity risk management functions. Moreover, the Company performs daily cash flow analysis to assess liquidity in normal circumstances, and performs regular stress test (at least monthly) to evaluate the Company's resilience under significant stress conditions. The stress test scenarios are designed with reference to the HKMA's Supervisory Policy Manuals, and also historical liquidity stress scenarios. The Company's stress test takes into account the impact of all assets, liabilities and off-balance sheet positions and estimates possible funding short-fall with historical data and plausible stress conditions. The results will be scrutinized and appropriate measures will be taken if necessary.

The Company has set up early warning indicator system, and movement of relevant indicators are closely monitored on a regular basis. In case of liquidity crisis emerges, the Company's Crisis Management Committee will be formed to formulate appropriate contingency funding plan to resolve the crisis. The Company also performs regular drill in order to ensure prompt actions and feasibility of contingency funding plan under crisis.

To cope with unpredictable liquidity needs, the Company has set up liquidity buffer to maintain sufficient highly liquid assets. The buffer portfolio contains cash, Exchange Fund Bills/Notes¸ unencumbered sovereign bonds and other high quality bonds, which is managed by Asset and Liability Management Department and operated by Global Markets Department on a daily basis.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.3 Non-derivative financial instruments cash flows

The table below presents the cash flows of the Company related to non-derivative financial liabilities (including accrued interest) by remaining contractual maturities at the end of the reporting date. The amounts disclosed in the tables are undiscounted contractual cash flows. The Company's expected cash flows on these financial instruments may vary significantly from the following analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance although they have been classified as repayable on demand in the following tables.

	On Demand	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Overdue	Undated	Total
As at 31 December 2019									
Financial liabilities									
Due to banks and other financial institutions	**893,526**	**4,257,386**	**20,159,183**	**1,577,260**	**–**	**2,018,313**	**–**	**–**	**28,905,668**
Due to customers	**56,976,420**	**49,419,265**	**48,129,887**	**16,358,893**	**1,838**	**–**	**–**	**–**	**170,886,303**
Lease liabilities	**–**	**15,636**	**30,107**	**106,029**	**155,011**	**1,049**	**–**	**–**	**307,832**
Other financial liabilities	**8,442**	**3,915,441**	**323,103**	**101,489**	**7**	**14,730**	**–**	**–**	**4,363,212**
Total financial liabilities	**57,878,388**	**57,607,728**	**68,642,280**	**18,143,671**	**156,856**	**2,034,092**	**–**	**–**	**204,463,015**

	On Demand	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Overdue	Undated	Total
As at 31 December 2018									
Financial liabilities									
Due to banks and other financial institutions	1,151,931	9,927,788	8,118,841	–	–	2,003,944	–	–	21,202,504
Due to customers	58,493,481	22,289,469	28,217,512	53,373,532	2,676	–	–	–	162,376,670
Other financial liabilities	279,842	4,399,196	235,300	340,990	12	14,591	–	–	5,269,931
Total financial liabilities	59,925,254	36,616,453	36,571,653	53,714,522	2,688	2,018,535	–	–	188,849,105

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.4 Derivative financial instruments cash flows

The Company's derivative financial instruments are either settled on a net basis or a gross basis.

The Company's derivative financial instruments that will be settled on a net basis mainly include interest rate swaps, forward rate agreements and others, whereas derivative financial instruments that will be settled on a gross basis mainly include currency forward and currency swaps.

The table below analyses the cash flows of the Company by remaining contractual period as at the reporting date. The amounts disclosed in the table are the contractual undiscounted cash flows.

	Up to 1 month	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
As at 31 December 2019						
Derivative financial instruments settled on net basis	**7,410**	**40,421**	**27,381**	**(203,949)**	**(3,403)**	**(132,140)**
Derivative financial instruments settled on a gross basis						
– Outflow	**(126,233,759)**	**(33,134,641)**	**(36,720,407)**	**(1,556,264)**	**–**	**(197,645,071)**
– Inflow	**126,244,425**	**32,992,658**	**36,771,837**	**1,560,239**	**–**	**197,569,159**
Total	**10,666**	**(141,983)**	**51,430**	**3,975**	**–**	**(75,912)**

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
As at 31 December 2018						
Derivative financial instruments settled on net basis	1,285	597	18,534	(43,780)	(5,491)	(28,855)
Derivative financial instruments settled on a gross basis						
– Outflow	(72,948,707)	(29,354,422)	(82,027,870)	(4,032,556)	–	(188,363,555)
– Inflow	73,077,909	29,305,793	82,758,922	4,029,869	–	189,172,493
Total	129,202	(48,629)	731,052	(2,687)	–	808,938

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.5 Maturity analysis

The table below analyses the Company's assets and liabilities into relevant maturity groupings based on the remaining period at the end of reporting date to the contractual maturity date.

	On demand	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Overdue	Undated	Total
As at 31 December 2019									
Assets									
Cash and balances with central banks	1,094,956	–	–	–	–	–	–	–	1,094,956
Due from banks and other financial institutions	2,600,646	2,338,993	–	–	12,728,269	–	–	–	17,667,908
Financial assets at fair value through profit or loss	–	484,743	217,857	260,203	24,778	77,345	–	–	1,064,926
Financial assets at fair value through other comprehensive income	–	2,877,750	8,531,613	18,113,310	79,026,583	13,683,052	–	9,965	122,242,273
Loans and advances to customers	2,408,975	452,250	2,440,628	6,375,084	28,787,124	38,507,967	229,587	–	79,201,615
Other financial assets	2,902	4,724,076	22,694	39,626	449,284	170,039	9,751	–	5,418,372
Total financial assets	6,107,479	10,877,812	11,212,792	24,788,223	121,016,038	52,438,403	239,338	9,965	226,690,050
Liabilities									
Due to banks and other financial institutions	893,526	4,226,235	20,060,545	1,556,264	–	2,000,000	–	–	28,736,570
Due to customers	56,976,420	49,405,406	48,076,879	16,294,765	1,819	–	–	–	170,755,289
Financial liabilities at fair value through profit or loss	–	525,672	215,192	211,890	121,987	94,057	–	–	1,168,798
Lease liabilities	–	15,241	29,375	103,545	152,287	1,040	–	–	301,488
Other financial liabilities	11,917	3,915,441	323,103	112,885	7	14,730	–	–	4,378,083
Total financial liabilities	57,881,863	58,087,995	68,705,094	18,279,349	276,100	2,109,827	–	–	205,340,228
Net amount on liquidity gap	(51,774,384)	(47,210,183)	(57,492,302)	6,508,874	120,739,938	50,328,576	239,338	9,965	21,349,822

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.5 Maturity analysis (continued)

	On demand	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Overdue	Undated	Total
As at 31 December 2018									
Assets									
Cash and balances with central banks	2,353,780	–	–	–	–	–	–	–	2,353,780
Due from banks and other financial institutions	8,669,337	4,263,724	1,081,473	380,000	10,687,903	–	–	–	25,082,437
Financial assets at fair value through profit or loss	–	296,837	57,126	1,495,340	6,051	–	–	–	1,855,354
Financial assets at fair value through other comprehensive income	–	4,368,036	6,512,334	48,934,349	46,776,451	2,713,902	–	9,990	109,315,062
Loans and advances to customers	1,464,922	1,064,537	208,405	6,727,289	25,424,400	32,527,079	272,087	–	67,688,719
Other financial assets	28,594	11,391	16,946	927,387	347,503	87,434	9,804	–	1,429,059
Total financial assets	12,516,633	10,004,525	7,876,284	58,464,365	83,242,308	35,328,415	281,891	9,990	207,724,411
Liabilities									
Due to banks and other financial institutions	1,151,931	9,897,946	8,077,074	–	–	2,000,000	–	–	21,126,951
Due to customers	58,493,481	22,279,509	28,167,636	53,131,413	2,644	–	–	–	162,074,683
Financial liabilities at fair value through profit or loss	–	163,216	69,998	202,735	19,746	12,069	–	–	467,764
Other financial liabilities	282,768	4,402,217	235,486	342,233	614	17,554	–	–	5,280,872
Total financial liabilities	59,928,180	36,742,888	36,550,194	53,676,381	23,004	2,029,623	–	–	188,950,270
Net amount on liquidity gap	(47,411,547)	(26,738,363)	(28,673,910)	4,787,984	83,219,304	33,298,792	281,891	9,990	18,774,141

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.6 Off-balance sheet items

The table below lists the off-balance sheet items of the Company according to their remaining period to the contractual maturity date. Financial guarantees are included at notional amounts and based on the earliest contractual maturity date.

	Up to 3 months	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
As at 31 December 2019					
Loan commitments and credit related commitments	**7,103,107**	**1,980,552**	**155,847**	**2,356,918**	**11,596,424**
Guarantees, acceptances and letters of credit	**126,844**	**61,973**	**1,914**	**2,906**	**193,637**
Total	**7,229,951**	**2,042,525**	**157,761**	**2,359,824**	**11,790,061**

	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
As at 31 December 2018					
Loan commitments and credit related commitments	7,872,156	1,344,434	125,905	2,597,322	11,939,817
Guarantees, acceptances and letters of credit	158,236	22,778	200	667	181,881
Total	8,030,392	1,367,212	126,105	2,597,989	12,121,698

3.4 Fair value of financial assets and liabilities

(a) Determination of fair value and valuation techniques

Certain financial assets and liabilities of the Company are measured at fair value or with fair value disclosed for financial reporting purposes. The fair value has been determined using appropriate valuation techniques and inputs for fair value measurements. The appropriateness of the valuation techniques and the inputs to the fair value measurements are reviewed periodically.

Fair value measurements are categorized into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

Level 1: The fair value of financial instruments traded in active markets is based on quoted (unadjusted) market prices at the end of the reporting period. The quoted market price used for financial assets held by the Company is the current bid price. These instruments are included in level 1.

Level 2: The fair value of financial instruments that are not traded in an active market is determined using valuation techniques. These valuation techniques maximize the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

Level 3: If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.4 Fair value of financial assets and liabilities *(continued)*

(a) Determination of fair value and valuation techniques (continued)

Specific valuation techniques used to value for Level 2 financial instruments include:

- The use of quoted market prices or dealer quotes for similar instruments.
- Calculation of the present value of the estimated future cash flows based on observable yield curves for interest rate swaps.
- The fair value of foreign currency forwards is determined using forward exchange rates at the balance sheet date.
- The fair value of the remaining financial instruments is determined using discounted cash flow analysis.

(b) Financial assets and financial liabilities measured at fair value on a recurring basis

The table below summarizes the information relating to the fair value hierarchy of the financial assets and financial liabilities measured at fair value on a recurring basis.

	Level 1	Level 2	Level 3	Total
As at 31 December 2019				
Financial assets at fair value through profit or loss				
Debt securities				
– Governments and central banks	189,962	–	–	189,962
Derivative financial instruments				
– Foreign exchange contracts	–	773,118	–	773,118
– Interest rate contracts and others	–	101,846	–	101,846
	189,962	874,964	–	1,064,926
Financial assets at fair value through other comprehensive income				
Debt securities				
– Governments and central banks	22,084,902	–	–	22,084,902
– Banks and other financial institutions	65,751,353	16,149,042	–	81,900,395
– Corporate entities	18,247,011	–	–	18,247,011
Equity securities				
– Banks and other financial institutions	–	–	9,965	9,965
	106,083,266	16,149,042	9,965	122,242,273
Total financial assets measured at fair value	106,273,228	17,024,006	9,965	123,307,199
Financial liabilities at fair value through profit or loss				
Derivative financial instruments				
– Foreign exchange contracts	–	951,285	–	951,285
– Interest rate contracts and others	–	217,513	–	217,513
Total financial liabilities measured at fair value	–	1,168,798	–	1,168,798

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.4 Fair value of financial assets and liabilities *(continued)*

(b) Financial assets and financial liabilities measured at fair value on a recurring basis (continued)

	Level 1	Level 2	Level 3	Total
As at 31 December 2018				
Financial assets at fair value through profit or loss				
Debt securities				
– Governments and central banks	544,483	–	–	544,483
– Banks and other financial institutions	20,821	–	–	20,821
Derivative financial instruments				
– Foreign exchange contracts	–	1,284,902	–	1,284,902
– Interest rate contracts and others	–	5,148	–	5,148
	565,304	1,290,050	–	1,855,354
Financial assets at fair value through other comprehensive income				
Debt securities				
– Governments and central banks	14,914,288	–	–	14,914,288
– Banks and other financial institutions	67,974,051	25,945,556	–	93,919,607
– Corporate entities	471,177	–	–	471,177
Equity securities				
– Banks and other financial institutions	–	–	9,990	9,990
	83,359,516	25,945,556	9,990	109,315,062
Total financial assets measured at fair value	83,924,820	27,235,606	9,990	111,170,416
Financial liabilities at fair value through profit or loss				
Derivative financial instruments				
– Foreign exchange contracts	–	438,645	–	438,645
– Interest rate contracts and others	–	29,119	–	29,119
Total financial liabilities measured at fair value	–	467,764	–	467,764

There was no transfer between level 1 and 2 during the years.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.5 Offsetting financial assets and financial liabilities

Certain financial assets and financial liabilities of the Company are subject to enforceable master netting arrangements or similar agreements. The agreement between the Company and the counterparty generally allows for net settlement of the relevant financial assets and financial liabilities when both elect to settle on a net basis. In the absence of such a mutual consent, financial assets and financial liabilities will be settled on a gross basis. However, each party to the master netting arrangements or similar agreements will have the option to settle all such amounts on a net basis in the event of default of the other party. These financial assets and financial liabilities of the Company are not offset in accordance with HKFRS.

The following table presents the recognized financial instruments that are offset, or subject to enforceable master netting arrangements and other similar agreements but not offset, as at 31 December 2019 and 31 December 2018. The column 'net amount' shows the impact on the Company's statement of financial position if all set-off rights were exercised.

				Related amounts not offset		
	Gross amounts of recognized financial assets	Gross amounts of recognized financial liabilities set off in the statement of financial position	Net amounts of financial assets presented in the statement of financial position	Financial instruments (including non-cash collateral)	Cash collateral received	Net amount
2019						
Financial assets						
Derivative financial instruments	874,964	–	874,964	(696,273)	(2,093)	176,598
Financial assets at fair value through other comprehensive income	11,067,402	–	11,067,402	(10,459,812)	–	607,590
Total	11,942,366	–	11,942,366	(11,156,085)	(2,093)	784,188

				Related amounts not offset		
	Gross amounts of recognized financial liabilities	Gross amounts of recognized financial assets set off in the statement of financial position	Net amounts of financial liabilities presented in the statement of financial position	Financial instruments (including non-cash collateral)	Cash collateral advanced	Net amount
2019						
Financial liabilities						
Derivative financial instruments	1,168,798	–	1,168,798	(696,273)	(217,465)	255,060
Due to banks and other financial institutions	10,459,812	–	10,459,812	(10,459,812)	–	–
Total	11,628,610	–	11,628,610	(11,156,085)	(217,465)	255,060

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.5 Offsetting financial assets and financial liabilities *(continued)*

(restated)	Gross amounts of recognized financial assets	Gross amounts of recognized financial liabilities set off in the statement of financial position	Net amounts of financial assets presented in the statement of financial position	Related amounts not offset: Financial instruments (including non-cash collateral)	Related amounts not offset: Cash collateral received	Net amount
2018						
Financial assets						
Derivative financial instruments	1,290,050	–	1,290,050	(448,378)	(219,325)	622,347
Financial assets at fair value through other comprehensive income	250,842	–	250,842	(250,000)	–	842
Total	1,540,892	–	1,540,892	(698,378)	(219,325)	623,189

	Gross amounts of recognized financial liabilities	Gross amounts of recognized financial assets set off in the statement of financial position	Net amounts of financial liabilities presented in the statement of financial position	Related amounts not offset: Financial instruments (including non-cash collateral)	Related amounts not offset: Cash collateral advanced	Net amount
2018						
Financial liabilities						
Derivative financial instruments	467,764	–	467,764	(448,378)	(930)	18,456
Due to banks and other financial institutions	250,000	–	250,000	(250,000)	–	–
Total	717,764	–	717,764	(698,378)	(930)	18,456

3.6 Capital management

The Company's objectives in managing "capital", which is a broader concept than the "shareholder equity" on the statement of financial position, are:

- To comply with the capital requirements set by the regulators of the markets where the Company operates;
- To ensure the Company's ability to maintain a stable operation so as to continue provide returns for shareholders and benefits for other stakeholders; and
- To maintain a strong capital base to support the development of its business.

Consistent with industry practice, the Company monitors its capital structure on the basis of the capital adequacy ratio and there have been no material changes in the Company's policy on the management of capital during the year.

The Company has complied with all externally imposed capital requirements during 2019.

(All amounts expressed in thousands of HK$ unless otherwise stated)

4 NET INTEREST INCOME

	2019	2018
Interest income		
Due from banks and other financial institutions	**408,951**	933,600
Loans and advances to customers	**2,135,929**	1,679,549
Financial assets at fair value through other comprehensive income	**3,531,136**	2,200,059
Others	**–**	884
	6,076,016	4,814,092
Interest expense		
Due to banks and other financial institutions	**(560,225)**	(360,719)
Due to customers	**(2,594,622)**	(2,476,770)
Debt securities and certificates of deposit issued	**–**	(119,347)
Others	**–**	(429)
	(3,154,847)	(2,957,265)
Net interest income	**2,921,169**	1,856,827

5 FEE AND COMMISSION INCOME

	2019	2018 (restated)
Settlement service	**46,684**	45,137
Interchange service	**38,575**	34,929
Credit facilities, guarantee and commitment	**2,589**	85,777
Agency service	**592,260**	542,169
Depositary service	**61,752**	59,095
Others	**4,763**	10,577
	746,623	777,684
Of which arise from:		
Financial assets/liabilities not at fair value through profit or loss	**2,589**	85,777
Trust and other fiduciary activities	**83,402**	87,420

6 FEE AND COMMISSION EXPENSE

	2019	2018
Settlement and brokerage service	**38,503**	28,826
Interchange service	**9,870**	9,748
Others	**8,163**	6,454
	56,536	45,028
Of which arise from:		
Financial assets/liabilities not at fair value through profit or loss	**9,870**	9,748

(All amounts expressed in thousands of HK$ unless otherwise stated)

7 DIVIDEND INCOME

	2019	2018
Financial assets at fair value through other comprehensive income – unlisted investments	**35**	700

8 NET GAINS ARISING FROM TRADING ACTIVITIES

	2019	2018
Foreign exchange	**37,585**	175,895
Interest rate instruments and others	**(163)**	318,456
Debt securities at fair value through profit or loss	**44,278**	(127,405)
Net losses of interest rate instruments and items under fair value hedge	**(5,287)**	(124)
	76,413	366,822

Net gains on foreign exchange include gains or losses from the trading of spot and forward contracts, currency swaps, cross currency interest rate swaps, currency options and the translation of foreign currency monetary assets and liabilities into HK$.

Net gains on interest rate instruments and others include trading gains and losses and fair value changes of interest rate swaps, interest rate options and other derivatives.

9 OTHER OPERATING INCOME

	2019	2018
Rental income	**–**	1,258
Management fee from a branch of the ultimate holding company (Note 33g)	**6,565**	6,684
Others	**14,976**	13,040
	21,541	20,982

Others mainly include income arising from miscellaneous banking services provided to the Company's customers.

(All amounts expressed in thousands of HK$ unless otherwise stated)

10 CHANGE IN EXPECTED CREDIT LOSSES ("ECL")

	2019	2018
Changes in ECL allowance		
Loans and advances to customers		
– new charges	126,463	204,710
– recoveries	(34,226)	(79,800)
	92,237	124,910
Financial investments	60,242	67,899
Other receivables	1,354	21,563
Due from banks and other financial institutions	2,224	11,586
Financial guarantees and credit related commitments	3,931	(13,369)
	67,751	87,679
	159,988	212,589

11 OTHER OPERATING EXPENSES

	2019	2018
Staff costs		
– salaries and other allowances	512,954	529,014
– retirement benefit costs (Note 12)	34,261	35,294
Loss on disposal of property and equipment	25	2,183
General operational and administrative expenses	260,597	215,094
Depreciation and amortization	30,365	33,154
Depreciation of right-of-use assets	166,890	–
Auditor's remuneration	4,200	4,200
Buildings administration fee	10,113	11,973
Rental expenses	45,645	209,870
Repairs and maintenance	44,162	46,657
Printing, postage and telegram	51,133	62,711
Withholding tax	–	59,363
Directors', senior management's and key personnel's emoluments (Note 13)	18,715	18,881
Management fee to a branch of the ultimate holding company	344,728	259,738
Finance costs – lease interest expense	4,820	–
Others	17,619	15,640
	1,546,227	1,503,772

12 RETIREMENT BENEFIT COSTS

	2019	2018
Pension costs – defined contribution plans	34,261	35,294

(All amounts expressed in thousands of HK$ unless otherwise stated)

13 BENEFITS AND INTEREST OF DIRECTORS (DISCLOSURES REQUIRED BY SECTION 383 OF THE COMPANIES ORDINANCE (CAP. 622) AND COMPANIES (DISCLOSURE OF INFORMATION ABOUT BENEFITS OF DIRECTORS) REGULATION (CAP. 622G)

(a) Directors' emoluments

Details of the emoluments paid to or receivable by the directors of the Company in respect of their services rendered for the Company are as follows:

	2019	2018
Directors' fees	**1,397**	1,513
Salaries, allowances and benefits in kind	**180**	817
Bonuses	**1,176**	852
Retirement benefit costs	**3**	17
	2,756	3,199

For the year ended 31 December 2019 and 2018, some of the executive directors received emoluments and emoluments receivable from HKBR, amounting to HK$13,834,000 (2018: HK$12,514,000), in respect of their service to the Company and HKBR. The portion of the directors' emoluments in relation to the services to the Company of HK$8,980,000 (2018: HK$8,346,000) has been borne by HKBR and included in management fee to a branch of the ultimate holding company (Note 11).

(b) Directors' material interests in transactions, arrangements or contracts

No significant transactions, arrangements and contracts in relation to the Company's business to which the Company was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

(All amounts expressed in thousands of HK$ unless otherwise stated)

14 INCOME TAX EXPENSES

	2019	2018
Current tax		
– Hong Kong profits tax	**390,780**	284,049
– (Over)/under provision in prior years	**(7,930)**	23,980
	382,850	308,029
Deferred income tax	**(16,690)**	(39,271)
Income tax expense	**366,160**	268,758

The current tax provision for the year ended 31 December 2019 and 2018 is based on the estimated assessable profit by using the Hong Kong profits tax rate of 16.5 per cent. The major reconciliation items are as follows:

	2019	2018
Profit before tax	**2,428,834**	1,251,775
Tax calculated at a tax rate of 16.5%	**400,758**	206,543
Tax effect of expense not deductible for tax purpose	**–**	32,699
Tax effect arising from income not subject to tax	**(35,332)**	(4,366)
(Over)/under provision in prior years	**(7,930)**	23,980
Utilization of tax loss previously not recognized	**–**	(1,246)
Others	**8,664**	11,148
	366,160	268,758

15 CASH AND BALANCES WITH CENTRAL BANK

	2019	2018
Cash	**440,753**	411,344
Balances with central bank	**654,203**	1,942,436
	1,094,956	2,353,780

(All amounts expressed in thousands of HK$ unless otherwise stated)

16 DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	2019	2018
Due from banks and other financial institutions	**2,600,649**	8,669,382
Placements with and loans to banks	**15,075,568**	16,419,140
Less: ECL allowances	**(8,309)**	(6,085)
	17,667,908	25,082,437

17 FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2019	2018
Derivative financial instruments (Note 18)	**874,964**	1,290,050
Debt securities at fair value through profit or loss		
Government bonds		
– Listed outside Hong Kong	**34,484**	–
– Unlisted	**155,478**	544,483
Other debt securities		
– Unlisted – banking sector	**–**	20,821
	1,064,926	1,855,354

Debt securities at fair value through profit or loss are analyzed by issuer as follows:

	2019	2018
Debt securities at fair value through profit or loss		
– Governments and central banks	**189,962**	544,483
– Banks and other financial institutions	**–**	20,821
	189,962	565,304

18 DERIVATIVE FINANCIAL INSTRUMENTS

The following derivative instruments are utilized by the Company for trading or hedging purposes:

Currency forwards are contracts between two parties to buy or sell certain currencies at a specified future date at a predetermined price. The party agreeing to buy the underlying currency in the future assumes a long position, and the party agreeing to sell the currency in the future assumes a short position. The price agreed upon is called the delivery price, which is equal to the forward price at the time the contract is entered into.

Currency and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies or interest rates (for example, fixed rate for floating rate) or a combination of all these (i.e. cross-currency interest rate swaps). The Company's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligation. This risk is monitored on an ongoing basis with reference to the current fair value, the notional amount of the contracts and the liquidity of the market. To control the level of credit risk taken, the Company assesses counterparties using the same techniques as for its lending activities.

Currency and interest rate options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, either to buy (a call option) or sell (a put option), on or before a set date or during a set period, a specific amount of a foreign currency at a predetermined price or to receive an interest payment based on a variable interest rate and pay a fixed interest rate or vice versa. The seller receives a premium from the purchaser in consideration for assuming foreign exchange or interest rate risk. Options may be either exchange-traded or negotiated between the Company and a customer (over the-counter market).

The notional amounts of certain types of financial instruments provide a reference of the amounts recognized in the statement of financial position but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Company's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The aggregate fair values of derivative financial assets and liabilities can fluctuate significantly from time to time. The fair values of derivative instruments held are set out in the following tables.

(All amounts expressed in thousands of HK$ unless otherwise stated)

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

	For hedging			For trading			Total		
	Contractual/ notional amount	Fair values Assets	Fair values Liabilities	Contractual/ Notional amount	Fair values Assets	Fair values Liabilities	Contractual/ Notional amount	Fair values Assets	Fair values Liabilities
As at 31 December 2019									
Foreign exchange contracts	**–**	**–**	**–**	**197,148,441**	**773,118**	**(951,285)**	**197,148,441**	**773,118**	**(951,285)**
Interest rate contracts and others	**25,129,426**	**96,572**	**(211,910)**	**749,341**	**5,274**	**(5,603)**	**25,878,767**	**101,846**	**(217,513)**
Total amount of derivative instruments recognized	**25,129,426**	**96,572**	**(211,910)**	**197,897,782**	**778,392**	**(956,888)**	**223,027,208**	**874,964**	**(1,168,798)**
As at 31 December 2018									
Foreign exchange contracts	–	–	–	189,963,423	1,284,902	(438,645)	189,963,423	1,284,902	(438,645)
Interest rate contracts and others	4,157,440	5,148	(29,119)	–	–	–	4,157,440	5,148	(29,119)
Total amount of derivative instruments recognized	4,157,440	5,148	(29,119)	189,963,423	1,284,902	(438,645)	194,120,863	1,290,050	(467,764)

The tables above provide a breakdown of the contractual or notional amounts and the fair values of the Company's derivative financial instruments outstanding at year end. These instruments, comprising foreign exchange and interest rate derivatives allow the Company and its customers to transfer, modify or reduce their foreign exchange and interest rate risks.

The Company undertakes its transactions in foreign exchange and interest rates contracts with other financial institutions and customers. Management has established limits for these contracts based on counterparty types, industry sectors and countries. Related risks are regularly monitored and controlled by management.

Notional amounts of derivative financial instruments by original currency:

	2019	2018
Renminbi	**42,237,988**	46,222,232
United States Dollar	**107,842,171**	95,597,519
Hong Kong Dollar	**67,861,606**	48,663,814
Others	**5,085,443**	3,637,298
Total	**223,027,208**	194,120,863

(All amounts expressed in thousands of HK$ unless otherwise stated)

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Hedge accounting

The Company applies hedge accounting on hedging its interest rate risk on certain bond investments and loans, as follows:

Interest rate risk on fixed rate financial assets (fair value hedge)

The Company holds a portfolio of long-term fixed rate debt securities and loans and therefore is exposed to changes in fair value due to movements in market rates. The Company manages this risk exposure by entering into pay fixed/receive floating interest rate swaps.

Only the interest rate risk element is hedged and therefore other risks, such as credit risk, are managed but not hedged by the Company. The interest rate risk component is determined as the change in fair value of the long-term fixed rate debt securities arising solely from changes in the benchmark rate of interest. Such changes are usually the largest component of the overall change in fair value.

This strategy is designated as a fair value hedge and its effectiveness is assessed by comparing changes in the fair value of the debt securities attributable to changes in the benchmark rate of interest with changes in the fair value of the interest rate swaps.

The Company establishes the hedging ratio by matching the notional of the derivatives with the principal of the portfolio being hedged. Following reasons could cause ineffectiveness:

1) Differences between the expected and actual holding amount, as the Company hedges to the expected maturity date but may sell the bond investment according to trading strategies;

2) The credit risk of the counterparty impacts the fair value of interest rate swaps, but has no impacts on hedged items.

a) The following table sets out the maturity profile and average interest rate of the hedging instruments used in the Company's hedging strategies:

	Maturity					
As at 31 December 2019	**Up to 1 month**	**1 to 3 months**	**3 months to 1 year**	**1 year to 5 years**	**More than 5 years**	**Total**
Fair value hedge						
Interest rate						
Interest rate contract						
Notional	**–**	**1,089,385**	**427,973**	**14,014,934**	**9,597,134**	**25,129,426**
Average fixed interest rate	**–**	**2.38%**	**2.64%**	**3.74%**	**3.92%**	**3.65%**

	Maturity					
As at 31 December 2018	Up to 1 month	1 to 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total
Fair value hedge						
Interest rate						
Interest rate contract						
Notional	–	–	782,945	2,810,774	563,721	4,157,440
Average fixed interest rate	–	–	2.00%	2.76%	4.35%	2.73%

(All amounts expressed in thousands of HK$ unless otherwise stated)

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Hedge accounting *(continued)*

b) The following table contains details of the hedging instruments used in the Company's hedging strategies:

		Carrying amount			
As at 31 December 2019	**Notional**	**Assets**	**Liabilities**	**Line item on statement of financial position**	**Fair value changes of the hedging instruments**
Fair value hedge					
Interest rate					
Interest rate contract	**25,129,426**	**96,572**	**(211,910)**	**Financial assets/ liabilities at fair value through profit or loss**	**(97,377)**

		Carrying amount			
As at 31 December 2018	Notional	Assets	Liabilities	Line item on statement of financial position	Fair value changes of the hedging instruments
Fair value hedge					
Interest rate					
Interest rate contract	4,157,440	5,148	(29,119)	Financial assets/liabilities at fair value through profit or loss	(23,971)

c) The following table contains details of the hedged exposures covered by the Company's hedging strategies:

As at 31 December 2019	**Carrying amount of hedged item**	**Accumulated amount of fair value adjustments on the hedged item**	**Line item on statement of financial position**	**Fair value changes of the hedged items**	**Ineffectiveness recognized in profit or loss**
Fair value hedge					
Interest rate					
Debt investments	**23,691,106**	**84,439**	**Financial asset at fair value through other comprehensive income**	**60,656**	**(6,004)**
Loans and advances to customers	**1,589,928**	**31,434**	**Loans and advances to customers**	**31,434**	**717**

(All amounts expressed in thousands of HK$ unless otherwise stated)

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Hedge accounting *(continued)*

As at 31 December 2018	Carrying amount of hedged item	Accumulated amount of fair value adjustments on the hedged item	Line item on statement of financial position	Fair value changes of the hedged items	Ineffectiveness recognized in profit or loss
Fair value hedge					
Interest rate					
Debt investments	4,184,685	25,302	Financial asset at fair value through other comprehensive income	25,302	(124)

The following table contains information regarding the effectiveness of the hedging relationships designated by the Company, as well as the impacts on profit or loss and other comprehensive income:

For the year ended 31 December 2019	**Gains/(losses) recognized in other comprehensive Income**	**Hedge ineffectiveness recognized in profit and loss**	**Profit and loss line item that includes hedge ineffectiveness**
Fair value hedge			
Interest rate	**–**	**(5,287)**	**Net gains arising from trading activities**

For the year ended 31 December 2018	Gains/(losses) recognized in other comprehensive Income	Hedge ineffectiveness recognized in profit and loss	Profit and loss line item that includes hedge ineffectiveness
Fair value hedge			
Interest rate	–	(124)	Net gains arising from trading activities

(All amounts expressed in thousands of HK$ unless otherwise stated)

19 LOANS AND ADVANCES TO CUSTOMERS

19.1 Loans and advances to customers

	2019	2018
Loans and advances to customers	**79,519,025**	67,920,933
Less: ECL allowance	**(317,410)**	(232,214)
	79,201,615	67,688,719

19.2 Analysis of loans and advances to customers by staging

As at 31 December 2019	**Stage 1 allowance**	**Stage 2 allowance**	**Stage 3 allowance**	**Total**
Gross loans and advances (Note)	**78,885,497**	**571,140**	**62,388**	**79,519,025**
ECL allowance	**(228,363)**	**(60,402)**	**(28,645)**	**(317,410)**
Net loans and advances to customers	**78,657,134**	**510,738**	**33,743**	**79,201,615**

Note: Included in the stage 1 balance is a fair value change of hedging adjustment of HK$31,434,000 which is not subject to ECL allowance.

As at 31 December 2018	Stage 1 allowance	Stage 2 allowance	Stage 3 allowance	Total
Gross loans and advances	67,575,769	280,848	64,316	67,920,933
ECL allowance	(176,698)	(31,962)	(23,554)	(232,214)
Net loans and advances to customers	67,399,071	248,886	40,762	67,688,719

19.3 Credit quality of loans and advances to customers

Loans and advances to customers analyzed by security type

	2019	2018
Unsecured loans	**22,323,157**	17,105,433
Loans secured by guarantee	**15,092,813**	13,737,768
Collateralized and other secured loans	**42,103,055**	37,077,732
Gross amount of loans and advances to customers before ECL allowance	**79,519,025**	67,920,933

(All amounts expressed in thousands of HK$ unless otherwise stated)

19 LOANS AND ADVANCES TO CUSTOMERS *(continued)*

19.4 Overdue loans

Gross advances to customers overdue for more than 3 months

	2019	**% of gross advances to customers**	2018	% of gross advances to customers
Six months or less but over three months	**28,486**	**0.04%**	3,392	0.00%
One year or less but over six months	**3,073**	**0.00%**	30,646	0.05%
Over one year	**15,359**	**0.02%**	15,320	0.02%
Total gross amount of advances overdue for more than three months	**46,918**	**0.06%**	49,358	0.07%
ECL allowance for stage 3	**26,689**		20,996	
Rescheduled advances excluding those overdue for more than three months	**1,271**	**0.00%**	1,523	0.00%

20 FINANCIAL ASSETS AT FAIR VALUE THROUGH COMPREHENSIVE INCOME

	2019	2018
Debt securities at fair value through other comprehensive income		
– Listed	**56,023,727**	235,181
– Unlisted	**66,208,581**	109,069,891
Equity securities at fair value through other comprehensive income		
– Unlisted	**9,965**	9,990
	122,242,273	109,315,062

The Company has designated the investment in equity instrument issued by Joint Electronic Teller Services Limited at fair value through other comprehensive income. The Company chose this presentation alternative because the investment was made for strategic purposes rather than with a view to profit on a subsequent sale, and there is no plan to dispose this investment in short or medium term.

(All amounts expressed in thousands of HK$ unless otherwise stated)

20 FINANCIAL ASSETS AT FAIR VALUE THROUGH COMPREHENSIVE INCOME *(continued)*

The fair value of this investment is HK$9,965,000 as at 31 December 2019 (31 December 2018: HK$9,990,000) and a dividend of HK$35,000 (31 December 2018: HK$700,000) was recognized for the year. There is no transfer of the cumulative loss within equity.

Financial investments analyzed by issuer are as follows:

	2019	2018
Debt securities at fair value through other comprehensive income		
– Governments and central banks	**22,084,902**	14,914,288
– Banks and other financial institutions	**81,900,395**	93,919,607
– Corporate entities	**18,247,011**	471,177
Equity securities at fair value through other comprehensive income		
– Banks and other financial institutions	**9,965**	9,990
	122,242,273	109,315,062

21 PROPERTY AND EQUIPMENT

	Equipment	**Property improvement**	**Total**
Cost			
As at 1 January 2019	**61,892**	**83,417**	**145,309**
Additions	**11,758**	**3,279**	**15,037**
Disposal	**(13,250)**	**(42,436)**	**(55,686)**
As at 31 December 2019	**60,400**	**44,260**	**104,660**
Accumulated depreciation			
As at 1 January 2019	**(31,000)**	**(46,891)**	**(77,891)**
Charge for the year	**(12,072)**	**(16,882)**	**(28,954)**
Disposal	**13,225**	**42,436**	**55,661**
As at 31 December 2019	**(29,847)**	**(21,337)**	**(51,184)**
Net book value			
As at 31 December 2019	**30,553**	**22,923**	**53,476**

(All amounts expressed in thousands of HK$ unless otherwise stated)

21 PROPERTY AND EQUIPMENT *(continued)*

	Buildings	Equipment	Transportation equipment	Property improvement	Total
Cost					
As at 1 January 2018	518,182	298,827	4,118	134,165	955,292
Additions	–	19,688	–	6,447	26,135
Disposal	–	(7,829)	–	(9,148)	(16,977)
Transfer of Excluded Business to HKBR (Note 2)	(518,182)	(248,794)	(4,118)	(48,047)	(819,141)
As at 31 December 2018	–	61,892	–	83,417	145,309
Accumulated depreciation					
As at 1 January 2018	(328,893)	(173,908)	(1,533)	(59,512)	(563,846)
Charge for the year	(961)	(14,116)	(104)	(17,945)	(33,126)
Disposal	–	5,654	–	9,140	14,794
Transfer of Excluded Business to HKBR (Note 2)	329,854	151,370	1,637	21,426	504,287
As at 31 December 2018	–	(31,000)	–	(46,891)	(77,891)
Net book value					
As at 31 December 2018	–	30,892	–	36,526	67,418

(All amounts expressed in thousands of HK$ unless otherwise stated)

22 DEFERRED INCOME TAX ASSETS/(LIABILITIES)

The movements on the net deferred tax assets/(liabilities) are as follows:

	2019	2018
As at 1 January	**10,978**	11,352
Deferred income tax charged to income statement	**16,690**	39,271
Deferred income tax debited to equity	**(74,574)**	(8,901)
Transfer of Excluded Business to HKBR (Note 2)	**–**	(30,744)
As at 31 December	**(46,906)**	10,978

Deferred tax assets and liabilities are attributable to the following items:

	2019	2018
Deferred tax assets		
ECL allowances	**52,042**	37,701
	52,042	37,701
Deferred tax liabilities		
Accelerated depreciation allowances	**(7,547)**	(9,896)
Revaluation of investment securities	**(91,401)**	(16,827)
	(46,906)	10,978

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The deferred tax assets and liabilities are to be recovered and settled after one year and the following amounts, determined after appropriate offsetting, are shown in the statement of financial position:

	2019	2018
Deferred tax assets	**52,042**	37,701
Deferred tax liabilities	**(98,948)**	(26,723)
	(46,906)	10,978

(All amounts expressed in thousands of HK$ unless otherwise stated)

23 RIGHT-OF-USE ASSETS

	2019
Gross:	
Opening balance	203,642
Additions	263,936
Reductions	(2,469)
Balance at the end of the year	465,109
Accumulated depreciation	
Opening balance	–
Additions	(166,890)
Reductions	190
Balance at the end of the year	(166,700)
Net book value	
As at 1 January 2019	203,642
As at 31 December 2019	298,409

(i) Amounts recognized in the statement of financial position

The statement of financial position shows the following amounts relating to leases:

	As at 31 December 2019	As at 1 January 2019
Right-of-use asset		
Properties	289,945	188,374
Equipment	8,328	15,198
Others	136	70
	298,409	203,642
Lease liabilities	301,488	207,291

(ii) Amounts recognized in the statement of profit or loss

The statement of profit or loss shows the following amounts relating to leases:

Depreciation charge of right-of-use assets (Note 11)	2019	1 January 2019
Properties	159,967	–
Equipment	6,870	–
Others	53	–
	166,890	–

Financial costs-lease interest expense (Note 11)	2019	1 January 2019
Properties	4,663	–
Equipment	136	–
Others	1	–
	4,820	–

The total cash outflow for leases in 2019 was HK$193,453,000 (2018: Nil).

(All amounts expressed in thousands of HK$ unless otherwise stated)

23 RIGHT-OF-USE ASSETS *(continued)*

(iii) The Company's leasing activities and how these are accounted for

The Company leases various retail stores, equipment and advertising spaces. Rental contracts are typically made for fixed periods of 1 year to 8 years, but may have extension options as described in (iv) below.

Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants but leased assets may not be used as security for borrowing purposes.

(iv) Extension and termination options

Extension and termination options are included in a number of retail stores across the Company. These terms are used to maximise operational flexibility in terms of managing contracts. The majority of extension and termination options held are exercisable only by the Company and not by the respective lessor.

24 OTHER ASSETS

	2019	2018
Interest receivable	**839,730**	755,467
Settlement accounts	**4,563,044**	685,639
Other receivables, prepayments and others	**89,960**	74,213
Less: ECL allowance	**(15,495)**	(13,840)
Intangible asset (a)	**12,198**	1,495
	5,489,437	1,502,974

(a) Intangible asset

	Software
Cost	
As at 1 January 2019	**1,523**
Additions	**12,114**
As at 31 December 2019	**13,637**
Accumulated amortization	
As at 1 January 2019	**(28)**
Amortization expenses	**(1,411)**
As at 31 December 2019	**(1,439)**
Net book value as at 31 December 2019	**12,198**
As at 1 January 2018	–
Additions	1,523
As at 31 December 2018	1,523
Accumulated amortization	
As at 1 January 2018	–
Amortization expenses	(28)
As at 31 December 2018	(28)
Net book value as at 31 December 2018	1,495

(All amounts expressed in thousands of HK$ unless otherwise stated)

25 DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	2019	2018
Deposits from banks and other financial institutions	**16,276,758**	18,876,951
Subordinated loan from the ultimate holding company	**2,000,000**	2,000,000
Financial assets sold under repurchase agreements (Note 32)	**10,459,812**	250,000
Total	**28,736,570**	21,126,951

26 DUE TO CUSTOMERS

	2019	2018
Demand deposits and current accounts	**7,904,693**	7,533,053
Saving deposits	**49,071,727**	50,960,428
Time, call, notice and other deposits	**113,778,869**	103,581,202
	170,755,289	162,074,683
Including:		
Deposits pledged as collateral	**2,240,493**	2,480,149

27 FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	2019	2018
Derivative financial instruments (Note 18)	**1,168,798**	467,764

For the year ended 31 December 2019 and 2018, there were no significant changes in the fair value of the Company's financial liabilities designated as at fair value through profit or loss that were attributable to the changes in credit risk.

28 OTHER LIABILITIES

	2019	2018
Interest payable	**727,400**	840,072
Settlement accounts	**2,471,380**	3,462,534
Withholding tax	**58,064**	59,363
Provision for ECL allowances on financial guarantee and credit related commitment	**14,872**	10,941
Others	**1,211,293**	1,049,184
Total	**4,483,009**	5,422,094

(All amounts expressed in thousands of HK$ unless otherwise stated)

29 SHARE CAPITAL

	Number of shares	Share capital
As at 31 December 2019 and 31 December 2018	17,900,000,000	17,900,000

30 FINANCIAL GUARANTEES AND CREDIT RELATED COMMITMENTS AND OTHER COMMITMENTS

Financial guarantees and credit related commitments

The following tables indicate the contractual amounts of the Company's financial guarantees and credit related commitments which the Company has committed to its customers:

	2019	2018
Letters of guarantee	**41,215**	66,874
Letters of credit commitments	**138,802**	87,858
Acceptances bills	**13,620**	27,149
Credit card commitments	**6,034,752**	6,420,292
Other credit-related commitments		
– Under 1 year	**3,048,907**	2,796,298
– More than 1 year	**2,512,765**	2,723,227
	11,790,061	12,121,698

Capital expenditure commitments

	2019	2018
Contracted but not provided for	**7,170**	16,095

Operating lease commitments

As at 31 December 2019 and 2018, the Company has no non-cancellable operating lease commitments related to short-term leases, which are the leases with a lease term of 12 months or less.

(All amounts expressed in thousands of HK$ unless otherwise stated)

31 NOTES TO STATEMENT OF CASH FLOWS

Analysis of the balance of cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following balances with original maturities of less than or equal to 90 days used for the purpose of meeting short-term cash commitments:

	2019	2018
Cash and balances with central bank (Note 15)	**1,094,956**	2,353,780
Due from banks and other financial institutions	**4,939,639**	9,351,210
	6,034,595	11,704,990

32 COLLATERALS

Financial assets sold under repurchase agreements included certain transactions under which, title of the pledged securities has been transferred to counterparties.

Sales and repurchase agreements are transactions in which the Company sells a security and simultaneously agrees to repurchase it (or an asset that is substantially the same) at a fixed price on a future date. Since the repurchase prices are fixed, the Company is still exposed to substantially all the credit risks and market risks and rewards of those securities sold. These securities, which the Company does not have the ability to use during the term of the arrangements, are not derecognized from the financial statements but regarded as "collateral" for the secured lending from these because the Company retains substantially all the risks and rewards of these securities. In addition, it recognizes a financial liability for cash received.

As at 31 December 2019 and 2018, the Company entered into repurchase agreements with certain counterparties. The proceeds from selling such securities were presented as "financial assets sold under repurchase agreements" (see Note 25).

	Transferred assets		**Associated liabilities**	
	2019	2018	**2019**	2018
Investment securities	**11,067,402**	250,842	**(10,459,812)**	(250,000)

(All amounts expressed in thousands of HK$ unless otherwise stated)

33 MATERIAL RELATED PARTY TRANSACTIONS

(a) Parent entity

The Company is controlled by the following entity:

Name	Type	Place of incorporation	Ownership interest	
			2019	2018
Bank of Communications Co., Ltd	Ultimate parent entity and controlling party	People's Republic of China	**100%**	100%

(b) Key management personnel compensation

	2019	2018
Short-term employee benefits	**14,780**	14,434
Post-employment benefits	**1,179**	1,248
	15,959	15,682

(c) Transactions with the Ministry of Finance of the People's Republic of China ("MOF")

As at 31 December 2019, the MOF holds 17,732 million (31 December 2018: 19,703 million) shares of the ultimate holding company of the Company which represents 23.88% (31 December 2018: 26.53%) of equity interest of the ultimate holding company of the Company.

The MOF is a Chinese government ministry, primarily responsible for managing state fiscal revenue and expenditures, and establishing and enforcing taxation policies. The Company enters into banking transactions with the MOF under normal course of business and they mainly include the purchase and redemption of financial investments issued by the MOF and the deposits from the MOF.

Details of transactions and outstanding balances are summarized below:

	2019	2018
Bonds issued by MOF	**5,263,457**	4,039,010
Other assets	**16,737**	20,939
Interest income	**141,272**	86,811

(All amounts expressed in thousands of HK$ unless otherwise stated)

33 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

(d) Transactions with The Hong Kong and Shanghai Banking Corporation Limited and its subsidiaries ("HSBC")

As at 31 December 2019, HSBC holds 13,886 million (31 December 2018: 13,886 million) shares of the ultimate holding company of the Company which represents 18.70% (31 December 2018: 18.70%) of total share capital of the ultimate holding company of the Company. Transactions between the Company and HSBC are carried out under normal commercial terms and paid at market rates.

Details of transactions and outstanding balances are summarized below:

	2019	2018
Due from banks and other financial institutions	**3,852**	3,664
Financial assets at fair value through other comprehensive income	**1,455,631**	770,991
Derivative financial assets	**97,336**	564
Other assets	**9,677**	8,937
Due to banks and other financial institutions	**17,643**	11,860
Derivative financial liabilities	**165,107**	4,189
Interest income	**39,418**	15,220
Interest expense	**78**	990
Net gains arising from trading activities	**201,031**	–
Net gains arising from financial investments	**2,497**	–

(e) Transactions with fellow subsidiaries

The pricing of the transactions with fellow subsidiaries is determined based on normal commercial banks.

Details of transactions and outstanding balances are summarized below:

	2019	2018 (restated)
Loans and advances to customers	**433,679**	438,541
Other assets	**173**	185
Due to customers	**471,755**	377,741
Other liabilities	**10,517**	12,425
Fee and commission income	**12,578**	1,657
Interest income	**15,698**	16,540
Interest expense	**618**	312
Fee and commission expense	**13,623**	12,048
Rental expense	**26,522**	27,879
Other operating expenses	**31,204**	20,606

(All amounts expressed in thousands of HK$ unless otherwise stated)

33 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

(f) Transactions with directors and senior management

	2019	2018
Loans and advances to customers	**324**	811
Due to customers	**46,804**	39,720
Interest income	**3**	9
Interest expense	**294**	672

Particular of loans made to directors of the Company pursuant to section 383 of the Hong Kong Companies Ordinance and Part 3 of the Companies (Disclosure of Information about Benefits of Directors) Regulation for the year ended 31 December 2019 and 2018 are as follows:

	2019	2018
Aggregate amount of relevant transactions outstanding at year end	**47**	99
Maximum aggregate amount of relevant transactions outstanding during the year	**386**	468

(g) Transactions with the ultimate holding company

Transactions between the Company and the ultimate holding company are carried out under normal commercial terms and paid at market price.

Details of transactions and outstanding balances are summarized below:

	2019	2018
Due from banks and other financial institutions	**11,548,722**	12,686,398
Other assets	**177,089**	5,565
Derivative financial assets	**602,306**	932,323
Due to banks and other financial institutions	**17,659,827**	20,167,573
Other liabilities	**276,231**	115,009
Derivative financial liabilities	**475,004**	411,154
Interest income	**280,609**	696,390
Interest expense	**357,593**	329,703
Other operating expenses	**409,833**	324,824
Other operating income	**6,565**	6,684
Purchase of debt securities	**51,155,354**	115,281,247
Disposal of debt securities	**18,796,221**	–
Purchase of loan and advances	**16,420,942**	29,501,670
Disposal of loan and advances	**1,020,712**	–
Net (losses)/gains arising from trading activities	**(343,520)**	465,835
Net gains arising from financial investments	**282,266**	–

(All amounts expressed in thousands of HK$ unless otherwise stated)

34 SEGMENTAL ANALYSIS

The Company manages the business mainly from a operating segment perspective and the majority of the Company's revenues, profits before tax and assets are derived from Hong Kong. The Company is engaged predominantly in banking and related financial activities. It comprises corporate banking, personal banking, treasury and other business. Corporate banking mainly comprises corporate loans, bills, trade finance, corporate deposits and remittance. Personal banking mainly comprises individual loans, individual deposits, credit cards and remittance. Treasury mainly comprises money market placements and takings, financial investment, and securities sold under repurchase agreements. The "Others" segment mainly comprises unallocated revenue and expenses and corporate expenses.

The business information of the Company is summarized as follows:

	2019				
	Corporate Banking	Personal Banking	Treasury	Others	Total
External net interest income	894,701	(1,325,869)	3,352,337	–	2,921,169
Inter-segment net interest income/ (expense)	(397,424)	2,807,313	(2,409,889)	–	–
Net interest income	497,277	1,481,444	942,448	–	2,921,169
Net fee and commission income	15,604	713,986	(39,503)	–	690,087
Net gains arising from trading activities	–	–	76,413	–	76,413
Net gains arising from financial investments	–	–	425,804	–	425,804
Dividend income	–	–	35	–	35
Other operating income	(81)	20,818	9	795	21,541
Total operating income	512,800	2,216,248	1,405,206	795	4,135,049
Change in expected credit losses	(14,668)	(81,797)	(63,495)	(28)	(159,988)
Other operating expense					
– Depreciation and amortization	(4,903)	(188,005)	(106)	(4,241)	(197,255)
– Others	(78,264)	(792,743)	(72,517)	(405,448)	(1,348,972)
Profit before tax	414,965	1,153,703	1,269,088	(408,922)	2,428,834
Income tax expense	–	–	–	(366,160)	(366,160)
Net profit for the year	414,965	1,153,703	1,269,088	(775,082)	2,062,674
Depreciation and amortization	(4,903)	(188,005)	(106)	(4,241)	(197,255)
Capital expenditure	(2,683)	(22,865)	(10)	(1,593)	(27,151)
Segment assets	44,332,957	36,638,607	145,994,973	–	226,966,537
Unallocated assets	–	–	–	146,463	146,463
Total assets	44,332,957	36,638,607	145,994,973	146,463	227,113,000
Segment liabilities	(17,600,926)	(156,060,154)	(31,263,776)	–	(204,924,856)
Unallocated liabilities	–	–	–	(1,102,136)	(1,102,136)
Total liabilities	(17,600,926)	(156,060,154)	(31,263,776)	(1,102,136)	(206,026,992)

Notes to the Financial Statements

For the year ended 31 December 2019
(All amounts expressed in thousands of HK$ unless otherwise stated)

34 SEGMENTAL ANALYSIS *(continued)*

	2018				
	Corporate Banking	Personal Banking	Treasury	Others	Total
External net interest income	310,288	(1,112,676)	2,659,198	17	1,856,827
Inter-segment net interest income/ (expense)	142,634	2,622,393	(2,765,017)	(10)	–
Net interest income	452,922	1,509,717	(105,819)	7	1,856,827
Net fee and commission income	109,624	630,242	(7,210)	–	732,656
Net gains arising from trading activities	1,198	23,771	341,853	–	366,822
Net losses arising from financial investments	–	–	(9,851)	–	(9,851)
Dividend income	–	–	700	–	700
Other operating income	132	15,957	2,513	2,380	20,982
Total operating income	563,876	2,179,687	222,186	2,387	2,968,136
Change in expected credit losses	(123,831)	10,754	(78,442)	(21,070)	(212,589)
Other operating expense					
– Depreciation and amortization	(1,635)	(27,443)	(221)	(3,855)	(33,154)
– Others	(96,768)	(930,353)	(69,893)	(373,604)	(1,470,618)
Profit before tax	341,642	1,232,645	73,630	(396,142)	1,251,775
Income tax expense	–	–	–	(268,758)	(268,758)
Net profit for the year	341,642	1,232,645	73,630	(664,900)	983,017
Depreciation and amortization	(1,635)	(27,443)	(221)	(3,855)	(33,154)
Capital expenditure	(265)	(18,620)	(636)	(6,614)	(26,135)
Segment assets	33,113,049	35,889,221	138,735,707	–	207,737,977
Unallocated assets	–	–	–	138,745	138,745
Total assets	33,113,049	35,889,221	138,735,707	138,745	207,876,722
Segment liabilities	(8,324,919)	(156,349,405)	(23,908,166)	–	(188,582,490)
Unallocated liabilities	–	–	–	(660,999)	(660,999)
Total liabilities	(8,324,919)	(156,349,405)	(23,908,166)	(660,999)	(189,243,489)

35 NON-ADJUSTING EVENT AFTER REPORTING PERIOD

35.1 Coronavirus and impact on ECL

The economic impact of the coronavirus outbreak for business and the world economy is expected to gradually unfold. Economic fallout from coronavirus in China, being the world's second-largest economy and leading trading nation, is expected to greatly impact the global economy and local community. Factory shutdowns in China is slowing the flow of products and parts exported, which affecting companies around the world. Nevertheless the impact is expected to be controllable as the Chinese government has stepped up efforts to support different industries, such as bank facilities, tax reduction and rent exemption.

In terms of risk management, the Company will continue to closely monitor the development of the coronavirus outbreak during 2020 through on-going comprehensive risk assessment and stressed testing, and will consider the impact on key economic indicators and scenarios when determining ECL estimate under HKFRS 9, as well as update its risk management measures for principal risks as necessary.

In addition, the Company has introduced corresponding contingency measures such as adopting flexible working hours, split operation for key function of business units. The Company has also introduced work-from-home arrangement whereby staff can use secured equipment provided by the Company to perform certain work remotely. The Company has suspended all travel to China and discourages all other travel unless business critical and has introduced quarantined at home arrangement for staff returning from overseas travel. The health of our staff and our customers is our top priority and is closely monitored. The Company provides disposable surgical masks, cleaning supplies to ensure enough protection to staff when work in office, as well as suspends all staff social gatherings activities. The Company also flexibly adjusts the number of branches and business centers for the temporary closure to reduce the chance of potential infection of the coronavirus in the community.

35.2 Issuance of Capital instruments

The Company issued USD500 million non-cumulative subordinated additional Tier 1 capital securities on 3 March 2020.

36 COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to current year presentation.

Independent Auditor's Report

TO THE MEMBER OF BANK OF COMMUNICATIONS (HONG KONG) LIMITED
(Incorporated in Hong Kong with limited liability)

Opinion

What we have audited

The financial statements of Bank of Communications (Hong Kong) Limited (the "Bank") set out on pages 10 to 103, which comprise:

- the statement of financial position as at 31 December 2020;
- the statement of profit or loss and other comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Our opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2020, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the HKICPA. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Bank in accordance with the HKICPA's Code of Ethics for Professional Accountants ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matters identified in our audit are summarized as follows:

- Impairment of loans and advances to customers
- Purchase of loans and advances to customers

Key Audit Matter	How our audit addressed the Key Audit Matter
Impairment of loans and advances to customers As at 31 December 2020, the Bank reported total gross loans and advances to customers of HK$138,089m and HK$574m of total expected credit loss ("ECL") allowance, comprising HK$381m, HK$149m and HK$44m in Stages 1, 2 and 3 respectively. Refer to notes 3.1 and 19 to the Bank's financial statements. ECL of the Bank is determined through management's assessment of the changes in credit quality of loans and advances to customers since their initial recognition through a three-stage impairment model. For loans and advances to customers classified into Stage 1 and Stage 2, a risk parameter modelling approach is taken, incorporating key management judgements such as management's macro-economic forecasts ("MEF"), determination of significant increase in credit risk ("SICR") and internal credit ratings. For loans and advances to customers in Stage 3, the loan loss allowance is determined by management through estimating the future cash flows from the credit-impaired loans and advances to customers.	We tested the key controls that management have established to support their calculation of ECL, including: • Governance process over ECL models, including applicability of the modelling methodology and appropriateness of significant management judgements applied over the SICR, internal credit ratings, MEF and, for ECL on Stage 3 loans and advances to customers, the estimated recoverable amounts based on future cashflows; • Analysis over reasonableness of ECL results; • Controls over key data inputs to source system, user access management, and interface between the source systems and the ECL models; and • Regular and additional thematic post draw-down monitoring controls to challenge the appropriateness of the credit quality grading, particularly on the customers or loan portfolios that were impacted by the pandemic. With the support of our internal credit modelling specialist, we evaluated the appropriateness of the modelling methodology, giving the specific considerations to the impact of COVID-19.

Key Audit Matters *(continued)*

Key Audit Matter	How our audit addressed the Key Audit Matter
The macro-economic environment was volatile in 2020 with the onset of the Covid-19 pandemic and geopolitical developments, adding challenges to the inherently complex ECL determination, primarily due to the greater estimation uncertainty surrounding the forward-looking economic information and assessment of credit risk in the Bank's loan portfolios under the lingering impact of the pandemic. The applicability of the existing ECL modelling methodology and appropriateness of management's assumptions require re-assessment as part of the Bank's governance process and particularly essential under the pandemic situation. Determination of the abovementioned MEF, SICR, internal credit ratings and assessment of the appropriateness of the ECL modelling methodology required significant management judgements and therefore we determined this area to be a key audit matter.	We independently assessed the reasonableness of the MEF scenarios and management's judgements in determining the probability weighting of each scenario applied by comparing them to external economic forecasts and other available public information, taking into consideration the latest developments of COVID-19 and the geopolitical situation. Our audit procedures also included assessing the reasonableness of the SICR determination applied in classifying loans between Stage 1 and Stage 2 as well as assessing the reasonableness of the internal credit ratings for a sample of loans with a focus of our testing on the higher risk industries hard hit by COVID-19, which in turn drives the determination of the probability of default in the ECL calculation. Our assessment considered the financial and non-financial information of the borrowers, along with external information available, including adjusting events occurring after the year end of 31 December 2020, if any. Based on the audit procedures performed, we considered the key judgements adopted by management in the impairment assessment of loans and advances to customers are supportable by available evidence.

Key Audit Matters *(continued)*

Key Audit Matter

Purchase of loans and advances to customers

For the year ended 31 December 2020, the Bank purchased total gross loans and advances to customers of HK$63b from the Hong Kong branch of its ultimate holding company, Bank of Communications Co. Ltd.. Refer to note 34(g) to the Bank's financial statements.

The Bank's purchase of loans and advances of customers from its ultimate holding company was under normal commercial terms, and measured and recorded at the fair value of the loans and advances to customers at the date of the purchase. The methodology applied in determination of fair value was through re-computation of the discounted cash flows of the individual loans and advances. Management judgement is required in the determination of fair value such as the calculation of the discount rate (or credit spread), which is impacted by the credit quality of the loans and advances to customers and the probability of the embedded options of the loans and advances to customers being exercised.

We determined this area to be a key audit matter due to the magnitude of the amount involved, along with significant management judgements required in the determination of the fair value of the loans and advances purchased.

How our audit addressed the Key Audit Matter

We performed a number of audit procedures over the purchase of these loans and advances to customers, in particular:

- We assessed the appropriateness of the methodology applied by the Bank in determining the fair value of the purchased loans and advances to customers, with the support of our internal valuation specialist; and
- We selected samples, and involved our internal valuation specialist to evaluate key judgements made by management and checked the mathematical accuracy of management's computation of the discounted cashflow balance. These key judgements include the assessment of whether there has been a material change in the credit quality of the loans and advances to customers since loan origination, changes in credit spread and probability of exercising any embedded options in the loans and advances to customers.

Based on the audit procedures performed, we found the management judgements applied in the fair value determination of the purchased loans and advances to customers to be reasonable.

Other Information

The directors are responsible for the other information. The other information comprises all of the information included in the annual report other than the financial statements and our auditor's report thereon.

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Directors and Audit Committee for the Financial Statements

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

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

The Audit Committee is responsible for overseeing the Bank's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. We report our opinion solely to you, as a body, in accordance with Section 405 of the Hong Kong Companies Ordinance and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

Auditor's Responsibilities for the Audit of the Financial Statements *(continued)*

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

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

The engagement partner on the audit resulting in this independent auditor's report is Tam Man Kit, James.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 1 April 2021

Statement of Profit or Loss and Other Comprehensive Income

(All amounts expressed in thousands of HK$ unless otherwise stated)

	Notes	Year ended 31 December 2020	2019
Interest income		**5,324,947**	6,076,016
Interest expense		**(3,046,807)**	(3,154,847)
Net interest income	4	**2,278,140**	2,921,169
Fee and commission income	5	**814,846**	746,623
Fee and commission expense	6	**(56,634)**	(56,536)
Net fee and commission income		**758,212**	690,087
Net gains arising from trading activities	8	**544,990**	76,413
Net gains arising from financial investments		**165,906**	425,804
Dividend income	7	**35**	35
Other operating income	9	**15,080**	21,541
Change in expected credit losses	10	**(470,324)**	(159,988)
Other operating expenses	11	**(1,544,103)**	(1,546,227)
Profit before tax		**1,747,936**	2,428,834
Income tax expenses	14	**(297,567)**	(366,160)
Net profit for the year		**1,450,369**	2,062,674
Other comprehensive income for the year, net of tax			
Item that will not be reclassified subsequently to profit or loss:			
Equity investments at fair value through other comprehensive income – net change in fair value		**(268)**	(25)
Items that may be reclassified to profit or loss:			
Debt investments at fair value through other comprehensive income			
Net gains recorded in equity		**920,285**	890,277
Net gains reclassified from equity to profit or loss		**(138,532)**	(496,062)
Other comprehensive income for the year		**781,485**	394,190
Total comprehensive income for the year		**2,231,854**	2,456,864

The accompanying notes form a part of these financial statements.

Statement of Financial Position

(All amounts expressed in thousands of HK$ unless otherwise stated)

		As at 31 December	
		2020	2019
	Notes		
ASSETS			
Cash and balances with central bank	15	**8,438,950**	1,094,956
Due from banks and other financial institutions	16	**20,094,736**	17,667,908
Financial assets at fair value through profit or loss	17	**905,433**	1,064,926
Financial assets at fair value through other comprehensive income	20	**201,947,823**	122,242,273
Loans and advances to customers	19	**137,514,670**	79,201,615
Property and equipment	21	**55,792**	53,476
Current tax assets		**50,290**	–
Right-of-use assets	23	**234,130**	298,409
Other assets	24	**3,722,018**	5,489,437
Total assets		**372,963,842**	227,113,000
LIABILITIES			
Due to banks and other financial institutions	25	**71,659,676**	28,736,570
Due to customers	26	**245,749,909**	170,755,289
Financial liabilities at fair value through profit or loss	27	**2,783,985**	1,168,798
Current tax liabilities		**–**	534,932
Deferred income tax liabilities	22	**163,500**	46,906
Lease liabilities	23	**238,333**	301,488
Other liabilities	28	**5,251,296**	4,483,009
Total liabilities		**325,846,699**	206,026,992
EQUITY			
Share capital	29	**37,900,000**	17,900,000
Additional equity instrument	30	**3,871,450**	–
Other reserves		**1,262,649**	481,164
Retained earnings		**4,083,044**	2,704,844
Total equity		**47,117,143**	21,086,008
Total equity and liabilities		**372,963,842**	227,113,000

The financial statements were approved and authorized for issuance by the Board of Directors on 1 April 2021 and signed on its behalf by:

Wang Feng, Chairman

Chan Ha Fong, Nancy, Chief Executive

The accompanying notes form a part of these financial statements.

Statement of Changes in Equity

(All amounts expressed in thousands of HK$ unless otherwise stated)

	Notes	Attributable to the shareholder of the Bank				
		Share capital	Additional equity instrument	Other reserve	Retained earnings (Note (a))	Total
At 1 January 2020		**17,900,000**	**–**	**481,164**	**2,704,844**	**21,086,008**
Net profit for the year		**–**	**–**	**–**	**1,450,369**	**1,450,369**
Other comprehensive income		**–**	**–**	**781,485**	**–**	**781,485**
		17,900,000	**–**	**1,262,649**	**4,155,213**	**23,317,862**
Issuance of additional equity instrument	30	**–**	**3,871,450**	**–**	**–**	**3,871,450**
Issuance of share capital	29	**20,000,000**	**–**	**–**	**–**	**20,000,000**
Dividends paid to additional equity instrument holders	30	**–**	**–**	**–**	**(72,169)**	**(72,169)**
At 31 December 2020		**37,900,000**	**3,871,450**	**1,262,649**	**4,083,044**	**47,117,143**
At 1 January 2019		17,900,000	–	86,974	646,259	18,633,233
Change in accounting policy		–	–	–	(4,089)	(4,089)
Restated balance at 1 January 2019		17,900,000	–	86,974	642,170	18,629,144
Net profit for the year		–	–	–	2,062,674	2,062,674
Other comprehensive income		–	–	394,190	–	394,190
At 31 December 2019		17,900,000	–	481,164	2,704,844	21,086,008

Note (a):

In accordance with the requirements of the Hong Kong Monetary Authority (the "HKMA"), the regulatory reserve is set aside for general banking risks, including future losses or other unforeseeable risks. The regulatory reserve is set up in compliance with the HKMA's requirements and is distributable to shareholder of the Bank subject to consultation with the HKMA. As at 31 December 2020, HK$749,460,000 (2019: HK$891,005,000) was earmarked as the regulatory reserve from the retained earnings.

The accompanying notes form a part of these financial statements.

Statement of Cash Flows

(All amounts expressed in thousands of HK$ unless otherwise stated)

	Notes	Year ended 31 December 2020	2019
Cash flows from operating activities:			
Profit before tax		**1,747,936**	2,428,834
Adjustments for:			
Change in expected credit losses		**470,324**	159,988
Depreciation and amortization		**24,420**	30,365
Depreciation of right-of-use assets		**177,833**	166,890
Finance costs – lease interest expense		**4,699**	4,820
Loss on disposal of property and equipment		**–**	25
Interest income from financial investments		**(2,868,572)**	(3,531,136)
Fair value losses/(gains)		**20,389**	(38,828)
Dividend income		**(35)**	(35)
Withholding tax		**144**	–
Net gains arising from financial investments		**(165,906)**	(425,804)
Operating cash flows before movements in operating assets and liabilities		**(588,768)**	(1,204,881)
Net decrease in due from banks and other financial institutions		**8,405,462**	3,000,205
Net decrease in financial assets at fair value through profit or loss		**139,104**	829,256
Net increase in loans and advances to customers		**(58,574,633)**	(11,605,133)
Net decrease/(increase) in other assets		**2,373,629**	(3,966,740)
Net increase in due to banks and other financial institutions		**42,923,106**	7,609,619
Net increase in financial liabilities at fair value through profit or loss		**1,615,187**	701,034
Net increase in due to customers		**74,994,620**	8,680,606
Net increase/(decrease) in other liabilities		**759,045**	(942,931)
Income tax paid		**(923,998)**	–
Net cash inflows from operating activities		**71,122,754**	3,101,035

Statement of Cash Flows

(All amounts expressed in thousands of HK$ unless otherwise stated)

	Notes	Year ended 31 December 2020	2019
Cash flows from investing activities:			
Purchase of financial investments		**(180,324,800)**	(155,694,231)
Disposal or redemption of financial investments		**101,526,815**	143,601,346
Dividend received		**35**	35
Interest received from financial investments		**2,267,302**	3,520,322
Purchase of property and equipment		**(23,479)**	(15,037)
Purchase of intangible assets		**(10,379)**	(12,114)
Net cash outflows from investing activities		**(76,564,506)**	(8,599,679)
Cash flows from financing activities:			
Principal elements of lease payments		**(176,709)**	(166,931)
Interest paid for lease		**(4,699)**	(4,820)
Proceeds from issuance of share capital		**20,000,000**	–
Issuance of additional equity instrument		**3,890,605**	–
Cost paid for issuance for additional equity instrument		**(19,155)**	–
Dividend paid to additional equity instrument holders		**(72,169)**	–
Net cash inflows/(outflows) from financing activities		**23,617,873**	(171,751)
Net increase/(decrease) in cash and cash equivalents		**18,176,121**	(5,670,395)
Cash and cash equivalents at the beginning of the year		**6,034,595**	11,704,990
Cash and cash equivalents at the end of the year	32	**24,210,716**	6,034,595
Net cash flows from operating activities include:			
Interest received		**2,269,520**	2,471,431
Interest paid		**(3,333,866)**	(3,267,520)

The accompanying notes form a part of these financial statements.

Notes to the Financial Statements

For the year ended 31 December 2020
(All amounts expressed in thousands of HK$ unless otherwise stated)

1 GENERAL

Bank of Communications (Hong Kong) Limited ("the Bank") is a company incorporated and domiciled in Hong Kong.

On 29 September 2015, the Hong Kong Monetary Authority granted the Bank a banking licence under the Banking Ordinance.

On 29 January 2018 (the "Appointed Day"), the Bank of Communications (Hong Kong) Limited (Merger) Ordinance (Chapter 1182 of the laws of Hong Kong) (the "Ordinance") has become effective. Pursuant to the Ordinance, certain activities, assets and liabilities which constitute the retail banking business and private banking business ("Transferred Business") of Bank of Communications Co., Ltd. Hong Kong Branch ("HKBR") have been transferred to the Bank in accordance with section 4 (1) of the Ordinance. Accordingly, the Bank commenced its retail banking business and private banking business on the Appointed Day.

On 6 January 2020, the Bank has altered its articles of association and the Bank's status has been changed from a private company to a public company with effect from 6 January 2020.

In March 2020, the Bank issued USD500 million undated non-cumulative subordinated Additional Tier 1 capital securities.

In September 2020, the Bank issued HKD20 billion share capital to Bank of Communications Co. Ltd.

The address of its registered office is 20 Pedder Street, Central, Hong Kong and principal place of business is Unit B B/F & G/F, Unit C G/F, 1-3/F, 16/F Rm01 & 18/F Wheelock House, 20 Pedder Street, Central, Hong Kong. Its ultimate holding company is Bank of Communications Co., Ltd., which is incorporated in the People's Republic of China.

These financial statements are presented in thousands of Hong Kong Dollars (HK$), unless otherwise stated.

The regulatory disclosure information required under the Banking (Disclosure) Rules is available in the Regulatory Disclosure Section of our website www.hk.bankcomm.com.

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ('HKFRSs') and the requirements of the Hong Kong Companies Ordinance (Cap. 622). The financial statements have been prepared on the historical cost basis except for certain financial instruments which are measured at fair value.

The Bank adopts the going concern basis in preparing its financial statements.

(All amounts expressed in thousands of HK$ unless otherwise stated)

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.1 Basis of preparation *(continued)*

2.1.1 New and revised HKFRSs applied by the Bank

Amendments to HKAS 1 and HKAS 8 (effective by 1 January 2020)	Definition of Material
Amendments to HKFRS 3 (effective by 1 January 2020)	Definition of a Business
Amendments to HKFRS16 (effective by 1 June 2020)	Covid-19-Related Rent Concessions
Amendments to HKFRS 9, HKAS 39 and HKFRS 7 (effective by 1 January 2020)	Interest Rate Benchmark Reform

Interest Rate Benchmark Reform

The amendments to HKFRS 9, HKAS 39 and HKFRS 7 provide targeted relief for financial instruments qualifying for hedge accounting in the lead up to Interest Rate Benchmark Reform. Key changes include:

- modifying specific hedge accounting requirements so that entities would apply those hedge accounting requirements assuming that the interest rate benchmark on which the hedged cash flows and cash flows from the hedging instrument are based will not be altered as a result of interest rate benchmark reform;
- mandatory for all hedging relationships that are directly affected by the interest rate benchmark reform;
- are not intended to provide relief from any other consequences arising from interest rate benchmark reform (if a hedging relationship no longer meets the requirements for hedge accounting for reasons other than those specified by the amendments, discontinuation of hedge accounting is required); and
- requiring specific disclosures about the extent to which the entities' hedging relationships are affected by the amendments.

The Bank has established a project to manage the transition for any of its contracts that could be affected. The project is coordinated by Deputy Chief Executive and involved senior representatives from functions across the Bank including the asset and liability management, front line business and product management, legal and compliance, finance, risk management, operations and technology. The project team provides progress updates to the project steering committee and the senior management at least on a monthly basis.

The Bank applies hedge accounting on hedging its interest rate risk on certain debt investments, loans and advances to customers and therefore is exposed to changes in fair value due to movements in market rates. The Bank's derivatives instruments designated in hedge accounting relationships have floating legs that are indexed to with HIBOR or USD LIBOR. The Bank has fair value hedge accounting relationships mature beyond the anticipated cessation date for USD LIBOR. The Bank expects that USD LIBOR will be discontinued after the end of 2021. Secured Overnight Financing Rate ("SOFR") is recommended as the alternative reference rate.

(All amounts expressed in thousands of HK$ unless otherwise stated)

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.1 Basis of preparation *(continued)*

2.1.1 New and revised HKFRSs applied by the Bank (continued)

Interest Rate Benchmark Reform (continued)

Significant judgement will be required in determining when uncertainty is expected to be resolved and when the targeted relief will cease to apply. As at 31 December 2020, the Bank believes uncertainty continues to exist as to when and how the replacement may occur with respect to the relevant derivative hedging instruments and so the targeted reliefs applied to the Bank's hedge accounting relationships that reference benchmarks subject to reform or replacement.

As at 31 December 2020, the derivative instruments designated in fair value hedge accounting relationships were linked to interbank offered rate reference rates and directly affected by the amendments:

As at 31 December 2020	**Notional amount**
Fair value hedge	
Interest rate contract	
USD London Interbank Offered Rate	**83,530,304**

The notional amount of derivative hedging instruments provides a close approximation to the extent of the risk exposure the Bank manages through hedging relationships that is directly affected by the reform and impacted by the amendments. The notional contract amounts of interest rate derivatives designated in qualifying hedge accounting relationships indicate the nominal value of transactions outstanding as at the reporting date, they do not represent amounts at risk. The Bank has initially adopted the new amendments to HKFRS 9, HKAS 39 and HKFRS 7 from 1 January 2020 and concluded it does not have a material impact on the Bank's operating results, financial position or other comprehensive income.

The other amendments listed above did not have any impact on the amounts recognized in prior periods and are not expected to significantly affect the current or future periods.

2.1.2 Standards and amendments that are not yet effective and have not been adopted by the Bank

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2020 reporting periods and have not been early adopted by the Bank. These standards are not expected to have a material impact on the entity in the current or future reporting periods and on foreseeable future transactions.

Annual Improvements to HKFRS Standards 2018-2020 (effective for annual period beginning on or after 1 January 2022)

The Annual Improvements to HKFRSs 2018-2020 Cycle include a number of amendments to various HKFRSs:

- HKFRS 9 Financial Instruments – clarifies which fees should be included in the 10% test for derecognition of financial liabilities.

- HKFRS 16 Leases – amendment of illustrative example 13 to remove the illustration of payments from the lessor relating to leasehold improvements, to remove any confusion about the treatment of lease incentives.

Amendments to HKFRS 9, HKAS 39, HKFRS 7, HKFRS 4 and HKFRS 16 (effective for annual period beginning on or after 1 January 2021)

Amendments to HKFRS 9, HKAS 39, HKFRS 7, HKFRS 4 and HKFRS 16 address issues not dealt with in the previous amendments which affect financial reporting when an existing interest rate benchmark is replaced with an alternative risk-free-rate ("RFR"). The Phase 2 amendments provide a practical expedient to allow the effective interest rate to be updated without adjusting the carrying amount when accounting for changes in the basis for determining the contractual cash flows of financial assets and liabilities, if the change is a direct consequence of the interest rate benchmark reform and the new basis for determining the contractual cash flows is economically equivalent to the previous basis immediately preceding the change.

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.1 Basis of preparation *(continued)*

2.1.2 Standards and amendments that are not yet effective and have not been adopted by the Bank (continued)

In addition, the amendments permit changes required by the interest rate benchmark reform to be made to hedge designations and hedge documentation without the hedging relationship being discontinued. Any gains or losses that could arise on transition are dealt with through the normal requirements of HKFRS 9 to measure and recognize hedge ineffectiveness. The amendments also provide a temporary relief to entities from having to meet the separately identifiable requirement when an RFR is designated as a risk component. The relief allows an entity, upon designation of the hedge, to assume that the separately identifiable requirement is met, provided the entity reasonably expects the RFR risk component to become separately identifiable within the next 24 months.

Furthermore, the amendments require an entity to disclose additional information to enable users of financial statements to understand the effect of interest rate benchmark reform on an entity's financial instruments and risk management strategy. The amendments are effective for annual periods beginning on or after 1 January 2021 and shall be applied retrospectively, but entities are not required to restate the comparative information.

The Bank held interest-bearing financial instruments denominated in Hong Kong dollars and foreign currencies based on various Interbank Offered Rates as at 31 December 2020. If the interest rates of these financial instruments are replaced by RFRs in a future period, the Bank will apply this practical expedient upon the modification of these financial instruments when the "economically equivalent" criterion is met. Moreover, the Bank currently has applied hedge accounting on hedging its interest rate risk on certain debt investments, loans and advances to customers and therefore is exposed to changes in fair value due to movements in market rates. The Bank's derivatives instruments designated in hedge accounting relationships have floating legs that are indexed to with HIBOR or USD LIBOR. The Bank will amend the formal designation of its hedge accounting relationships upon modification of the derivative instruments.

2.2 Significant Accounting Policies

2.2.1 Interest income and expense

Interest income and expense are recognized in profit or loss for interest-bearing financial instruments classified under amortized cost and fair value through other comprehensive income using the effective interest method.

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (including a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant periods. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument (but does not consider future credit losses). The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Interest income on an impaired financial asset or a group of impaired similar financial assets is recognized using the original interest rate which was used to discount the future cash flows for the purpose of measuring the impairment loss.

2.2.2 Fee and commission income

The Bank earns fee and commission income from a diverse range of services it provides to its customers. For those services that are over a period of time, fee and commission income are accrued over that period when the services are rendered. For other services, fee and commission income are recognized when the services are rendered.

2.2.3 Dividend income

Dividends are recognized when the right to receive the dividends is established.

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Significant Accounting Policies *(continued)*

2.2.4 Financial assets and liabilities

Measurement methods

Initial recognition and measurement

Financial assets and financial liabilities are recognized when the Bank becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognized on trade-date, the date on which the Bank commits to purchase or sell the asset.

At initial recognition, the Bank measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability, such as fees and commissions. Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss are expensed in profit or loss. Immediately after initial recognition, an expected credit loss allowance (ECL) is recognized for financial assets measured at amortized cost and investments in debt instruments measured at financial assets at fair value through other comprehensive income, which results in an accounting loss being recognized in profit or loss when an asset is newly originated.

When the fair value of financial assets and liabilities differs from the transaction price on initial recognition, the Bank recognizes the difference as follows:

(a) When the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e. a Level 1 input) or based on a valuation technique that uses only data from observable markets, the difference is recognized as a gain or loss.

(b) In all other cases, the difference is deferred and the timing of recognition of deferred day one profit or loss is determined individually. It is either amortized over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or realized through settlement.

Amortized cost and effective interest rate

The amortized cost is the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any ECL allowance.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset (i.e. its amortized cost before any impairment allowance) or to the amortized cost of a financial liability. The calculation does not consider expected credit losses and includes transaction costs, premiums or discounts and fees and points paid or received that are integral to the effective interest rate, such as origination fees. For purchased or originated credit-impaired ('POCI') financial assets – assets that are credit-impaired (see definition on note 3.1.2.2) at initial recognition – the Bank calculates the credit-adjusted effective interest rate, which is calculated based on the amortized cost of the financial asset instead of its gross carrying amount and incorporates the impact of expected credit losses in estimated future cash flows.

When the Bank revises the estimates of future cash flows, the carrying amount of the respective financial assets or financial liability is adjusted to reflect the new estimate discounted cash flows using the original effective interest rate. Any changes are recognized in profit or loss.

Interest income

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets classified under amortized cost and fair value through other comprehensive income, except for:

(a) POCI financial assets, for which the original credit-adjusted effective interest rate is applied to the amortized cost of the financial asset.

(b) Financial assets that are not 'POCI' but have subsequently become credit-impaired (or 'stage 3'), for which interest revenue is calculated by applying the effective interest rate to their amortized cost (i.e. net of the expected credit loss provision).

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Significant Accounting Policies *(continued)*

2.2.4 Financial assets and liabilities *(continued)*

2.2.4.1 Financial assets

(i) Classification and subsequent measurement

Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds.

Classification and subsequent measurement of debt instruments depend on:

(i) The Bank's business model for managing the asset; and

(ii) The cash flow characteristics of the asset.

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

- Amortized 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 fair value through profit or loss, are measured at amortized cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognized and measured from these financial assets. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

- Fair value through other comprehensive income: 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 fair value through profit or loss, 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 gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortized cost which are recognized in profit or loss. When the financial asset is derecognized, the cumulative gain or loss previously recognized in other comprehensive income is reclassified from equity to profit or loss and recognized in 'Net gains/losses arising from financial investment'. Interest income from these financial assets is recognized in profit or loss and included in 'Interest income' using the effective interest rate method.

- Fair value through profit or loss: Assets that do not meet the criteria for amortized cost or fair value through other comprehensive income are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognized in profit or loss and recognized in the profit or loss within 'Net gains/losses arising from trading activities' in the period in which it arises.

Business model: the business model reflects how the Bank manages the assets in order to generate cash flows. That is, whether the Bank'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 (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'other' business model and measured at fair value through profit or loss. Factors considered by the Bank in determining the business model for a group of assets include past experience on how the cash flows for these assets were 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 Bank assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Bank 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. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Significant Accounting Policies *(continued)*

2.2.4 Financial assets and liabilities (continued)

2.2.4.1 Financial assets (continued)

(i) Classification and subsequent measurement (continued)

Debt instruments *(continued)*

Financial assets with embedded derivatives are considered in their entirely when determining whether their cash flows are solely payment of principal and interest.

The Bank reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period.

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. Examples of equity instruments include basic ordinary shares.

The Bank subsequently measures all equity investments at fair value through profit or loss, except where the Bank's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Bank's policy is to designate equity investments as fair value through other comprehensive income when those investments are held for purposes other than to sell. When this election is used, fair value gains and losses are recognized in other comprehensive income and are not subsequently reclassified to profit or loss, including on disposal. Dividends, when representing a return on such investments, continue to be recognized in profit or loss as 'Dividend income' when the Bank's right to receive payments is established.

Gains and losses on equity investments at fair value through profit or loss are recognized in the profit or loss as 'Net gains/losses arising from trading activities'.

(ii) Impairment

The Bank assesses on a forward-looking basis the ECL associated with its debt instrument assets carried at amortized cost and fair value through other comprehensive income and with the exposure arising from loan commitments and financial guarantee contracts. The Bank recognizes a ECL allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Regarding these judgment and estimates, refer to Credit Risk management in Note 3.1. Note 3.1.2 provides details of how the ECL allowance is measured.

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Significant Accounting Policies *(continued)*

2.2.4 Financial assets and liabilities *(continued)*

2.2.4.1 Financial assets (continued)

(iii) Modification of loans

The Bank sometimes renegotiates or otherwise modifies the contractual cash flows of loans to customers. When this happens, the Bank assesses whether or not the new terms are substantially different to the original terms. The Bank does this by considering, among others, the following factors:

- If the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay.
- Whether any substantial new terms are introduced, such as a profit share/equity-based return that substantially affects the risk profile of the loan.
- Significant extension of the loan term when the borrower is not in financial difficulty.
- Significant change in the interest rate.
- Change in the currency the loan is denominated in.
- Insertion of collateral, other security or credit enhancements that significantly affect the credit risk associated with the loan.

If the terms are substantially different, the Bank derecognizes the original financial asset and recognizes a 'new' asset at fair value and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Bank also assesses whether the new financial asset recognized is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognized in profit or loss as a gain or loss on derecognition.

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Bank recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognizes a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets).

(iv) Derecognition other than on a modification

Financial assets, or a portion thereof, are derecognized when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either (i) the Bank transfers substantially all the risks and rewards of ownership, or (ii) the Bank neither transfers nor retains substantially all the risks and rewards of ownership and the Bank has not retained control.

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Significant Accounting Policies *(continued)*

2.2.4 Financial assets and liabilities (continued)

2.2.4.1 Financial assets (continued)

(iv) Derecognition other than on a modification (continued)

The Bank enters into transactions where it retains the contractual rights to receive cash flows from assets but assumes a contractual obligation to pay those cash flows to other entities and transfers substantially all of the risks and rewards. These transactions are accounted for as 'pass through' transfers that result in derecognition if the Bank:

(i) Has no obligation to make payments unless it collects equivalent amounts from the assets;

(ii) Is prohibited from selling or pledging the assets; and

(iii) Has an obligation to remit any cash it collects from the assets without material delay.

Collateral (shares and bonds) furnished by the Bank under standard repurchase agreements and securities lending and borrowing transactions are not derecognized because the Bank retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met. This also applies to certain securitization transactions in which the Bank retains a subordinated residual interest.

When the contractual rights to receive the cash flows from the assets have been transferred, and the Bank neither transfers nor retains substantially all the risks and rewards of ownership, and the Bank has retained control of the transferred assets, the Bank applies continuing involvement approach. Under this approach, the Bank continues to recognize the transferred asset to the extent of its continuing involvement and recognize the associated liability, to reflect the rights and obligations retained by the Bank. The net carrying amount of the transferred asset and associated liability is: (a) the amortized cost of the rights and obligations retained by the Bank, if the transferred asset is measured at amortized cost; or (b) equal to the fair value of the rights and obligations retained by the Bank when measured on a stand-alone basis, if the transferred asset is measured at fair value.

2.2.4.2 Financial liabilities

(i) Classification and subsequent measurement

In both the current and prior period, financial liabilities are classified as liabilities measured at amortized cost, except for:

- Financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading (e.g. short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in profit or loss;

- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition or when the continuing involvement approach applies. When the transfer of financial asset did not qualify for derecognition, a financial liability is recognized for the consideration received for the transfer. In subsequent periods, the Bank recognizes any expense incurred on the financial liability; when continuing involvement approach applies, see note 2.2.4.1 (iv); and

- Financial guarantee contracts and loan commitments (see note 2.2.5).

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Significant Accounting Policies *(continued)*

2.2.4 Financial assets and liabilities (continued)

2.2.4.2 Financial liabilities (continued)

(ii) Derecognition

Financial liabilities are derecognized when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

The exchange between the Bank and its original lenders of debt instruments with substantially different terms, as well as substantial modifications of the terms of existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is more than 10% different from the discounted present value of the remaining cash flows of the original financial liability. In addition, other qualitative factors, such as the currency that the instrument is denominated in, changes in the type of interest rate, new conversion features attached to the instrument and change in covenants are also taken into consideration. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognized as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortized over the remaining term of the modified liability.

2.2.5 Financial guarantee contracts and loan commitments

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and others on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of:

- The amount of the ECL allowance; and
- The premium received on initial recognition less income recognized in accordance with the principles of HKFRS 15.

Loan commitments provided by the Bank are measured as the amount of the ECL allowance. The Bank has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

For loan commitments and financial guarantee contracts, the ECL allowance is recognized as provision. However, for contracts that include both a loan and an undrawn commitment and the Bank cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component, the expected credit losses on the undrawn commitment are recognized together with the ECL allowance for the loan. To the extent that the combined expected credit losses exceed the gross carrying amount of the loan, the expected credit losses are recognized as a provision.

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Significant Accounting Policies *(continued)*

2.2.6 Derivatives and hedging activities

The Bank has elected to apply the hedge accounting requirements of HKFRS 9.

Derivatives are initially recognized at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Certain derivatives are embedded in hybrid contracts, such as the conversion option in a convertible bond. If the hybrid contract contains a host that is a financial asset, then the Bank assesses the entire contract as described in the financial assets section above for classification and measurement purposes. Otherwise, the embedded derivatives are treated as separate derivatives when:

(i) Their economic characteristics and risks are not closely related to those of the host contract;

(ii) A separate instrument with the same terms would meet the definition of a derivative; and

(iii) The hybrid contract is not measured at fair value through profit or loss.

These embedded derivatives are separately accounted for at fair value, with changes in fair value recognized in the statement of profit or loss unless the Bank chooses to designate the hybrid contracts at fair value through profit or loss.

The method of recognizing the resulting fair value gain or loss depends on whether the derivative is designated and qualifies as a hedging instrument, and if so, the nature of the item being hedged. The Bank designates certain derivatives as either:

(a) Hedges of the fair value of recognized assets or liabilities or a firm commitment (fair value hedges); or

(b) Hedges of highly probable future cash flows attributable to a recognized asset or liability (cash flow hedges).

At the inception of the hedging, the Bank documents the economic relationship between hedging instruments and hedged items. The Bank documents its risk management objective and strategy for undertaking its hedge transactions. The Bank also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair values of derivative financial instruments designated in hedge relationships are disclosed in note 18. Movements in the hedging reserve in shareholder's equity are shown in statement of changes in equity.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the statement of profit or loss, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortized to profit or loss over the period to maturity and recorded as net interest income.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in other comprehensive income. The gain or loss relating to the ineffective portion is recognized immediately in the statement of profit or loss.

Amounts accumulated in equity are recycled to the statement of profit or loss in the periods when the hedged item affects profit or loss. They are recorded in the income or expense lines in which the revenue or expense associated with the related hedged item is reported.

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Significant Accounting Policies *(continued)*

2.2.6 Derivatives and hedging activities (continued)

Cash flow hedge (continued)

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognized in the periods when the hedged item affects profit or loss. When a forecast transaction is no longer expected to occur (for example, the recognized hedged asset is disposed of), the cumulative gain or loss previously recognized in other comprehensive income is immediately reclassified to the statement of profit or loss.

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognized immediately in profit or loss and are included in gains/(losses) from trading activities.

2.2.7 Assets transferred under repurchase agreements

Financial assets sold subject to agreements with a commitment to repurchase at a specific future date at a fixed or determinable price are not derecognized in the statement of financial position. The proceeds from selling such assets are presented under "due to banks and other financial institutions" in the statement of financial position. The difference between the selling price and repurchasing price is recognized as interest expense during the term of the agreement using the effective interest method.

2.2.8 Property and equipment

The Bank's property and equipment mainly comprise buildings, equipment, transportation equipment and property improvement.

The assets purchased are initially measured at acquisition cost.

Subsequent expenditures incurred for the property and equipment are included in the cost of the property and equipment if it is probable that economic benefits associated with the asset will flow to the Bank and the subsequent expenditures can be measured reliably. Meanwhile the carrying amount of the replaced part is derecognized. Other subsequent expenditures are recognized in profit or loss in the period in which they are incurred.

Depreciation is calculated on the straight-line method to write down the cost of such assets over their estimated useful lives. The useful lives of assets are reviewed, and adjusted if appropriate, at each financial reporting date.

Buildings comprise primarily branch office premises and office premises. The estimated useful lives and depreciation rate of buildings, equipment, transportation equipment and property improvement are as follows:

Type of assets	Estimated useful lives
Buildings	50 years
Equipment	5 years
Transportation equipment (excluding equipment under operating leases)	3 years
Property improvement	Over the shorter of the economic useful lives and remaining lease terms

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in profit or loss.

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Significant Accounting Policies *(continued)*

2.2.9 Repossessed assets

Repossessed assets are initially recognized at lower of fair value less cost to sell or amortized cost of the corresponding debt at the date of repossession and included in other assets. At each reporting date, repossessed assets are subsequently measured at lower of fair value less cost to sell and the carrying amount. When the fair value less cost to sell is lower than the carrying amount, an impairment loss is recognized in profit or loss.

When a repossessed asset is disposed, the difference between the disposal proceeds and the carrying amount is recognized in profit or loss.

2.2.10 Investment property

Investment property is a property held to earn rentals or for capital appreciation or both and initially measured at cost.

As there is an active property market in the location in which the Bank's investment property is situated, and the Bank can obtain the market price and other relevant information regarding the same or similar type of property from the property market so as to reasonably estimate the fair value of the investment property; therefore, the Bank uses the fair value model for subsequent measurement of the investment property, with changes in the fair value included in profit or loss for the period in which they arise.

When an investment property is sold, transferred, retired or damaged, the Bank recognizes the amount of any proceeds on disposal net of the carrying amount and related taxes in profit or loss for the period.

2.2.11 Intangible assets

An intangible asset is measured initially at cost. When an intangible asset with a finite useful life is available for use, its original cost is amortized over its estimated useful life using the straight-line method. An intangible asset with an indefinite useful life is not amortized.

For an intangible asset with a finite useful life, the Bank reviews the useful life and amortization method at the end of each reporting period, and makes adjustments when necessary.

An intangible asset is derecognized on disposal, or when no future economic benefits are expected from use or disposal. Gains and losses arising from de-recognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognized in profit or loss when the asset is derecognized.

2.2.12 Impairment of non-financial assets

At the end of the reporting period or whenever there is an indication that the non-financial assets are impaired, the Bank reviews the carrying amounts of its tangible and intangible assets with finite useful lives to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized in profit or loss immediately.

Intangible assets with indefinite useful life are tested for impairment annually, irrespective of whether there is any indication that the assets may be impaired.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but the increased carrying amount should not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is recognized in profit or loss immediately.

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Significant Accounting Policies *(continued)*

2.2.13 Leases

Leases are recognized as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Bank.

Contracts may contain both lease and non-lease components. The Bank allocates the consideration in the contract to the lease and non-lease components based on their relative stand-alone prices.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable; and

- amounts expected to be payable by the Bank under residual value guarantees.

Lease payments to be made under reasonably certain extension options are also included in the measurement of the liability.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be readily determined, which is generally the case for leases in the Bank, the lessee's incremental borrowing rate is used, being the rate that the individual lessee would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions.

To determine the incremental borrowing rate, the Bank:

- where possible, uses recent third-party financing received by the individual lessee as a starting point, adjusted to reflect changes in financing conditions since third party financing was received; and

- makes adjustments specific to the lease, e.g. term, country, currency and security.

Lease payments are allocated between principal and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability;

- any lease payments made at or before the commencement date less any lease incentives received;

- any initial direct costs; and

- restoration costs.

Right-of-use assets are generally depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. If the Bank is reasonably certain to exercise a purchase option, the right-of-use asset is depreciated over the underlying asset's useful life.

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Significant Accounting Policies *(continued)*

2.2.14 Cash and cash equivalents

Cash and cash equivalents are assets with a maturity of less than 3 months from the date of acquisition or highly liquid assets with an original maturity of less than three months, which are readily convertible into known amounts of cash and subject to an insignificant risk of changes in value.

2.2.15 Provisions

Provisions are recognized when the Bank has a present obligation related to a contingency, it is probable that an outflow of economic benefits will be required to settle the obligation, and the amount of the obligation can be measured reliably.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account factors pertaining to a contingency such as the risks, uncertainties and time value of money. Where the effect of the time value of money is material, the amount of the provision is determined by discounting the related future cash outflows.

Where all or some of the expenditure required to settle a provision is expected to be reimbursed by a third party, the reimbursement is recognized as a separate asset only when it is virtually certain that reimbursement will be received, and the amount of reimbursement recognized does not exceed the carrying amount of the provision.

2.2.16 Current and deferred income taxes

Income tax expense represents the sum of the tax currently payable and deferred tax.

(a) Current income tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the statement of profit or loss and other comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Bank's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Significant Accounting Policies *(continued)*

2.2.16 Current and deferred income taxes (continued)

(b) Deferred income tax

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax base used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary difference to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Such deferred tax assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at the end of the reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset is realized, based on tax rate (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Bank expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. Current and deferred tax is recognized in profit or loss, except when it relates to items that are recognized in other comprehensive income, in which case the current and deferred tax are also recognized in other comprehensive income.

For the purposes of measuring deferred tax liabilities or deferred tax assets for investment properties that are measured using the fair value model, the carrying amounts of such properties are presumed to be recovered entirely through sale, unless the presumption is rebutted. The presumption is rebutted when the investment property is depreciable and is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale.

2.2.17 Contingent liabilities and contingencies

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

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

2.2.18 Fiduciary activities

In activities where the Bank acts in a fiduciary capacity such as trustee, custodian or agent, the assets and income arising from the transaction together with the related undertakings to return the assets to customers are excluded from the Bank's financial statements.

2.2.19 Acceptances

Acceptances comprise the Bank's commitments on payment for bills that are issued to customers. Acceptances are accounted for as financial guarantees and credit related commitments and are disclosed as contingent liabilities and commitments.

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.2 Significant Accounting Policies *(continued)*

2.2.20 Employee benefits

(i) Employee leave entitlements

Liabilities for wages and salaries, including non-monetary benefits and accumulating sick leave that are expected to be settled wholly within 12 months after the end of the period in which the employees render the related service are recognized in respect of employees' services up to the end of the reporting period and are measured at the amounts expected to be paid when the liabilities are settled.

(ii) Retirement benefit schemes

The Bank contributes to defined contribution schemes under either recognized Occupational Retirement Schemes Ordinance (ORSO) Schemes or Mandatory Provident Fund (MPF) Schemes that are available to the Bank's employees. Contributions to the schemes by the Bank and employees are calculated as a percentage of employees' basic salaries for the ORSO schemes and in accordance with the MPF rules for MPF schemes. When an employee leaves the Bank prior to his/her interest in the Bank's employer non-mandatory contributions vesting with the employee, the ongoing contributions payable by the Bank may be reduced by the relevant amount of forfeited contributions.

The assets of the schemes are held in independently-administered funds separate from those of the Bank.

2.2.21 Offset financial assets and liabilities

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the assets and settle the liability simultaneously.

2.2.22 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker is the person or company that allocates resources to and assesses the performance of the operating segments of an entity. The Bank has determined the senior management team represented by the governor as its chief operating decision maker.

An operating segment is a component of the Bank with all of the following conditions are satisfied: (1) that component can earn revenues and incur expenses from ordinary activities; (2) the component's operating results are regularly reviewed by the chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and (3) discrete financial information for the component is available to the Bank. If two or more operating segments have similar economic characteristics, and certain conditions are satisfied, they may be aggregated into a single operating segment.

Intra-segment income and expenses are eliminated. Income and expenses directly associated with each segment are considered in determining segment performance.

2.2.23 Foreign currency translation

HK$ is the currency of the primary economic environment in which the Bank operates. Therefore, the Bank chooses HK$ as their functional currency and adopts HK$ to prepare its financial statements.

In preparing the financial statements, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in the respective functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions.

At the reporting date, foreign currency monetary items are translated into HK$ using the spot exchange rates at the reporting date. Exchange differences arising from the differences between the spot exchange rates prevailing at the reporting date and those on initial recognition or at the previous reporting date are recognized in profit or loss for the period except that (1) exchange differences related to hedging instruments for the purpose of hedging against foreign exchange risks are accounted for using hedge accounting and (2) exchange differences arising from available-for-sale non-monetary items denominated in foreign currencies and changes in the carrying amounts (other than the amortized cost) of available-for-sale monetary items are recognized as other comprehensive income.

2 SUMMARY OF SIGINIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Critical accounting estimates and judgements in applying accounting policies

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense.

In preparing these financial statements, the significant judgements made by management in applying the Bank's accounting policies and the key sources of estimation uncertainty were as follow:

(a) Measurement of the expected credit loss ("ECL") allowance

The measurement of the expected credit loss allowance for financial assets measured at amortized cost and fair value through other comprehensive income is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behavior (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 note 3.1.2 and 3.1.3, which also sets out key sensitivities of the ECL to changes in these elements.

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 group of similar financial assets for the purposes of measuring ECL.

Detailed information about the judgements and estimates made by the Bank in the above areas is set out in note 3.1.2.

(b) Fair value of financial instruments

The fair values of financial instruments that are not quoted in active markets are determined by using valuation techniques (e.g. discounted cash flow model). To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty's), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

(c) Determination of lease term

In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. Extension options (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated).

For leases of retail stores, the following factors are normally the most relevant:

- If any leasehold improvements are expected to have significant remaining value, the Bank is typically reasonably certain to extend (or not terminate).
- Otherwise, the Bank considers other factors including historical leases durations and the costs and business disruption required to replace the leased asset.

The lease term is reassessed if an option is actually exercised (or not exercised) or the Bank becomes obliged to exercise (or not exercise) it. The assessment of reasonable certainty is only revised if a significant event or a significant change in circumstances occurs, which affects this assessment, and that is within the control of the lessee.

3 FINANCIAL RISK MANAGEMENT

The Bank's activities expose it to a variety of financial risks and those activities involve analysis, evaluation, acceptance and management of a certain degree of risks or a portfolio of risks. The Bank's aim is to achieve an appropriate balance between risk and return and minimize potential adverse effects on the Bank's financial performance.

The Bank's risk management policies are designed to identify and analyze these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Bank regularly reviews its risk management policies and systems to reflect changes in markets, products and the latest best practice.

The Board of Directors sets out strategies and risk preference for overall risk management strategy and decides the risk tolerance level. The senior management establishes related risk management policies and procedures under the strategy approved by the Board of Directors. Business Units act as the first line of defense in risk management while the Risk Management Department undertakes the main risk management operational functions of the Bank. In addition, internal audit department is responsible for the independent review of risk management and the control environment.

The main types of financial risks of the Bank are credit risk, market risk, liquidity risk and operational risk, etc. Market risk also includes interest rate risk, foreign exchange risk and other price risk.

3.1 Credit risk

Credit risk, the risk that a borrower or counterparty of the Bank will be unable or unwilling to honor a repayment obligation, is one of the key risks encountered by the Bank as the Bank's main business is still dominated by credit business such as lending, billing and stock financing. If credit deterioration or default occurs, it will cause certain losses and affect the Bank's business stability. Therefore, the risks must be strictly monitored. Starting with quality of business, the monitoring approach includes not only rigorous credit review but also ongoing post-lending monitoring. This ensures that the non-performing loan ratio is less than risk tolerance and there is sufficient provision for coverage. The Bank manages and controls the overall credit risk in a prudent manner and reports regularly to the senior management and the Board of Directors of the Bank.

3.1.1 Credit risk management

The Bank's credit risk management is assumed by major functions including Corporate Business Management Department, Retail Business Management Department, Credit Card Centre, Credit Management Department, Risk Management Department, and Finance Department, which are responsible for the standardized management for corporate and retail credit businesses in terms of credit investment, credit investigation and report, credit approval, loan granting, post-loan monitoring and non-performing loan management.

In 2020, Risk Management Department completed various thematic reviews in response to Covid-19. The scope covered sectors under deep impact in the pandemic, including review on small and medium enterprises, medium size corporations, exposure related to energy industry, loans secured by listed shares, as well as companies under debt relief measures. Some customers were identified with higher risk, as they experienced sharp drop in profit or net loss, cease of business, and laid off of staffs. These customers were put into a watch list, and those in highest risk level were classified as Special Mention or closely monitored monthly. Regular reporting of situation is submitted to Senior Management for their attention.

(a) Loans and advances to customers

As for corporate loans, the Bank's relationship managers are responsible for receiving application files submitted by the applicants, conducting pre-loan investigation, assessing the credit risk suffered by applicants and relevant businesses, and completing initial internal rating. The Bank adopts the hierarchical approval system based on the credit approval authority. Credit line is determined by taking into account the credit record, financial position, collaterals and guarantees of the applicant, overall credit risk of the credit portfolio, macroeconomic regulation and control policies and relevant laws and regulations. The Bank keeps a close eye on the economic and financial trend and credit risk profile in the industry and provides more guidance on credit investment by formulating guidance for different industries. It strengthens daily risk pre-warning, monitoring and specific risk investigation to identify customers under major risks and material potential risk points. With improvements in post-loan management, the Bank enhanced the refinement of post-loan management in a practical manner. The independent Credit Management Department shall review the compliance, completeness and effectiveness of relevant credit files before loan granting according to the applications for drawdown of credit line. The Bank's relationship manager is the person primarily responsible for post-loan management. The Bank adopts a series of tools and approaches, such as risk filtering, list management, risk warning and risk investigation, in daily risk monitoring of corporate loans. To minimize the losses arising from credit risks, the Bank manages NPLs mainly through (1) collection; (2) restructuring; (3) disposal of collaterals or recourse to the guarantor; (4) litigation or arbitration; and (5) write-off pursuant to regulations and requirements.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.1 Credit risk management (continued)

(a) Loans and advances to customers (continued)

For retail credit assets, the Bank adopts categorized management for retail credit assets on the basis of overdue ageing and guarantee mode. With regard to retail credit customers with overdue loans, different approaches are adopted to collect such loans based on their overdue days. Retail credit businesses overdue by a certain period shall be managed as impaired assets and relevant impairment allowance shall be provided for such assets.

Credit Card Centre accounted for independently by the Bank is in charge of the operation and management of credit card business. Credit Card Centre of the Bank adopts various supervisory and preventive measures simultaneously. It reinforces data cross-validation to enhance risk prevention in the approval process, tightens credit line on high risk customers through secondary credit investigation to enter into the collection process earlier than scheduled, deploys collection strength in a proper manner to significantly enhance collection efficiency, and optimizes data analytic system to further propel the refined management of credit card business.

(b) Treasury business

For treasury business, the Bank chooses banks and other financial institutions prudently and balances the credit risk and return rate of investments. By making reference to internal and external credit rating information, the Bank adopts hierarchical credit and uses an appropriate credit limit management system to review and adjust credit lines, aiming to manage the credit risk exposed to the treasury business.

For debt investments, internal and external ratings (such as Standard and Poor's) are used by the Bank when available for managing the credit risk exposed to debt investments and bills. The investment in those debts and bills is to have better credit quality assets while maintaining readily available funding sources. The bond issuers involved with the Bank are subject to the credit granting review and approval of the Global Market Department and credit limits are placed on such issuers.

As for derivative instruments, the Bank maintains strict limits on net open derivative investment positions (i.e., the difference between long and short contracts), by both amount and maturity. At any time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Bank (i.e., assets where their fair value is positive), which, in relation to derivative instruments, is only a fraction of the contract's notional amount used to express the amount outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market fluctuations. Collateral or other security is not usually obtained for credit risk exposures on these instruments, except when the Bank requires margin deposits from counterparties. The management has set limits of these contracts according to counterparty, and regularly monitor and control the actual credit risk when the Bank concludes foreign exchange and interest rate contracts with other financial institutions and clients.

The Bank manages the credit quality of due from and placements with banks and other financial institutions by considering the size, financial position and the external credit rating of the banks and financial institutions. The Risk Management Department monitors and reviews the credit risk of due from and placements with banks and other financial institutions by counterparties periodically. Limits are placed on different counterparties.

(c) Credit related commitments

Credit risk exposures to financial guarantees are the same as that of loans. However, commercial letters of credit are usually pledged by the relevant shipped goods, and therefore is subject to lower risk compared with direct loans. Credit related commitments are included in the management of overall credit line granted to the applicant. For customers with transactions beyond the credit limit or infrequent transactions, the applicant shall be requested to provide relevant guarantee in order to reduce credit risk exposures.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.1 Credit risk management (continued)

(d) Credit risk quality

In accordance with the Guideline on Loan Classification System issued by the HKMA, the Bank has established a loan credit risk classification system and performs credit risk management based on loan classification in one of five categories. The Bank classifies loans into the following five categories: normal, special-mention, substandard, doubtful and loss, of which substandard, doubtful and loss loans are regarded as non-performing loans.

The five categories of loan classification into which the Bank classifies its loans and advances to customers are set out below:

Pass:	Loans for which borrowers are current in meeting commitments and for which the full repayment of interest and principal is not in doubt.
Special-mention:	Loans with which borrowers are experiencing difficulties and which may threaten the authorized institution's position.
Substandard:	Loans in which borrowers are displaying a definable weakness that is likely to jeopardise repayment.
Doubtful:	Loans for which collection in full is improbable and the authorized institution expects to sustain a loss of principal and/or interest, taking into account the net realizable value of collateral.
Loss:	Loans that are considered uncollectable after all collection options (such as the realization of collateral or the institution of legal proceedings) have been exhausted.

Regarding risk, the treasury business is classified into five categories based on five categories of loan classification.

(e) Credit risk measurement

The Bank has established an internal rating system to measure credit risk arising from default events.

The credit risk internal rating system considers the "probability of default" by debtors (or debts). This is similar to the approach used for the purposes of measuring Expected Credit Loss ("ECL") under HKFRS 9. Please refer to note 3.1.2 for more details.

Probability of default is the probability of occurrence of default event in a given period of time in future.

Exposure at default represents the total amount of on-balance sheet and off-balance sheet exposure at the time of default by debtor, reflecting the total amount of possible losses to be incurred. In general, this includes the utilized credit limit, interest receivable, the anticipated usage of unused credit facilities as well as the related expenses to be incurred.

Loss given default represents the percentage of amount of loss to be occurred in the event of default to the total risk exposure. It is expressed as the loss percentage per unit of exposure which typically varies by nature of debtor, type and seniority of claim and the availability of collaterals or other credit enhancements.

The Bank summarized a series of financial and other related factors to build the internal credit rating model to measure the probability of default, which is based on historical data collection, data statistics and data analysis on the characteristics of risks of the clients/debts before the default occurs. Internal rating model applies the principle of regression to forecast the probability of default and then matches the probability of default with relevant rank of default risk which is used for determination of the borrower's credit ranking within the internal rating system. In order to improve the model's accuracy and stability, the Bank performs evaluation of the model every three months and monitors the results by performing back testing and comparing the results from model using the default from customers.

The above credit risk factors are considered for the measurement of possible credit losses to be incurred, and applied in the daily operations of the Bank.

For retail business, the assets are categorized and credit risk is measured by aging analysis.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.1 Credit risk management (continued)

(e) Credit risk measurement (continued)

For corporate business, the rating is determined at the borrower level. A relationship manager will incorporate any updated or new information/credit assessments into the credit system on an ongoing basis. In addition, the relationship manager will also update information about the creditworthiness of the borrower every year from sources such as public financial statements. This will determine the updated internal credit rating and the probability of default.

For debt securities in the Treasury portfolio, external rating agency credit grades are mapped onto the master scale. These published grades are continuously monitored and updated. The mapping to the master scale will determine the updated internal credit rating and the probability of default. An approximated PD is determined by management to represent the probability of default for unrated exposures.

The Bank's rating method comprises 18 rating levels for instruments not in default (1.1 to 1.4, 2 to 15) and one default class. The master scale assigns each rating category a specific range of probabilities of default, which is stable over time. The rating methods are subject to annual validation and recalibration so that they reflect the latest projections in light of all actual observed defaults.

The Bank's internal rating scale and mapping of external ratings are set out below:

Internal Rating	PD Range	Corresponding Rating (S&P)	Description of Grade
1.1 – 4	0.03% – 0.53%	AAA to BBB–	Investment Grade
5 – 11	0.53% – 14.07%	BB+ to B–	Standard Monitoring
12 – 15	14.07% – 99.99%	CCC+ to C	Special Monitoring
Default	100.00%	D	Default

3.1.2 Expected credit loss measurement

HKFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarized below:

If the credit risk on a financial instrument has not increased significantly since initial recognition, the financial instrument is classified in 'Stage 1' and has its credit risk continuously monitored by the Bank.

If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. Please refer to note 3.1.2.1 for a description of how the Bank determines when a significant increase in credit risk has occurred.

If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Please refer to note 3.1.2.2 for a description of how the Bank defined credit-impaired and default.

Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis. Please refer to note 3.1.2.3 for a description of inputs, assumptions and estimation techniques used in measuring the ECL.

A pervasive concept in measuring ECL in accordance with HKFRS 9 is that it should consider forward-looking information. Note 3.1.2.4 includes an explanation of how the Bank has incorporated this in its ECL models.

Purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired on initial recognition. Their ECL is always measured on a lifetime basis.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement *(continued)*

The following diagram summaries the impairment requirements under HKFRS 9 (other than purchased or originated credit-impaired financial assets):

Stage 1	Stage 2	Stage 3
(Initial recognition)	(Significant increase in credit risk since initial recognition)	(Credit-impaired assets)
12- month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses

The key judgements and assumptions adopted at the Bank in addressing the requirements of the standards are addressed below.

3.1.2.1 Significant increase in credit risk (SICR)

The criteria for the determination of "a significant increase in credit risk" includes but is not limited to the following factors:

(a) Notch difference

For investment securities, significant increase in credit risk is assessed based on the notch difference threshold by comparing ratings at measurement date and initial recognition date.

Internal Rating	Notch Difference
1.1 – 1.3	4
1.4 – 4	3
5 – 8	2
9 – 15	1

(b) Days past due

Different levels of days past due are considered as significant credit deterioration criteria for different portfolios.

(c) Watch list

Qualitative and forward-looking information, e.g. industry outlook of obligor, future organization, restructure plan of obligor, are considered as criteria of adding to the watch list, which is considered as significant increase in credit risk. For investment securities, significant decrease in market price and external rating are considered as significant increase in credit risk.

(d) HKMA ratings

Under HKMA's Guideline on Loan Classification System, the Special Mention grade is considered as threshold for retail loan, corporate loan and credit card portfolio.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement (continued)

3.1.2.1 Significant increase in credit risk (SICR) (continued)

(e) Other risk alarm indicators imply growing potential risk, and could cause losses of financial assets to the Bank.

The financial assets are moveable between stages. For instance, financial instruments originally classified at stage 1 should be downgraded to stage 2 if events occur such as a significant increase in credit risk. Financial instruments at stage 2 could be upgraded to stage 1 if credit risk decreases and the criteria for the determination of "a significant increase in credit risk" are no longer met.

The assessment of significant increase in credit risk incorporates forward-looking information (refer to note 3.1.2.4 for further information) and is performed on a periodic basis at a counterparty level for all financial instruments held by the Bank.

3.1.2.2 Definition of default and credit-impaired assets

The Bank defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

- The borrower is more than 90 days past due on its contractual payments (with the sole exception of credit card where a borrower only needs to be 60 days past due to be considered in default).

- The borrower has been classified as Substandard, Doubtful or Loss under the HKMA classification system

- The loan has been placed on individual assessment list (applicable only to loans)

The credit impairment definition has been applied consistently to model the probability of default, exposure at default and loss given default throughout the Bank's expected loss calculations.

3.1.2.3 Measuring ECL – Explanation of inputs, assumptions and estimation techniques

The ECL is measured on either a 12-month or lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

- The PD represents the likelihood of a borrower defaulting on its financial obligation, either over the next 12 months (12M PD), or over the remaining lifetime (Lifetime PD) of the obligation.

- EAD is based on the amounts the Bank expects to be owed at the time of default. For example, for a revolving commitment, the Bank includes the current drawn balance plus any further amount that is expected to be drawn up to the current contractual limit by the time of default, should it occur.

- LGD represents the Bank's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type and seniority of claim and availability of collateral or other credit support. LGD is expressed as a percentage loss per unit of exposure at the time of default (EAD).

The ECL is determined by projecting the PD, LGD and EAD for each future year and for each individual exposure. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has not prepaid or defaulted in an earlier year). This effectively calculates an ECL for each future year, which is then discounted back to the reporting date and summed. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

The Lifetime PD is developed by using forecasted macroeconomic factor to calculate a forecasted 12M PD for the 2nd to 5th year. For the years after the fifth year, it is assumed that the PD will remain the same.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement *(continued)*

3.1.2.3 Measuring ECL – Explanation of inputs, assumptions and estimation techniques (continued)

EAD represents the total amount of on-balance sheet and off-balance sheet exposure at the time of default by debtor, reflecting the total amount of possible losses to be incurred. In general, this includes the utilized credit limit, interest receivable, the anticipated usage of unused credit facilities as well as the related expenses to be incurred.

LGDs are determined based on the factors which impact the recoveries made post default. These vary by product type.

- For secured products, this is primarily based on collateral type and projected collateral values, historical discounts to market/book values due to forced sales, time to repossession and recovery costs observed.

- For unsecured products, LGDs are typically set at product level due to the limited differentiation in recoveries achieved across different borrowers. These LGDs are influenced by collection strategies, including contracted debt sales and price.

3.1.2.4 Forward-looking information incorporated in the ECL models

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. The Bank 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 judgment has also been applied in this process. Forecasts of these economic variables to come up with the base economic scenario over the next five years are gathered from different sources including economics team of the Bank of Communications Co. Ltd., and the International Monetary Fund (IMF). After five years, economic variables are assumed to remain stable and the last available forecast is used. The impact of these economic variables on the PD, EAD and LGD has been determined by performing statistical regression analysis to understand the impact changes in these variables have had historically on default rates and on the components of LGD and EAD.

In addition to the base economic scenario, the Bank's Risk Management Department and Development Strategy Team have also considered other economic scenarios which are calculated using historical data, along with weightings for each of the scenarios. At 31 December 2019 and 31 December 2020, the Bank concluded that three scenarios are used in the calculation. The scenario weightings are determined by expert credit judgement, taking account of the range of possible outcomes each chosen scenario is representative of.

Following this assessment, the Bank then measures ECL as either a probability weighted 12 month ECL (Stage 1), or a probability weighted lifetime ECL (Stages 2 and 3). These probability-weighted ECLs are determined by running each scenario through the relevant ECL model and multiplying it by the appropriate scenario weighting (as opposed to weighting the inputs).

As with any economic forecasts, the projections and likelihoods of occurrence of the economic scenarios are based on estimates to future economic conditions which are sensitive to changes in these conditions caused by macro events, including the COVID-19 pandemic and geopolitical developments. They are therefore subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The Bank considers these forecasts to represent its best estimate of the possible outcomes and has analyzed the non-linearities and asymmetries within the Bank's different portfolios to establish that the chosen scenarios are appropriately representative of the range of possible scenarios. The proposed macroeconomic forecasts and probability weightings are subject to management review.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement (continued)

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

Economic variable assumptions

The COVID-19 pandemic has created unprecedented economic and social challenges to all regions of the world. In order to limit the spread of COVID-19, different restrictions (including social distancing or lock down) are implemented by governments over the world which resulted in a sharp decline in global economic activities in the year of 2020. At the same time, different forms of relief measures have also been rolled out by governments around the world at unprecedented scale and speed to prevent the further deterioration and support the recovery of economies. Besides, the development of different COVID-19 vaccines are completed. COVID-19 vaccination programme is launched in different regions. It is expected that global economic activities would gradually recover over time.

The above development of COVID-19 pandemic and geopolitical environment changes in the year of 2020 have added complications to the estimates of the economic scenarios and caused the Bank to revisit its economic scenarios and probability weightings in calculating ECL.

The Bank has continued to adopt the use of three economic scenarios for all portfolios. They represent a most likely scenario (i.e. the "Base" scenario) and two, less likely, "outer" scenarios on either side of the Base scenario, referred to as an "Upside" and a "Downside" scenario respectively. The two outer scenarios, the "Upside" and the "Downside", have been determined with reference to the historical observations of the macro-economic factors and the Bank's historical loss experience. The "Base" scenario can be described as follows:

After a severe economic shock to the global economy is observed in 2020, a notable recovery is expected in 2021 as COVID-19 vaccination programme is launched subsequently, pandemic containment measures will be loosened and global economic activities could be resumed accordingly. A moderate growth is expected afterwards as relief measures are expected to cease gradually. GDP in most regions is contracted in 2020 and is expected to rebound in 2021.

The most significant period-end assumptions used for the ECL estimate as at 31 December 2020 are set out below.

		2021	2022	2023	2024	2025
Hong Kong CPI	Base	**2.00%**	**2.00%**	**2.00%**	**2.00%**	**2.00%**
	Upside	**6.32%**	**5.84%**	**2.86%**	**-4.02%**	**-3.69%**
	Downside	**-1.66%**	**-3.06%**	**-2.50%**	**-0.45%**	**0.90%**
Hong Kong Unemployment rate	Base	**5.00%**	**4.50%**	**4.00%**	**3.50%**	**3.50%**
	Upside	**2.77%**	**2.20%**	**4.70%**	**6.25%**	**4.95%**
	Downside	**5.09%**	**7.32%**	**7.94%**	**6.81%**	**5.59%**
Mainland China Real GDP (first difference)	Base	**6.08%**	**-2.68%**	**-0.06%**	**-0.09%**	**-0.15%**
	Upside	**-1.08%**	**-0.65%**	**-1.58%**	**-0.03%**	**0.75%**
	Downside	**-0.10%**	**0.67%**	**0.98%**	**0.13%**	**1.15%**
US Real GDP (first difference)	Base	**7.35%**	**-0.14%**	**-0.68%**	**-0.36%**	**-0.07%**
	Upside	**1.08%**	**0.69%**	**-0.04%**	**0.24%**	**-0.59%**
	Downside	**-3.12%**	**0.81%**	**1.02%**	**0.98%**	**-0.44%**

However, the level of recovery is highly uneven in the global economy. Mainland China's GDP will be expanded largely while a weak growth is forecasted in Hong Kong. The unemployment rate is expected to drop slightly in 2021 in most of the regions compared with the high level of 2020. It is forecasted to return to the growth level similar to that in 2019 gradually over the future years.

In consideration of the above development of COVID-19 pandemic in the world, the Bank has considered its impact and revisited the probability weightings in calculating ECL.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement (continued)

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

Economic variable assumptions (continued)

The weightings assigned to each economic scenario as at 31 December 2020 were as follows:

Upside	Base	Downside
10%	50%	40%

The most significant period-end assumptions used for the ECL estimate as at 31 December 2019 are set out below.

		2020	2021	2022	2023	2024
Hong Kong CPI	Base	2.50%	2.50%	2.50%	2.50%	2.50%
	Upside	6.32%	5.84%	2.86%	-4.02%	-3.69%
	Downside	-1.66%	-3.06%	-2.50%	-0.45%	0.90%
Hong Kong Unemployment rate	Base	3.70%	4.00%	4.30%	4.50%	4.50%
	Upside	2.77%	2.20%	4.70%	6.25%	4.95%
	Downside	5.09%	7.32%	7.94%	6.81%	5.59%
Mainland China Real GDP (first difference)	Base	-0.10%	0.00%	-0.20%	-0.10%	-0.10%
	Upside	-1.08%	-0.65%	-1.58%	-0.03%	0.75%
	Downside	-0.10%	0.67%	0.98%	0.13%	1.15%
US Real GDP (first difference)	Base	-0.26%	-0.34%	-0.19%	0.02%	0.04%
	Upside	1.08%	0.69%	-0.04%	0.24%	-0.59%
	Downside	-3.12%	0.81%	1.02%	0.98%	-0.44%

The weightings assigned to each economic scenario as at 31 December 2019 were as follows:

Upside	Base	Downside
20%	65%	15%

Other forward-looking considerations not otherwise incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have also been considered, but are not deemed to have a material impact and therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness on a quarterly basis.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.2 Expected credit loss measurement (continued)

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

Sensitivity analysis

The following table presents the base ECL scenario compared to the probability-weighted ECL derived from using three ECL scenarios. The difference reflects the impact of deriving multiple scenarios around the base ECL and resultant change in ECL due to non-linearity and sensitivity to using macroeconomic forecasts.

Change from Base to Probability-weighted ECL	**As at 31 December 2020**	As at 31 December 2019
Probability-weighted ECL	**943,930**	477,417
Base ECL	**520,127**	480,756
Difference in amount	**423,803**	(3,339)
Difference in percentage	**44.9%**	(0.7%)

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure

3.1.3.1 Maximum exposure to credit risk – Financial instruments subject to impairment

The following tables contain an analysis of the credit risk exposure of financial instruments for when an ECL allowance is recognized.

The gross carrying amount of financial assets below also represents the Bank's maximum exposure of credit risk on these assets.

	2020			
	Stage 1	**Stage 2**	**Stage 3**	
Corporate Loan	**12 month ECL**	**Lifetime ECL**	**Lifetime ECL**	**Total**
Investment Grade	**25,720,451**	**–**	**–**	**25,720,451**
Standard Monitoring	**31,721,184**	**622,377**	**–**	**32,343,561**
Special Monitoring	**–**	**211,392**	**–**	**211,392**
Defaults	**–**	**–**	**58,071**	**58,071**
Unrated	**34,866,935**	**945,225**	**–**	**35,812,160**
Gross carrying amount	**92,308,570**	**1,778,994**	**58,071**	**94,145,635**
ECL allowance	**(297,231)**	**(80,938)**	**(25,418)**	**(403,587)**
Carrying amount	**92,011,339**	**1,698,056**	**32,653**	**93,742,048**

	2019			
	Stage 1	Stage 2	Stage 3	
Corporate Loan	12 month ECL	Lifetime ECL	Lifetime ECL	Total
Investment Grade	10,474,278	–	–	10,474,278
Standard Monitoring	15,201,423	108,155	–	15,309,578
Special Monitoring	13,529	181,967	–	195,496
Defaults	–	–	32,605	32,605
Unrated	18,333,628	34,338	–	18,367,966
Gross carrying amount	44,022,858	324,460	32,605	44,379,923
ECL allowance	(138,330)	(16,797)	(14,316)	(169,443)
Carrying amount	43,884,528	307,663	18,289	44,210,480

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure (continued)

3.1.3.1 Maximum exposure to credit risk – Financial instruments subject to impairment (continued)

	2020			
	Stage 1	**Stage 2**	**Stage 3**	
Retail loan	**12 month ECL**	**Lifetime ECL**	**Lifetime ECL**	**Total**
Investment Grade	**43,011,299**	**12,279**	**–**	**43,023,578**
Standard Monitoring	**110,790**	**577,434**	**–**	**688,224**
Special Monitoring	**–**	**34,446**	**–**	**34,446**
Defaults	**–**	**–**	**47,811**	**47,811**
Gross carrying amount	**43,122,089**	**624,159**	**47,811**	**43,794,059**
ECL allowance	**(83,968)**	**(68,427)**	**(18,815)**	**(171,210)**
Carrying amount	**43,038,121**	**555,732**	**28,996**	**43,622,849**

	2019			
	Stage 1	Stage 2	Stage 3	
Retail loan	12 month ECL	Lifetime ECL	Lifetime ECL	Total
Investment Grade	34,672,630	22,340	–	34,694,970
Standard Monitoring	158,575	204,003	–	362,578
Special Monitoring	–	20,337	–	20,337
Defaults	–	–	29,783	29,783
Gross carrying amount	34,831,205	246,680	29,783	35,107,668
ECL allowance	(90,033)	(43,605)	(14,329)	(147,967)
Carrying amount	34,741,172	203,075	15,454	34,959,701

	2020			
	Stage 1	**Stage 2**	**Stage 3**	
Due from banks and other financial institutions	**12 month ECL**	**Lifetime ECL**	**Lifetime ECL**	**Total**
Investment Grade	**19,715,245**	**–**	**–**	**19,715,245**
Standard Monitoring	**387,622**	**–**	**–**	**387,622**
Gross carrying amount	**20,102,867**	**–**	**–**	**20,102,867**
ECL allowance	**(8,131)**	**–**	**–**	**(8,131)**
Carrying amount	**20,094,736**	**–**	**–**	**20,094,736**

	2019			
	Stage 1	Stage 2	Stage 3	
Due from banks and other financial institutions	12 month ECL	Lifetime ECL	Lifetime ECL	Total
Investment Grade	17,676,217	–	–	17,676,217
Gross carrying amount	17,676,217	–	–	17,676,217
ECL allowance	(8,309)	–	–	(8,309)
Carrying amount	17,667,908	–	–	17,667,908

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure (continued)

3.1.3.1 Maximum exposure to credit risk – Financial instruments subject to impairment (continued)

	2020			
	Stage 1	**Stage 2**	**Stage 3**	
Debt securities at fair value through other comprehensive income	**12 month ECL**	**Lifetime ECL**	**Lifetime ECL**	**Total**
Investment Grade	**128,410,681**	**–**	**–**	**128,410,681**
Standard Monitoring	**2,327,684**	**–**	**–**	**2,327,684**
Unrated	**71,199,761**	**–**	**–**	**71,199,761**
Gross carrying amount	**201,938,126**	**–**	**–**	**201,938,126**
ECL allowance	**(318,962)**	**–**	**–**	**(318,962)**
Carrying amount	**201,619,164**	**–**	**–**	**201,619,164**

	2019			
	Stage 1	Stage 2	Stage 3	
Debt securities at fair value through other comprehensive income	12 month ECL	Lifetime ECL	Lifetime ECL	Total
Investment Grade	83,818,392	–	–	83,818,392
Unrated	38,413,916	–	–	38,413,916
Gross carrying amount	122,232,308	–	–	122,232,308
ECL allowance	(121,331)	–	–	(121,331)
Carrying amount	122,110,977	–	–	122,110,977

Information on how the Expected Credit Loss (ECL) is measured and how the three stages above are determined is included in notes 3.1.2.

3.1.3.2 Maximum exposure to credit risk – Financial instruments

The following table contains an analysis of the maximum credit risk exposure from financial assets not subject to impairment:

	Maximum exposure to credit risk	
	2020	2019
Financial assets at fair value through profit or loss		
Derivative financial instruments	**905,433**	874,964
Government bonds	**–**	189,962
Total	**905,433**	1,064,926

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure (continued)

3.1.3.3 Collateral and other credit enhancements

The Bank manages limits and controls concentrations of credit risk wherever they are identified, in particular, to individual counterparties, Banking groups and geographical regions.

The Bank structures the levels of credit risk it undertakes by placing limits in relation to one borrower, or group of borrowers. Such risks are monitored on a regular basis and subject to annual or more frequent reviews, whenever necessary.

The exposure to any single borrower including banks and brokers is further restricted by sub-limits covering on-balance and off-balance sheet exposures, and daily delivery risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored daily.

Exposure to credit risk is also managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations and by changing their lending limits where appropriate.

Some other specific control and risk mitigation measures are outlined below:

(a) Collaterals

The Bank employs a range of policies and practices to mitigate credit risk. The most useful practice is to accept collaterals. The Bank implements guidelines on the acceptability of specific classes of collaterals. The principal types of collaterals for loans and advances to customers are:

- Residential properties;

- Business assets such as premises, inventory and accounts receivable; and

- Financial instruments such as debt securities and stocks.

Long-term loans and advances to corporate and individual customers are generally secured; while revolving individual credit facilities are generally unsecured. In addition, in order to minimize the credit loss the Bank will seek additional collaterals from the counterparties as soon as impairment indicators are noted for the relevant individual loans and advances.

For loans guaranteed by a third-party guarantor, the Bank will assess the financial condition, credit history and ability to meet obligations of the guarantor.

Collaterals held as security for financial assets other than loans and advances to customers are determined by the nature of the instrument. Debt securities and treasury bonds are generally unsecured, with the exception of asset backed securities, which are secured by portfolios of financial instruments.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.3 Credit risk exposure (continued)

3.1.3.3 Collateral and other credit enhancements (continued)

(a) Collaterals (continued)

The Bank closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Bank will take possession of collateral to mitigate potential credit losses. The fair value is capped at lower of carrying amount and fair value. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

As at 31 December 2020:

	Gross exposure	**ECL allowance**	**Carrying amount**	**Fair value of collateral held**
Loans to individuals	**47,811**	**(18,815)**	**28,996**	**27,245**
Loans to corporate entities	**58,071**	**(25,418)**	**32,653**	**17,327**
	105,882	**(44,233)**	**61,649**	**44,572**

As at 31 December 2019:

	Gross exposure	ECL allowance	Carrying amount	Fair value of collateral held
Loans to individuals	29,783	(14,329)	15,454	13,687
Loans to corporate entities	32,605	(14,316)	18,289	10,560
	62,388	(28,645)	33,743	24,247

(b) Master netting arrangements

The Bank further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of assets and liabilities in the statement of financial position, as transactions are usually settled on a gross basis. However, the credit risk associated with favourable contracts is reduced by a master netting arrangement to the extent that if a default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Bank's overall exposure to credit risk on derivative instruments subject to master netting arrangements can change substantially within a short period, as each transaction subject to the arrangement affects credit risk.

3.1.4 Movements of gross carrying amount and ECL allowance

The ECL allowance recognized in the period is impacted by a variety of factors, such as:

- Transfers between Stage 1 and Stages 2 or 3 due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit-impaired in the period, and the consequent step up (or step down) between 12-month and Lifetime ECL;
- Additional allowances for new financial instruments recognized during the period, as well as releases for financial instruments derecognized in the period;
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular refreshing of inputs to models;
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis; and
- Financial assets derecognized during the period and write-offs of allowances related to assets that were written off during the period (see note 3.1.5).

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

The following tables explain the changes in the ECL allowance between the beginning and the end of the annual period due to these factors:

Movement of gross amount – Corporate Loan

Corporate Loan	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2020	**44,022,858**	**324,460**	**32,605**	**44,379,923**
Transfers:				
Transfer from Stage 1 to Stage 2	**(630,515)**	**630,515**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(28,994)**	**–**	**28,994**	**–**
Transfer from Stage 2 to Stage 1	**70,871**	**(70,871)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(5,254)**	**5,254**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending *(Note)*	**48,885,110**	**900,144**	**(8,756)**	**49,776,498**
Foreign exchange and other movements	**(10,760)**	**–**	**(26)**	**(10,786)**
Gross carrying amount as at 31 December 2020	**92,308,570**	**1,778,994**	**58,071**	**94,145,635**

Note: The balances include the corporate loans originated or purchased in the year and subsequently transferred between stage 1, stage 2 and stage 3 during the year.

Corporate Loan	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2019	39,535,107	79,561	17,900	39,632,568
Transfers:				
Transfer from Stage 1 to Stage 2	(124,257)	124,257	–	–
Transfer from Stage 1 to Stage 3	(12,789)	–	12,789	–
Transfer from Stage 2 to Stage 1	21,431	(21,431)	–	–
Transfer from Stage 2 to Stage 3	–	(2,390)	2,390	–
New financial assets originated or purchased, assets derecognized, repayments and further lending *(Note)*	4,648,945	144,463	(452)	4,792,956
Foreign exchange and other movements	(45,579)	–	(22)	(45,601)
Gross carrying amount as at 31 December 2019	44,022,858	324,460	32,605	44,379,923

Note: The balances include the corporate loans originated or purchased in the year and subsequently transferred between stage 1, stage 2 and stage 3 during the year.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of ECL allowance – Corporate Loan

Corporate Loan	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance as at 1 January 2020	**138,330**	**16,797**	**14,316**	**169,443**
Transfers:				
Transfer from Stage 1 to Stage 2	**(5,758)**	**5,758**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(103)**	**–**	**103**	**–**
Transfer from Stage 2 to Stage 1	**8,584**	**(8,584)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(412)**	**412**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**171,491**	**41,291**	**(859)**	**211,923**
Changes in PDs/LGDs/EADs	**(14,429)**	**25,813**	**10,729**	**22,113**
Unwind of discount	**–**	**395**	**–**	**395**
Foreign exchange and other movements	**(884)**	**(120)**	**717**	**(287)**
ECL allowance amount as at 31 December 2020	**297,231**	**80,938**	**25,418**	**403,587**

Corporate loan	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance as at 1 January 2019	141,821	8,578	8,236	158,635
Transfers:				
Transfer from Stage 1 to Stage 2	(941)	941	–	–
Transfer from Stage 1 to Stage 3	(107)	–	107	–
Transfer from Stage 2 to Stage 1	2,317	(2,317)	–	–
Transfer from Stage 2 to Stage 3	–	(374)	374	–
New financial assets originated or purchased, assets derecognized, repayments and further lending	17,600	3,534	1,705	22,839
Changes in PDs/LGDs/EADs	(22,040)	6,274	3,799	(11,967)
Unwind of discount	–	203	–	203
Foreign exchange and other movements	(320)	(42)	95	(267)
ECL allowance amount as at 31 December 2019	138,330	16,797	14,316	169,443

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance *(continued)*

Movement of gross amount – Retail Loan

Retail Loan	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2020	**34,831,205**	**246,680**	**29,783**	**35,107,668**
Transfers:				
Transfer from Stage 1 to Stage 2	**(495,487)**	**495,487**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(20,502)**	**–**	**20,502**	**–**
Transfer from Stage 2 to Stage 1	**122,902**	**(122,902)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(8,188)**	**8,188**	**–**
Transfer from Stage 3 to Stage 1	**5**	**–**	**(5)**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending *(Note)*	**8,686,009**	**13,097**	**(6,456)**	**8,692,650**
Write-offs	**–**	**–**	**(4,203)**	**(4,203)**
Foreign exchange and other movements	**(2,043)**	**(15)**	**2**	**(2,056)**
Gross carrying amount as at 31 December 2020	**43,122,089**	**624,159**	**47,811**	**43,794,059**

Note: The balances include the retail loans originated or purchased in the year and subsequently transferred between stage 1, stage 2 and stage 3 during the year.

Retail Loan	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2019	28,040,662	201,287	46,416	28,288,365
Transfers:				
Transfer from Stage 1 to Stage 2	(185,428)	185,428	–	–
Transfer from Stage 1 to Stage 3	(18,522)	–	18,522	–
Transfer from Stage 2 to Stage 1	89,474	(89,474)	–	–
Transfer from Stage 2 to Stage 3	–	(1,357)	1,357	–
Transfer from Stage 3 to Stage 1	74	–	(74)	–
Transfer from Stage 3 to Stage 2	–	495	(495)	–
New financial assets originated or purchased, assets derecognized, repayments and further lending *(Note)*	6,910,503	(49,586)	(29,148)	6,831,769
Write-offs	–	–	(6,794)	(6,794)
Foreign exchange and other movements	(5,558)	(113)	(1)	(5,672)
Gross carrying amount as at 31 December 2019	34,831,205	246,680	29,783	35,107,668

Note: The balances include the retail loans originated or purchased in the year and subsequently transferred between stage 1, stage 2 and stage 3 during the year.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of ECL allowance – Retail Loan

Retail Loan	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 1 January 2020	**90,033**	**43,605**	**14,329**	**147,967**
Transfers:				
Transfer from Stage 1 to Stage 2	**(1,155)**	**1,155**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(58)**	**–**	**58**	**–**
Transfer from Stage 2 to Stage 1	**26,588**	**(26,588)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(2,816)**	**2,816**	**–**
Transfer from Stage 3 to Stage 1	**4**	**–**	**(4)**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**16,963**	**8,588**	**11**	**25,562**
Unwind of discount	**–**	**771**	**–**	**771**
Changes in PDs/LGDs/EADs	**(48,283)**	**43,676**	**5,112**	**505**
Recoveries of loans written-off in previous years	**–**	**–**	**392**	**392**
Write-offs	**–**	**–**	**(4,203)**	**(4,203)**
Foreign exchange and other movements	**(124)**	**36**	**304**	**216**
ECL allowance amount as at 31 December 2020	**83,968**	**68,427**	**18,815**	**171,210**

Retail Loan	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 1 January 2019	34,877	23,384	15,318	73,579
Transfers:				
Transfer from Stage 1 to Stage 2	(409)	409	–	–
Transfer from Stage 1 to Stage 3	(44)	–	44	–
Transfer from Stage 2 to Stage 1	15,529	(15,529)	–	–
Transfer from Stage 2 to Stage 3	–	(266)	266	–
Transfer from Stage 3 to Stage 1	13	–	(13)	–
Transfer from Stage 3 to Stage 2	–	506	(506)	–
New financial assets originated or purchased, assets derecognized, repayments and further lending	22,116	1,482	(845)	22,753
Unwind of discount	–	558	–	558
Changes in PDs/LGDs/EADs	18,127	33,178	6,546	57,851
Write-offs	–	–	(6,794)	(6,794)
Foreign exchange and other movements	(176)	(117)	313	20
ECL allowance amount as at 31 December 2019	90,033	43,605	14,329	147,967

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of ECL allowance – Loans and advances to customers

Loans and advances to customers	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 1 January 2020	**228,363**	**60,402**	**28,645**	**317,410**
Transfers:				
Transfer from Stage 1 to Stage 2	**(6,913)**	**6,913**	**–**	**–**
Transfer from Stage 1 to Stage 3	**(161)**	**–**	**161**	**–**
Transfer from Stage 2 to Stage 1	**35,172**	**(35,172)**	**–**	**–**
Transfer from Stage 2 to Stage 3	**–**	**(3,228)**	**3,228**	**–**
Transfer from Stage 3 to Stage 1	**4**	**–**	**(4)**	**–**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**188,454**	**49,879**	**(848)**	**237,485**
Changes in PDs/LGDs/EADs	**(62,712)**	**69,489**	**15,841**	**22,618**
Unwind of discount	**–**	**1,166**	**–**	**1,166**
Recoveries of loans written-off in previous years	**–**	**–**	**392**	**392**
Write-offs	**–**	**–**	**(4,203)**	**(4,203)**
Foreign exchange and other movements	**(1,008)**	**(84)**	**1,021**	**(71)**
ECL allowance amount as at 31 December 2020	**381,199**	**149,365**	**44,233**	**574,797**

Loans and advances to customers	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 1 January 2019	176,698	31,962	23,554	232,214
Transfers:				
Transfer from Stage 1 to Stage 2	(1,350)	1,350	–	–
Transfer from Stage 1 to Stage 3	(151)	–	151	–
Transfer from Stage 2 to Stage 1	17,846	(17,846)	–	–
Transfer from Stage 2 to Stage 3	–	(640)	640	–
Transfer from Stage 3 to Stage 1	13	–	(13)	–
Transfer from Stage 3 to Stage 2	–	506	(506)	–
New financial assets originated or purchased, assets derecognized, repayments and further lending	39,716	5,016	860	45,592
Changes in PDs/LGDs/EADs	(3,913)	39,452	10,345	45,884
Unwind of discount	–	761	–	761
Write-offs	–	–	(6,794)	(6,794)
Foreign exchange and other movements	(496)	(159)	408	(247)
ECL allowance amount as at 31 December 2019	228,363	60,402	28,645	317,410

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of gross carrying amount – Due from banks and other financial institutions

Due from banks and other financial institutions	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2020	**17,676,217**	**–**	**–**	**17,676,217**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**2,314,015**	**–**	**–**	**2,314,015**
Foreign exchange and other movements	**112,635**			**112,635**
Gross carrying amount as at 31 December 2020	**20,102,867**	**–**	**–**	**20,102,867**

Due from banks and other financial institutions	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2019	25,088,522	–	–	25,088,522
New financial assets originated or purchased, assets derecognized, repayments and further lending	(7,412,305)	–	–	(7,412,305)
Gross carrying amount as at 31 December 2019	17,676,217	–	–	17,676,217

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of ECL allowance – Due from banks and other financial institutions

Due from banks and other financial institutions	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 1 January 2020	**8,309**	**–**	**–**	**8,309**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**(2,054)**	**–**	**–**	**(2,054)**
Change in PDs/LGDs/EADs	**1,859**	**–**	**–**	**1,859**
Foreign exchange and other movements	**17**	**–**	**–**	**17**
ECL allowance amount as at 31 December 2020	**8,131**	**–**	**–**	**8,131**

Due from banks and other financial institutions	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 1 January 2019	6,085	–	–	6,085
New financial assets originated or purchased, assets derecognized, repayments and further lending	1,868	–	–	1,868
Change in PDs/LGDs/EADs	356	–	–	356
Foreign exchange and other movements	–	–	–	–
ECL allowance amount as at 31 December 2019	8,309	–	–	8,309

Movement of gross amount – Debt securities at fair value through other comprehensive income

Debt securities at fair value through other comprehensive income	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2020	**122,232,308**	**–**	**–**	**122,232,308**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**77,265,950**	**–**	**–**	**77,265,950**
Foreign exchange and other movements	**2,439,868**	**–**	**–**	**2,439,868**
Gross carrying amount as at 31 December 2020	**201,938,126**	**–**	**–**	**201,938,126**

Debt securities at fair value through other comprehensive income	Stage 1	Stage 2	Stage 3	Total
Gross carrying amount as at 1 January 2019	109,305,072	–	–	109,305,072
New financial assets originated or purchased, assets derecognized, repayments and further lending	13,396,487	–	–	13,396,487
Foreign exchange and other movements	(469,251)	–	–	(469,251)
Gross carrying amount as at 31 December 2019	122,232,308	–	–	122,232,308

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.4 Movements of gross carrying amount and ECL allowance (continued)

Movement of ECL allowance – Debt securities at fair value through other comprehensive income

Debt securities at fair value through other comprehensive income	**Stage 1 12-month ECL allowance**	**Stage 2 Lifetime ECL allowance**	**Stage 3 Lifetime ECL allowance**	**Total**
ECL allowance amount as at 1 January 2020	**121,331**	**–**	**–**	**121,331**
New financial assets originated or purchased, assets derecognized, repayments and further lending	**141,029**	**–**	**–**	**141,029**
Changes in PDs/LGDs/EADs	**55,984**	**–**	**–**	**55,984**
Foreign exchange and other movements	**618**	**–**	**–**	**618**
ECL allowance amount as at 31 December 2020	**318,962**	**–**	**–**	**318,962**

Debt securities at fair value through other comprehensive income	Stage 1 12-month ECL allowance	Stage 2 Lifetime ECL allowance	Stage 3 Lifetime ECL allowance	Total
ECL allowance amount as at 1 January 2019	61,089	–	–	61,089
New financial assets originated or purchased, assets derecognized, repayments and further lending	52,428	–	–	52,428
Changes in PDs/LGDs/EADs	7,814	–	–	7,814
ECL allowance amount as at 31 December 2019	121,331	–	–	121,331

Financial guarantees and credit related commitment	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Gross carrying amount as at 31 December 2020	**15,277,026**	**199,064**	**–**	**15,476,090**
Gross carrying amount as at 31 December 2019	**11,780,758**	**9,303**	**–**	**11,790,061**

Financial guarantees and credit related commitment	**Stage 1 12-month ECL allowance**	**Stage 2 Lifetime ECL allowance**	**Stage 3 Lifetime ECL allowance**	**Total**
ECL allowance amount as at 31 December 2020	**14,890**	**9,080**	**–**	**23,970**
ECL allowance amount as at 31 December 2019	**12,780**	**2,092**	**–**	**14,872**

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.5 Write-off policy

The Bank writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include but is not limited to (i) ceasing enforcement activity and (ii) where the Bank'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.

The Bank may write-off financial assets that are still subject to enforcement activity. The Bank still seeks to recover amounts it is legally owed in full, but which have been partially written off due to no reasonable expectation of full recovery.

3.1.6 Derivative instruments

The Bank undertakes its transactions in foreign exchange, interest rate derivative contracts and others with other financial institutions and customers. The management has established limits for these contracts based on counterparties, industry sectors and countries. Actual credit exposures and limits are regularly monitored and controlled by management.

Settlement risk arises mainly from foreign exchange transactions with counterparties and also from derivatives transactions in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily settlement limits are established for each counterparty or customer to cover all settlement risk arising from the Bank's market transactions on any single day.

3.1.7 Repossessed assets

Repossessed assets are collateral of the outstanding indebtedness that the Bank takes possession of the collateral assets through court proceedings or voluntary delivery actions by the borrower. It will be sold as soon as practicable with the proceeds used to repay the outstanding indebtedness.

As at 31 December 2020 and 2019, there was no repossessed asset that being held by the Bank.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Credit risk *(continued)*

3.1.8 Concentration risk analysis for loans and advances to customers with credit risk exposure

The Bank mainly manages concentration risk for loans and advances to customers by geographical sectors. The following tables are the geographical analysis of gross loans and advances to customers:

Geographical sectors

	2020	2019
Mainland China	**10,613,016**	10,630,761
Hong Kong	**126,580,180**	68,517,199
Others	**896,271**	371,065
	138,089,467	79,519,025

3.2 Market risk

3.2.1 Overview

The Bank takes on exposure to market risks, which is initiated by the fluctuation of the fair value of or future cash flow of financial instruments as a result of the changes of the market prices. Market risks arise from open positions in interest rates and exchange rates products, all of which are exposed to market fluctuations and changes in interest rates and foreign exchange rates.

The Bank established a management model of "large and small middle offices" for its market risk management, which is a centralized control framework led by Board of Directors and senior management. With the establishment of segregation of different duties, the Risk Management Department formulates market risk policies and ensures the Bank's exposure are within risk appetite of the Board of Directors, while Global Markets Department is the execution unit of market risk management. The Internal Audit Department is responsible for independent verification of the market risk management system policies and processes.

The Bank monitors market risk separately in respect of trading portfolios and non-trading portfolios. The trading account consists of financial instruments held either for trading intent or economic hedging for other elements of the trading account. The non-trading account consists of the investments purchased by the Bank with excess funds and other financial instruments that are not captured in the trading account.

With regard to the exchange rate risks and the interest rate risks of trading book, the Bank established an effective limit management system by implementing Net Position, Risk Sensitivity, Value at Risk ("VaR") and other indicators. Net interest income sensitivity analysis, interest rate repricing gap analysis and foreign exchange risk concentration analysis are the major tools used by the Bank to monitor the market risk of its overall businesses. In addition, through adequate pricing management and asset allocation, the Bank strived to maximize its rate of return while keeping its risks under control.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.1 Overview (continued)

The Bank has continuously improved the management system of market risk. The Bank conducted stress tests on historical scenarios and hypothetical scenarios in the consideration of the Bank's major market risk factors. The Bank has implemented daily automatic collection of trading data and market data in the system. The Bank conducted the management of risk capital and VaR quota, and formulated the quota allocation plans.

As part of market risk management, the Bank enters into interest rate swaps to match the interest rate risk associated with the structured deposits and fix-rate long-term debt securities.

The major measurement techniques used to measure and control market risk are outlined below:

3.2.2 VaR

VaR refers to the maximum loss that an investment portfolio may incur at a given confidence level and holding period caused by the changes in market price factors such as interest rates and exchange rates etc. The Bank adopted the historical simulation method to calculate daily VaR (99% confidence interval, the holding period of one day).

A summary of VaR by risk type of the Bank's portfolios is as follows:

	For the year ended 31 December 2020			
Items	**31 December 2020**	**Average**	**Maximum**	**Minimum**
VaR	**2,219**	**4,819**	**18,276**	**1,381**
– Interest rate risk	**51**	**508**	**2,244**	**51**
– Foreign exchange risk	**2,219**	**4,910**	**18,104**	**1,929**

	For the year ended 31 December 2019			
Items	31 December 2019	Average	Maximum	Minimum
VaR	1,422	1,071	3,324	182
– Interest rate risk	1,519	1,465	2,360	4
– Foreign exchange risk	2,111	1,797	4,182	732

3.2.3 Sensitivity tests

Interest rate sensitivity test

The Bank performs interest rate sensitivity analysis on net interest income for the Bank by measuring the impact of a change in net interest income of financial assets and liabilities, not taking customer behaviour and repayment option into consideration.

On an assumption of a parallel shift of 100 basis points in RMB, USD and HKD interest rates, the Bank calculates the changes in net interest income for the year on a monthly basis.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.3 Sensitivity tests (continued)

Interest rate sensitivity test (continued)

The table below illustrates the impact to net interest income of the coming year of the Bank based on the structure of interest bearing assets and liabilities as at 31 December 2020 and 31 December 2019, caused by a parallel shift of 100 basis points of RMB, USD and HKD interest rates.

	Expected changes in net interest income	
	As at 31 December 2020	As at 31 December 2019
+100 basis points parallel shift in yield curves	**(662,389)**	(174,814)
-100 basis points parallel shift in yield curves	**662,389**	174,814

The results of the interest rate sensitivity tests set out in the table above are illustrative only and are based on simplified scenarios. The figures represent the projected impact to the net interest income caused by the projected movement of current interest risk structure yield curves. This effect, however, does not take into account actions that would be taken by the Bank to mitigate the impact of interest rate changes. The projections above also assume that interest rates of all maturities excluding demand deposits move by the same amount and, therefore, do not reflect the potential impact on net interest income due to changes in certain rates while others remain unchanged. The projections make other simplifying assumptions as well, including that all positions are to be held to maturity. There will be changes to the projection if positions are not held to maturity but it is not expected that the changes would be material.

Foreign exchange sensitivity test

The Bank performs exchange rate sensitivity analysis on net profit and equity for the Bank by measuring the impact of a change in exchange rate on financial assets and liabilities denominated in different currencies. Since HK$ is pegged to USD under linked exchange rate system, no sensitivity analysis against USD is presented. On an assumption of an appreciation or depreciation of RMB, GBP, AUD and EUR spot and forward rates against HK$ by 5%, the Bank calculates the changes in net profit and other comprehensive income for the year on a monthly basis.

The table below illustrates the impact of an appreciation or depreciation of RMB, GBP, AUD and EUR spot and forward rates against HK$ by 5% on the Bank's net profit and equity:

	Expected changes in net profit and equity	
	As at 31 December 2020	As at 31 December 2019
5% appreciation of RMB	**(15,350)**	(796,224)
5% depreciation of RMB	**15,350**	796,224

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.3 Sensitivity tests (continued)

Foreign exchange sensitivity test (continued)

	Expected changes in net profit and equity	
	As at 31 December 2020	As at 31 December 2019
5% appreciation of GBP	**111,703**	54,480
5% depreciation of GBP	**(111,703)**	(54,480)
5% appreciation of AUD	**877,418**	1,022,361
5% depreciation of AUD	**(877,418)**	(1,022,361)
5% appreciation of EUR	**186,983**	91,979
5% depreciation of EUR	**(186,983)**	(91,979)

3.2.4 Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the market value of a financial instrument will fluctuate because of changes in market interest rates.

The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows.

The interest rate repricing risk for foreign currency denominated debt securities and the remaining part of the financial guarantees and credit commitments businesses which are not based upon these basic interest rates is not expected to be significant.

The tables below summarize the Bank's exposures to interest rate risks. The tables show the Bank's assets and liabilities at carrying amounts, categorized by the earlier of contractual repricing or maturity dates.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.4 Interest rate risk (continued)

	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Non-interest bearing	Total
As at 31 December 2020							
Assets							
Cash and balances with central bank	–	–	–	–	–	8,438,950	8,438,950
Due from banks and other financial institutions	18,627,299	1,312,750	154,687	–	–	–	20,094,736
Financial assets at fair value through profit or loss	–	–	–	–	–	905,433	905,433
Financial assets at fair value through other comprehensive income	27,695,463	51,620,765	13,574,987	69,398,885	39,648,026	9,697	201,947,823
Loans and advances to customers	123,037,458	10,559,020	1,532,412	267,350	2,118,430	–	137,514,670
Other financial assets	–	–	–	–	–	3,650,086	3,650,086
Total financial assets	169,360,220	63,492,535	15,262,086	69,666,235	41,766,456	13,004,166	372,551,698
Liabilities							
Due to banks and other financial institutions	21,031,885	32,892,562	17,473,034	–	–	262,195	71,659,676
Due to customers	145,064,190	71,038,353	26,728,791	2,490	–	2,916,085	245,749,909
Financial liabilities at fair value through profit or loss	–	–	–	–	–	2,783,985	2,783,985
Lease liabilities	14,086	28,230	82,565	111,740	1,712	–	238,333
Other financial liabilities	–	–	–	–	–	5,135,147	5,135,147
Total financial liabilities	166,110,161	103,959,145	44,284,390	114,230	1,712	11,097,412	325,567,050
Total interest sensitivity gap	3,250,059	(40,466,610)	(29,022,304)	69,552,005	41,764,744	1,906,754	46,984,648

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.4 Interest rate risk (continued)

	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Non-interest bearing	Total
As at 31 December 2019							
Assets							
Cash and balances with central bank	–	–	–	–	–	1,094,956	1,094,956
Due from banks and other financial institutions	6,675,582	10,992,326	–	–	–	–	17,667,908
Financial assets at fair value through profit or loss	–	155,478	34,484	–	–	874,964	1,064,926
Financial assets at fair value through other comprehensive income	21,797,930	51,856,957	11,323,189	24,118,908	13,135,324	9,965	122,242,273
Loans and advances to customers	71,775,867	4,803,560	384,790	337,202	1,900,196	–	79,201,615
Other financial assets	–	–	–	–	–	5,418,372	5,418,372
Total financial assets	100,249,379	67,808,321	11,742,463	24,456,110	15,035,520	7,398,257	226,690,050
Liabilities							
Due to banks and other financial institutions	7,102,118	20,060,545	1,556,264	–	–	17,643	28,736,570
Due to customers	104,042,804	48,076,879	16,294,765	1,819	–	2,339,022	170,755,289
Financial liabilities at fair value through profit or loss	–	–	–	–	–	1,168,798	1,168,798
Lease liabilities	15,241	29,375	103,545	152,287	1,040	–	301,488
Other financial liabilities	–	–	–	–	–	4,378,083	4,378,083
Total financial liabilities	111,160,163	68,166,799	17,954,574	154,106	1,040	7,903,546	205,340,228
Total interest sensitivity gap	(10,910,784)	(358,478)	(6,212,111)	24,302,004	15,034,480	(505,289)	21,349,822

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.5 Foreign exchange risk

The Bank conducts the majority of its businesses in HK$, with certain foreign transactions in USD, RMB and other currencies. The Bank takes on exposure to the effects of fluctuations in the prevailing foreign exchange rates and changes on its financial position and cash flows. The senior management sets limits on the level of exposure in exchange rate risk and monitors the exposure regularly. The tables below summarize the Bank's exposure to foreign exchange risk at the end of the year. The tables show the Bank's total assets and liabilities in carrying amounts in HK$, are categorized by the original currency.

	HK$	RMB (HK$ Equivalent)	USD (HK$ Equivalent)	Others (HK$ Equivalent)	Total
As at 31 December 2020					
Assets					
Cash and balances with central bank	**8,030,743**	**22,900**	**373,343**	**11,964**	**8,438,950**
Due from banks and other financial institutions	**4,059,565**	**161,938**	**11,111,474**	**4,761,759**	**20,094,736**
Financial assets at fair value through profit or loss	**706,909**	**180**	**198,292**	**52**	**905,433**
Financial assets at fair value through other comprehensive income	**7,625,263**	**23,604,208**	**139,985,459**	**30,732,893**	**201,947,823**
Loans and advances to customers	**110,453,320**	**251,672**	**26,792,069**	**17,609**	**137,514,670**
Other financial assets	**1,776,343**	**332,782**	**1,404,820**	**136,141**	**3,650,086**
Total financial assets	**132,652,143**	**24,373,680**	**179,865,457**	**35,660,418**	**372,551,698**
Liabilities					
Due to banks and other financial institutions	**3,893,807**	**439,709**	**61,587,129**	**5,739,031**	**71,659,676**
Due to customers	**171,793,292**	**24,091,111**	**42,656,866**	**7,208,640**	**245,749,909**
Financial liabilities at fair value through profit or loss	**1,125,543**	**123**	**1,658,319**	**–**	**2,783,985**
Lease liabilities	**238,333**	**–**	**–**	**–**	**238,333**
Other financial liabilities	**3,553,950**	**149,745**	**1,293,370**	**138,082**	**5,135,147**
Total financial liabilities	**180,604,925**	**24,680,688**	**107,195,684**	**13,085,753**	**325,567,050**
Net position	**(47,952,782)**	**(307,008)**	**72,669,773**	**22,574,665**	**46,984,648**

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Market risk *(continued)*

3.2.5 Foreign exchange risk (continued)

	HK$	RMB (HK$ Equivalent)	USD (HK$ Equivalent)	Others (HK$ Equivalent)	Total
As at 31 December 2019					
Assets					
Cash and balances with central bank	1,053,928	24,047	9,960	7,021	1,094,956
Due from banks and other financial institutions	14,400,318	231,532	694,820	2,341,238	17,667,908
Financial assets at fair value through profit or loss	771,072	189,970	103,826	58	1,064,926
Financial assets at fair value through other comprehensive income	9,868,713	11,696,443	73,939,649	26,737,468	122,242,273
Loans and advances to customers	68,270,613	276,087	10,637,366	17,549	79,201,615
Other financial assets	4,424,277	133,769	789,592	70,734	5,418,372
Total financial assets	98,788,921	12,551,848	86,175,213	29,174,068	226,690,050
Liabilities					
Due to banks and other financial institutions	6,246,364	24,006	22,336,912	129,288	28,736,570
Due to customers	101,926,676	26,899,726	34,250,657	7,678,230	170,755,289
Financial liabilities at fair value through profit or loss	973,920	–	194,862	16	1,168,798
Lease liabilities	301,488	–	–	–	301,488
Other financial liabilities	1,983,634	1,552,595	756,883	84,971	4,378,083
Total financial liabilities	111,432,082	28,476,327	57,539,314	7,892,505	205,340,228
Net position	(12,643,161)	(15,924,479)	28,635,899	21,281,563	21,349,822

3.2.6 Other price risk

The Bank is exposed to other price risk arising from financial assets such as equity investments and derivatives linked to commodity price. The Bank considers the exposure to the other price risk to be insignificant.

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk

3.3.1 Overview

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations associated with its financial liabilities when they fall due and other current liquidity needs. The consequence may be the failure to meet obligations to repay depositors and fulfill loan commitments for lending. The Bank's objective in liquidity management is to ensure the availability of adequate funding to meet the demands of fund deposit withdrawals and other liabilities as they fall due and to ensure that it is able to meet its obligations to fund loan originations and commitments and to take advantage of new investment opportunities.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, matured deposits, loan drawdowns, guarantees and from margin and other calls on cash settled derivatives. The Bank set limits on the minimum proportion of funds to meet such calls and on the minimum level of interbank and other borrowing facilities that should be in place to cover different levels of unexpected withdrawals.

3.3.2 Liquidity risk management process

Funding liquidity risk relates to the Bank's ability to fulfill its obligations arising from financial liabilities as they fall due, or its ability to fulfill maturing funding needs, which subsequently affects the Bank's capacity to support deposit withdrawal or drawdown on loan commitments. Effective liquidity risk management helps to sustain the expansion of the Bank's business with liquidity cost and risk under control. The Bank has established and implemented its own liquidity risk management policy per local regulatory requirements in order to fulfill its liquidity risk management. The Asset and Liability Management Committee (ALCO) of the Bank is the decision-making body in balance sheet management and is responsible for coordinating and overseeing all related strategies, including risk management framework and risk appetite. Asset and Liability Management Department is responsible for analyzing and monitoring activities related to liquidity risk. Global Markets Department is responsible for managing daily liquidity position and related executions. Internal Audit Department is responsible for conducting periodic review to ensure liquidity risk management framework is effectively implemented.

The cornerstone of the Bank's funding sources is customer deposit. The Bank strives to build up core deposits while diversifying funding sources via various funding channels to enhance financing capacity. Regarding liquidity arrangement with parent bank, the Bank performs regular funding transfer with parent bank to preserve prompt intragroup backup funding supply if necessary. Monitoring and control on intragroup funding transactions are in line with those of third parties. Moreover, parent bank has set up groupwide internal limits to control the Bank's reliance on parent bank's funding.

The majority of the liquidity risk of the Bank arises from maturity mismatch of assets and liabilities. Therefore, regular cash flow analysis and projections on both on- and off-balance sheet items falling within different maturity buckets is performed to ensure funding need. Moreover, the Bank closely monitors off-balance sheet funding obligations (such as commitments or letters of guarantee) and assesses their impact to our liquidity capacity. Furthermore, the Bank strives to maintain high marketability of the asset portfolio to allow prompt monetization in case of unforeseeable liquidity crunch in the market.

The Bank has in place various limits and indicators for liquidity risk, including liquidity coverage ratio, loan-to-deposit ratio, concentration limits on customer deposits, interbank borrowing utilization ratio, etc. for effective identification and control of liquidity risk. The Bank utilizes relevant management information systems to perform daily liquidity risk management functions. Moreover, the Bank performs daily cash flow analysis to assess liquidity in normal circumstances, and performs regular stress test (at least monthly) to evaluate the Bank's resilience under significant stress conditions. The stress test scenarios are designed with reference to the HKMA's Supervisory Policy Manuals, and also historical liquidity stress scenarios. The Bank's stress test takes into account the impact of all assets, liabilities and off-balance sheet positions and estimates possible funding short-fall with historical data and plausible stress conditions. The results will be scrutinized and appropriate measures will be taken if necessary.

The Bank has set up early warning indicator system, and movement of relevant indicators are closely monitored on a regular basis. In case of liquidity crisis emerges, the Bank's Crisis Management Committee will be formed to formulate appropriate contingency funding plan to resolve the crisis. The Bank also performs regular drill in order to ensure prompt actions and feasibility of contingency funding plan under crisis.

To cope with unpredictable liquidity needs, the Bank has set up liquidity buffer to maintain sufficient highly liquid assets. The buffer portfolio contains cash, Exchange Fund Bills/Notes¸ unencumbered sovereign bonds and other high quality bonds, which is managed by Asset and Liability Management Department and operated by Global Markets Department on a daily basis.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.3 Non-derivative financial instruments cash flows

The table below presents the cash flows of the Bank related to non-derivative financial liabilities (including accrued interest) by remaining contractual maturities at the end of the reporting date. The amounts disclosed in the tables are undiscounted contractual cash flows. The Bank's expected cash flows on these financial instruments may vary significantly from the following analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance although they have been classified as repayable on demand in the following tables.

	On Demand	**Up to 1 month**	**1 – 3 months**	**3 – 12 months**	**1 – 5 years**	**Over 5 years**	**Total**
As at 31 December 2020							
Financial liabilities							
Due to banks and other financial institutions	**12,549,599**	**6,747,437**	**32,924,190**	**17,503,877**	**–**	**2,010,294**	**71,735,397**
Due to customers	**78,937,565**	**69,209,537**	**71,214,798**	**26,914,263**	**2,500**	**21**	**246,278,684**
Lease liabilities	**–**	**14,372**	**28,742**	**84,203**	**113,361**	**1,721**	**242,399**
Other financial liabilities	**16,042**	**4,815,564**	**159,398**	**111,884**	**11**	**8,280**	**5,111,179**
Total financial liabilities	**91,503,206**	**80,786,910**	**104,327,128**	**44,614,227**	**115,872**	**2,020,316**	**323,367,659**

	On Demand	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Total
As at 31 December 2019							
Financial liabilities							
Due to banks and other financial institutions	893,526	4,257,386	20,159,183	1,577,260	–	2,018,313	28,905,668
Due to customers	56,976,420	49,419,265	48,129,887	16,358,893	1,838	–	170,886,303
Lease liabilities	–	15,636	30,107	106,029	155,011	1,049	307,832
Other financial liabilities	8,442	3,915,441	323,103	101,489	7	14,730	4,363,212
Total financial liabilities	57,878,388	57,607,728	68,642,280	18,143,671	156,856	2,034,092	204,463,015

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.4 Derivative financial instruments cash flows

The Bank's derivative financial instruments are either settled on a net basis or a gross basis.

The Bank's derivative financial instruments that will be settled on a net basis mainly include interest rate swaps, forward rate agreements and others, whereas derivative financial instruments that will be settled on a gross basis mainly include currency forward and currency swaps.

The table below analyses the cash flows of the Bank by remaining contractual period as at the reporting date. The amounts disclosed in the table are the contractual undiscounted cash flows.

	Up to 1 month	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
As at 31 December 2020						
Derivative financial instruments settled on net basis	**30,268**	**55,214**	**(318,009)**	**(1,367,488)**	**(12,866)**	**(1,612,881)**
Derivative financial instruments settled on a gross basis						
– Outflow	**(165,951,075)**	**(60,324,731)**	**(31,154,342)**	**–**	**–**	**(257,430,148)**
– Inflow	**165,743,198**	**60,313,467**	**31,100,879**	**–**	**–**	**257,157,544**
Total	**(207,877)**	**(11,264)**	**(53,463)**	**–**	**–**	**(272,604)**

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
As at 31 December 2019						
Derivative financial instruments settled on net basis	7,410	40,421	27,381	(203,949)	(3,403)	(132,140)
Derivative financial instruments settled on a gross basis						
– Outflow	(126,233,759)	(33,134,641)	(36,720,407)	(1,556,264)	–	(197,645,071)
– Inflow	126,244,425	32,992,658	36,771,837	1,560,239	–	197,569,159
Total	10,666	(141,983)	51,430	3,975	–	(75,912)

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.5 Maturity analysis

The table below analyses the Bank's assets and liabilities into relevant maturity groupings based on the remaining period at the end of reporting date to the contractual maturity date.

	On demand	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Overdue	Undated	Total
As at 31 December 2020									
Assets									
Cash and balances with central banks	8,438,950	–	–	–	–	–	–	–	8,438,950
Due from banks and other financial institutions	15,771,749	–	927,674	1,952,969	1,442,344	–	–	–	20,094,736
Financial assets at fair value through profit or loss	–	518,037	93,487	94,489	49,329	150,091	–	–	905,433
Financial assets at fair value through other comprehensive income	–	4,804,379	4,604,924	29,689,445	122,396,089	40,443,289	–	9,697	201,947,823
Loans and advances to customers	2,413,563	811,592	2,116,258	17,235,072	67,643,350	47,073,030	221,805	–	137,514,670
Other financial assets	16,154	2,353,589	69,252	75,717	729,609	393,791	11,974	–	3,650,086
Total financial assets	26,640,416	8,487,597	7,811,595	49,047,692	192,260,721	88,060,201	233,779	9,697	372,551,698
Liabilities									
Due to banks and other financial institutions	12,549,599	6,744,481	32,892,562	17,473,034	–	2,000,000	–	–	71,659,676
Due to customers	78,921,524	69,058,751	71,038,353	26,728,791	2,490	–	–	–	245,749,909
Financial liabilities at fair value through profit or loss	–	741,434	94,386	154,879	882,007	911,279	–	–	2,783,985
Lease liabilities	–	14,086	28,230	82,565	111,740	1,712	–	–	238,333
Other financial liabilities	40,010	4,815,564	159,398	111,884	11	8,280	–	–	5,135,147
Total financial liabilities	91,511,133	81,374,316	104,212,929	44,551,153	996,248	2,921,271	–	–	325,567,050
Net amount on liquidity gap	(64,870,717)	(72,886,719)	(96,401,334)	4,496,539	191,264,473	85,138,930	233,779	9,697	46,984,648

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.5 Maturity analysis (continued)

	On demand	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Overdue	Undated	Total
As at 31 December 2019									
Assets									
Cash and balances with central banks	1,094,956	–	–	–	–	–	–	–	1,094,956
Due from banks and other financial institutions	2,600,646	2,338,993	–	–	12,728,269	–	–	–	17,667,908
Financial assets at fair value through profit or loss	–	484,743	217,857	260,203	24,778	77,345	–	–	1,064,926
Financial assets at fair value through other comprehensive income	–	2,877,750	8,531,613	18,113,310	79,026,583	13,683,052	–	9,965	122,242,273
Loans and advances to customers	2,408,975	452,250	2,440,628	6,375,084	28,787,124	38,507,967	229,587	–	79,201,615
Other financial assets	2,902	4,724,076	22,694	39,626	449,284	170,039	9,751	–	5,418,372
Total financial assets	6,107,479	10,877,812	11,212,792	24,788,223	121,016,038	52,438,403	239,338	9,965	226,690,050
Liabilities									
Due to banks and other financial institutions	893,526	4,226,235	20,060,545	1,556,264	–	2,000,000	–	–	28,736,570
Due to customers	56,976,420	49,405,406	48,076,879	16,294,765	1,819	–	–	–	170,755,289
Financial liabilities at fair value through profit or loss	–	525,672	215,192	211,890	121,987	94,057	–	–	1,168,798
Lease liabilities	–	15,241	29,375	103,545	152,287	1,040	–	–	301,488
Other financial liabilities	11,917	3,915,441	323,103	112,885	7	14,730	–	–	4,378,083
Total financial liabilities	57,881,863	58,087,995	68,705,094	18,279,349	276,100	2,109,827	–	–	205,340,228
Net amount on liquidity gap	(51,774,384)	(47,210,183)	(57,492,302)	6,508,874	120,739,938	50,328,576	239,338	9,965	21,349,822

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Liquidity risk *(continued)*

3.3.6 Off-balance sheet items

The table below lists the off-balance sheet items of the Bank according to their remaining period to the contractual maturity date. Financial guarantees are included at notional amounts and based on the earliest contractual maturity date.

	Up to 3 months	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
As at 31 December 2020					
Loan commitments and credit related commitments	**6,082,947**	**5,416,312**	**1,367,960**	**2,280,846**	**15,148,065**
Guarantees, acceptances and letters of credit	**292,148**	**27,650**	**2,905**	**5,322**	**328,025**
Total	**6,375,095**	**5,443,962**	**1,370,865**	**2,286,168**	**15,476,090**

	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
As at 31 December 2019					
Loan commitments and credit related commitments	7,103,107	1,980,552	155,847	2,356,918	11,596,424
Guarantees, acceptances and letters of credit	126,844	61,973	1,914	2,906	193,637
Total	7,229,951	2,042,525	157,761	2,359,824	11,790,061

3.4 Fair value of financial assets and liabilities

(a) Determination of fair value and valuation techniques

Certain financial assets and liabilities of the Bank are measured at fair value or with fair value disclosed for financial reporting purposes. The fair value has been determined using appropriate valuation techniques and inputs for fair value measurements. The appropriateness of the valuation techniques and the inputs to the fair value measurements are reviewed periodically.

Fair value measurements are categorized into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

Level 1: The fair value of financial instruments traded in active markets is based on quoted (unadjusted) market prices at the end of the reporting period. The quoted market price used for financial assets held by the Bank is the current bid price. These instruments are included in level 1.

Level 2: The fair value of financial instruments that are not traded in an active market is determined using valuation techniques. These valuation techniques maximize the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

Level 3: If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.4 Fair value of financial assets and liabilities *(continued)*

(a) Determination of fair value and valuation techniques (continued)

Specific valuation techniques used to value for Level 2 financial instruments include:

- The use of quoted market prices or dealer quotes for similar instruments.
- Calculation of the present value of the estimated future cash flows based on observable yield curves for interest rate swaps.
- The fair value of foreign currency forwards is determined using forward exchange rates at the balance sheet date.
- The fair value of the remaining financial instruments is determined using discounted cash flow analysis.

(b) Financial assets and financial liabilities measured at fair value on a recurring basis

The table below summarizes the information relating to the fair value hierarchy of the financial assets and financial liabilities measured at fair value on a recurring basis:

	Level 1	Level 2	Level 3	Total
As at 31 December 2020				
Financial assets at fair value through profit or loss				
Derivative financial instruments				
– Foreign exchange contracts	–	705,726	–	705,726
– Interest rate contracts and others	–	199,707	–	199,707
	–	905,433	–	905,433
Financial assets at fair value through other comprehensive income				
Debt securities				
– Governments and central banks	26,521,450	860,630	–	27,382,080
– Banks and other financial institutions	101,091,487	19,476,813	–	120,568,300
– Corporate entities	53,580,340	407,406	–	53,987,746
Equity securities				
– Banks and other financial institutions	–	–	9,697	9,697
	181,193,277	20,744,849	9,697	201,947,823
Total financial assets measured at fair value	181,193,277	21,650,282	9,697	202,853,256
Financial liabilities at fair value through profit or loss				
Derivative financial instruments				
– Foreign exchange contracts	–	982,850	–	982,850
– Interest rate contracts and others	–	1,801,135	–	1,801,135
Total financial liabilities measured at fair value	–	2,783,985	–	2,783,985

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.4 Fair value of financial assets and liabilities *(continued)*

(b) Financial assets and financial liabilities measured at fair value on a recurring basis *(continued)*

	Level 1	Level 2	Level 3	Total
As at 31 December 2019				
Financial assets at fair value through profit or loss				
Debt securities				
– Governments and central banks	189,962	–	–	189,962
Derivative financial instruments				
– Foreign exchange contracts	–	773,118	–	773,118
– Interest rate contracts and others	–	101,846	–	101,846
	189,962	874,964	–	1,064,926
Financial assets at fair value through other comprehensive income				
Debt securities				
– Governments and central banks	22,084,902	–	–	22,084,902
– Banks and other financial institutions	65,751,353	16,149,042	–	81,900,395
– Corporate entities	18,247,011	–	–	18,247,011
Equity securities				
– Banks and other financial institutions	–	–	9,965	9,965
	106,083,266	16,149,042	9,965	122,242,273
Total financial assets measured at fair value	106,273,228	17,024,006	9,965	123,307,199
Financial liabilities at fair value through profit or loss				
Derivative financial instruments				
– Foreign exchange contracts	–	951,285	–	951,285
– Interest rate contracts and others	–	217,513	–	217,513
Total financial liabilities measured at fair value	–	1,168,798	–	1,168,798

There was no transfer between level 1 and 2 during the year.

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.5 Offsetting financial assets and financial liabilities

Certain financial assets and financial liabilities of the Bank are subject to enforceable master netting arrangements or similar agreements. The agreement between the Bank and the counterparty generally allows for net settlement of the relevant financial assets and financial liabilities when both elect to settle on a net basis. In the absence of such a mutual consent, financial assets and financial liabilities will be settled on a gross basis. However, each party to the master netting arrangements or similar agreements will have the option to settle all such amounts on a net basis in the event of default of the other party. These financial assets and financial liabilities of the Bank are not offset in accordance with HKFRS.

The following table presents the recognized financial instruments that are offset, or subject to enforceable master netting arrangements and other similar agreements but not offset, as at 31 December 2020 and 31 December 2019. The column 'net amount' shows the impact on the Bank's statement of financial position if all set-off rights were exercised.

	Gross amounts of recognized financial assets	Gross amounts of recognized financial liabilities set off in the statement of financial position	Net amounts of financial assets presented in the statement of financial position	Related amounts not offset		Net amount
				Financial instruments (including non-cash collateral)	Cash collateral received	
2020						
Financial assets						
Derivative financial instruments	905,433	–	905,433	(725,558)	(118,302)	61,573
Financial assets at fair value through other comprehensive income	29,069,588	–	29,069,588	(26,921,033)	–	2,148,555
Total	29,975,021	–	29,975,021	(27,646,591)	(118,302)	2,210,128

	Gross amounts of recognized financial liabilities	Gross amounts of recognized financial assets set off in the statement of financial position	Net amounts of financial liabilities presented in the statement of financial position	Related amounts not offset		Net amount
				Financial instruments (including non-cash collateral)	Cash collateral advanced	
2020						
Financial liabilities						
Derivative financial instruments	2,783,985	–	2,783,985	(725,558)	(268,390)	1,790,037
Due to banks and other financial institutions	26,921,033	–	26,921,033	(26,921,033)	–	–
Total	29,705,018	–	29,705,018	(27,646,591)	(268,390)	1,790,037

(All amounts expressed in thousands of HK$ unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT *(continued)*

3.5 Offsetting financial assets and financial liabilities *(continued)*

	Gross amounts of recognized financial assets	Gross amounts of recognized financial liabilities set off in the statement of financial position	Net amounts of financial assets presented in the statement of financial position	Related amounts not offset: Financial instruments (including non-cash collateral)	Related amounts not offset: Cash collateral received	Net amount
2019						
Financial assets						
Derivative financial instruments	874,964	–	874,964	(696,273)	(2,093)	176,598
Financial assets at fair value through other comprehensive income	11,067,402	–	11,067,402	(10,459,812)	–	607,590
Total	11,942,366	–	11,942,366	(11,156,085)	(2,093)	784,188

	Gross amounts of recognized financial liabilities	Gross amounts of recognized financial assets set off in the statement of financial position	Net amounts of financial liabilities presented in the statement of financial position	Related amounts not offset: Financial instruments (including non-cash collateral)	Related amounts not offset: Cash collateral advanced	Net amount
2019						
Financial liabilities						
Derivative financial instruments	1,168,798	–	1,168,798	(696,273)	(217,465)	255,060
Due to banks and other financial institutions	10,459,812	–	10,459,812	(10,459,812)	–	–
Total	11,628,610	–	11,628,610	(11,156,085)	(217,465)	255,060

3.6 Capital management

The Bank's objectives in managing "capital", which is a broader concept than the "shareholder equity" on the statement of financial position, are:

- To comply with the capital requirements set by the regulators of the markets where the Bank operates;
- To ensure the Bank's ability to maintain a stable operation so as to continue provide returns for shareholders and benefits for other stakeholders; and
- To maintain a strong capital base to support the development of its business.

Consistent with industry practice, the Bank monitors its capital structure on the basis of the capital adequacy ratio and there have been no material changes in the Bank's policy on the management of capital during the year.

The Bank has complied with all externally imposed capital requirements during 2020.

(All amounts expressed in thousands of HK$ unless otherwise stated)

4 NET INTEREST INCOME

	2020	2019
Interest income		
Due from banks and other financial institutions	**338,956**	408,951
Loans and advances to customers	**2,117,419**	2,135,929
Financial assets at fair value through other comprehensive income	**2,868,572**	3,531,136
	5,324,947	6,076,016
Interest expense		
Due to banks and other financial institutions	**(442,626)**	(560,225)
Due to customers	**(2,604,181)**	(2,594,622)
	(3,046,807)	(3,154,847)
Net interest income	**2,278,140**	2,921,169

5 FEE AND COMMISSION INCOME

	2020	2019
Settlement service	**41,026**	46,684
Interchange service	**22,617**	38,575
Credit facilities, guarantee and commitment	**2,905**	2,589
Agency service	**682,328**	592,260
Depositary service	**61,043**	61,752
Others	**4,927**	4,763
	814,846	746,623
Of which arise from:		
Financial assets/liabilities not at fair value through profit or loss	**2,905**	2,589
Trust and other fiduciary activities	**88,074**	83,402

(All amounts expressed in thousands of HK$ unless otherwise stated)

6 FEE AND COMMISSION EXPENSE

	2020	2019
Settlement and brokerage service	**34,796**	38,503
Interchange service	**10,121**	9,870
Others	**11,717**	8,163
	56,634	56,536
Of which arise from:		
Financial assets/liabilities not at fair value through profit or loss	**10,121**	9,870

7 DIVIDEND INCOME

	2020	2019
Financial assets at fair value through other comprehensive income – unlisted investments	**35**	35

8 NET GAINS ARISING FROM TRADING ACTIVITIES

	2020	2019
Foreign exchange	**565,379**	37,585
Interest rate instruments and others	**10,740**	(163)
Debt securities at fair value through profit or loss	**32,564**	44,278
Net losses of interest rate instruments and items under fair value hedge	**(63,693)**	(5,287)
	544,990	76,413

Net gains on foreign exchange include gains or losses from the trading of spot and forward contracts, currency swaps, cross currency interest rate swaps, currency options and the translation of foreign currency monetary assets and liabilities into HK$.

Net gains on interest rate instruments and others include trading gains and losses and fair value changes of interest rate swaps, interest rate options and other derivatives.

9 OTHER OPERATING INCOME

	2020	2019
Management fee received from a branch of the ultimate holding company (Note 34 (g))	**3,490**	6,565
Others	**11,590**	14,976
	15,080	21,541

Others mainly include income arising from miscellaneous banking services provided to the Bank's customers.

(All amounts expressed in thousands of HK$ unless otherwise stated)

10 CHANGE IN EXPECTED CREDIT LOSSES ("ECL")

	2020	2019
Change in ECL allowance		
Loans and advances to customers		
– new charges	**474,407**	126,463
– recoveries	**(212,829)**	(34,226)
	261,578	92,237
Financial investments	**197,631**	60,242
Cash and balances with central bank	**15**	–
Other receivables	**2,180**	1,354
Due from banks and other financial institutions	**(178)**	2,224
Financial guarantees and credit related commitments	**9,098**	3,931
	208,746	67,751
	470,324	159,988

11 OTHER OPERATING EXPENSES

	2020	2019
Staff costs		
– salaries and other allowances	**473,136**	512,954
– retirement benefit costs (Note 12)	**35,944**	34,261
Loss on disposal of property and equipment	**–**	25
General operational and administrative expenses	**231,573**	260,597
Depreciation and amortization	**24,420**	30,365
Depreciation of right-of-use assets (Note 23)	**177,833**	166,890
Auditor's remuneration	**5,931**	4,200
Buildings administration fee	**9,634**	10,113
Rental expenses	**32,925**	45,645
Repairs and maintenance	**31,389**	44,162
Printing, postage and telegram	**49,675**	51,133
Withholding tax	**144**	–
Directors', senior management's and key personnel's emoluments (Note 13)	**18,992**	18,715
Management fee paid to a branch of the ultimate holding company	**418,296**	344,728
Finance costs – lease interest expense (Note 23)	**4,699**	4,820
Others	**29,512**	17,619
	1,544,103	1,546,227

(All amounts expressed in thousands of HK$ unless otherwise stated)

12 RETIREMENT BENEFIT COSTS

	2020	2019
Pension costs – defined contribution plans	**35,944**	34,261

13 BENEFITS AND INTEREST OF DIRECTORS (DISCLOSURES REQUIRED BY SECTION 383 OF THE COMPANIES ORDINANCE (CAP. 622) AND COMPANIES (DISCLOSURE OF INFORMATION ABOUT BENEFITS OF DIRECTORS) REGULATION (CAP. 622G)

(a) Directors' emoluments

Details of the emoluments paid to or receivable by the directors of the Bank in respect of their services rendered for the Bank are as follows:

	2020	2019
Directors' fees	**2,473**	1,397
Salaries, allowances and benefits in kind	**–**	180
Bonuses	**–**	1,176
Retirement benefit costs	**–**	3
	2,473	2,756

For the year ended 31 December 2020 and 2019, some of the executive directors received emoluments and emoluments receivable from HKBR, amounting to HK$14,227,000 (2019: HK$13,834,000), in respect of their service to the Bank and HKBR. The portion of the directors' emoluments in relation to the services to the Bank of HK$9,207,000 (2019: HK$8,980,000) has been borne by HKBR and included in management fee to a branch of the ultimate holding company (Note 11).

(b) Directors' material interests in transactions, arrangements or contracts

No significant transactions, arrangements and contracts in relation to the Bank's business to which the Bank was a party and in which a director of the Bank had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

(All amounts expressed in thousands of HK$ unless otherwise stated)

14 INCOME TAX EXPENSES

	2020	2019
Current tax		
– Hong Kong profits tax	**339,685**	390,780
– Overprovision in prior years	**(909)**	(7,930)
	338,776	382,850
Deferred income tax (Note 22)	**(41,209)**	(16,690)
Income tax expense	**297,567**	366,160

The current tax provision for the year ended 31 December 2020 and 2019 is based on the estimated assessable profit by using the Hong Kong profits tax rate of 16.5 per cent. The major reconciliation items are as follows:

	2020	2019 (restated)
Profit before tax	**1,747,936**	2,428,834
Tax calculated at a tax rate of 16.5%	**288,409**	400,758
Tax effect of expense not deductible for tax purpose	**32,609**	9,940
Tax effect arising from income not subject to tax	**(22,417)**	(35,332)
Overprovision in prior years	**(909)**	(7,930)
Others	**(125)**	(1,276)
	297,567	366,160

15 CASH AND BALANCES WITH CENTRAL BANK

	2020	2019
Cash	**1,824,960**	440,753
Balances with central bank	**6,614,005**	654,203
Less: ECL allowances	**(15)**	–
	8,438,950	1,094,956

(All amounts expressed in thousands of HK$ unless otherwise stated)

16 DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	2020	2019
Due from banks and other financial institutions	**15,771,766**	2,600,649
Placements with and loans to banks	**4,331,101**	15,075,568
Less: ECL allowances	**(8,131)**	(8,309)
	20,094,736	17,667,908

17 FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2020	2019
Derivative financial instruments (Note 18)	**905,433**	874,964
Debt securities at fair value through profit or loss		
Government bonds		
– Listed outside Hong Kong	**–**	34,484
– Unlisted	**–**	155,478
	905,433	1,064,926

Debt securities at fair value through profit or loss are analyzed by issuer as follows:

	2020	2019
Debt securities at fair value through profit or loss		
– Governments and central banks	**–**	189,962

18 DERIVATIVE FINANCIAL INSTRUMENTS

The following derivative instruments are utilized by the Bank for trading or hedging purposes:

Currency forwards are contracts between two parties to buy or sell certain currencies at a specified future date at a predetermined price. The party agreeing to buy the underlying currency in the future assumes a long position, and the party agreeing to sell the currency in the future assumes a short position. The price agreed upon is called the delivery price, which is equal to the forward price at the time the contract is entered into.

Currency and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies or interest rates (for example, fixed rate for floating rate) or a combination of all these (i.e. cross-currency interest rate swaps). The Bank's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligation. This risk is monitored on an ongoing basis with reference to the current fair value, the notional amount of the contracts and the liquidity of the market. To control the level of credit risk taken, the Bank assesses counterparties using the same techniques as for its lending activities.

Currency and interest rate options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, either to buy (a call option) or sell (a put option), on or before a set date or during a set period, a specific amount of a foreign currency at a predetermined price or to receive an interest payment based on a variable interest rate and pay a fixed interest rate or vice versa. The seller receives a premium from the purchaser in consideration for assuming foreign exchange or interest rate risk. Options may be either exchange-traded or negotiated between the Bank and a customer (over the-counter market).

The notional amounts of certain types of financial instruments provide a reference of the amounts recognized in the statement of financial position but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Bank's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The aggregate fair values of derivative financial assets and liabilities can fluctuate significantly from time to time. The fair values of derivative instruments held are set out in the following tables.

(All amounts expressed in thousands of HK$ unless otherwise stated)

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

	For hedging			For trading			Total		
	Contractual/ notional amount	Fair values		Contractual/ notional amount	Fair values		Contractual/ notional amount	Fair values	
		Assets	Liabilities		Assets	Liabilities		Assets	Liabilities
As at 31 December 2020									
Foreign exchange contracts	**–**	**–**	**–**	**256,886,730**	**705,726**	**(982,850)**	**256,886,730**	**705,726**	**(982,850)**
Interest rate contracts and others	**85,590,304**	**156,020**	**(1,768,972)**	**4,541,625**	**43,687**	**(32,163)**	**90,131,929**	**199,707**	**(1,801,135)**
Total amount of derivative instruments recognized	**85,590,304**	**156,020**	**(1,768,972)**	**261,428,355**	**749,413**	**(1,015,013)**	**347,018,659**	**905,433**	**(2,783,985)**
As at 31 December 2019									
Foreign exchange contracts	–	–	–	197,148,441	773,118	(951,285)	197,148,441	773,118	(951,285)
Interest rate contracts and others	25,129,426	96,572	(211,910)	749,341	5,274	(5,603)	25,878,767	101,846	(217,513)
Total amount of derivative instruments recognized	25,129,426	96,572	(211,910)	197,897,782	778,392	(956,888)	223,027,208	874,964	(1,168,798)

The tables above provide a breakdown of the contractual or notional amounts and the fair values of the Bank's derivative financial instruments outstanding at year end. These instruments, comprising foreign exchange and interest rate derivatives allow the Bank and its customers to transfer, modify or reduce their foreign exchange and interest rate risks.

The Bank undertakes its transactions in foreign exchange and interest rates contracts with other financial institutions and customers. Management has established limits for these contracts based on counterparty types, industry sectors and countries. Related risks are regularly monitored and controlled by management.

Notional amounts of derivative financial instruments by original currency:

	2020	2019
Renminbi	**17,892,359**	42,237,988
United States Dollar	**175,000,219**	107,842,171
Hong Kong Dollar	**143,601,025**	67,861,606
Others	**10,525,056**	5,085,443
Total	**347,018,659**	223,027,208

(All amounts expressed in thousands of HK$ unless otherwise stated)

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Hedge accounting

The Bank applies hedge accounting on hedging its interest rate risk on certain bond investments and loans, as follows:

Interest rate risk on fixed rate financial assets (fair value hedge)

The Bank holds a portfolio of long-term fixed rate debt securities and loans and therefore is exposed to changes in fair value due to movements in market rates. The Bank manages this risk exposure by entering into pay fixed/receive floating interest rate swaps.

Only the interest rate risk element is hedged and therefore other risks, such as credit risk, are managed but not hedged by the Bank. The interest rate risk component is determined as the change in fair value of the long-term fixed rate debt securities arising solely from changes in the benchmark rate of interest. Such changes are usually the largest component of the overall change in fair value.

This strategy is designated as a fair value hedge and its effectiveness is assessed by comparing changes in the fair value of the debt securities attributable to changes in the benchmark rate of interest with changes in the fair value of the interest rate swaps.

The Bank establishes the hedging ratio by matching the notional of the derivatives with the principal of the portfolio being hedged. Following reasons could cause ineffectiveness:

1) Differences between the expected and actual holding amount, as the Bank hedges to the expected maturity date but may sell the bond investment according to trading strategies;

2) The credit risk of the counterparty impacts the fair value of interest rate swaps, but has no impacts on hedged items.

a) The following table sets out the maturity profile and average interest rate of the hedging instruments used in the Bank's hedging strategies:

	Maturity					
As at 31 December 2020	**Up to one month**	**One to three months**	**Three months to one year**	**One year to five years**	**More than five years**	**Total**
Fair value hedge						
Interest rate						
Interest rate contract						
Notional amount	**403,127**	**785,323**	**1,196,589**	**51,893,754**	**31,311,511**	**85,590,304**
Average fixed interest rate	**2.42%**	**3.5%**	**3.10%**	**3.37%**	**3.33%**	**3.35%**

	Maturity					
As at 31 December 2019	Up to one month	One to three months	Three months to one year	One year to five years	More than five years	Total
Fair value hedge						
Interest rate						
Interest rate contract						
Notional amount	–	1,089,385	427,973	14,014,934	9,597,134	25,129,426
Average fixed interest rate	–	2.38%	2.64%	3.74%	3.92%	3.65%

(All amounts expressed in thousands of HK$ unless otherwise stated)

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Hedge accounting *(continued)*

b) The following table contains details of the hedging instruments used in the Bank's hedging strategies:

		Carrying amount			
As at 31 December 2020	**Notional amount**	**Assets**	**Liabilities**	**Line item on statement of financial position**	**Fair value changes of the hedging instruments**
Fair value hedge					
Interest rate					
Interest rate contract	**85,590,304**	**156,020**	**(1,768,972)**	**Financial assets/ liabilities at fair value through profit or loss**	**(1,522,803)**

		Carrying amount			
As at 31 December 2019	Notional amount	Assets	Liabilities	Line item on statement of financial position	Fair value changes of the hedging instruments
Fair value hedge					
Interest rate					
Interest rate contract	25,129,426	96,572	(211,910)	Financial assets/ liabilities at fair value through profit or loss	(97,377)

(All amounts expressed in thousands of HK$ unless otherwise stated)

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Hedge accounting *(continued)*

c) The following table contains details of the hedged exposures covered by the Bank's hedging strategies:

As at 31 December 2020	**Carrying amount of hedged item**	**Accumulated amount of fair value adjustments on the hedged item**	**Line item on statement of financial position**	**Fair value changes of the hedged items**	**Ineffectiveness recognized in profit or loss**
Fair value hedge					
Interest rate					
Debt investments	**85,629,923**	**1,421,159**	**Financial asset at fair value through other comprehensive income**	**1,340,771**	**(64,653)**
Loans and advances to customers	**1,708,267**	**149,773**	**Loans and advances to customers**	**118,339**	**960**

As at 31 December 2019	Carrying amount of hedged item	Accumulated amount of fair value adjustments on the hedged item	Line item on statement of financial position	Fair value changes of the hedged items	Ineffectiveness recognized in profit or loss
Fair value hedge					
Interest rate					
Debt investments	23,691,106	84,439	Financial asset at fair value through other comprehensive income	60,656	(6,004)
Loans and advances to customers	1,589,928	31,434	Loans and advances to customers	31,434	717

18 DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Hedge accounting *(continued)*

The following table contains information regarding the effectiveness of the hedging relationships designated by the Bank, as well as the impacts on profit or loss and other comprehensive income:

For the year ended 31 December 2020	**Gains/(losses) recognized in other comprehensive Income**	**Hedge ineffectiveness recognized in profit and loss**	**Profit and loss line item that includes hedge ineffectiveness**
Fair value hedge			
Interest rate	**–**	**(63,693)**	**Net gains arising from trading activities**

For the year ended 31 December 2019	Gains/(losses) recognized in other comprehensive Income	Hedge ineffectiveness recognized in profit and loss	Profit and loss line item that includes hedge ineffectiveness
Fair value hedge			
Interest rate	–	(5,287)	Net gains arising from trading activities

(All amounts expressed in thousands of HK$ unless otherwise stated)

19 LOANS AND ADVANCES TO CUSTOMERS

19.1 Loans and advances to customers

	2020	2019
Loans and advances to customers	**138,089,467**	79,519,025
Less: ECL allowance	**(574,797)**	(317,410)
	137,514,670	79,201,615

19.2 Analysis of loans and advances to customers by staging

As at 31 December 2020	**Stage 1 allowance**	**Stage 2 allowance**	**Stage 3 allowance**	**Total**
Gross loans and advances (Note)	**135,580,432**	**2,403,153**	**105,882**	**138,089,467**
ECL allowance	**(381,199)**	**(149,365)**	**(44,233)**	**(574,797)**
Net loans and advances to customers	**135,199,233**	**2,253,788**	**61,649**	**137,514,670**

Note: Included in the stage 1 balance is a fair value change of hedging adjustment of HK$149,773,000 which is not subject to ECL allowance.

As at 31 December 2019	Stage 1 allowance	Stage 2 allowance	Stage 3 allowance	Total
Gross loans and advances (Note)	78,885,497	571,140	62,388	79,519,025
ECL allowance	(228,363)	(60,402)	(28,645)	(317,410)
Net loans and advances to customers	78,657,134	510,738	33,743	79,201,615

Note: Included in the stage 1 balance is a fair value change of hedging adjustment of HK$31,434,000 which is not subject to ECL allowance.

19.3 Credit quality of loans and advances to customers

Loans and advances to customers analyzed by security type

	2020	2019
Unsecured loans	**36,512,184**	22,323,157
Loans secured by guarantee	**40,947,786**	15,092,813
Collateralized and other secured loans	**60,629,497**	42,103,055
Gross amount of loans and advances to customers before ECL allowance	**138,089,467**	79,519,025

(All amounts expressed in thousands of HK$ unless otherwise stated)

19 LOANS AND ADVANCES TO CUSTOMERS *(continued)*

19.4 Overdue loans

Gross advances to customers overdue for more than 3 months

	2020	**% of gross advances to customers**	2019	% of gross advances to customers
Six months or less but over three months	**27,852**	**0.02%**	28,486	0.04%
One year or less but over six months	**25,675**	**0.02%**	3,073	0.00%
Over one year	**46,558**	**0.03%**	15,359	0.02%
Total gross amount of advances overdue for more than three months	**100,085**	**0.07%**	46,918	0.06%
ECL allowance for stage 3	**43,292**		26,689	
Rescheduled advances excluding those overdue for more than three months	**800**	**0.00%**	1,271	0.00%

20 FINANCIAL ASSETS AT FAIR VALUE THROUGH COMPREHENSIVE INCOME

	2020	2019
Debt securities at fair value through other comprehensive income		
– Listed	**93,603,225**	56,023,727
– Unlisted	**108,334,901**	66,208,581
Equity securities designated at fair value through other comprehensive income		
– Unlisted	**9,697**	9,965
	201,947,823	122,242,273

The Bank has designated the investment in equity instrument issued by Joint Electronic Teller Services Limited at fair value through other comprehensive income. The Bank chose this presentation alternative because the investment was made for strategic purposes rather than with a view to profit on a subsequent sale, and there is no plan to dispose this investment in short or medium term.

(All amounts expressed in thousands of HK$ unless otherwise stated)

20 FINANCIAL ASSETS AT FAIR VALUE THROUGH COMPREHENSIVE INCOME *(continued)*

The fair value of this investment is HK$9,697,000 as at 31 December 2020 (31 December, 2019: HK$9,965,000) and a dividend of HK$35,000 (31 December, 2019: HK$35,000) was recognized for the year. There is no transfer of the cumulative loss within equity.

Financial investments analyzed by issuer are as follows:

	2020	2019
Debt securities at fair value through other comprehensive income		
– Governments and central banks	**27,382,080**	22,084,902
– Banks and other financial institutions	**120,568,300**	81,900,395
– Corporate entities	**53,987,746**	18,247,011
Equity securities at fair value through other comprehensive income		
– Banks and other financial institutions	**9,697**	9,965
	201,947,823	122,242,273

21 PROPERTY AND EQUIPMENT

	Equipment	**Property improvement**	**Total**
Cost			
As at 1 January 2020	**60,400**	**44,260**	**104,660**
Additions	**13,036**	**10,443**	**23,479**
As at 31 December 2020	**73,436**	**54,703**	**128,139**
Accumulated depreciation			
As at 1 January 2020	**(29,847)**	**(21,337)**	**(51,184)**
Charge for the year	**(10,962)**	**(10,201)**	**(21,163)**
As at 31 December 2020	**(40,809)**	**(31,538)**	**(72,347)**
Net book value			
As at 31 December 2020	**32,627**	**23,165**	**55,792**

(All amounts expressed in thousands of HK$ unless otherwise stated)

21 PROPERTY AND EQUIPMENT *(continued)*

	Equipment	Property improvement	Total
Cost			
As at 1 January 2019	61,892	83,417	145,309
Additions	11,758	3,279	15,037
Disposal	(13,250)	(42,436)	(55,686)
As at 31 December 2019	60,400	44,260	104,660
Accumulated depreciation			
As at 1 January 2019	(31,000)	(46,891)	(77,891)
Charge for the year	(12,072)	(16,882)	(28,954)
Disposal	13,225	42,436	55,661
As at 31 December 2019	(29,847)	(21,337)	(51,184)
Net book value			
As at 31 December 2019	30,553	22,923	53,476

(All amounts expressed in thousands of HK$ unless otherwise stated)

22 DEFERRED INCOME TAX ASSETS/(LIABILITIES)

The movements on the net deferred tax assets/(liabilities) are as follows:

	2020	2019
As at 1 January	**(46,906)**	10,978
Deferred income tax credited to income statement (Note 14)	**41,209**	16,690
Deferred income tax debited to equity	**(157,803)**	(74,574)
As at 31 December	**(163,500)**	(46,906)

Deferred tax assets and liabilities are attributable to the following items:

	2020	2019
Deferred tax assets		
ECL allowances	**93,579**	52,042
Deferred tax liabilities		
Accelerated depreciation allowances	**(7,875)**	(7,547)
Revaluation of investment securities	**(249,204)**	(91,401)
	(163,500)	(46,906)

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The deferred tax assets and liabilities are to be recovered and settled after one year and the following amounts, determined after appropriate offsetting, are shown in the statement of financial position:

	2020	2019
Deferred tax assets	**93,579**	52,042
Deferred tax liabilities	**(257,079)**	(98,948)
	(163,500)	(46,906)

(All amounts expressed in thousands of HK$ unless otherwise stated)

23 RIGHT-OF-USE ASSETS

	2020
Gross:	
As at 1 January 2020	**465,109**
Additions	**113,863**
Reductions	**(824)**
As at 31 December 2020	**578,148**
Accumulated depreciation	
As at 1 January 2020	**(166,700)**
Charge for the year (Note 11)	**(177,833)**
Reduction	**515**
As at 31 December 2020	**(344,018)**
Net book value	
As at 1 January 2020	**298,409**
As at 31 December 2020	**234,130**

	2019
Gross:	
As at 1 January 2019	203,642
Additions	263,936
Reductions	(2,469)
As at 31 December 2019	465,109
Accumulated depreciation	
As at 1 January 2019	–
Charge for the year (Note 11)	(166,890)
Reduction	190
As at 31 December 2019	(166,700)
Net book value	
As at 1 January 2019	203,642
As at 31 December 2019	298,409

(All amounts expressed in thousands of HK$ unless otherwise stated)

23 RIGHT-OF-USE ASSETS *(continued)*

(i) Amounts recognized in the statement of financial position

The statement of financial position shows the following amounts relating to leases:

Right-of-use asset	2020	2019
Properties	**230,001**	289,945
Equipment	**3,867**	8,328
Others	**262**	136
	234,130	298,409
Lease liabilities	**238,333**	301,488

(ii) Amounts recognized in the statement of profit or loss

The statement of profit or loss shows the following amounts relating to leases:

Depreciation charge of right-of-use assets (Note 11)	2020	2019
Properties	**171,047**	159,967
Equipment	**6,666**	6,870
Others	**120**	53
	177,833	166,890

The statement of profit or loss shows the following amounts relating to leases:

Finance costs-lease interest expense (Note 11)	2020	2019 (restated)
Properties	**4,597**	4,663
Equipment	**97**	156
Others	**5**	1
	4,699	4,820

The total cash outflow for leases in 2020 was HK$209,630,000 (2019:HK$193,453,000).

(iii) The Bank's leasing activities and how these are accounted for

The Bank leases various retail stores, equipment and advertising spaces. Rental contracts are typically made for fixed periods of 1 year to 8 years, but may have extension options as described in (iv) below.

Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants but leased assets may not be used as security for borrowing purposes.

(iv) Extension and termination options

Extension and termination options are included in a number of retail stores across the Bank. These terms are used to maximise operational flexibility in terms of managing contracts. The majority of extension and termination options held are exercisable only by the Bank and not by the respective lessor.

(All amounts expressed in thousands of HK$ unless otherwise stated)

24 OTHER ASSETS

	2020	2019
Interest receivable	**1,627,855**	839,730
Settlement accounts	**2,015,500**	4,563,044
Other receivables, prepayments and others	**77,398**	89,960
Less: ECL allowances	**(18,055)**	(15,495)
Intangible assets (a)	**19,320**	12,198
	3,722,018	5,489,437

(a) Intangible assets

	Software
Cost	
As at 1 January 2020	**13,637**
Additions	**10,379**
As at 31 December 2020	**24,016**
Accumulated amortization	
As at 1 January 2020	**(1,439)**
Amortization expenses	**(3,257)**
As at 31 December 2020	**(4,696)**
Net book value as at 31 December 2020	**19,320**
Cost	
As at 1 January 2019	1,523
Additions	12,114
As at 31 December 2019	13,637
Accumulated amortization	
As at 1 January 2019	(28)
Amortization expenses	(1,411)
As at 31 December 2019	(1,439)
Net book value as at 31 December 2019	12,198

(All amounts expressed in thousands of HK$ unless otherwise stated)

25 DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	2020	2019
Deposits from banks and other financial institutions	**42,738,643**	16,276,758
Subordinated loan from the ultimate holding company	**2,000,000**	2,000,000
Financial assets sold under repurchase agreements (Note 33)	**26,921,033**	10,459,812
Total	**71,659,676**	28,736,570

26 DUE TO CUSTOMERS

	2020	2019
Demand deposits and current accounts	**11,312,443**	7,904,693
Saving deposits	**67,609,080**	49,071,727
Time, call, notice and other deposits	**166,828,386**	113,778,869
	245,749,909	170,755,289
Including:		
Deposits pledged as collateral	**3,113,674**	2,240,493

27 FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	2020	2019
Derivative financial instruments (Note 18)	**2,783,985**	1,168,798

For the year ended 31 December 2020 and 2019, there were no significant changes in the fair value of the Bank's financial liabilities designated as at fair value through profit or loss that were attributable to the changes in credit risk.

28 OTHER LIABILITIES

	2020	2019
Interest payable	**440,341**	727,400
Settlement accounts	**1,908,546**	2,471,380
Withholding tax	**61,840**	58,064
Provision for impairment allowances on financial guarantees and credit related commitment	**23,970**	14,872
Others	**2,816,599**	1,211,293
Total	**5,251,296**	4,483,009

(All amounts expressed in thousands of HK$ unless otherwise stated)

29 SHARE CAPITAL

	Number of shares	Share capital
As at 31 December 2019	17,900,000,000	17,900,000
As at 31 December 2020	37,900,000,000	37,900,000

The Bank issued 20,000,000,000 ordinary shares to its ultimate holding company, Bank of Communications Co. Ltd on 21 September 2020.

30 ADDITIONAL EQUITY INSTRUMENT

	2020	2019
Undated non-cumulative subordinated Additional Tier 1 capital securities with US$500 million	**3,871,450**	–

In March 2020, the Bank issued USD500 million undated non-cumulative subordinated Additional Tier 1 capital securities. The capital securities are perpetual securities and listed on the Stock Exchange of Hong Kong Limited in respect of which they may be redeemed at the Bank's option on 3 March 2025 and every six months thereafter or the occurrence of certain other events. They have an initial rate of distribution of 3.725% per annum payable semi-annually in arrear in year 1 to year 5 and resettable on year 5 and every 5 years thereafter at then prevailing 5-year U.S. Treasury yield plus 2.525% per annum. The Bank has paid dividend of HKD72,169,000 to the additional equity instrument holders for the year ended 31 December 2020 (31 December 2019:Nil).

(All amounts expressed in thousands of HK$ unless otherwise stated)

31 FINANCIAL GUARANTEES AND CREDIT RELATED COMMITMENTS AND OTHER COMMITMENTS

Financial guarantees and credit related commitments

The following tables indicate the contractual amounts of the Bank's financial guarantees and credit related commitments which the Bank has committed to its customers:

	2020	2019
Letters of guarantee	**39,106**	41,215
Letters of credit commitments	**206,580**	138,802
Acceptances bills	**82,339**	13,620
Credit card commitments	**5,337,565**	6,034,752
Other credit-related commitments		
Under 1 year	**6,161,693**	3,048,907
More than 1 year	**3,648,807**	2,512,765
	15,476,090	11,790,061

Capital expenditure commitments

	2020	2019
Contracted but not provided for	**13,583**	7,710

Operating lease commitments

As at 31 December 2020 and 2019, the Bank has no non-cancellable operating lease commitments related to short-term leases, which are the leases with a lease term of 12 months or less.

32 NOTES TO STATEMENT OF CASH FLOWS

Analysis of the balance of cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following balances with original maturities of less than or equal to 90 days used for the purpose of meeting short-term cash commitments:

	2020	2019
Cash and balances with central bank (Note 15)	**8,438,950**	1,094,956
Due from banks and other financial institutions	**15,771,766**	4,939,639
	24,210,716	6,034,595

(All amounts expressed in thousands of HK$ unless otherwise stated)

33 COLLATERALS

Financial assets sold under repurchase agreements included certain transactions under which, title of the pledged securities has been transferred to counterparties.

Sales and repurchase agreements are transactions in which the Bank sells a security and simultaneously agrees to repurchase it (or an asset that is substantially the same) at a fixed price on a future date. Since the repurchase prices are fixed, the Bank is still exposed to substantially all the credit risks and market risks and rewards of those securities sold. These securities, which the Bank does not have the ability to use during the term of the arrangements, are not derecognized from the financial statements but regarded as "collateral" for the secured lending from these because the Bank retains substantially all the risks and rewards of these securities. In addition, it recognizes a financial liability for cash received.

As at 31 December 2020 and 2019, the Bank entered into repurchase agreements with certain counterparties. The proceeds from selling such securities were presented as "financial assets sold under repurchase agreements" (see Note 25).

	Transferred assets		Associated liabilities	
	2020	2019	**2020**	2019
Investment securities	**29,069,588**	11,067,402	**(26,921,033)**	(10,459,812)

34 MATERIAL RELATED PARTY TRANSACTIONS

(a) Parent entity

The Bank is controlled by the following entity:

Name	**Type**	**Place of incorporation**	**Ownership interest**	
			2020	2019
Bank of Communications Co., Ltd	Ultimate parent entity and controlling party	People's Republic of China	**100%**	100%

(b) Key management personnel compensation

	2020	2019
Short-term employee benefits	**15,161**	14,780
Post-employment benefits	**1,358**	1,179
	16,519	15,959

(All amounts expressed in thousands of HK$ unless otherwise stated)

34 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

(c) Transactions with the Ministry of Finance of the People's Republic of China ("MOF")

As at 31 December 2020, the MOF holds 17,732 million (31 December 2019: 17,732 million) shares of the ultimate holding company of the Bank which represents 23.88% (31 December 2019: 23.88%) of equity interest of the ultimate holding company of the Bank.

The MOF is a Chinese government ministry, primarily responsible for managing state fiscal revenue and expenditures, and establishing and enforcing taxation policies. The Bank enters into banking transactions with the MOF under normal course of business and they mainly include the purchase and redemption of financial investments issued by the MOF and the deposits from the MOF.

Details of transactions and outstanding balances are summarized below:

	2020	2019
Bonds issued by MOF	**11,189,106**	5,263,457
Other assets	**9,650**	16,737
Interest income	**131,770**	141,272
Net gains arising from trading activities	**5,674**	–

(d) Transactions with The Hong Kong and Shanghai Banking Corporation Limited and its subsidiaries ("HSBC")

As at 31 December 2020, HSBC holds 13,886 million (31 December 2019: 13,886 million) shares of the ultimate holding company of the Bank which represents 18.7% (31 December 2019: 18.70%) of total share capital of the Bank. Transactions between the Bank and HSBC are carried out under normal commercial terms and paid at market rates.

Details of transactions and outstanding balances are summarized below:

	2020	2019
Due from banks and other financial institutions	**724,356**	3,852
Financial assets at fair value through other comprehensive income	**1,545,394**	1,455,631
Derivative financial assets	**63,620**	97,336
Other assets	**344**	9,677
Due to banks and other financial institutions	**6,426,055**	17,643
Derivative financial liabilities	**50,848**	165,107
Other liabilities	**5,492**	–
Interest income	**26,118**	39,418
Interest expense	**834**	78
Net(losses)/gains arising from trading activities	**(246,566)**	201,031
Net gains arising from financial investments	**13,507**	2,497

(All amounts expressed in thousands of HK$ unless otherwise stated)

34 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

(e) Transactions with fellow subsidiaries

The pricing of the transactions with fellow subsidiaries is determined based on normal terms of commercial banks.

Details of transactions and outstanding balances are summarized below:

	2020	2019
Loans and advances to customers	**428,632**	433,679
Other assets	**627**	173
Due to customers	**433,338**	471,755
Other liabilities	**8,570**	10,517
Fee and commission income	**13,057**	12,578
Interest income	**12,742**	15,698
Interest expense	**274**	618
Fee and commission expense	**16,266**	13,623
Rental expenses	**28,286**	26,522
Other operating expenses	**33,323**	31,204

(f) Transactions with directors and senior management

	2020	2019
Loans and advances to customers	**1,307**	324
Due to customers	**80,582**	46,804
Interest income	**3**	3
Interest expense	**778**	294

Particular of loans made to directors of the Bank pursuant to section 383 of the Hong Kong Companies Ordinance and Part 3 of the Companies (Disclosure of Information about Benefits of Directors) Regulation for the year ended 31 December 2020 and 2019 are as follows:

	2020	2019
Aggregate amount of relevant transactions outstanding at year end	**304**	47
Maximum aggregate amount of relevant transactions outstanding during the year	**440**	386

(All amounts expressed in thousands of HK$ unless otherwise stated)

34 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

(g) Transactions with the ultimate holding company

Transactions between the Bank and the ultimate holding company are carried out under normal commercial terms and paid at market price.

Details of transactions and outstanding balances are summarized below:

	2020	2019 (restated)
Due from banks and other financial institutions	**12,773,122**	11,548,722
Other assets	**389,125**	291,934
Derivative financial assets	**509,310**	602,306
Due to banks and other financial institutions	**28,358,299**	17,659,827
Other liabilities	**789,875**	470,543
Derivative financial liabilities	**1,909,162**	475,004
Interest income	**131,904**	280,609
Interest expense	**207,908**	357,593
Other operating expenses	**484,744**	409,833
Other operating income	**3,490**	6,565
Purchase of debt securities	**1,975,017**	51,737,488
Disposal of debt securities	**843,232**	20,028,592
Purchase of loans and advances	**62,948,109**	16,420,942
Disposal of loans and advances	**–**	1,020,712
Net losses arising from trading activities	**1,415,204**	343,520
Net gains arising from financial investments	**3**	282,266

35 SEGMENTAL ANALYSIS

The Bank manages the business mainly from an operating segment perspective and the majority of the Bank's revenues, profits before tax and assets are derived from Hong Kong. The Bank is engaged predominantly in banking and related financial activities. It comprises corporate banking, personal banking, treasury and other business. Corporate banking mainly comprises corporate loans, bills, trade finance, corporate deposits and remittance. Personal banking mainly comprises individual loans, individual deposits, credit cards and remittance. Treasury mainly comprises money market placements and takings, financial investment, and securities sold under repurchase agreements. The "Others" segment mainly comprises unallocated revenue and expenses and corporate expenses.

(All amounts expressed in thousands of HK$ unless otherwise stated)

35 SEGMENTAL ANALYSIS *(continued)*

The business information of the Bank is summarized as follows:

	2020				
	Corporate Banking	Personal Banking	Treasury	Others	Total
External net interest income/(expense)	735,660	(1,172,856)	2,715,336	–	2,278,140
Inter-segment net interest income/(expense)	(208,500)	2,892,089	(2,683,589)	–	–
Net interest income	527,160	1,719,233	31,747	–	2,278,140
Net fee and commission income/(expense)	33,393	762,418	(37,599)	–	758,212
Net gains arising from trading activities	–	–	544,990	–	544,990
Net gains arising from financial investments	–	–	165,906	–	165,906
Dividend income	–	–	35	–	35
Other operating (expense)/income	(160)	14,976	10	254	15,080
Total operating income	560,393	2,496,627	705,089	254	3,762,363
Change in expected credit losses	(239,973)	(32,577)	(197,455)	(319)	(470,324)
Other operating expense					
– Depreciation and amortization	(4,782)	(191,810)	(107)	(5,554)	(202,253)
– Others	(73,690)	(760,115)	(72,161)	(435,884)	(1,341,850)
Profit/(loss) before tax	241,948	1,512,125	435,366	(441,503)	1,747,936
Income tax expense	–	–	–	(297,567)	(297,567)
Net profit/(loss) for the year	241,948	1,512,125	435,366	(739,070)	1,450,369
Depreciation and amortization	(4,782)	(191,810)	(107)	(5,554)	(202,253)
Capital expenditure	(2,395)	(21,972)	–	(9,491)	(33,858)
Segment assets	94,888,544	46,719,355	230,036,002	–	371,643,901
Unallocated assets	–	–	–	1,319,941	1,319,941
Total assets	94,888,544	46,719,355	230,036,002	1,319,941	372,963,842
Segment liabilities	(40,481,753)	(209,984,113)	(74,376,633)	–	(324,842,499)
Unallocated liabilities	–	–	–	(1,004,200)	(1,004,200)
Total liabilities	(40,481,753)	(209,984,113)	(74,376,633)	(1,004,200)	(325,846,699)

(All amounts expressed in thousands of HK$ unless otherwise stated)

35 SEGMENTAL ANALYSIS *(continued)*

	2019				
	Corporate Banking	Personal Banking	Treasury	Others	Total
External net interest income/(expense)	894,701	(1,325,869)	3,352,337	–	2,921,169
Inter-segment net interest income/ (expense)	(397,424)	2,807,313	(2,409,889)	–	–
Net interest income	497,277	1,481,444	942,448	–	2,921,169
Net fee and commission income/(expense)	15,604	713,986	(39,503)	–	690,087
Net gains arising from trading activities	–	–	76,413	–	76,413
Net gains arising from financial investments	–	–	425,804	–	425,804
Dividend income	–	–	35	–	35
Other operating (expense)/income	(81)	20,818	9	795	21,541
Total operating income	512,800	2,216,248	1,405,206	795	4,135,049
Change in expected credit losses	(14,668)	(81,797)	(63,495)	(28)	(159,988)
Other operating expense					
– Depreciation and amortization	(4,903)	(188,005)	(106)	(4,241)	(197,255)
– Others	(78,264)	(792,743)	(72,517)	(405,448)	(1,348,972)
Profit/(loss) before tax	414,965	1,153,703	1,269,088	(408,922)	2,428,834
Income tax expense	–	–	–	(366,160)	(366,160)
Net profit/(loss) for the year	414,965	1,153,703	1,269,088	(775,082)	2,062,674
Depreciation and amortization	(4,903)	(188,005)	(106)	(4,241)	(197,255)
Capital expenditure	(2,683)	(22,865)	(10)	(1,593)	(27,151)
Segment assets	44,332,957	36,638,607	145,994,973	–	226,966,537
Unallocated assets	–	–	–	146,463	146,463
Total assets	44,332,957	36,638,607	145,994,973	146,463	227,113,000
Segment liabilities	(17,600,926)	(156,060,154)	(31,263,776)	–	(204,924,856)
Unallocated liabilities	–	–	–	(1,102,136)	(1,102,136)
Total liabilities	(17,600,926)	(156,060,154)	(31,263,776)	(1,102,136)	(206,026,992)

36 NON-ADJUSTING EVENT AFTER REPORTING PERIOD

Loans Portfolio transfer

Subsequent to the reporting date, the Bank expanded its loans business by acquiring certain loans portfolio approximately HK$10 billion and HK$4.5 billion in February 2021 and March 2021 from HKBR respectively. These loan transfer transactions entered with HKBR were conducted in the ordinary and usual course of business and on normal commercial terms.

37 COMPARATIVE FIGURES

Certain comparative figures have been reclassified to confirm to current year presentation.

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Printed by **ProTop Financial Press Limited**
210891-01