PUBLICATION OF THE OFFERING CIRCULAR

上海商業銀行
SHANGHAI COMMERCIAL BANK

Shanghai Commercial Bank Limited

(incorporated with limited liability in Hong Kong)

(the "**Issuer**")

U.S.$350,000,000 Tier 2 Subordinated Notes due 2033

(Stock Code: 5713)

(the **"Notes**")

This announcement is issued pursuant to Rule 37.39A of the Rules Governing the Listing of Securities (the "**Listing Rules**") on The Stock Exchange of Hong Kong Limited (the "**Hong Kong Stock Exchange**").

Please refer to the offering circular dated 21 February 2023 (the "**Offering Circular**") appended hereto in relation to the issuance of the Notes at an initial interest rate of 6.375 per cent. per annum. As disclosed in the Offering Circular, the Notes are intended for purchase by professional investors (as defined in Chapter 37 of the Listing Rules) only and have been listed on the Hong Kong Stock Exchange 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 Issuer, and no such inducement is intended.

Hong Kong, 1 March 2023

As at the date of this announcement, the Board of Directors of Shanghai Commercial Bank Limited comprises Mr. Stephen Ching Yen Lee (Chairman), Mr. David Sek-chi Kwok# (Deputy Chairman, Managing Director & Chief Executive), Mr. Yih Pin Chen*, Mr. Yu Jin*, Mr. John Con-sing Yung*, Mr. Jafar Altaf Amin*, Ms. Maria Pui Man Kiang*, Mr. Jun Ye*, Mr. Johnson Mou Daid Cha**, Mr. Gordon Che Keung Kwong**, Mr. E. Michael Fung**, Mr. Charles Chi Man Ma** and Mr. Sunny Yiu Tong Cheung**.*

\# *Executive Director*

* *Non-executive Director*

** *Independent Non-executive Director.*

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, and you are therefore advised to read this carefully before reading, accessing or making any other use of the offering circular. In accessing the 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 the Issuer (as defined herein) 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 HAVE NOT BEEN, AND WILL NOT BE REGISTERED UNDER THE UNITED STATES 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 MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES EXCEPT IN ACCORDANCE WITH REGULATION S UNDER THE SECURITIES ACT OR 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 ADDRESS IN THE UNITED STATES. 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. 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 IN THE FOLLOWING OFFERING CIRCULAR.

Confirmation of your Representation: In order to be eligible to view this offering circular or make an investment decision with respect to the securities, investors must not be located in the U.S. This offering circular is being sent at your request and by accepting the e-mail and accessing this offering circular, you shall be deemed to have represented to the Issuer that (1) the electronic mail address that you gave to the Issuer and to which this e-mail has been delivered is not located in the United States and, to the extent you purchase the securities described in the attached document, you will be doing so pursuant to Regulation S under the Securities Act and (2) you consent to delivery of such offering circular and any amendments and supplements thereto by electronic transmission.

The attached offering circular is being furnished in connection with an offering in offshore transactions outside the United States in compliance with Regulation S under the Securities Act solely for the purpose of enabling a prospective investor to consider the purchase of the securities described herein. You are reminded that the information in the attached offering circular is not complete and may be changed. 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 the offering of the 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 the 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.

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 neither the Issuer nor the Joint Lead Managers (as defined in the offering circular) nor any person who controls any of them nor any director, officer, employee nor agent of any of them or affiliate of any such person accepts any liability or responsibility whatsoever in respect of any difference between the offering circular distributed to you in electronic format and the hard copy version available to you on request from 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. You should not reply by e-mail to this notice, and you may not purchase any securities by doing so. Any reply e-mail communications, including those you generate by using the "Reply" function on your e-mail software, will be ignored or rejected.

上海商業銀行
SHANGHAI COMMERCIAL BANK

SHANGHAI COMMERCIAL BANK LIMITED

(incorporated with limited liability in Hong Kong)

U.S.$350,000,000 6.375% Tier 2 Subordinated Notes due 2033

Issue Price: 99.385%

The 6.375% Tier 2 Subordinated Notes due 2033 (the "**Notes**") will be issued in an initial aggregate principal amount of U.S.$350,000,000 by Shanghai Commercial Bank Limited (the "**Issuer**" or the "**Bank**"). The Notes bear interest on their principal amount (subject to adjustments following the occurrence of a Non-Viability Event (as defined in the Terms and Conditions of the Notes (the "**Conditions**") in accordance therewith) from, and including, the Issue Date at the applicable Interest Rate (as defined in the Conditions), payable semi-annually in arrear on 28 February and 28 August in each year (each an "**Interest Payment Date**") in equal instalments.

The Notes will mature on 28 February 2033, 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 described in the Conditions, redeem all but not some only of the Notes then outstanding on the Reset Date (as defined in the Conditions), at their outstanding principal amount together (if appropriate) with interest accrued to (but excluding) the date fixed for redemption, subject to adjustments following the occurrence of a Non-Viability Event (as defined in the Conditions). See "*Terms and Conditions of the Notes — Redemption and Purchase*".

If a Non-Viability Event occurs and is continuing, the Issuer shall, upon the provision of a Non-Viability Event Notice (as defined in the Conditions), irrevocably (without the need for the consent of the Noteholders) reduce the then principal amount of, and cancel any accrued but unpaid interest in respect of, each Note (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 Note. Once the principal amount of, and any accrued but unpaid interest under, the Notes 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 Noteholder may exercise, claim or plead any right to any amount that has been Written-off, and each Noteholder shall, by virtue of his holding of any Notes, be deemed to have waived all such rights to such amount that has been Written-off.

The Notes constitute direct, unsecured and subordinated obligations of the Issuer and shall at all times rank *pari passu* and without any preference among themselves. The rights and claims of the Noteholders are subordinated in the manner described in the Conditions. See "*Terms and Conditions of the Notes — Status, Qualification and Subordination of the Notes*".

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

Notice to Hong Kong investors: The Issuer confirms that the Notes 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 Notes 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 document, other than to ensure that the prescribed form disclaimer and responsibility statements, and a statement limiting distribution of this document to Professional Investors only have been reproduced in this document. Listing of the Notes on the Hong Kong Stock Exchange is not to be taken as an indication of the commercial merits or credit quality of the Notes or the Issuer or quality of disclosure in this document. Hong Kong Exchanges and Clearing Limited and the Hong Kong Stock Exchange take no responsibility for the contents of this document, 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 document.

Prohibition of sales to EEA Retail Investors – The Notes 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, "**EU MiFID II**"); or (ii) a customer within the meaning of Directive (EU) 2016/97 (as amended, the "**Insurance Distribution Directive**"), where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of EU MiFID II. Consequently no key information document required by Regulation (EU) No 1286/2014 (as amended, the "**EU PRIIPs Regulation**") for offering or selling the Notes or otherwise making them available to retail investors in the EEA has been prepared and therefore offering or selling the Notes or otherwise making them available to any retail investor in the EEA may be unlawful under the EU PRIIPs Regulation.

Prohibition of sales to UK Retail Investors – The Notes 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 ("**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 EU PRIIPs Regulation as it forms part of domestic law by virtue of the European Union (Withdrawal) Act 2018 (the "**UK PRIIPs Regulation**") for offering or selling the Notes or otherwise making them available to retail investors in the UK has been prepared and therefore offering or selling the Notes or otherwise making them available to any retail investor in the UK may be unlawful under the UK PRIIPs Regulation.

UK MiFIR product governance / Professional investors and ECPs only target market – Solely for the purposes of each manufacturer's product approval process, the target market assessment in respect of the Notes has led to the conclusion that: (i) the target market for the Notes is only eligible counterparties, as defined in the FCA Handbook Conduct of Business Sourcebook ("**COBS**"), and professional clients, as defined in Regulation (EU) No 600/2014 as it forms part of domestic law by virtue of the EUWA ("**UK MiFIR**"); and (ii) all channels for distribution of the Notes to eligible counterparties and professional clients are appropriate. Any person subsequently offering, selling or recommending the Notes (a "**distributor**") should take into consideration the manufacturers' target market assessment; however, a distributor subject to the FCA Handbook Product Intervention and Product Governance Sourcebook (the "**UK MiFIR Product Governance Rules**") is responsible for undertaking its own target market assessment in respect of the Notes (by either adopting or refining the manufacturers' target market assessment) and determining appropriate distribution channels.

Singapore Securities and Futures Act Product Classification – Solely for the purposes of its obligations pursuant to sections 309B(1)(a) and 309B(1)(c) of the Securities and Futures Act 2001 (the "**SFA**"), the Issuer has determined, and hereby notifies all relevant persons (as defined in Section 309A of the SFA) that the Notes are "prescribed capital markets products" (as defined in the Securities and Futures (Capital Markets Products) 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).

The Notes are expected to be rated "BBB" by Fitch, Inc. ("**Fitch**") and "A3" by Moody's Investors Services, Inc. ("**Moody's**"). A rating is not a recommendation to buy, sell or hold Notes and maybe subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

The Notes are complex and high risk. There are risks inherent in the holding of the Notes, including the risks in relation to their subordination and the circumstances in which Noteholders may suffer loss as a result of holding the Notes. Investors must not purchase the Notes unless they have sufficient knowledge and expertise to evaluate the effect and likelihood of the occurrence of Non-Viability Event or the exercise of Hong Kong Resolution Authority Power (each as defined in the Conditions), which may result in a loss up to the full principal amount of the Notes. Investors should also be aware that there are various other risks relating to the Notes, the Issuer and its subsidiaries, their business and their jurisdictions of operations which investors should familiarise themselves with before making an investment in the Notes. See "*Investment Considerations*" beginning on page 22 for a discussion of certain considerations to be taken into account in connection with an investment in the Notes.

By acquiring the Notes, the investors acknowledge and are deemed to represent to the Issuer and the Joint Lead Managers that they do not fall within the definition of "specified connected person" of the Issuer under Section 17D(5) of the Inland Revenue Ordinance (Cap. 112) of Hong Kong (the "IRO"). Investors must not acquire and hold the beneficial interests in the Notes whether under the initial subscription exercise or subsequent secondary trading, and will not directly or indirectly receive the relevant interests on the Notes, if they fall within the definition of "specified connected person" of the Issuer under section 17D(5) of the IRO.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended (the "**Securities Act**") and, subject to certain exceptions, may not be offered or sold within the United States. The Notes are being offered and sold only outside the United States in accordance with Regulation S under the Securities Act ("**Regulation S**").

The Notes 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 28 February 2023 (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 Notes will not be issued in exchange for beneficial interests in the Global Certificate. See "*The Global Certificate*".

THE NOTES ARE OFFERED TO PROFESSIONAL INVESTORS ONLY AND ARE NOT SUITABLE FOR RETAIL INVESTORS. INVESTORS SHOULD NOT PURCHASE THE NOTES IN THE PRIMARY OR SECONDARY MARKETS UNLESS THEY ARE PROFESSIONAL INVESTORS. INVESTING IN THE NOTES INVOLVES RISKS. SEE "*INVESTMENT CONSIDERATIONS*" BEGINNING ON PAGE 22. INVESTORS SHOULD HAVE SUFFICIENT KNOWLEDGE AND EXPERTISE TO EVALUATE EFFECT OR THE LIKELIHOOD OF THE OCCURRENCE OF NON-VIABILITY EVENT FOR THE NOTES WHICH FEATURE LOSS ABSORPTION.

Joint Global Coordinators

Citigroup **HSBC**

Joint Bookrunners and Joint Lead Managers

Citigroup **HSBC** **Crédit Agricole CIB** **Wells Fargo Securities**

Offering Circular dated 21 February 2023

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 Notes. 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 Notes, which is material in the context of the issue and offering of the Notes; (ii) the statements contained herein relating to the Issuer and 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 and 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, the Group or the Notes, the omission of which would, in the context of the issue and offering of the Notes (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 document 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 and the Group. 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.

This Offering Circular has been prepared by the Issuer solely for use in connection with the proposed offering of the Notes described in this Offering Circular. The distribution of this Offering Circular and the offering of the Notes 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*" to inform themselves about and to observe any such restrictions. No action is being taken to permit a public offering of the Notes 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 Notes, and the circulation of documents relating thereto, in certain jurisdictions including, without limitation, the United States, the United Kingdom, Hong Kong, Singapore, Japan and Taiwan, and to persons connected therewith. For a description of certain further restrictions on offers, sales and resales of the Notes and distribution of this Offering Circular, see "*Subscription and Sale*".

No person has been or is authorised to give any information or to make any representation concerning the Issuer, the Group or the Notes 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, the Trustee or the Agents (each as defined in the Terms and Conditions of the Notes). Neither the delivery of this Offering Circular nor any offering, sale or delivery made in connection with the issue of the Notes 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, the Group 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, the Trustee or the Agents to subscribe for or purchase any of the Notes 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.

No representation or warranty, express or implied, is made or given by the Joint Lead Managers, the Trustee, 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, the Trustee or the Agents accept any responsibility for the contents of the Offering Circular or for any other statement, made or purported to be made by the Joint Lead Managers, the Trustee or the Agents or on its behalf in connection with the Issuer or the issue and offering of the Notes. Each of the Joint Lead Managers, the Trustee 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 the Offering Circular or any such statement. Neither the 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 Trustee, the Agents or their affiliates or advisers that any recipient of the Offering Circular or any other financial statements should purchase the Notes. Each potential purchaser of Notes should determine for itself the relevance of the information contained in the Offering Circular and its purchase of Notes should be based upon such investigation as it deems necessary. None of the Joint Lead Managers, the Trustee or the Agents undertakes to review the financial condition or affairs of the Issuer during the life of the arrangements contemplated by the Offering Circular nor to advise any investor or potential investor in the Notes of any information coming to the attention of any of the Joint Lead Managers, the Trustee or the Agents.

Prohibition of sales to EEA Retail Investors – The Notes 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, "**EU MiFID II**"); or (ii) a customer within the meaning of Directive (EU) 2016/97 (as amended, the "**Insurance Distribution Directive**"), where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of EU MiFID II. Consequently no key information document required by Regulation (EU) No 1286/2014 (as amended, the "**EU PRIIPs Regulation**") for offering or selling the Notes or otherwise making them available to retail investors in the EEA has been prepared and therefore offering or selling the Notes or otherwise making them available to any retail investor in the EEA may be unlawful under the EU PRIIPs Regulation.

Prohibition of sales to UK Retail Investors – The Notes 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 ("**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 ("**UK MiFIR**"). Consequently no key information document required by the EU PRIPPs Regulation as it forms part of domestic law by virtue of the EUWA (the "**UK PRIIPs Regulation**") for offering or selling the Notes or otherwise making them available to retail investors in the UK has been prepared and therefore offering or selling the Notes or otherwise making them available to any retail investor in the UK may be unlawful under the UK PRIIPs Regulation.

UK MiFIR product governance / Professional investors and ECPs only target market – Solely for the purposes of each manufacturer's product approval process, the target market assessment in respect of the Notes has led to the conclusion that: (i) the target market for the Notes is only eligible counterparties, as defined in the FCA Handbook Conduct of Business Sourcebook ("**COBS**"), and professional clients, as defined in UK MiFIR; and (ii) all channels for distribution of the Notes to eligible counterparties and professional clients are appropriate. Any person subsequently offering, selling or recommending the Notes (a "**distributor**") should take into consideration the manufacturers' target market assessment; however, a distributor subject to the FCA Handbook Product Intervention and Product Governance Sourcebook (the "**UK MiFIR Product Governance Rules**") is responsible for undertaking its own target market assessment in respect of the Notes (by either adopting or refining the manufacturers' target market assessment) and determining appropriate distribution channels.

Singapore Securities and Futures Act Product Classification – Solely for the purposes of its obligations pursuant to sections 309B(1)(a) and 309B(1)(c) of the Securities and Futures Act 2001 of Singapore) (the "**SFA**"), the Issuer has determined, and hereby notifies all relevant persons (as defined in Section 309A(1) of the SFA) that the Notes are "prescribed capital markets products" (as defined in the Securities and Futures (Capital Markets Products) 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).

Important Notice to Prospective Investors pursuant to Paragraph 21 of The Hong Kong SFC Code of Conduct: Prospective investors should be aware that certain intermediaries in the context of this offering of the Notes, including certain Joint Lead Managers, are "capital market intermediaries" ("**CMIs**") subject to Paragraph 21 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the "**SFC Code**"). This notice to prospective investors is a summary of certain obligations the SFC Code imposes on such CMIs, which require the attention and cooperation of prospective investors. Certain CMIs may also be acting as "overall coordinators" ("**OCs**") for this offering and are subject to additional requirements under the SFC Code.

Prospective investors who are the directors, employees or major shareholders of the Issuer, a CMI or its group companies would be considered under the SFC Code as having an association ("**Association**") with the Issuer, the CMI or the relevant group company. Prospective investors associated with the Issuer or any CMI (including its group companies) should specifically disclose this when placing an order for the Notes and should disclose, at the same time, if such orders may negatively impact the price discovery process in relation to this offering. Prospective investors who do not disclose their Associations are hereby deemed not to be so associated. Where prospective investors disclose their Associations but do not disclose that such order may negatively impact the price discovery process in relation to this offering, such order is hereby deemed not to negatively impact the price discovery process in relation to this offering.

Prospective investors should ensure, and by placing an order prospective investors are deemed to confirm, that orders placed are bona fide, are not inflated and do not constitute duplicated orders (i.e. two or more corresponding or identical orders placed via two or more CMIs). If a prospective investor is an asset management arm affiliated with any Joint Lead Manager, such prospective investor should indicate when placing an order if it is for a fund or portfolio where the Joint Lead Manager or its group company has more than 50% interest, in which case it will be classified as a "proprietary order" and subject to appropriate handling by CMIs in accordance with the SFC Code and should disclose, at the same time, if such "proprietary order" may negatively impact the price discovery process in relation to this offering. Prospective investors who do not indicate this information when placing an order are hereby deemed to confirm that their order is not a "proprietary order". If a prospective investor is otherwise affiliated with any Joint Lead Manager, such that its order may be considered to be a "proprietary order" (pursuant to the SFC Code), such prospective investor should indicate to the relevant Joint Lead Manager when placing such order. Prospective investors who do not indicate this information when placing an order are hereby deemed to confirm that their order is not a "proprietary order". Where prospective investors disclose such information but do not disclose that such "proprietary order" may negatively impact the price discovery process in relation to this offering, such "proprietary order" is hereby deemed not to negatively impact the price discovery process in relation to this offering.

Prospective investors should be aware that certain information may be disclosed by CMIs (including private banks) which is personal and/or confidential in nature to the prospective investor. By placing an order, prospective investors are deemed to have understood and consented to the collection, disclosure, use and transfer of such information by the Joint Lead Managers and/or any other third parties as may be required by the SFC Code, including to the Issuer, any OCs, relevant regulators and/or any other third parties as may be required by the SFC Code, it being understood and agreed that such information shall only be used for the purpose of complying with the SFC Code, during the bookbuilding process for this offering. Failure to provide such information may result in that order being rejected.

IN CONNECTION WITH THIS ISSUE, CITIGROUP GLOBAL MARKETS LIMITED AND THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED (OR ANY PERSONS ACTING ON BEHALF OF THE STABILISATION MANAGERS) (THE "STABILISATION MANAGERS") MAY OVER-ALLOT SECURITIES OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE PRICE OF THE SECURITIES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL FOR A LIMITED PERIOD AFTER THE ISSUE DATE. HOWEVER, THERE IS NO OBLIGATION ON SUCH STABILISATION MANAGERS TO DO THIS. SUCH STABILISATION, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME, AND MUST BE BROUGHT TO AN END AFTER A LIMITED PERIOD. SUCH STABILISATION SHALL BE IN COMPLIANCE WITH ALL APPLICABLE LAWS, REGULATIONS AND RULES.

Any purchase or acquisition of the Notes 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 Notes 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 Notes 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 Notes are not issued by the Issuer to the Joint Lead Managers pursuant to the Subscription Agreement.

In making an investment decision, investors must rely on their own examination of the Issuer, the Group and the terms of the offering of the Notes, 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 Notes.

Each person receiving this Offering Circular acknowledges that such person has not relied on the Joint Lead Managers, the Trustee or the Agents or any person affiliated with the Joint Lead Managers, the Trustee 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 Shanghai Commercial Bank Limited, and references to the "Group" are to Shanghai Commercial Bank Limited and its consolidated subsidiaries.

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 "China" and the "PRC" are to the People's Republic of China excluding Hong Kong, Macau and Taiwan, references to "HKFRSs" are to Hong Kong Financial Reporting Standards and references to "IFRS" are to International Financial Reporting Standards.

PRESENTATION OF FINANCIAL INFORMATION

The Bank has prepared audited consolidated financial statements for the years ended 31 December 2020 and 2021 and unaudited interim financial information for the period ended 30 June 2022 in accordance with HKFRSs. Unless otherwise specified, the financial information set out in this Offering Circular is presented on a consolidated basis for the Bank and its subsidiaries.

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 Bank 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 Bank 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 Bank 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 Bank'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 of the date of this Offering Circular. The Bank 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 "*Description of the Bank*", identifies important factors that might cause the forward-looking statements not to be realised.

TABLE OF CONTENTS

SUMMARY

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

The Bank, established in 1950, is one of the renowned local Chinese banks in Hong Kong building on its core strength and holding a niche market position in corporate and small and medium-sized enterprises ("**SME**"), and high-net-worth individuals. In addition to over 40 branches in Hong Kong, the Bank has an international network of overseas branches in San Francisco, Los Angeles, New York City and London. In the PRC, the Bank has established branches in Shenzhen and Shanghai and a Shanghai FTZ sub-branch. As at 30 June 2022, the Group had total assets worth approximately HK$232.8 billion.

The Group provides a comprehensive range of retail and corporate banking services and products including personal and corporate loans, deposits, securities trading, trade finance, investment and wealth management, life and general insurance products, treasury products, foreign exchange, remittance, credit cards, international banking and internet and mobile banking.

Since April 2000, the Group has formed a strategic alliance with Bank of Shanghai Co., Ltd. ("**Bank of Shanghai**") in the PRC and The Shanghai Commercial & Savings Bank, Ltd. ("**The Shanghai Commercial & Savings Bank**") in Taiwan to provide unique one-stop, cross-strait premium banking services through a broad footprint comprising more than 400 outlets around the globe to valued customers of all three banks.

As at 30 June 2022, on a consolidated basis, the Group's total equity, gross loans and advances to customers and deposits from customers were approximately HK$33.0 billion, HK$97.4 billion and HK$184.0 billion, respectively. For the six months ended 30 June 2022, the Group's operating profit was HK$1.5 billion and profit attributable to shareholders was HK$1.2 billion.

As at 30 June 2022, the Bank's common equity tier 1 ("**CET1**") ratio was 18.1 per cent., its tier 1 capital ratio was 18.1 per cent. and its total capital ratio was 21.4 per cent.

Strengths

- Consistently profitable banking franchise with sound asset quality and strong capital adequacy
- Comprehensive and one-stop service capabilities
- Stable customer base with long-standing customer relationships
- Strong support from shareholders and Tri-bank Alliance
- Uniquely positioned with international network and banking capabilities across the United States, United Kingdom and the PRC
- Portfolio of self-owned properties which contributes to the Group's revenue stream

Strategy

- Strengthen and expand the Group's mainstay corporate business
- Diversify customer service and revenue sources
- Leverage international and cross-regional banking capabilities
- Enhance and maintain an innovative digital banking platform
- Chart and steer a long-term sustainability journey

Recent Development

Redemption of 2027 Tier 2 Subordinated Notes

On 29 November 2022, the Bank has redeemed all of the U.S.$250,000,000 3.75% tier 2 subordinated notes due 2027 (the "**2027 Tier 2 Subordinated Notes**") outstanding. Following the completion of the redemption of the 2027 Tier 2 Subordinated Notes, there are no 2027 Tier 2 Subordinated Notes in issue. Listing of the 2027 Tier 2 Subordinated Notes on the Hong Kong Stock Exchange was withdrawn on 7 December 2022.

General

- The Bank is a financial institution incorporated in Hong Kong. The address of its registered office is Shanghai Commercial Bank Tower, 12 Queen's Road Central, Hong Kong. The ultimate holding company is The Shanghai Commercial & Savings Bank, Ltd., which is incorporated in Taiwan.

SUMMARY OF THE OFFERING

The following summary does not purport to be complete and should be read in conjunction with Conditions. It does not contain all the information that is important to investors. For a more complete description of the Notes, please refer to "Terms and Conditions of the Notes". Terms used in this summary and not otherwise defined shall have the meanings given to them in the "Terms and Conditions of the Notes".

Issuer	Shanghai Commercial Bank Limited 上海商業銀行有限公司.
Description	U.S.$350,000,000 6.375% Tier 2 Subordinated Notes due 2033 (the "**Notes**").
Joint Lead Managers	Citigroup Global Markets Limited. The Hongkong and Shanghai Banking Corporation Limited. Crédit Agricole Corporate and Investment Bank. Wells Fargo Securities International Limited
Issue Date	28 February 2023.
Maturity Date	28 February 2033.
Status of the Notes	The Notes constitute direct, unsecured and subordinated obligations of the Issuer and shall at all times rank *pari passu* and without any preference among themselves.
Qualification of the Notes	The Notes are intended to qualify as Tier 2 capital under the Banking (Capital) Rules (Cap.155L) (as amended) of Hong Kong (the "**Banking (Capital) Rules**").
Subordination in respect of the Notes	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 of the Noteholders to payment of principal and interest on the Notes, and any other obligations in respect of the Notes, shall rank (i) subordinate and junior in right of payment to, and of all claims of, (a) all unsubordinated creditors of the Issuer (including its depositors), and (b) all other Subordinated Creditors of the Issuer whose claims are stated to rank senior to the Notes or rank senior to the Notes 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 (a) the holders of Junior Obligations, and (b) holders of Tier 1 Capital Instruments (as defined below) of the Issuer, in each case in the manner provided in the Trust Deed. "**Junior Obligation**" means the Shares, and any other class of the Issuer's share capital and any instrument or other obligation (including without limitation any preference shares) issued, entered into or guaranteed by the Issuer that ranks or is expressed to rank junior to the Notes by operation of law or contract. "**Parity Obligation**" means any instrument or other obligation issued, entered into or guaranteed by the Issuer that constitutes

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

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

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

"**Tier 1 Capital Instruments**" means any instrument or other similar obligation issued, entered into or guaranteed by the Issuer that constitutes Tier 1 capital of (x) the Issuer, on an unconsolidated basis, or (y) the Group, on a consolidated basis, pursuant to the Capital Regulations. For the avoidance of doubt, Tier 1 Capital Instruments does not include Shares.

"**Tier 2 Capital Instruments**" means any instrument or other similar obligation issued, entered into or guaranteed by the Issuer that constitutes Tier 2 capital of (x) the Issuer, on an unconsolidated basis, or (y) the Group, on a consolidated basis, pursuant to the Capital Regulations.

"**Winding-Up**" means, a final and effective order or resolution by a competent authority in the jurisdiction of the Issuer for the bankruptcy, winding up, liquidation, administrative receivership, or similar proceeding in respect of the Issuer.

No Set off

Subject to applicable law, no Noteholder 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 Notes and each Noteholder shall, by virtue of being the Noteholder of any Note be deemed to have waived all such rights of such setoff, counter-claim or retention.

Form and Denomination

The Notes will be issued in registered form in the denomination of U.S.$250,000 and integral multiples of U.S.$1,000 in excess thereof.

Interest Rate

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

(a) in respect of the period from, and including, the Issue Date to, but excluding, 28 February 2028 (the "**Reset Date**"), 6.375 per cent. per annum; and

(b) in respect of the period from, and including, the Reset Date to, but excluding, 28 February 2033 (the "**Maturity Date**"), the Reset Interest Rate.

Events of Default

See "*Terms and Conditions of the Notes — Events of Default and Enforcement — Events of Default and Winding-up Proceedings*".

Loss Absorption upon a Non-Viability Event in respect of the Notes

The ability to operationally effect any Write-off of any Notes under Condition 5 with respect to the clearing and/or settlement of any Notes 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 Notes with respect to the Issuer under Condition 5 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, upon or prior to the provision of a Non-Viability Event Notice, irrevocably (without the need for the consent of the Noteholders) reduce the then outstanding principal amount of, and cancel any accrued but unpaid interest in respect of, each Note (in each case in whole or in part) by an amount equal to the Non-Viability Event Write-off Amount per Note (such reduction and cancellation, and the reduction and cancellation or conversion of any other Subordinated Capital Instruments 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).

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

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

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

"**Non-Viability Event Write-off Amount**" means the amount of interest and/or principal to be Written-off as the HKMA may direct or, in the absence of such a direction, as the Issuer shall (in consultation with the HKMA) determine to be necessary to satisfy the HKMA that the Non-Viability Event will cease to continue. For the avoidance of doubt, (a) the full amount of the Notes 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 Note will be calculated based on a percentage of the outstanding principal amount of that Note.

Consequence of Non-Viability Loss Absorption

Once the outstanding principal amount of, and any accrued but unpaid interest under, the Notes 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 Noteholder may exercise, claim or plead any right to any amount that has been Written-off, and each Noteholder shall, by virtue of his holding of any Notes, be deemed to have waived all such rights to such amount that has been Written-off.

Each Noteholder shall be deemed to have authorised, ratified, directed (in the case of the Trustee only) and consented to the Trustee and the Agents to take any and all necessary action to give effect to any Write-off following the occurrence of the Non-Viability Event.

Hong Kong Resolution Authority Power

Notwithstanding any other term of the Notes, including without limitation Condition 5, or any other agreement or arrangement, each Noteholder and the Trustee shall be subject, and shall be deemed to agree, be bound by and acknowledge that they are each subject, to having the Notes being written off, cancelled, converted or modified, or to having the form of the Notes 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 Notes;

(b) the conversion of all or a part of the outstanding principal amount of, or interest on, the Notes 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 Notes; and

(c) the amendment or alteration of the maturity of the Notes or amendment or alteration of the amount of interest payable on the Notes, 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, 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 maturity date), but which have not been paid, prior to the exercise of any Hong Kong Resolution Authority Power. The rights of the Noteholders and the Trustee under the Notes 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 Notes or payment of interest on the Notes 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 Notes, the Issuer shall provide a written notice as soon as practicable regarding such exercise of the Hong Kong Resolution Authority Power to the Noteholders and to the Trustee and the Principal Paying Agent.

Neither the reduction or cancellation, in part or in full, of the outstanding principal amount of, or interest on the Notes, 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 Notes shall constitute an Event of Default.

The Bank is also subject to the Financial Institutions (Resolution) Ordinance. See "*Regulation and Supervision — The Hong Kong Resolution Regime*".

Redemption for Tax Reasons

Subject to Condition 8(g), the Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time prior to maturity for tax reasons.

See "*Terms and Conditions of the Notes — Redemption and Purchase — Redemption for Tax Reasons*".

Redemption for Tax Deduction Reasons	Subject to Condition 8(g), the Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving notice to the Trustee, the Principal Paying Agent and the Registrar and to the Noteholders (which notice shall be irrevocable, subject to Condition 5, and shall specify the date fixed for redemption), following the occurrence of a Tax Deduction Event. See "*Terms and Conditions of the Notes — Redemption, and Purchase — Redemption of the Notes for Tax Deduction Reasons*".
Redemption for Regulatory Reasons	Subject to Condition 8(g), the Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time on giving notice to the Trustee, the Principal Paying Agent and the Registrar in and to the Noteholders (which notice shall be irrevocable and shall specify the date fixed for redemption) if as a result of a change or amendment in (or any change in the application or official interpretation of) the relevant provisions of the Banking Ordinance (Cap. 155) of Hong Kong, the Capital Regulations, or any successor legislation or regulations made thereunder, or any supervisory guidance issued by the HKMA in relation thereto (in each case, as amended or superseded from time to time), the Notes, after having qualified as such, will no longer qualify, in whole or in part, as Tier 2 Capital (or equivalent) of the Issuer (other than non-qualification solely as a result of any discounting or amortisation requirements as to the eligibility of the Notes for such inclusion pursuant to the relevant legislation and supervisory guidance in force from time to time) (a "Capital Event"). See "*Terms and Conditions of the Notes — Redemption and Purchase — Redemption of the Notes for Regulatory Reasons*".
Redemption at the Option of the Issuer	Subject to Condition 8(g), the Issuer may redeem all, but not some only, of the Notes then outstanding on the Reset Date, at their outstanding principal amount together (if appropriate) 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. See "*Terms and Conditions of the Notes — Redemption and Purchase — Redemption at the Option of the Issuer*".
Purchase and Cancellation	Subject to Condition 8(g), the Issuer and any of its Subsidiaries may, at any time, purchase Notes in the open market or otherwise at any price. See "*Terms and Conditions of the Notes — Redemption and Purchase — Purchase and Cancellation*".
Taxation	All payments of principal and interest in respect of the Notes will be made free and clear of withholding taxes of Hong Kong,

	subject to customary exceptions, all as described in "*Terms and Conditions of the Notes — Taxation*".
Governing Law	English law, except that the provisions relating to subordination and set-off shall be governed by, and construed in accordance with, Hong Kong law.
Trustee	The Hongkong and Shanghai Banking Corporation Limited.
Principal Paying Agent, Paying Agent and Transfer Agent	The Hongkong and Shanghai Banking Corporation Limited.
Registrar	The Hongkong and Shanghai Banking Corporation Limited.
Rating	The Notes are expected to be assigned a rating of "BBB" by Fitch and "A3" by Moody's. The rating does not constitute a recommendation to buy, sell or hold the Notes and may be subject to suspension, reduction or withdrawal at any time by the assigning rating organisation.
Listing	Application has been made to the Hong Kong Stock Exchange for the listing of, and permission to deal in, the Notes by way of debt issues to Professional Investors only and such permission is expected to become effective on or about 1 March 2023.
Clearing Systems	Euroclear and Clearstream.
Use of proceeds	See "*Use of Proceeds*".

SUMMARY FINANCIAL AND OTHER INFORMATION

*The following tables set forth the summary consolidated financial information and other selected financial data relating to the Bank as at and for the years ended 31 December 2019, 2020 and 2021 and the period ended 30 June 2022. The summary consolidated financial information and other selected financial data for the years ended 31 December 2019, 2020 and 2021 have been extracted from and should be read in conjunction with, the Bank's audited consolidated financial statements for the years ended 31 December 2020 and 2021, respectively, including the notes thereto, which have been audited by PricewaterhouseCoopers, Certified Public Accountants. The summary consolidated financial information and other selected financial data for the periods ended 30 June 2021 and 2022 have been extracted from and should be read in conjunction with, the Bank's unaudited interim financial disclosure statement as at and for the period ended 30 June 2022, which have been reviewed by PricewaterhouseCoopers, Certified Public Accountants, in accordance with the Hong Kong Standard on Review Engagement 2410 — "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Hong Kong Institute of Certified Public Accountants ("**HKICPA**").*

The Bank has prepared and presented its audited consolidated financial statements for the years ended 31 December 2020 and 2021 in accordance with the HKFRSs applicable, and the unaudited interim financial disclosure statement for the period ended 30 June 2022 in accordance with Hong Kong Accounting Standard 34 "Interim financial reporting". The Bank's audited consolidated statement of profit or loss for the years ended 31 December 2020 and 2021 and its unaudited condensed consolidated statement of profit or loss for the period ended 30 June 2022, and the Bank's audited consolidated statement of financial position as at 31 December 2020 and 2021 and its unaudited condensed consolidated statement of financial position as at 30 June 2022 are included elsewhere in this Offering Circular. The unaudited interim financial information as at and for the six months ended 30 June 2022 should not be taken as an indication of the expected business, financial condition and results of operations for the full year ending 31 December 2022. The Bank's financial results for any past period are not and should not be taken as an indication of the Bank's performance, financial position and results of operations in future years.

Save for the Bank's audited consolidated financial statements as at and for the years ended 31 December 2020 and 2021, the financial information contained in this Offering Circular does not constitute the Bank's specified financial statements (as defined in the Companies Ordinance (Cap. 622) of Hong Kong) for the financial years ended 31 December 2019, 2020 and 2021 but, in respect of financial information relating to the full financial year, is derived from those specified financial statements. The Issuer has delivered the specified financial statements for the financial years ended 31 December 2020 and 2021 to the Registrar of Companies of Hong Kong. PricewaterhouseCoopers, Certified Public Accountants, the auditor of the Bank, has issued auditor's report on the specified financial statements in relation to the Issuer for the financial years ended 31 December 2020 and 2021. Such report was not qualified or otherwise modified, did not refer to any matters to which the auditors drew attention by way of emphasis without qualifying the reports and did not contain any statement under Sections 406(2) or 407(2) or (3) of the Companies Ordinance (Cap. 622) of Hong Kong.

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

	Year ended 31 December			Six months ended 30 June	
	2019	2020	2021	2021	2022
		(Audited)		*(Unaudited)*	
			HK$'000		
Interest income	6,746,101	5,679,681	4,756,976	2,420,338	2,421,714
Interest expense	(2,768,808)	(2,128,022)	(1,104,411)	(555,812)	(627,646)
Net interest income	3,977,293	3,551,659	3,652,565	1,864,526	1,794,068
Fee and commission income	870,836	879,829	840,187	473,261	362,631
Fee and commission expense	(55,159)	(56,923)	(53,630)	(29,217)	(23,925)
Net fee and commission income	815,677	822,906	786,557	444,044	338,706
Dividend income from investment securities at fair value through other comprehensive income ("**FVOCI**")	176,872	196,954	217,705	4,354	2,525
Net trading income	225,226	206,951	300,323	161,539	244,817
Net gains from disposal of investment securities at FVOCI	60,685	131,656	105,200	79,621	22,128
Other operating income	164,937	148,295	133,690	70,397	61,830
Net earned insurance premium	50,388	43,592	37,815	17,971	18,008
Net insurance claims incurred and movement in policyholders' liabilities	(38,152)	(32,058)	(25,957)	(12,361)	(13,043)
Operating expenses	(1,649,253)	(1,621,139)	(1,696,656)	(857,226)	(880,787)
Credit impairment losses	(60,504)	(125,440)	(29,410)	(44,221)	(46,348)
Operating profit	3,723,169	3,323,376	3,481,832	1,728,644	1,541,904
Share of net profits of associates and joint venture	36,519	45,609	61,393	54,142	37,619
Profit before income tax	3,759,688	3,368,985	3,543,225	1,782,786	1,579,523
Income tax expense	(737,705)	(626,938)	(637,595)	(336,076)	(328,144)
Profit for the year/period	3,021,983	2,742,047	2,905,630	1,446,710	1,251,379
Attributable to:					
Equity holders of the Bank	3,016,086	2,736,368	2,900,088	1,443,398	1,249,098
Non-controlling interests	5,897	5,679	5,542	3,312	2,281
	3,021,983	2,742,047	2,905,630	1,446,710	1,251,379

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	As at 31 December			As at 30 June
	2019	**2020**	**2021**	**2022**
		(Audited)		*(Unaudited)*
		HK$'000		
Assets				
Cash and balances with banks..........................	34,128,614	29,995,254	30,685,587	37,514,795
Placements with banks.....................................	7,090,556	9,234,097	15,478,679	21,336,379
Loans and advances to customers	98,773,691	101,247,939	95,906,226	96,845,109
Financial assets at fair value through profit or loss ("**FVTPL**")..	1,881,025	2,198,751	2,103,933	862,122
Derivative financial instruments	285,089	842,146	317,330	771,387
Investment securities at FVOCI.......................	71,558,546	75,689,043	81,438,993	66,087,313
Investment securities at amortised cost............	2,480,924	344,670	1,573,635	1,976,081
Properties for sale	449,462	591,418	683,924	695,914
Investments in associates and joint venture	417,663	443,480	466,829	449,192
Properties and equipment................................	2,700,014	2,657,156	2,550,277	2,492,733
Investment properties......................................	1,017,148	1,010,526	1,002,672	998,225
Deferred income tax assets	28,115	27,668	55,610	383,363
Other assets...	1,814,267	2,450,000	1,669,618	2,359,786
Total Assets	222,625,114	226,732,148	233,933,313	232,772,399
Liabilities				
Deposits and balances from banks...................	11,677,610	7,840,334	9,032,550	8,302,040
Deposits from customers	172,438,516	177,796,939	183,587,245	184,003,544
Derivative financial instruments	292,599	924,669	251,085	669,660
Subordinated debts	4,257,647	4,241,480	4,269,682	4,298,361
Other liabilities	2,813,883	3,206,269	2,426,108	2,272,733
Current income tax liabilities...........................	501,694	117,787	140,035	249,054
Deferred income tax liabilities.........................	18,901	109,871	5,241	5,241
Total Liabilities...	192,000,850	194,237,349	199,711,946	199,800,633
Equity				
Capital and Reserves Attributable to the Equity Holders				
Share capital	2,000,000	2,000,000	2,000,000	2,000,000
Retained earnings	17,158,968	18,977,170	21,608,831	22,545,035
Reserves..	11,378,917	11,426,064	10,515,909	8,327,933
	30,537,885	32,403,234	34,124,740	32,872,968
Non-controlling interests in equity	86,379	91,565	96,627	98,798
Total Equity	30,624,264	32,494,799	34,221,367	32,971,766
Total Equity and Liabilities	222,625,114	226,732,148	233,933,313	232,772,399

OTHER SELECTED FINANCIAL DATA

	As at and for year ended 31 December			As at and for the six months ended 30 June
	2019	2020	2021	2022
		%		
Profitability Indicators				
Return on average assets [(1)]	1.4	1.2	1.3	1.1
Return on equity [(2)]	10.3	8.7	8.7	7.5
Net interest margin	2.01	1.67	1.66	1.61
Non-interest income to operating income	26.8	29.9	29.9	27.3
Cost-to-income ratio	30.4	32.0	32.6	35.7
Average liquidity maintenance ratio	53.3	56.5	60.5	58.4
Capital Adequacy Ratio [(3)]				
Total capital ratio	19.5	20.1	21.5	21.4
Tier 1 capital ratio	16.2	16.9	18.2	18.1
Common Equity Tier 1 capital ratio	16.2	16.9	18.2	18.1
Asset Quality Indicator				
Impaired loans ratio	0.57	0.17	0.54	0.85
Other indicators				
Loan to deposit ratio	57.5	57.2	52.5	52.9

Notes:

(1) Return on average assets: Calculated as profit attributable to shareholders divided by the average balance of total assets at the beginning and end of the relevant year.

(2) Return on equity: Calculated as profit attributable to shareholders divided by the average balance of the total equity at the beginning and end of the relevant year.

(3) The capital adequacy ratios were calculated based on the Banking (Capital) Rules effective during the reporting periods.

INVESTMENT CONSIDERATIONS

Prospective investors should carefully take into account the following considerations, in addition to the other information contained in this Offering Circular, before investing in the Notes. The occurrence of one or more events described below could have an adverse effect on the Group's business, financial condition or results of operations, and could affect the Bank's ability to make payments of principal, premium and/or interest (if any) under the Notes. The following considerations and uncertainties described below may not be the only ones which the Group faces. Additional considerations and uncertainties not presently known to the Bank, or which the Bank currently deems immaterial, may also have an adverse effect on an investment in the Notes.

CONSIDERATIONS RELATING TO THE GROUP

The COVID-19 pandemic may have an adverse effect on the Group's financial condition and results of operations.

On 12 March 2020, the World Health Organisation declared the coronavirus ("**COVID-19**") as a global pandemic. The COVID-19 pandemic has resulted in many countries, including the PRC, India, Japan, the United States, members of the European Union and the United Kingdom, declaring a state of emergency and imposing extensive business and travel restrictions from time to time with a view to containing the pandemic. Widespread reductions in consumption, industrial production and business activities arising from the COVID-19 pandemic has significantly disrupted the global economy and global markets. In addition, the COVID-19 pandemic 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 were rolled out in various countries, including the United States, the PRC, the European Union and the United Kingdom. However, the effect of the vaccination programmes on the COVID-19 pandemic remains uncertain, and some countries are experiencing another wave of the COVID-19 pandemic, in some cases of new variants of COVID-19 such as the Delta variant and the Omicron variant. The Omicron variant in particular appears to be highly transmissible and this has resulted in a significant increase in cases globally, including Hong Kong, where the Group's primary operations are located. These or future variants of COVID-19 could also prove to be more resistant to vaccines. The impact of different variants cannot be predicted at this time, and could depend on numerous factors, including vaccination rates among the population, the effectiveness of COVID-19 vaccines against such variants, and the response by governments. In Hong Kong, the outlook for COVID-19 remains unpredictable and its long-term implications on the Group's business and results of operations locally are uncertain as Hong Kong is still battling waves of COVID-19 from time to time. As the COVID-19 pandemic continues to adversely affect business activities globally, governments and central banks across the world have introduced or are planning fiscal and monetary stimulus measures including direct subsidies, tax cuts, interest rates cuts and quantitative easing programmes. For example, the Group has participated in the relief measures initiated by the HKMA, such as the Pre-approved Principal Payment Holiday Scheme and Special 100% Loan Guarantee under the SME Financing Guarantee Scheme. While these measures aim to contain the economic impact of the COVID-19 pandemic, stabilise the capital markets and provide liquidity easing to the markets, there can be no assurance that such measures will result in the intended effects.

The uncertainties brought about by the COVID-19 pandemic globally, including Hong Kong, the PRC, the United States and the United Kingdom, have caused credit conditions to deteriorate and business to delay their investment decisions. These have had, and may continue to have, an adverse impact on both net interest income and non-interest income of the Group. While the Group seeks to continue with its prudent management and effective control of cost of funds as well as to strength its risk management strategies, it remains uncertain how the COVID-19 pandemic will play out both locally and abroad, and further worsening market conditions as a result of the COVID-19 pandemic may further adversely affect the Group's financial condition and results of operations.

Significant competition in Hong Kong, United States, United Kingdom and the PRC banking industries could adversely affect the Group's profitability.

The Group focuses principally on the Hong Kong market for individual and corporate customers and the United States, United Kingdom and PRC markets for corporate customers. The banking industry in Hong Kong is a mature market, and the Group is subject to significant competition from many other Hong Kong-incorporated banks and Hong Kong branches of international banks, including competitors that have significantly greater financial and other resources. According to statistics published by the Hong Kong Monetary Authority (the "**HKMA**"), there were more than 170 international and local licensed banks as at 30 June 2022, competing for a population in Hong Kong of approximately 7.7 million people. There is a limited market, especially for business from personal banking products such as residential mortgage loans, credit cards and personal loans. There can be no assurance that the Group will be able to compete effectively in the face of such competition. Significant competition may make it difficult for the Group to increase the size of its loan portfolio and depositor base and may cause intense pricing competition, which could have an adverse effect on its growth plans, interest, margins, ability to pass on increased costs of funding, results of operations and financial condition. In addition, as movements in interest rates on non-Hong Kong government-guaranteed new residential mortgage loans ("**Mortgage Interest Rates**") are uncertain, there can be no assurance that competition among banks in Hong Kong for residential mortgage loans will not result in fluctuations in Mortgage Interest Rates, which could have an adverse effect on the Group's business, financial condition or results of operations.

In addition to the Hong Kong market, the Group continues to explore new business opportunities in the PRC, the United States and the United Kingdom. However, the Group is likely to face significant competition in the PRC market from existing large state-owned commercial banks, local Chinese banks (including the increasing number of local virtual banks) and other foreign banks entering the market. A number of foreign banks have established locally incorporated banks in the PRC. In May 2019, the China Banking and Insurance Regulatory Commission ("**CBIRC**") removed the single shareholding cap in domestic banks and foreign banks, as a result of which the Group expects a further increase in competition in the PRC market from foreign banks. In addition, the PRC's Closer Economic Partnership Arrangement ("**CEPA**") with Hong Kong and Macau allows smaller banks from these jurisdictions to operate in the PRC, a development which may also increase competition in the banking industry in the PRC. The Group is also likely to face significant competition from new entrants in the United States and United Kingdom markets and existing competitors may combine to increase their existing presence of market share. In order to remain competitive, the Group may not realise the margins in certain markets which it would otherwise have expected or desired, and certain competitors may have access to lower cost funding and be able to offer loans on more favourable terms than the Group. The above matters, individually or in combination, may have a material adverse effect on the Group's financial condition, results of operations and prospects.

The Group is exposed to the Hong Kong property market due to its portfolio of property-related loans, and if these sectors experience volatility or an extended downturn in the future, the Group's business and financial condition could be adversely affected.

The Group is exposed to the Hong Kong property market due to its portfolio of loans to real estate investors and developers and residential mortgage loans.

The Hong Kong property market is highly cyclical and property prices in general have been volatile. In view of the increasing risk of a property price bubble, the Hong Kong government has in recent years introduced various cooling measures to the Hong Kong property market, including the new Special Stamp Duty and new Buyer's Stamp Duty. In November 2016, the Hong Kong government announced further cooling measures in the form of a 15 per cent. increase to stamp duty payable on property transactions, effective from 5 November

2016, and applying to all residential property acquisitions by individuals or companies (except for first time home buyers who are Hong Kong permanent residents). On 12 April 2017, this increased stamp duty was extended to apply to first-time Hong Kong permanent resident property buyers acquiring multiple properties under a single contract.

Property prices are affected by a number of factors, including, among other things, the supply of, and demand for, comparable properties, the rate of economic growth in Hong Kong, the policies of the Hong Kong government, Hong Kong interest rate movements which are largely dependent on the timing and pace of the U.S. rate hikes, political and economic developments in the PRC, and the relationship between the PRC, Hong Kong and other countries. In Hong Kong, the HKMA has implemented regulatory measures in recent years to mitigate risks in property-related lending in the banking sector. These regulatory measures include prudential measures implemented gradually between late-2009 and mid-2011 to lower loan-to-value ratio caps for mortgages on various types of properties, from 60 per cent. to 50 per cent., which has had a negative impact on property values in Hong Kong. The Hong Kong government has also tried to increase land supply and the supply of real estate. Any prolonged decrease or fluctuations in property values and/or liquidity of the Hong Kong property market could adversely affect the Group's business, financial condition and results of operations.

All of the aforesaid measures by the Hong Kong government and the HKMA are subject to policy changes from time to time reflecting domestic, political or economic circumstances. There is no assurance that the Hong Kong government or HKMA will not introduce further measures in the future that may have a significant impact on the Hong Kong property market, which may in turn have a negative impact on the Group's asset quality or the Group's business.

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

As with most banks, net interest income is a significant factor in determining the Group's overall financial performance. Changes in market interest rates affect the interest received on the Group's interest-earning assets and the interest paid on the Group's interest-bearing liabilities. These changes in market interest rates could result in an increase in the interest expenses of the Group relative to its interest income, which may lead to a reduction in its net interest income. Interest rates in Hong Kong are sensitive to factors over which the Group has no control, including Prime Rate and HIBOR movements in Hong Kong, domestic and international economic and political conditions, liquidity of the domestic interbank market and the international capital markets, as well as competition for loan demand, which may have an impact on local and international interest rates. Any significant volatility and abrupt movements in interest rates could adversely affect the Group's business, financial condition and results of operations.

In the event that interest rates move against the Group's position, it may adversely affect the Group's business, financial condition or results of operations. Interest rates in Hong Kong have remained relatively low but have increased on various occasions in 2022 following the increases in interest rates in the United States. An increase in interest rates could lead to a decline in the value of securities in the Group's treasury portfolio. A sustained increase in interest rates could also raise the Group's funding costs without a proportionate increase, or any increase at all, in loan demand or yield. Rising interest rates would therefore require the Group to re-balance its assets and liabilities in order to minimise the risk of potential mismatches and maintain its profitability. In addition, high interest rate levels may adversely affect the economy in Hong Kong and the PRC in particular and the financial condition and repayment ability of relevant corporate and retail borrowers, including holders of credit cards, which in turn may lead to a deterioration of the Group's credit portfolio.

The Group's funding is primarily short-term, and if depositors do not roll over their deposits upon maturity, the Group's liquidity could be adversely affected.

The Group's primary sources of funding comprise customer and inter-bank deposits (which are relatively short-term) and shareholders' funds. As at 30 June 2022, approximately 90.0 per cent. of the Group's customer deposits had a remaining maturity of three months or less. Historically, a substantial portion of such customer deposits have been rolled over upon maturity. However, no assurance can be given that this pattern will continue. There are many factors affecting the growth of the Group's deposits, some of which are beyond the Group's control, such as economic and political conditions, the availability of alternative investment choices (including but not limited to securities issued by governmental or corporate entities, unit trusts and mutual funds, investment-linked assurance schemes and structured investment products), change of government monetary policies, and retail customers' changing perceptions toward savings. As at 30 June 2022, the Group had HK$184 billion in customer deposits and HK$8.3 billion in deposits and balances from banks. While the Group's short-term customer deposits have been a stable and predictable source of funding, there can be no assurance that the Group will always be able to rely on this source of funding. If the Group fails to maintain its expected growth rate in deposits or if a substantial number of depositors fail to roll over deposited funds upon maturity, the Group's liquidity position would be adversely affected and it may need to seek alternative sources of short-term or long-term funding to finance its operations, which may be more expensive than current deposits, and in turn, the Group's business, financial condition and results of operations may be materially and adversely affected. In order to minimise the impact of the financial crisis on the banks in Hong Kong and to restore depositor confidence, the Hong Kong government has enacted measures to protect customer deposits through its Deposit Protection Scheme (the "**Deposit Protection Scheme**" or the "**Scheme**") which protects eligible deposits (being all types of ordinary deposits such as current accounts, savings accounts, secured deposits and time deposits with a maturity longer than five years) held with banks in Hong Kong which are members of the Scheme. The Deposit Protection Scheme compensates deposit holders with eligible deposits up to a limit of HK$500,000. With the exception of a few overseas-incorporated banks which are covered by a similar scheme in their country of incorporation, all licenced banks in Hong Kong are members of the Deposit Protection Scheme. On 24 March 2016, the Deposit Protection Scheme (Amendment) Ordinance 2016 (the "**2016 Amendment Ordinance**") came into effect. Among other things, a gross pay-out approach was 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. However, there can be no assurance that the level of customer deposits of the Group will not be adversely affected by the expiration of the guarantee, the future withdrawal of or any other changes to the Deposit Protection Scheme.

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

The Group may need additional capital in the future, and there can be no assurance that it would be able to obtain such capital on acceptable terms or at all.

Uncertainties in the economic and business environment in Hong Kong, the PRC, the United States, the United Kingdom and certain other developed countries may result in a deterioration of the Group's capital adequacy position. In particular, the Group may experience a deterioration in its asset quality as a result of a worsening macroeconomic climate. Any increase in the Group's allowances for impaired assets will decrease its operating profit after such allowances. To the extent that the Group's future operating income is not sufficient to meet provisioning requirements, its capital will be eroded, and the Group may be required to obtain new capital. A requirement to increase significantly the level of the Group's provisions would adversely affect its financial condition, results of operations and capital position. Moreover, the HKMA may increase the Bank's required capital adequacy ratio levels in the future in response to, among other things, an adverse economic or credit environment or regulatory changes. In addition, in order for the Group to grow, remain competitive, enter new businesses or expand its base of operations, the Group may require new capital. The Bank may seek to raise additional capital in the future through equity issuances or other capital instruments that are eligible for capital adequacy purposes under the Banking (Capital) Rules or successor legislation. There can be no assurance that the Group will be able to obtain additional capital in a timely manner, on acceptable terms or at all.

The Group may not be able to maintain the quality of its loan portfolio, investment securities, the collateral securing its loans or other assets, and the allowance for impairment losses on loans of the Group may not be sufficient for covering the actual losses on its loan portfolio which may be incurred in the future.

The Group's results of operations could be materially and adversely affected by any deterioration in the quality of its loan portfolio, investment securities or other assets. Since 1 January 2018, the Group has adopted HKFRS 9 for impairment based on changes in credit quality since initial recognition, pursuant to which the new expected credit losses model categorises financial assets into three stages. In addition, expected credit losses are continuously re-estimated and the Bank is required to take up full lifetime expected losses on a more timely basis.

Risks from changes in credit quality and the recoverability of loans and amounts due from counterparties as well as risks from the Group's investment activities are inherent in a wide range of the Group's businesses. The Group may not be able to control effectively the level of impaired loans in its current loan portfolio or control the level of new loans that may become impaired in the future. In particular, the amount of the Group'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 Group's loan portfolio, investment securities or other assets may occur for a variety of reasons, including factors which are beyond the Group's control, such as a slowdown in growth of 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 and other parts of the world. These factors may cause operational, financial and liquidity problems for the borrowers of the Group and the issuers of the Group'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 Group'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 Group has substantial exposure), declines in residential and commercial property prices, higher unemployment rates and reduced profitability of corporate borrowers. Moreover, to the extent that a material portion of the Group's loans has been extended to a relatively small number of counterparties, the overall quality of its loan portfolio could be adversely affected by a decline in the credit quality of such borrowers. In addition, the Group's expansion in the PRC and overseas markets may potentially impact the quality of its loan portfolio, where the Group is less able to control its loan portfolio quality and where uncertainties in economic and monetary policies are likely to affect its borrowers severely. Lastly, in connection with its periodic examinations of the Bank's operations, the HKMA may in the future require the Bank to change the classification of some of its loans which may increase the level of the Group's impaired loans. In addition, the Group 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 Group's loans may result in an increase in its impairment allowances and a reduction in its recovery from collateral realisation. If the level of the Group's impaired loans or write-offs in its investment securities and other assets increases, its business, financial condition and results of operations may be materially and adversely affected.

The allowance for impairment losses on loans of the Group may not be sufficient for covering the actual losses on its loan portfolio which may be incurred in the future. The allowance for impairment losses of the Group is determined according to the assessments and forecasts on various factors which may affect the quality of the loan portfolio. Such factors include, but are not limited to, a borrower's financial condition, solvency and willingness to repay, the realisable value of the collateral, the ability of the borrower's guarantor to perform the contract, as well as Hong Kong's and the PRC's economic condition, policies for the industry, interest rates, accounting standards, laws and regulatory environment. Many of these factors are beyond the Group's control, and the judgment and expectations on the aforesaid factors may not be consistent with the real conditions emerging in the future. Any change in the aforementioned factors may make the Group's allowance for such impairment losses on loans insufficient to cover the actual losses, and as a result, may require the Group to increase its allowance for such impairment losses. Hence, the Group's profits may decrease, and its asset quality, results of operation and financial condition may also be materially and adversely affected.

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

In accordance with guidelines set by the HKMA, the Group classifies its problem loans into one of three categories corresponding to levels of risks: "sub-standard", "doubtful" and "loss". In grading loans, the Group considers relevant factors including: (a) the general economic outlook; (b) the borrower's cash flow and expected cash flow; (c) the borrower's financial condition; (d) the management and operation of the borrower's business; (e) the borrower's experience in his/her business and future business plans; (f) market conditions affecting the borrower's industry; and (g) the borrower's borrowing and repayment records with the Group and with other banks. Loans are reviewed on an ongoing basis and by periodic reviews when the appropriateness of the assigned loan grade and impairment level, if any, is re-examined. Considerations for impairment include factors such as (i) delinquency in contractual payments of principal or interest, (ii) cash flow difficulties experienced by the borrower, (iii) breach of loan covenants or conditions, (iv) initiation of bankruptcy proceedings, (v) deterioration of the borrower's competitive position, (vi) deterioration in the value of collateral and (vii) downgrading below investment grade level. Impairment allowance is made for the Group's non-performing loans in accordance with HKFRS 9.

The laws, regulations and guidelines governing banking business 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. Whilst the Group believes that its loan provisioning policies are more prudent than those which are required under Hong Kong laws and regulations, the Group is not required to maintain such policies at levels above those generally applicable to banks in Hong Kong. For a description of the banking regulations that apply to banks in Hong Kong, see "*Regulation and Supervision*" in this Offering Circular.

The Group is subject to minimum regulatory capital and liquidity requirements.

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

Under Basel III, capital and liquidity requirements have been raised. On 17 December 2009, the Basel Committee of Banking Supervision (the "**Basel Committee**") proposed a number of fundamental reforms to the regulatory capital framework in its consultative document entitled 'Strengthening the resilience of the banking sector'. On 16 December 2010 and 13 January 2011, the Basel Committee issued its final guidance on Basel III. The Basel Committee's package of reforms includes increasing the minimum common equity (or equivalent) requirement and the total Tier 1 capital requirement. In addition, banks will be required to maintain, in the form of common equity (or equivalent), a capital conservation buffer to withstand future periods of stress. If there is excessive credit growth in any given country resulting in a system-wide build-up of risk, a countercyclical buffer of common equity is to be applied as an extension of the conservation buffer. The role of any other fully loss-absorbing capital in the context of any countercyclical buffer remains under discussion according to the guidance issued by the Basel Committee on 16 December 2010 (as revised in June 2011). Furthermore, systemically important banks should have loss-absorbing capacity beyond these standards. The Basel III reforms also require Tier 1 and Tier 2 capital instruments to be more loss-absorbing. These reforms therefore increase the minimum quantity and quality of capital which banks are obliged to maintain. There can be no assurance as to the availability or cost of such capital. The capital requirements are to be supplemented by a leverage ratio, and a liquidity coverage ratio and a net stable funding ratio will also be introduced. The initial stage of these proposed Basel III capital reforms has been implemented by the Hong Kong government since the beginning of 2013, and the full implementation of such reforms is expected to be completed by 2023. With respect to the Basel III liquidity standards, the HKMA has publicly announced its plan to implement the standards in full following the Basel schedule and transitional arrangement. The Banking (Liquidity) Rules (Cap. 155Q) of Hong Kong have been enacted into local regulations in October 2014 and these rules have commenced operation since 1 January 2015.

Aside from its compliance with Basel III regulatory capital requirements, the Bank will also need to comply with the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules (Cap. 628B) of Hong Kong (the "**LAC Rules**") came into operation on 14 December 2018. The LAC Rules introduced an additional loss absorbing capacity ratio which the Bank may need to maintain in addition to existing capital and liquidity requirements implemented under Basel III. However, the definitive requirements under the LAC Rules that apply to a particular authorised institution will be determined depending on institution-specific circumstances of that authorised institution in a way which supports the preferred resolution strategy of the authorised institution, and imposed in accordance with the LAC Rules, depending on institution-specific circumstances of that authorised institution. The Bank may in the future 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.

Going forward, it is foreseeable that there would be further reinforcements and more stringent requirements on the regulations, particularly those in relation to fairness and transparency of providing banking products and services to customers. The Group has taken steps to implement the recommendations by relevant regulators and to comply with any new or modified regulations. 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 Group's operations. There can be no assurance that the relevant regulatory will not implement further regulations and that such changes will not materially increase the Group's operational and compliance cost or adversely affect its business or operations. There can also be no assurance that breaches of legislation or regulations by the Group will not occur and, to the extent that such a breach does occur, that significant liability or penalties will not be incurred.

As at 30 June 2022, the Group was in compliance with the regulatory capital requirements in Hong Kong. If the regulatory capital requirements, liquidity requirements or ratios applied to the Group continue to increase in the future, the Group's return on capital and profitability could be materially and adversely affected, which may in turn affect the ability of the Group to pay interest under the Notes. In addition, any failure by the Group to satisfy such increased regulatory capital adequacy ratios or liquidity requirements within the applicable timeline could result in administrative actions or sanctions or significant reputational harm, which in turn may have a material adverse effect on the Group's business, financial condition and results of operations.

There are operational risks associated with the industry that the Group operates in which, if realised, may have an adverse effect on its business.

As with other financial institutions, the Group is exposed to many types of operational risks, including the risk of fraud, unauthorised transactions or other misconduct by employees (including the violation of regulations for the prevention of corrupt practices, and other regulations governing its business activities), unintentional or negligent failure to meet professional obligations to specific clients (including fiduciary and suitability requirements). The business, reputation and prospects of the Bank may be adversely affected if it is not able to detect and prevent fraud, corruption or other misconduct committed by its employees, customers or other third parties in a timely manner.

In addition, the Group is exposed to risks associated with operational errors, including clerical or record-keeping errors or errors resulting from faulty computer or telecommunications systems. The Group is further exposed to the risk that external vendors may be unable to fulfil their contractual obligations to the Group (or will be subject to the same risk of fraud or operational errors by their employees). Moreover, the Group is exposed to the risk that its (or its vendors') business continuity and data security systems prove to be insufficient in case of a system failure or natural disaster.

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

Failures of or inadequacies in information technology ("IT") systems could have a material adverse effect on the Group's business, financial condition and results of operations.

The Group's business operations depend heavily on its business, accounting and other data processing systems. The failure of normal operation or even inability in operation of any of such systems will expose it to financial losses, business disruption, intervention of regulatory authorities or reputational damage.

The proper functioning of its business processing, accounting, financial controls, risk management, customer service and other business is dependent on the Group's IT systems and communication networks with third parties. If the fundamental system which supports the Group's business suffers from malfunction or disruption, including system problems or communication disruption of its systems and the systems of any third parties it engaged may be indirectly affected, which will have a material adverse effect on its ongoing business. These failures could be caused by, among other things, hardware failure, software program errors, computer virus attacks, network failure, conversion errors due to system upgrade or system relocation, failure to implement new IT initiatives, human errors, natural disasters, war, terrorist attacks, blackouts and unanticipated problems of facilities, many of which are beyond its control. Although the Group backs up business data regularly, any prolonged disruption to or malfunction in the operation of its IT systems could have a large impact on its normal business operations and limit its ability to monitor and manage data, control financial and operation conditions, monitor and manage its risk exposures, keep accurate records, provide high-quality customer service and develop and sell profitable products and services. Recovery from such disasters may be unable to mitigate the Group's losses incurred during such malfunction and disruptions. In addition, insurances or other precaution measures may only partly, if at all, indemnify the Group's losses.

The Group updates its IT systems and introduce new IT systems from time to time. However, delays, system failures or other accidents may occur during such system upgrades or introduction of new systems. In addition, the upgraded or new IT systems may not be able to achieve the anticipated processing capacity and availability, and may also not be able to meet the needs of its business growth in the future. The Group's failure to address these problems promptly, including any delay in the implementation of any upgraded or new information systems, could result in its inability to perform, or delays in performing critical business operational functions, the loss of key business data, or a failure to comply with regulatory requirements, which could have a material adverse effect on its business, financial condition and results of operations.

The Group's internet banking and trading services are subject to security risks and the proper functioning and maintenance of its information technology system.

The Group uses its internet banking and trading services as a means of providing customers with greater access to its products and services and attracting new customers. The Group's business may be adversely affected if its internet banking and trading services do not continue to grow or grow more slowly than anticipated. Usage of the Group's internet banking and trading services may be adversely affected for a number of reasons, including inadequate network infrastructure, security concerns, inconsistent quality of service and unavailability of high-speed internet access.

To the extent that the Group's internet banking and trading activities involve the storage and transmission of confidential information, security breaches could expose the Group to possible liability and/or damage the Group's reputation. The Group's networks may be vulnerable to unauthorised access, computer viruses and other disruptive problems. Costs required to rectify such disruptive problems may be high and may adversely affect the Group's financial condition and results of operations. Concerns regarding security risks, including the risk of suspicious or fraudulent websites redirecting to the Group's services or information, may deter the Group's existing and potential customers from using its internet banking and trading products and services. Eliminating computer viruses and alleviating other security problems may result in interruptions, delays or termination of service to customers accessing the Group's internet banking and trading services. Undetected defects in software products that the Group uses in its products and the Group's inability to sustain a high volume of traffic may materially and adversely affect the Group's internet banking and trading business.

The Group will be exposed to various risks as it expands its range of products and services.

In order to meet the needs of the Group's customers and to diversify its business portfolio, the Group has been expanding the range of products and services it provides to its customers. Expansion of the Group's business is subject to certain risks and challenges, including:

(a) the failure to obtain regulatory approval for new products or services;

(b) new products and services may not be accepted by customers or meet the Group's expectations for profitability;

(c) the requirement to hire experienced professionals or additional qualified personnel to offer new products and services, who may not be available due to keen competition in the labour market; and

(d) the inability to enhance risk management capabilities and information technology systems to support a broader range of products and services.

If the Group is unable to achieve the intended results with respect to the new products and services to be offered to its customers, the Group could experience an adverse effect on its business, financial condition and results of operations.

The Group'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 Group's operations and products exposes it to various risks, including credit risk, market risk, liquidity risk, operational risk, reputational risk, legal and compliance risk and strategic risks. The Group 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. See "*Selected Statistical and Other Information — Risk Management*". 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 information, tools, models and technologies available to the Group, 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 Group's risk management and internal control systems require constant maintenance and continual improvements. The Group's efforts in maintaining these systems may be ineffective or inadequate.

The effectiveness of the Group's risk management and internal control systems and procedures may also be adversely affected by oversight, clerical mishandling and errors, reporting errors or limited experience or resources in making accurate, complete, up-to-date or proper evaluations. Many of the Group'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 Group relies on may quickly become obsolete as a result of changes in market situations and regulatory requirements, and the Group'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 Group'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 Group 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 Group may not be able to detect and prevent fraud or other misconduct committed by its employees, representatives, agents, customers or other third parties in a timely manner.

The Group may encounter fraud or other misconduct committed by its employees, representatives, agents, customers or other third parties, which could result in violations of laws and regulations by the Group and expose it to regulatory sanction. Even if such instances of misconduct do not result in any legal liabilities on its part, they could cause serious reputational or financial harm to the Group. This misconduct could include, but may not be limited to, committing fraud.

The Group's internal control procedures are designed to monitor its operations and ensure overall compliance. However, its internal control procedures may be unable to identify all incidents of noncompliance or suspicious transactions in a timely manner or at all. Furthermore, it is not always possible to detect and prevent fraud and other misconduct. The precautions taken to detect and prevent such activities may not be fully effective. There can be no assurance that fraud or other misconducts will not occur in the future. The Group's failure to detect and prevent fraud and other misconducts in a timely manner may have a material and adverse effect on its business reputation, financial condition and results of operations.

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

Legal risks arise from a variety of sources with the potential to cause harm to the Group and its ability to operate. These issues require the Group to deal appropriately with, amongst other things, potential conflicts of interest, legal and regulatory requirements, ethical issues, anti-money laundering and antiterrorist financing laws or regulations, privacy laws, information security policies, sales and trading practices, and conduct by companies with which it is associated. Failure to address these issues appropriately may give rise to additional legal and compliance risk to the Group, which may increase the number of litigation claims and the amount of damages asserted against the Group, or subject the Group to regulatory enforcement actions, fines, or penalties or reputational damage.

Litigation and claims will always be a possibility and such claims, in aggregate, may become material to the Group. Similarly, there can be no assurance that relevant government authorities or regulators will not seek to impose fines and/or suspend the Group's regulated activities as a result of regulatory proceedings. Regulatory pressure to settle claims could also result in material payments by the Group 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 Group's reputation with existing and potential customers, as well as the Group's business, financial condition or results of operations.

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

Downgrades to the Group's credit ratings or outlook could impair its access to funding and its competitive position.

The Group's ability to access the capital and, to a lesser extent, the wholesale markets, and the cost of borrowing in these markets, is influenced by the credit ratings assigned to the Group by the rating agencies. The Group's earnings are partly affected by its ability to value financial instruments properly. Rating agencies, in determining the Group's credit ratings, will take into consideration the Group's success at managing its liquidity risk. However, in certain illiquid markets, determining the value at which such financial instruments can be realised is highly subjective and there can be no assurance that the Group will not be subject to downgrades of its credit ratings. Any changes in the credit ratings of the Group could affect its ability to borrow from other financial institutions or to engage in funding transactions on favourable terms, or at all. Downgrade in the credit ratings of the Group may also lead to deteriorating investor sentiment towards the Group. All of these factors may reduce the Group's earnings and its profit in any given period.

Discontinuation of the link of the Hong Kong dollar to the U.S. dollar or revaluation of the Hong Kong dollar could adversely affect the Group's liquidity position as well as its financial condition and results of operations.

The significant portion of the Group's revenues are 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 HKMA has entered into bilateral repurchase agreements with the central banks of Australia, the PRC, Indonesia, Japan, the Republic of Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand. In addition, the Hong Kong government is committed to maintaining exchange rate stability under the "Linked Exchange Rate System", an automatic interest rate adjustment mechanism. No assurance can be given 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 for the Hong Kong dollar. The Group's business, financial condition and results of operations could be adversely affected by the impact on the Hong Kong economy of the discontinuation of the link of the Hong Kong dollar to the U.S. dollar, any change in the liquidity of the Hong Kong dollar or any devaluation of the Hong Kong dollar.

CONSIDERATIONS RELATING TO HONG KONG AND PRC

An economic downturn in Hong Kong and the PRC may materially and adversely affect the Group's business, financial condition or results of operations.

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

In recent years, the global credit markets have experienced significant volatility predominantly as a result of various global financial and economic crises and events and heightened geopolitical tensions, including the European debt crisis, the United Kingdom's withdrawal from the European Union in 2020 ("**Brexit**"), the Sino-U.S. trade tensions since July 2018 and the conflict between Russian and Ukraine which started in February 2022, along with measures taken by the United States and related sanctions, export controls and other similar actions in connection with such conflict, all of which have culminated in less favourable and less stable financial and economic conditions. In addition, the COVID-19 pandemic has caused stock markets worldwide to lose significant value since February 2020. Market interest rates in the United States have been increasing recently and Hong Kong banks have increased the prime rate for the first time in four years in September 2022. These changes in interest rates may result in continued significant volatility in global capital markets and adversely affect business and consumer confidence. See also "*Investment Considerations – Considerations relating to the Group – The COVID-19 pandemic may have an adverse effect on the Group's financial condition and results of operations.*".

The Hong Kong economy is sensitive to global economic conditions and depends in part upon economic performance of the United States, the PRC and other developed countries. It is impossible to predict how the Hong Kong economy will develop in the future and whether it may slow down due to a global crisis or experience a financial crisis. If there is any renewed economic downturn or slowdown in global economic recovery, there can be no assurance that the Hong Kong economy or the Group's business, financial condition and results of operations will not be adversely affected. The Group expects the recovery of, and the continued growth in, the Hong Kong economy to depend in part upon the economic performance of the United States and the PRC and certain other developed countries. There can be no assurance that future global events will not have an adverse effect on the Hong Kong economy and the Group.

There has been a slowdown in the growth of the PRC's gross domestic product ("**GDP**") since the second half of 2013 and this has raised market concerns that the historic rapid growth of the economy of the PRC may not be sustainable. According to the National Statistics Bureau of the PRC, the annual growth rate of China's GDP in 2019 slowed down to 6.0 per cent. on a year-on-year basis compared to 6.7 per cent. in 2018, and it further dropped to 2.3 per cent. in 2020 on a year-on-year basis. The substantial decrease in GDP growth in 2020 could be attributed to COVID-19 and the continued effects of the Sino-U.S. trade tensions. In June 2021, however, Moody's and S&P Global Ratings affirmed China's credit rating outlook at "stable", citing that although growth momentum was likely to decelerate somewhat compared to the first half of 2021, China would remain supported by domestic policies and robust external demand as the global recovery gathers pace. Indeed, the growth rate of China's GDP reached 8.1% in 2021 on a year-on-year basis, representing a significant increase compared to 2.3% in 2020. However, there can be no assurance that the economic environment in the PRC will remain favourable to the Group's operations in the PRC in the future.

In response to economic slowdown, the PRC government adopted a series of stimulus measures including, *inter alia*, reductions in the reserve requirement ratio and interest rates. Since November 2014, the People's Bank of China ("**PBOC**") has cut rates a number of times to attempt to reduce the slowdown in growth in the PRC. Moreover, while a multi-year appreciation of the Renminbi exchange rate had already started to give way to two-way fluctuations, the PBOC's decision to change its daily rate fixing mechanism triggered a noticeable downward pressure on the Renminbi exchange rate and fuelled expectations of further devaluation ahead. As far as the banking sector was concerned, this affected loan demand as well as increased credit risk. If the PRC's economy experiences a continued slowdown in growth or a downturn in the future, or if the RMB exchange rate experiences unexpected fluctuations, there can be no assurance that the Group's business, financial condition and results of operations will not be adversely affected.

The Bank is subject to different regulatory requirements specific to banking industry and the resolution and broader regulatory regime for banks and other financial institutions in Hong Kong.

Under the Banking Ordinance (Cap. 155) of Hong Kong (the "**Banking Ordinance**"), the HKMA regulates the business activities and operations of commercial banks and has the ability to influence banking and financial markets generally. Potential investors should be aware that regulatory requirements in Hong Kong may differ from those that prevail in other countries. Since the Group operates in the highly regulated banking and securities industries in Hong Kong, potential investors should also be aware that the regulatory authorities have been consistently imposing higher standards and developing new guidelines and regulatory requirements, such as the Basel III capital adequacy standards which have been adopted in Hong Kong. These standards require banks to disclose key pieces of information on capital, risk exposures, risk assessment processes and hence capital adequacy. The aim of the 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. From time to time, the regulators in Hong Kong may introduce 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 products to retail customers. See also "*Investment Considerations – Considerations relating to the Group – The Group is subject to minimum regulatory capital and liquidity requirements*.". 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 Group 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.

On 7 July 2017, the Financial Institutions (Resolution) Ordinance (Cap. 628) of Hong Kong (the "**FIRO**") came into operation. The FIRO provides for, among other things, the establishment of a resolution regime for authorized institutions and other within scope financial institutions as designated by the relevant resolution authorities, which includes the Bank as the issuer of the Notes. The resolution regime seeks to provide the relevant resolution authorities with administrative powers to bring about timely and orderly resolutions in order to stabilise and secure continuity for a failing authorised institution or financial institution in Hong Kong. In particular, subject to certain safeguards, the relevant resolution authority is 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 cancel, write off, modify, convert or replace all or part of the Notes or the principal amount of, or interest on, the Notes, and powers to amend or alter the contractual provisions of the Notes. See "*Investment Considerations – Considerations relating to the Notes – The operation of the resolution regime in Hong Kong may override the contractual terms of the Notes.*" and "*Regulation and Supervision — The Hong Kong Resolution Regime*". While 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 Group cannot currently be fully accurately assessed.

In addition, the Group is required to comply with applicable anti-money laundering laws, anti-terrorism laws and other regulations in Hong Kong, the PRC and overseas. Financial institutions in Hong Kong and the PRC, are required to establish sound internal control policies and procedures with respect to anti-money laundering monitoring and reporting activities. Such policies and procedures require the Group, *inter alia*, to designate an independent anti-money laundering officer, establish a customer identification system in accordance with relevant rules, record the details of customer activities and report suspicious transactions to relevant authorities. While the Group has already adopted policies and procedures to detect and prevent the use of the Group's network for money laundering activities and by terrorists and terrorist-related organisations and individuals generally, such policies and procedures may not completely eliminate instances where the Group may be used by other parties to engage in money laundering and other illegal or improper activities. Any failure of the Group to detect money laundering and other illegal or improper activities fully or in a timely manner may expose the Group to additional liability or harm to reputation. To the extent the Group fails to fully comply with applicable laws, rules and regulations, the relevant government agencies to which the Group reports have the power and authority to impose fines, freeze assets and impose other penalties on the Group. There can be no assurance that there will not be any future failures in detecting money laundering or other illegal or improper activities which may adversely affect the Group's business reputation, operations and financial results of operations.

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

Occurrence (or escalation and/or intensification) of any force majeure events, political unrest or civil disobedience movements, natural disasters, outbreaks of contagious diseases and other disasters in Hong Kong and the PRC may materially and adversely affect the Group's business, results of operations and financial condition.

Force majeure events, natural disasters, catastrophe or other events could result in severe personal injury to the Group's staff, property damage and other damage, which may curtail the Group's operations and could in turn materially and adversely affect the Group's business, results of operations and financial condition.

A substantial part of the Group's operations is based in Hong Kong and, to a lesser extent, the PRC, which are exposed to potential natural disasters. If any of the Group's property is damaged by severe weather or any other disasters, accidents, catastrophes or other events, the Group's operations may be significantly interrupted. The occurrence or continuance of any of such unforeseen events or similar events could increase the costs associated with the Group's operations and reduce its ability to operate its businesses effectively, thereby reducing its operating income and profits.

In addition, the Group's contracts with its counterparties may have force majeure provisions that permit such parties to suspend, terminate or otherwise not perform their obligations under the relevant contracts upon the occurrence of certain events such as strikes and other industrial or labour disturbances, terrorism, restraints of government, civil protests, disobedience movements or disturbances, or any natural disasters, all of which are beyond the control of the party asserting such force majeure event. If one or more of the Group's counterparties do not fulfil their contractual obligations for any extended period of time due to a force majeure event or otherwise, the Group's results of operations and financial condition could be materially and adversely affected.

Furthermore, the Group's services and operations could be interrupted by unforeseen events beyond its control, such as civil disobedience movements, social unrest and strikes. For example, there had been a series of protests and strikes in Hong Kong in 2019. The social unrest in the second half of 2019 has adversely impacted consumer confidence, dampened consumer spending and affected inbound tourism to Hong Kong, which in turn may have a negative impact on the local economy and have a material adverse impact on the Group's business, results of operations, financial condition and prospects.

The Group's operations and financial condition could also be materially and adversely affected by any outbreak, epidemic and/or pandemic of (or the escalation and/or intensification of any outbreak, epidemic and/or pandemic of) infectious or contagious diseases and/or other adverse public health developments in Hong Kong, the PRC or elsewhere. In particular, the ongoing COVID-19 pandemic in Hong Kong, the PRC and other countries has led to business suspension, travel and other restrictions, labour shortages and supply or delivery chain constraints. See also "*Investment Considerations – Considerations relating to the Group – The COVID-19 pandemic may have an adverse effect on the Group's financial condition and results of operations*.". The Group's operations have also been adversely affected by a decline in demand of residential mortgage advances, a reduction in the numbers of customers visiting the Group's branches, an adverse impact on quality of loan portfolio and other assets of the Group due to a weakened economy and higher unemployment rate. In addition, certain actions taken by governmental authorities that are intended to ameliorate the macroeconomic effects of the ongoing COVID-19 pandemic may have a negative impact on the Group's net interest income and the return from the Group's investment securities and other assets.

In addition, all levels of business in Hong Kong, the PRC and other Asian countries were adversely affected by the outbreak of severe acute respiratory syndrome ("**SAR**") in 2003. There have also been sporadic outbreaks of the H5N1 virus or "Avian Influenza A" among birds, in particular poultry, as well as some isolated cases of transmission of the virus to humans. In 2009 and 2010, there have also been outbreaks among humans of the A/H1N1 influenza virus. Other recent epidemics include the Middle East Respiratory Syndrome (MERS), the H5N1 avian flu, the H7N9 avian flu, the Ebola virus disease and the Zika virus disease. The occurrence of another outbreak of SARS, the A/H1N1 influenza virus or of any other highly contagious disease or epidemic disease (whether known or unknown to the world) (or the escalation and/or intensification of any outbreak, epidemic and/or pandemic of infectious diseases) in Hong Kong, the PRC or elsewhere may result in another economic downturn regionally and/or globally and could materially and adversely affect the overall level of business and travel activities in the affected areas and/or globally, which in turn could have a material adverse effect on the Group's business, results of operations and financial condition.

CONSIDERATIONS RELATING TO THE NOTES

The Notes may not be a suitable investment for all investors.

The Notes are complex and high risk. Each potential investor in the Notes 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 Notes, the merits and risks of investing in the Notes 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 Notes 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 Notes, including where the currency for principal or interest payments is different from the potential investor's currency;

(d) understand thoroughly the terms of the Notes 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.

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

Furthermore, a potential investor should not purchase the Notes unless it has sufficient knowledge and expertise to evaluate the effect and likelihood of the occurrence of Non-Viability Event or the exercise of Hong Kong Resolution Authority Power (each as defined in the Conditions), which may result in a loss up to the full principal amount of the Notes.

By acquiring the Notes, the investors acknowledge and are deemed to represent to the Issuer and the Joint Lead Managers that they do not fall within the definition of "specified connected person" of the Issuer under Section 17D(5) of the Inland Revenue Ordinance (Cap. 112) of Hong Kong (the "**IRO**"). Investors must not acquire and hold the beneficial interests in the Notes whether under the initial subscription exercise or subsequent secondary trading, and will not directly or indirectly receive the relevant interests on the Notes, if they fall within the definition of "specified connected person" of the Issuer under section 17D(5) of the IRO.

Certain considerations relating to enforcement.

In most circumstances, the sole remedy against the Bank available to the Trustee (on behalf of the holders of Notes) to recover any amounts owing in respect of the principal of or interest on the Notes will be to institute proceedings for the winding-up of the Bank in Hong Kong.

If the Bank defaults on the payment of principal or interest on the Notes, the Trustee will only institute a proceeding in Hong Kong for the winding-up of the Bank in the circumstances contemplated in the Conditions. The Trustee will have no right to accelerate payment of the Notes in the case of default in payment or failure to perform a covenant except as they may be so permitted in the Trust Deed.

To the extent that the Trustee or the holders of the Notes are entitled to any recovery with respect to the Notes in any Hong Kong proceedings, the Trustee and such holders of the Notes might not be entitled in such proceedings to a recovery in U.S. dollars and might be entitled only to a recovery in Hong Kong dollars.

In Hong Kong proceedings, if the Bank's assets become subject to the control of a court-appointed receiver, interest on the Notes would cease to accrue on the date of the court order and the relevant U.S. dollar amounts would be converted to Hong Kong dollars as at such date for purpose of claims.

Subordination of the Notes could impair an investor's ability to enforce its rights or realise any claims on the Notes.

The Notes will be direct, unsecured and subordinated obligations of the Bank and the rights of the Noteholders will rank subordinate and junior in right of payment to, and of all claims of, (a) all unsubordinated creditors of the Bank (including its depositors), and (b) all other Subordinated Creditors (as defined in the Conditions) of the Bank whose claims are stated to rank senior to the Notes or rank senior to the Notes by operation of law or contract.

In the event of a winding-up of the Bank, the rights of the Noteholders to payments on the Notes will be subordinated in right of payment to the prior payment in full of all deposits and other liabilities of the Bank except those liabilities which rank equally with or junior to the Notes. In a winding-up proceeding, the Noteholders may recover less than the holders of deposit liabilities or the holders of other unsubordinated liabilities of the Bank. The Notes and the Trust Deed do not limit the amount of the liabilities ranking senior to the Notes that may be hereafter incurred or assumed by the Bank. As there is no precedent for a winding-up of a major financial institution in Hong Kong, there is uncertainty as to the manner in which such a proceeding would occur and the results thereof. Although Notes may pay a higher rate of interest than comparable notes which are not subordinated, there is a risk that an investor in Notes will lose all or some of its investment should the Bank become insolvent. See Condition 3 of "*Terms and Conditions of the Notes*" for a full description of subordination and the payment obligations of the Bank under the Notes.

It is intended that the Notes should constitute Tier 2 capital of the Bank and, accordingly, under statutory requirements prevailing at the date of this Offering Circular relating to Tier 2 capital, and by virtue of the above provisions, any redemption of such Notes prior to the stated maturity is subject to the prior approval of the HKMA at the relevant time.

The Notes may be redeemed early at the Issuer's option on the Reset Date and on the occurrence of certain other events.

Under the Conditions, the Noteholders do not have any right to require the Issuer to redeem their Notes prior to the maturity date. However, the Issuer can at its option redeem the Notes prior to the maturity date (i) on the Reset Date or (ii) upon the occurrence of a Withholding Tax Event, a Tax Deduction Event or a Capital Event (each as defined in the Conditions), in each case subject to the Bank obtaining the written consent of the HKMA (if then required) prior to the redemption, to the extent such consent is required under the Capital Regulations (as defined in the Conditions) or any successor legislation or regulations made thereunder, or any supervisory guidance issued by the HKMA in relation thereto and other requirements as prescribed by the Conditions.

In particular, in relation to a Capital Event, the HKMA from time to time may introduce measures or make proposals to strengthen capital and liquidity regulations with the goal of promoting a more resilient banking sector. It may lead to changes in the requirements for bank capital and certain term subordinated debt may not qualify as regulatory capital beyond a certain time frame. In particular, the HKMA may decide that the Notes do not qualify as Tier 2 capital of the Bank. If the Notes do not qualify, the Bank may choose to redeem the Notes (subject to the prior consent of the HKMA) prior to the relevant maturity date pursuant to the Capital Event redemption right.

The date on which the Issuer elects to redeem the Notes may not accord with the preference of individual Noteholders. This may be disadvantageous to the Noteholders in light of market conditions or the individual circumstances of the Noteholders. 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 Notes.

The terms of Notes contain non-viability loss absorption and bail-in provisions.

Under the Conditions, a Non-Viability Event occurs when the HKMA notifies the Issuer in writing that the HKMA is of the opinion that a Write-off (as defined in the Conditions) or conversion is necessary, without which the Issuer would become non-viable; or 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 Conditions also provide that each Noteholder (as defined in the Conditions) and the Trustee shall be subject, and deemed to agree that the relevant Hong Kong Resolution Authority (as defined in the Conditions) can exercise the Hong Kong Resolution Authority Power (as defined in the Conditions) in relation to the Notes. The Hong Kong Resolution Authority Power allows the relevant Hong Kong Resolution Authority to take certain actions in relation to the Notes, including to:

- cancel all or a part of the principal amount of, or interest on, the Notes;
- modify or change the form of the Notes;

- suspend the operation of the Conditions in relation to the Notes or deem payments of principal or interest to have been made in relation to the Notes when no payments of principal or interest have been made; and
- order anything else the relevant Hong Kong Resolution Authority considers appropriate in consequence of exercising the Hong Kong Resolution Authority Power.

If a Non-Viability Event occurs and is continuing, the Issuer shall, upon the provision of a Non-Viability Event Notice, irrevocably (without the need for the consent of the Noteholders) reduce the then principal amount of, and cancel any accrued but unpaid Interest in respect of, each Note (in each case in whole or in part). If the Hong Kong Resolution Authority Power is exercised by the relevant Hong Kong Resolution Authority, the provisions detailed in the instrument by which the relevant Hong Kong Resolution Authority exercises the Hong Kong Resolution Authority Power (the "**Hong Kong Resolution Authority Power Instrument**") shall apply to the Notes. Although the Issuer has agreed to notify the clearing systems and the Noteholders 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 Noteholders via the clearing systems are notified of the occurrence of the relevant event through their clearing systems accounts or otherwise. Such delay may exceed several days during which trading and settlement in the Notes 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 Notes or on the rights of the Noteholders. See "*Terms and Conditions of the Notes — Non-Viability Loss Absorption" and "Terms and Conditions of the Notes – Hong Kong Resolution Authority Power*". The notification of a Non-Viability Event is at the discretion of the HKMA and the exercise of the Hong Kong Resolution Authority Power is at the discretion of the relevant Hong Kong Resolution Authority and both are 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.

Noteholders should note that any amount that is Written-off (as defined in the Conditions) 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, even if the relevant Non-Viability Event or exercise of the Hong Kong Resolution Authority Power has ceased. In addition, a Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power may occur on more than one occasion and each Note may be Written-off on more than one occasion. As the Interest Rate (as defined in the Conditions) is calculated on the basis of the 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, Noteholders will receive less interest on their Notes. In addition, upon the occurrence of a Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power, Noteholders could risk losing up to the full principal amount of the Notes, as well as the cancellation of any accrued (and unpaid) interests, without receiving any compensation for such loss or cancellation. See "*Regulation and Supervision — The Hong Kong Resolution Regime*".

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 HKMA (a) that a Write-off or conversion is necessary, without which the Issuer would become non-viable; or (b) 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 HKMA 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 Bank and the Group and with which neither the Bank nor the Group 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 Notes will occur. Accordingly, the trading behaviour in respect of the Notes is not necessarily expected to follow trading behaviour associated with other types of securities. Any indication that the Bank 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 Notes.

Potential investors should consider the risk that a holder of Notes may lose all of their investment in the Notes, 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 HKMA may implement in the future. There is a risk that the HKMA 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 feature similar to Condition 5 or the exercise of the Hong Kong Resolution Authority Power as set out in Condition 6 has not been tested in Hong Kong and some degree of uncertainty may exist in their application.

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

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

In addition, the subordination and set off provisions set out in Condition 3 are effective only upon the occurrence of any winding-up proceedings of the Bank. In the event that a Non-Viability Event occurs the rights of holders of Notes shall be subject to Condition 6. In the event that the Hong Kong Resolution Authority Power is exercised, the rights of the holders of the Notes 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 Noteholders as would otherwise occur under Condition 3 upon the occurrence of any winding-up proceedings of the Bank.

Furthermore, upon the occurrence of a Write-off of any Notes or if specified in the Hong Kong Resolution Authority Power Instrument, interest will cease to accrue and all interest amounts that were not due and payable prior to the Write-off or as specified in the Hong Kong Resolution Authority Power Instrument shall become null and void. Consequently, Noteholders will not be entitled to receive any interest that has accrued on such Notes from (and including) the last Interest Payment Date (as defined in the Conditions) falling on or prior to the Non-Viability Event Notice or the relevant cut-off time specified in the Hong Kong Resolution Authority Power Instrument. Upon the occurrence of a Write-off or if specified in the Hong Kong Resolution Authority Power Instrument, no Noteholder may exercise, claim or plead any right to any such amounts Written-off, and each Noteholder 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 Noteholders 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 Bank or be entitled to any other participation in the upside potential of any equity or debt securities issued by the Bank or any other member of the Group, or be entitled to any subsequent write-up or any other compensation in the event of a potential recovery of the Bank or the Group.

Transfers scheduled to settle through Euroclear and Clearstream (the "Clearing Systems") are expected to be rejected if the scheduled settlement is after any suspension by the Clearing Systems of clearance and settlement of the Notes 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 Clearing Systems 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 Clearing Systems 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 or (ii) are settled through the Clearing Systems 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 Clearing Systems are expected to suspend all clearance and settlement of transfers of the Notes by Noteholders after receipt of a Non-Viability Event Notice or as specified in the Hong Kong Resolution Authority Power Instrument, and any transfer of the Notes that is scheduled to settle after commencement of such suspension is expected to be rejected by the Clearing Systems and will not be settled within the Clearing Systems.

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 Clearing Systems and the Noteholders via the Clearing Systems after the occurrence of a Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power, the records of the Clearing Systems 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 Notes through the Clearing Systems 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 Clearing Systems commence such suspension will fail to settle through the Clearing Systems 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 Notes would not receive any consideration through the Clearing Systems in respect of such intended transfer because the Clearing Systems 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 Clearing Systems commence such suspension will be settled through the Clearing Systems even though such transfers were initiated after the Non-Viability Event or the relevant cut-off time specified in the Hong Kong Resolution Authority Instrument. In such circumstances, transferees of the Notes may be required to pay consideration through the Clearing Systems 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 Notes will thereafter become due, and such transferees will have no rights whatsoever under the Trust Deed or the Notes to take any action or enforce any rights or instruct the Trustee to take any action or enforce any rights whatsoever against the Bank, regardless of whether they have received actual or constructive notice of such fact. The settlement of the Notes following a Non-Viability Event or the exercise of the Hong Kong Resolution Authority Power will be subject to procedures of the Clearing Systems that are in place at such time.

Tax treatment of the Notes, which contains non-viability loss absorption provisions, is unclear.

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

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

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

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

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

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

In Hong Kong, the FIRO became effective on 7 July 2017. The FIRO provides for, among other things, the establishment of a resolution regime for authorized institutions and other within scope financial institutions in Hong Kong which may be designated by the relevant resolution authorities, which includes the Bank as the issuer of the Notes. 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 authorised institution or within scope financial institution in Hong Kong. In particular, subject to certain safeguards, the relevant resolution authority is 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.

The HKMA is the relevant Hong Kong Resolution Authority in relation to banking sector entities in Hong Kong, such as the Bank. In relation more specifically to the Notes, the HKMA's powers under FIRO include, but are not limited to, powers to cancel, write off, modify, convert or replace all or a part of the Notes or the principal amount of, or interest on, the Notes, and powers to amend or alter the contractual provisions of the Notes, all of which may adversely affect the value of the Notes, and the holders thereof may suffer a loss of some or all of their investment as a result. 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 Notes 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 Noteholders and could result in the Noteholders losing their rights in relation to accrued and future interest without compensation. See "*Investment Considerations — Considerations relating to the Notes — The Notes may be subject to a full or partial Write-off*" and "*Investment Considerations — Considerations relating to the Notes — The terms of Notes contain non-viability loss absorption and bail-in provisions*".

The implementation of OECD's Common Reporting Standard may 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 CRS in the PRC and Hong Kong has been effective from 1 January 2017. PRC and Hong Kong financial institutions has started collecting tax residency information from their account holders since 1 January 2017 for submission of information on reportable account holders. The increased due diligence of customer information and the reporting of information to the tax authorities will increase operational and compliance costs for banks, including the Bank.

Credit ratings of the Notes.

The Notes are expected to be assigned a rating of BBB" by Fitch and "A3" by Moody's. These ratings reflect the Issuer's ability to make timely payments of principal and interest on the Notes. A rating is not a recommendation to buy, sell or hold any security, does not address the likelihood or timing of payment of the Notes 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 Notes 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 Notes.

Liquidity of the Notes.

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

The Trustee may decline to take actions requested by the Noteholders.

In certain circumstances (including, without limitation institution of a Winding-up Proceeding (as defined in the Conditions) against the Issuer or the giving of notice to the Issuer pursuant to Condition 11(a)(ii)), the Trustee may (at its sole discretion) request the Noteholders to provide an indemnity and/or security and/or pre-funding to its satisfaction before it takes actions on behalf of the Noteholders and shall not be obliged to take any such actions until it is indemnified and/ or secured and/or pre-funded to its satisfaction. Negotiating and agreeing to an indemnity and/ or security and/or pre-funding can be a lengthy process and may have an impact upon when such actions can be taken.

The Trustee may decline to take action requested by the Noteholders, notwithstanding the provision of an indemnity or security or pre-funding to it, where it is not satisfied that the action is permitted by applicable law or regulation and, to the extent permitted by the agreements and applicable law, it will be for the Noteholders to take such actions directly.

The Bank may raise other capital which affects the price of the Notes.

The Bank 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 Bank may issue or incur and which rank senior to, or *pari passu* with, the Notes, and there is no restriction on the Bank issuing securities with or without Non-Viability Loss Absorption provisions (whether or not such provisions are similar to those of the Notes). The issue of any such securities or the incurrence of any such other liabilities may reduce the amount (if any) recoverable by Noteholders on a dissolution or winding-up and/or may increase the likelihood of a cancellation of accrued but unpaid interest in respect of the Notes. 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 Notes and/or the ability of Noteholders to sell their Notes.

USE OF PROCEEDS

The gross proceeds from this Offering will be U.S.$347,847,500, which after deducting the underwriting commissions and other expenses in connection with this Offering, will be used to strengthen the Bank's capital base and fund the growth of the Bank's operations and development.

CAPITALISATION AND INDEBTEDNESS

As at 30 June 2022, the Bank had issued and fully paid up share capital of HK$2,000.0 million consisting of 20,000,000 ordinary shares.

The following table sets out the Bank's unaudited consolidated capitalisation and indebtedness as at 30 June 2022 and as adjusted for the issue of the Notes. This table should be read in conjunction with the consolidated financial statements of the Bank and related notes thereto included elsewhere in this Offering Circular.

	As at 30 June 2022	
	Actual	**As adjusted**
	(HK$'000)	
Indebtedness:		
Deposits and balances from banks	8,302,040	8,302,040
Deposits from customers	184,003,544	184,003,544
Subordinated debts (1)	4,298,361	4,298,361
Notes to be issued (2)	—	2,747,465
Total indebtedness	196,603,945	199,351,410
Capital and reserves attributable to equity holders:		
Share capital	2,000,000	2,000,000
Retained earnings	22,545,035	22,545,035
Reserves	8,327,933	8,327,933
Total capital resources	32,872,968	32,872,968
Total capitalisation (3)	229,476,913	232,224,378

Notes:

(1) The Bank has redeemed its U.S.$250,000,000 3.75% tier 2 subordinated notes due 2027 on 29 November 2022. See "*Description of the Bank – Recent Development – Redemption of 2027 Tier 2 Subordinated Notes*" for further details.

(2) The aggregate principal amount of Notes of U.S.$350,000,000 (representing approximately HK$2,747,465,000, translated at the exchange rate of HK$7.8499 to US$1.00, being the latest HKD/USD exchange rate published by the United States Federal Reserve on 30 June 2022).

(3) Total capitalisation equals the sum of total indebtedness and total capital resources.

Except as otherwise disclosed above, there has been no material change in the Bank's total capitalisation since 30 June 2022.

DESCRIPTION OF THE BANK

INTRODUCTION

The Bank, established in 1950, is one of the renowned local Chinese banks in Hong Kong building on its core strength and holding a niche market position in corporate and SME, and high-net-worth individuals. In addition to over 40 branches in Hong Kong, the Bank has an international network of overseas branches in San Francisco, Los Angeles, New York City and London. In the PRC, the Bank has established branches in Shenzhen and Shanghai and a Shanghai FTZ sub-branch. As at 30 June 2022, the Group had total assets worth approximately HK$232.8 billion.

The Group provides a comprehensive range of retail and corporate banking services and products including personal and corporate loans, deposits, securities trading, trade finance, investment and wealth management, life and general insurance products, treasury products, foreign exchange, remittance, credit cards, international banking and internet and mobile banking.

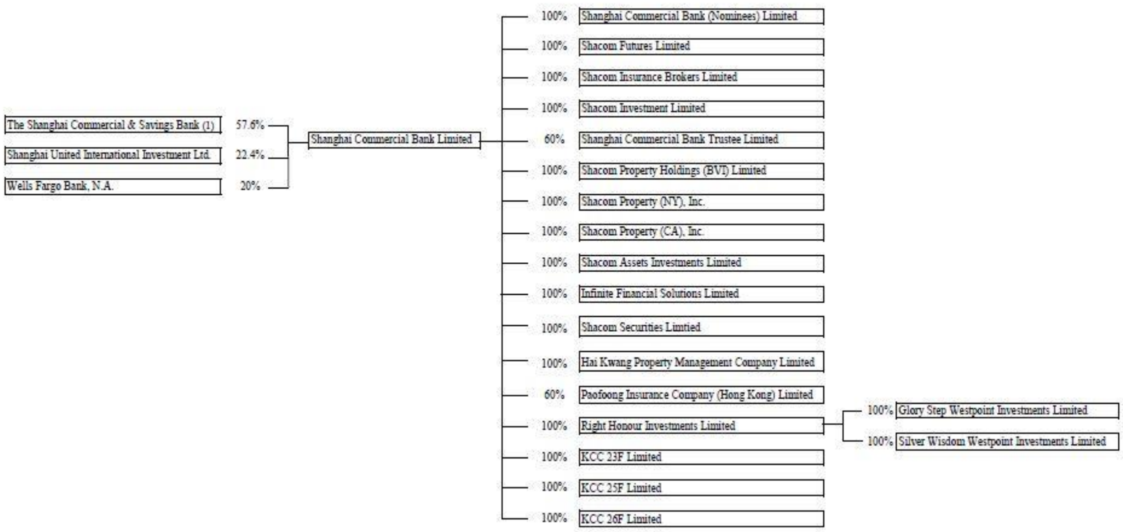
Since April 2000, the Group has formed a strategic alliance with Bank of Shanghai Co., Ltd. ("**Bank of Shanghai**") in the PRC and The Shanghai Commercial & Savings Bank, Ltd. ("**The Shanghai Commercial & Savings Bank**") in Taiwan to provide unique one-stop, cross-strait premium banking services through a broad footprint comprising more than 400 outlets around the globe to valued customers of all three banks.

As at 30 June 2022, on a consolidated basis, the Group's total equity, gross loans and advances to customers and deposits from customers were approximately HK$33.0 billion, HK$97.4 billion and HK$184.0 billion, respectively. For the six months ended 30 June 2022, the Group's operating profit was HK$1.5 billion and profit attributable to shareholders was HK$1.2 billion.

As at 30 June 2022, the Bank's common equity tier 1 ("**CET1**") ratio was 18.1 per cent., its tier 1 capital ratio was 18.1 per cent. and its total capital ratio was 21.4 per cent.

ORGANISATION

The following chart sets out the Group's organisation structure as at 30 June 2022:



Note:

(1) The Shanghai Commercial & Savings Bank holds a 57.6 per cent. interest in the Bank through two indirect wholly-owned subsidiaries, Empresa Inversiones Generales, S.A. and Krinein Company.

STRENGTHS

The major strengths of the Group are as follows:

Consistently profitable banking franchise with sound asset quality and strong capital adequacy

The Group has recorded consistent earnings and profitability even during financial downturns, which is attributable to its prudent business model and competitiveness in the banking industries in which the Group operates. The steady growth in the Group's balance sheet and improved risk management have contributed to its consistent profitability over the years. The Group's profit was HK$3,022.0 million, HK$2,742.0 million, HK$2,905.6 million, HK$1,446.7 million and HK$1,251.4 million for the years ended 31 December 2019, 2020 and 2021 and the six months ended 30 June 2021 and 2022, respectively.

The Group has also been able to maintain a healthy asset quality, with prudent credit risk management backed by good collateralisation. Meanwhile, the Bank's capital adequacy ratio and tier 1 capital ratio have been maintained at a healthy level and well above regulatory requirements.

Comprehensive and one-stop service capabilities

In line with the Group's heritage of providing personalised services, the Group offers comprehensive and one-stop services with a diverse range of products and offerings to its customers, supported by the Group's partnerships, associates, joint venture and subsidiaries across a range of capabilities such as insurance, MPF, banking technology and operations. The retail and corporate banking services and products provided by the Group through its network of over 40 branches in Hong Kong, four overseas branches and two branches and one sub-branch in the PRC include personal and corporate loans, deposits, trade finance, remittances, securities trading, investment and wealth management, life and general insurance products, treasury products, foreign exchange, credit cards, international banking and internet and mobile banking.

Stable customer base with long-standing customer relationships

The Group maintains a stable customer base developed from its corporate and commercial business, which formed the Group's traditional areas of expertise through its 72-year history. Many of these customers have been banking with the Group for many years, and this has led to other retail relationships and businesses with the Group, particularly with high net worth clients. The Group's stable customer base has allowed the Group to further diversify its revenue and ensure stability in its funding base.

Strong support from shareholders and the Tri-bank Alliance

The Group enjoys strong backing and support from its shareholders and the strategic alliance partners, comprising experienced and well-established financial institutions including Wells Fargo Bank, Bank of Shanghai in the PRC and The Shanghai Commercial & Savings Bank in Taiwan. This has benefited the Group in terms of business development, experience and training, and provides the Group with a unique branding proposition by harnessing the common strength of the Shanghai-linked heritage and customer base (the "**Tri-bank Alliance**").

The Tri-bank Alliance encompasses multiple aspects of collaboration, including collaboration on syndication/club and corporate deals, the "Green Channel" for serving high net worth clients across the Greater China network, collaboration on IT, Fintech, and operational enhancement initiatives, and co-marketing and co-branding initiatives.

In particular, the three Shanghai banks have recently signed a Green Finance Strategic Cooperation Agreement, pledging close collaboration on corporate and retail banking initiatives embracing sustainability and green products.

Uniquely positioned with international network and banking capabilities across the United States, United Kingdom and PRC

In addition to offering Hong Kong banking capabilities similar to other local Hong Kong banks, the Group is also uniquely positioned to serve the PRC and overseas needs of its Hong Kong and Greater China customers through its branches in the United States, the United Kingdom and the PRC, as well as through the synergies provided by the Tri-bank Alliance. Since establishing its first U.S. branch in 1973 and its UK branch in 1980, the Group has provided an extensive range of corporate banking and property loan services to individuals and corporate customers through its branches in San Francisco, Los Angeles, New York and London, developing a significant and valued local customer base in the local Chinese communities.

In 1999, the Group set up its Shenzhen representative office, which was the Group's first branch in the PRC, and has since also set up a branch in Shanghai. The Tri-bank Alliance further strengthens the Group's development in the PRC by allowing the Group to expand the corporate customer base by offering more diverse products and higher quality banking and financial services to the Group's own customers in the PRC.

Portfolio of self-owned properties which contributes to the Group's revenue stream

The Group maintains a portfolio of self-owned properties supporting banking network and services as well as for long term investment and income purposes. Approximately half of the branch network in Hong Kong is operating at self-owned properties while the Group's anchor properties such as Shanghai Commercial Bank Tower provide multiple functions to enhance diversification of income stream from banking operation and property-related income to the Group. All self-owned properties are stated at cost in the statement of financial position of the Group. The appreciation of the value of these properties has not been reflected in the financial book or capital base of the Group.

STRATEGY

The Group's long-term strategy is to continue to grow relative to its historical asset size to serve its quality customer base while leveraging its competitive strengths by achieving growth in loans and fee income for profit diversification and contribution, and to continue to maintain the Group's health and long-standing high capital adequacy.

The major components of the Group's overall strategy are as follows:

Strengthen and expand the Group's mainstay corporate business

The Group aims to strengthen and expand its corporate banking business, which is the Group's traditional area of expertise. The Group believes this can be done by continually strengthening long-standing customer relationships with one-stop, tailored finance solutions and fully serving its customers in a differentiated fashion, with a particular focus on its associated individual and high net worth client segments through the Group's wealth management, investment and insurance businesses. The Group further intends to supplement its corporate banking business with expanded products and offerings such as treasury products.

Diversify customer service and revenue sources

The Group intends to continue to diversify its revenue sources by offering more comprehensive products and services across the securities and futures, investments, wealth management and insurance businesses to further penetrate the high net worth, mass affluent and retail customer segments. The Group intends to tap into its long-standing relationships with many of its customers, and has focused on various initiatives to enhance the customer experience, such as the SMART Banking service to better serve its high net worth and mass affluent customer segments. The Group believes that such diversification of the Group's product offering will also create a more balanced revenue structure for the Group encompassing both interest and non-interest income sources.

Leverage international and cross-regional banking capabilities

The Group intends to leverage its international and cross-regional banking capabilities to help its customers expand their investment and business interests across the core markets of the PRC, the United States and the United Kingdom, reinforcing the Group's ability to provide comprehensive services while providing strong earnings contribution to the Group beyond Hong Kong for greater diversification and stability.

The Group has a relatively large and differentiated geographical footprint and presence given its size, which helps strengthen the Group's focus on building long-standing customer relationships. The Group aims to grow its PRC business by closely following the needs of its Hong Kong customers in the PRC and further developing its corporate and syndication lending business lines in collaboration with its partners in the Tri-bank Alliance while remaining watchful of credit risk, serving premium customers of the Tri-bank Alliance through the "Green Channel" in Hong Kong and overseas. The Group's presence in the key markets of New York, Los Angeles, San Francisco and London allows it to provide comprehensive services to its Greater China customers and businesses, having been present in such markets for over 30 years and with strong ties with the local Chinese communities and businesses.

Enhance and maintain an innovative digital banking platform

The Group aims to enhance and maintain an innovative digital banking platform, which is a key technological component of the Group's long-term strategy, by leveraging the Tri-bank Alliance, its technology subsidiaries and collaboration partnerships to strengthen its automated channels, optimise costs and enhance marketing capabilities through technology. The Group intends to apply its technological improvements to multiple customer offerings, in particular its treasury, corporate banking, wealth management and securities businesses. In addition, to align with the "Fintech 2025" strategy promoted by the HKMA, the Group has established the Digital Transformation Committee to oversee the formulation and execution of its digital transformation strategies. The Group has put together a corresponding 3-year plan on fintech adoption to pursue initiatives that enhance customer experience, operational efficiency, risk management and monitoring, and big data usage. The Group believes a strong digital banking platform will allow it to meet the digital needs of both its existing and new customers and meet the Fintech and e-Banking evolution in the marketplace.

Chart and steer a long-term sustainability journey

The Group aims to step up contributions for a sustainable world and building climate resilience, taking a holistic approach to Environmental, Social and Governance ("**ESG**") related matters and climate change adaptation. The Group has set a vision to be a trusted bank that promotes sustainability through integrating sustainable operations, culture and business together with stakeholders and the community. To achieve this vision, the Group has put in place the sustainability governance bodies that will oversee and implement the Group's sustainability strategy and provide visibility on progress and a channel of communication on sustainability from the operational level to the Board. It is the shared responsibility of all in the Group to contribute in the sustainability areas: from delivering on customers' sustainability needs and driving awareness, to being environmentally mindful, and volunteering in the community.

RECENT DEVELOPMENT

Redemption of 2027 Tier 2 Subordinated Notes

On 29 November 2022, the Bank has redeemed all of the 2027 Tier 2 Subordinated Notes outstanding. Following the completion of the redemption of the 2027 Tier 2 Subordinated Notes, there are no 2027 Tier 2 Subordinated Notes in issue. Listing of the 2027 Tier 2 Subordinated Notes on the Hong Kong Stock Exchange was withdrawn on 7 December 2022.

BUSINESS SEGMENTS

Deposit Services

The Group has a diversified depositor base which provides a stable source of funding and a broad platform across which it is able to cross-sell other products to create stronger, multi-product customer relationships.

The Group offers a range of deposit services to customers, including checking accounts, savings and current accounts and fixed deposits denominated in a number of currencies such as Hong Kong dollars, U.S. dollars and Renminbi.

Corporate Banking

The principal corporate banking services offered by the Group to corporate customers include current accounts, savings accounts, time deposits, overdrafts, term loans, revolving loans and trade finance facilities. The Group's corporate customers are principally engaged corporates in the property development, property investment, hotels, finance, manufacturing, wholesale and retail trading businesses based in Hong Kong, the PRC, the United States and the United Kingdom, many of whom have long-standing relationships with the Group for many years.

The major corporate banking products and services offered by the Group are as follows:

(A) Commercial Loans and Other Credit Facilities

The Group provides mortgage and loans including term/instalment loans, revolving loans, business installations and equipment loans, project financing, overdraft facilities, working capital loans and loans against standby letters of credit issued by banks to its corporate customers. The Group also offers a wide range of other loan products to corporate customers, such as SME Financing Guarantee Scheme (guaranteed by The Hong Kong Mortgage Corporation Ltd.) to manufacturing, wholesale & retail and SME customers. Credit facilities are subject to review at least annually depending on credit performance.

The Group also provides syndicated loans to larger corporate customers. The Group's participation in syndicated loans is dependent on the creditworthiness of borrowers, pricing and the Group's relationship with arrangers.

(B) Trade Finance

The trade finance services provided by the Group include import and export financing (including RMB businesses) covering issuance of letters of credit, inward bills loan/advance, inward collection loans, invoice financing loans, packing loans, outward bills negotiation, outward bills collections, invoice discounting loans, documents against acceptance and document against payment, export credit insurance and Hong Kong Export Credit Insurance Corporation ("**ECIC**")-supported export finance for SMEs. The Group also offers other trade finance services including shipping guarantee, issuance of guarantee and standby letters of credit to support corporate customers' various needs.

Retail Loans (Consumer, Mortgage, Investment- and Insurance-related Financing)

The Group provides its customers with a wide range of tailored mortgages for residential, commercial and industrial properties. The types of residential mortgages offered by the Group are divided mainly into the following types: (i) loans for the home financing schemes subsidised by the Hong Kong Housing Authority or Hong Kong Housing Society; (ii) loans for the purchase of other residential properties; and (iii) loans for refinancing mortgages.

The Group's general policy in relation to mortgage loans in Hong Kong is consistent with the guidelines established by the HKMA, and the Group is one of the participating financial institutions of the mortgages arrangement for residential flats in the private sector, the Hong Kong Housing Authority's Home Ownership Scheme/Tenants Purchase Scheme and the Hong Kong Housing Society's Flat-for-Sale Scheme Secondary

Market Flats. The Group also offers the Reverse Mortgage Programme of The Hong Kong Mortgage Corporation Limited, allowing successful applicants to use their residential property in Hong Kong as security to borrow from a participating bank. Borrowers will receive monthly payouts and continue to stay in their property for the rest of their life.

The Group also offers non-residential mortgage loans to its customers for commercial shops and industrial properties. In addition, the Group offers other consumer loans such as personal instalment loans and personal tax loans. Consumer loans and mortgage loans are principally made at variable rates of interest based on the Bank's prime rate or interbank offered rates plus or minus a margin depending on factors such as the relevant credit circumstances of the borrower, the borrower's relationship with the Group and the quality of the collateral. The Group also offers investment- and insurance-related financing such as shares overdraft facility based on securities holdings of a selection of recognised shares, unit trusts and bonds, and insurance premium financing.

The Group intends to grow its consumer loan and mortgage loan business by customising the loans offered to its customers and providing tailor-made services to its existing and potential customers.

Credit Cards

The Group offers a range of credit card products in Hong Kong with a total of more than 10 co-brand or affinity card programmes. The Group has a number of credit card options to satisfy its customers' personal and company purposes, including personal credit cards, business credit cards and co-branded credit cards, and will seek to continue to come up with initiatives aimed at attracting and retaining customers and to support its close partners. For example, the Group launched a co-branded credit card with The Council of St. Paul's Co-educational College and Shanghai Fraternity Association, and looks to cooperate with more institutions in the future.

Wealth Management

(A) Securities Trading

In relation to securities trading, the Group maintains its securities trading platform through its subsidiaries, Shacom Securities Limited and Shacom Futures Limited. For stock, the Group enables retail and corporate customers to place various types of orders through multiple trading channels.

As for futures, Shacom Futures Limited offers Hang Seng Index Futures, Mini-Hang Seng Index Futures, H-shares Index Futures and Mini H-shares Index Futures trading, and the Group aims to continue enhancing its capabilities in this area and maintain its competitive edge by providing timely new services.

(B) Investment Services

The Group offers a wide range of wealth management products and services, including structured products (such as currency-linked deposits), and other investment products created by third parties (such as unit trusts, bonds, equity-linked notes and equity-linked investments). The Group sells investment products by providing market information and product solutions, and also provides additional personalised services and tailor-made products for high net worth customers.

(C) Insurance Services

The Group provides a broad range of insurance products to meet the diverse needs of customers. Life insurance is mainly focused on long-term protection for customer to help them with family needs, mortgage protection, retirement planning, education funding, medical protection, estate planning and business continuity planning. Under General Insurance, the Group offers a wide range of personal line and commercial line products to retail clients and corporate clients respectively. Personal line products include Travel, Home and Domestic Helper Insurance whereas commercial line products are

Contractors' All Risks, Property All Risks, Marine Cargo, Third Party Liability, Commercial Motor, Employees' Compensation, and Group Medical Insurance.

Treasury

The Group conducts treasury operations for its trading and investment purposes such as foreign exchange, money market and capital market activities while also provides treasury products such as yield enhancement and hedging products to customers.

Within the Group, the treasury department of the Group is also responsible for carrying out the treasury activities set by the Asset and Liability Committee for balance sheet and liquidity management of the Group and overseeing the Group's interest rate and foreign exchange positions. It manages the funding positions, overall interest rate risk, intraday and daily cash flow of the Group, conducts foreign exchange trading on behalf of the Group and maintains regular presence in the market, keeps good relationships with correspondent banks which provide relevant services to the Group.

PRC and Overseas Operations

The Group has experienced growth in the businesses of its PRC branches and overseas branches including the Group's branches in the United States and the United Kingdom due to the development in outbound investments made by the Group's customers from Hong Kong and the PRC.

PRC Operations

The Group's PRC commercial lending operations are conducted through Shanghai and Shenzhen branches. In 1999, the Group set up its Shenzhen representative office, which was the Group's first branch in the PRC. In 2016, Shanghai Branch obtained RMB lending licence to help the Group further expand its presence in the PRC. The Group's PRC branches focus on corporate and SME banking business by offering a range of banking services including working capital loans, trade facilities as well as property backed loans.

In addition, the Tri-Bank Alliance provides the Group with new business opportunities and further strengthens the Group's development in the PRC by allowing it to offer more diverse products and higher quality banking and financial services to its customers in the PRC.

Overseas Operations

The Group's overseas operations are conducted through its branches in the United States and the United Kingdom. Since establishing its first U.S. branch in 1973 and its UK branch in 1980, the Group has provided banking services to individuals and corporate customers domiciled in or outside the United Kingdom and the United States, developing a significant and valued customer base in the local Chinese communities.

The Group's overseas branches are more focused on corporate banking business, offering working capital loans, property backed loans (namely residential mortgages, commercial property lending, hotel construction and operation loans) and high quality trade financing related services.

Customer Base

The Group has an extensive base of retail and corporate customers. The Bank has maintained good and long-standing relationships with many of the business groups, companies and retail customers in Hong Kong, and its customer base in the PRC and overseas in the United States and the United Kingdom has also expanded. Such extensive customer bases drive the growth and development of the Group's products across different business segments.

Insurance Coverage

The Group maintains insurance policies with comprehensive coverage for its properties including building structure and renovation, computer systems and money etc as well as public liability insurance, professional indemnity policy and directors' and officers' liability insurance to protect the legal liability of the Group from its operation. The Group also periodically reviews the insurance coverage to ensure protection is adequate and appropriate. The Group generally requires borrowers to obtain appropriate insurance coverage for certain types of security, such as residential premises, provided by them.

Sales and Distribution

The Group currently has the following distribution channels: branch network, ATMs, online and mobile banking and phone banking services. Leveraging on the Group's Tri-bank Alliance with Bank of Shanghai in the PRC and its parent bank, The Shanghai Commercial & Savings Bank in Taiwan, the Group will also continue its efforts to expand market coverage in the PRC. The Group will continue to build an integrated multi-channel distribution network to distribute its products and services by leveraging on its existing distribution channels, including its branch network and diversifying into other distribution channels.

Competition

The Hong Kong banking industry is well developed and the Group faces intense competition from many other Hong Kong banks and international banks. In addition, the banking industry in Hong Kong is a mature market and a number of competitors of the Group have enjoyed a long presence in this market.

The intensity of competition can adversely impact the pricing of certain products including investment and insurance products, home mortgage loans, credit cards, personal loans and corporate lending businesses.

To counter the effects of increased competition, the Group has actively pursued a strategy of diversifying and differentiating its product and service offerings and enhancing its fees and commission income, as well as pursuing additional technological solutions and service platforms to grasp new business opportunities. See "*Investment Considerations — Considerations relating to the Group — Significant competition in Hong Kong, United States, United Kingdom and the PRC banking industries could adversely affect the Group's profitability*" in this Offering Circular.

Related Party Transactions

A number of banking transactions were entered into with related parties by the Bank in the normal course of business. Related party transactions entered into by the Bank and related parties are conducted on arm's length terms at normal commercial rates.

Litigation

Neither the Bank nor any of its subsidiaries is currently involved in any material litigation, arbitration or similar proceedings and the Bank is not aware of any circumstances under which any of the same is pending or threatened.

Employees

As at 30 June 2022, the Group had a total of 1,796 employees, of which 1,610 were in Hong Kong, 70 in the PRC and 116 overseas.

The Group believes that it maintains a good relationship with its employees and has not experienced any material employment disputes. The Group strives to build an engaged workforce through maintaining the well-being of individuals and providing them with various benefits including life and medical insurance, retirement benefits and education subsidies.

SUBSIDIARIES, ASSOCIATES AND JOINT VENTURE OF THE BANK

Subsidiaries of the Bank

The Bank's subsidiaries are involved in the provision of banking-related financial services. Details of the Bank's subsidiaries and its effective equity interest in each, as at 30 June 2022, are set out in the table below:

Name of Company	Place of incorporation	Particulars of issued share capital	Percentage of ordinary share capital held (%)	Principal activities and place of operation
Shanghai Commercial Bank (Nominees) Limited	Hong Kong	100 ordinary shares	100%(1)	Nominee services, Hong Kong
Shanghai Commercial Bank Trustee Limited	Hong Kong	1,000 ordinary shares	60%(2)	Trustee services, Hong Kong
Shacom Futures Limited	Hong Kong	600,000 ordinary shares	100%(1)	Advising and dealing in futures contracts, Hong Kong
Shacom Investment Limited	Hong Kong	10,000 ordinary shares	100%(1)	Investment in Exchange Fund Bills and Notes, Hong Kong
Shacom Property Holdings (BVI) Limited	British Virgin Islands	2 ordinary shares of US$1 each	100%(1)	Property holding, United Kingdom
Shacom Property (NY), Inc.	United States of America	10 ordinary shares of US$1 each	100%(1)	Property holding, United States of America
Shacom Property (CA), Inc.	United States of America	10 ordinary shares of US$1 each	100%(1)	Property holding, United States of America
Shacom Assets Investments Limited	Hong Kong	10,000 ordinary shares	100%(1)	Investment in notes and bonds, Hong Kong
Infinite Financial Solutions Limited	Hong Kong	500,000 ordinary shares	100%(1)	I.T. application services provider, Hong Kong
Shacom Insurance Brokers Limited	Hong Kong	1,000,000 ordinary shares	100%(1)	Insurance broker, Hong Kong
Shacom Securities Limited	Hong Kong	2,000,000 ordinary shares(3)	100%(1)	Securities brokerage services, Hong Kong
Hai Kwang Property Management Company Limited	Hong Kong	2 ordinary shares	100%(1)	Property management, Hong Kong
Paofoong Insurance Company (Hong Kong) Limited	Hong Kong	500,000 ordinary shares	60%(2)	Insurance, Hong Kong
Right Honour Investments Limited	British Virgin Islands	1 ordinary share of US$1 each	100%(1)	Property holding, Hong Kong
Glory Step Westpoint Investments Limited	British Virgin Islands	1 ordinary share of US$1 each	100%	Property holding, Hong Kong
Silver Wisdom Westpoint Investments Limited	British Virgin Islands	1 ordinary share of US$1 each	100%	Property holding, Hong Kong
KCC 23F Limited	British Virgin Islands	1 ordinary share of HK$1 each	100%(1)	Property holding, Hong Kong

Name of Company	Place of incorporation	Particulars of issued share capital	Percentage of ordinary share capital held (%)	Principal activities and place of operation
KCC 25F Limited	British Virgin Islands	1 ordinary share of HK$1 each	100%[(1)]	Property holding, Hong Kong
KCC 26F Limited	British Virgin Islands	1 ordinary share of HK$1 each	100%[(1)]	Property holding, Hong Kong

Notes:

(1) Ordinary share capital is held directly by the Bank.

(2) 60% of ordinary share capital is held directly by the Bank and 40% of ordinary share capital is held by non-controlling interests in equity.

(3) On 27 September 2021, the share capital of Shacom Securities Limited increased by HK$100,000,000 to HK$200,000,000 and the Bank subscribed its new capital to maintain 100% equity interests and voting rights of Shacom Securities Limited.

Associates and Joint Venture of the Bank

As at 30 June 2022, the Group invested in three associates and one joint venture namely Bank Consortium Holding Limited, BC Reinsurance Limited, Hong Kong Life Insurance Limited and Joint Electronic Teller Services Limited with business partners to strengthen the business and service capabilities of the Group.

Protection of Depositors

The Bank is a member of the Deposit Protection Scheme which protects eligible deposits (being all types of ordinary deposits such as current accounts, savings accounts, secured deposits and time deposits with a maturity shorter than five years). The Deposit Protection Scheme compensates deposit holders with eligible deposits up to a limit of HK$500,000. On 24 March 2016, the Deposit Protection Scheme (Amendment) Ordinance 2016 (the "**2016 Amendment Ordinance**") came into effect. Amongst other things, a gross pay-out approach was 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.

SELECTED STATISTICAL AND OTHER INFORMATION

The selected statistical and other information set forth below relates only to the Group and has, except where otherwise indicated, been compiled as at and for each of the periods indicated below, and should be read in conjunction with the information contained elsewhere in this Offering Circular, including "Description of the Bank".

LOANS AND ADVANCES PORTFOLIO

Overview

As at 30 June 2022, the Group's total outstanding gross loans and advances to customers were HK$97.4 billion, which represented approximately 41.8 per cent. of its total assets.

A substantial amount of the Group's loans for use in Hong Kong are in respect of loans and advances for property investment and development and home mortgages, which together, as at 30 June 2022, represented approximately 11.6 per cent. of the Group's total advances to customers (excluding trade bills and other eligible bills). Another substantial amount of the Group's advances are in respect of wholesale and retail trade, recreational activities and financial concerns, which amounted to approximately HK$6.4 billion as at 30 June 2022 and represented approximately 6.6 per cent. of the Group's total loans and advances to customers. As at 30 June 2022, the total amount of loans for use outside Hong Kong, which mainly comprises loans provided by the PRC and overseas branches of the Group, amounted to approximately HK$45.4 billion and represented approximately 46.9 per cent. of the Group's total loans and advances to customers.

Breakdown by Industry Sector

The table below sets forth a summary of the Group's total gross loans and advances to customers (excluding trade bills and other eligible bills) by industry sector as at the dates indicated:

	31 December 2019		31 December 2020		31 December 2021		30 June 2022[1]	
	HK$'000	*% covered by collateral*	*HK$'000*	*% covered by collateral*	*HK$'000*	*% covered by collateral*	*HK$'000*	*% covered by collateral*
Loans for use in Hong Kong								
Industrial, commercial and financial								
—Property development	4,870,738	53%	3,307,366	61%	2,944,336	53%	2,646,525	46%
—Property investment	6,878,804	93%	6,340,395	93%	5,048,305	94%	4,891,807	91%
—Financial concerns............	2,176,346	8%	2,157,314	7%	2,723,750	13%	2,661,295	20%
—Stockbrokers	460,367	20%	817,691	74%	424,980	88%	184,600	100%
—Wholesale and retail trade .	2,199,875	47%	1,696,627	48%	1,337,980	54%	1,234,405	61%
—Manufacturing..................	1,253,394	71%	1,113,524	63%	898,676	66%	842,484	65%
—Transport and transport equipment	415,212	96%	638,595	59%	593,337	57%	393,668	34%
—Recreational activities	526,287	85%	2,442,598	18%	2,239,583	11%	2,482,408	13%
—Information technology — telecommunication	85,777	70%	4,884	100%	4,773	100%	4,815	100%
—Hotels, boarding houses and catering..........................	1,912,016	90%	2,089,880	91%	1,950,340	91%	2,190,470	91%
—Others...............................	14,030,765	58%	13,422,363	58%	12,573,081	57%	15,868,544	41%
Individuals								
—Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme or	82,168	100%	73,510	100%	64,374	99%	59,499	100%

	31 December 2019		31 December 2020		31 December 2021		30 June 2022[(1)]	
	HK$'000	*% covered by collateral*	*HK$'000*	*% covered by collateral*	*HK$'000*	*% covered by collateral*	*HK$'000*	*% covered by collateral*
their respective successor schemes................................								
—Loans for the purchase of other residential properties	4,066,948	100%	4,199,453	100%	3,744,094	100%	3,600,047	100%
—Credit card advances	195,944	0%	166,720	0%	194,080	0%	157,670	0%
—Others................................	7,205,968	93%	7,151,373	98%	6,673,119	96%	5,990,104	96%
Trade finance	7,894,868	68%	7,941,981	61%	8,763,904	58%	8,101,954	59%
Loans for use outside Hong Kong	44,558,560	86%	47,743,633	85%	45,758,582	87%	45,365,136	87%
Total.....................................	98,814,037	77%	101,307,907	77%	95,937,294	76%	96,675,431	73%

Note:

(1) This information has been extracted from the unaudited supplementary financial information in the published interim financial disclosure statement of the Group for the six months ended 30 June 2022.

Breakdown by Geographical Location

The table below sets forth a summary of the Group's total gross loans and advances to customers (excluding trade bills and other eligible bills) by geographical location after taking into account of any transfer of risk, as at the dates indicated.

	Gross loans and advances to customers	**Stage 3 loans and advances**	**Loans and advances overdue for over three months**	**Total Stage 3 credit impairment allowances**	**Total Stage 1 and Stage 2 credit impairment allowances**
			(HK$'000)		
As at 30 June 2022[(1)]					
Hong Kong..	59,332,024	132,475	63,144	26,913	354,891
Mainland China..	5,781,176	276,357	276,357	82,959	15,019
United States	27,568,856	415,632	256,625	—	45,094
Others...	3,993,375	—	—	—	19,091
	96,675,431	824,464	596,126	109,872	434,095
As at 31 December 2021					
Hong Kong..	58,712,390	84,439	33,463	16,642	383,190
Mainland China..	6,367,989	73,629	73,629	36,815	17,204
United States	26,817,058	362,433	—	—	41,200
Others...	4,039,857	—	—	—	20,340
	95,937,294	520,501	107,092	53,457	461,934
As at 31 December 2020					
Hong Kong..	62,915,349	71,610	24,287	15,749	375,327
Mainland China..	7,155,458	71,751	47,907	29,914	14,799
United States	26,557,550	22,066	—	—	39,718
Others...	4,679,550	2,909	2,804	—	14,767
	101,307,907	168,336	74,998	45,663	444,611

	Gross loans and advances to customers	Stage 3 loans and advances	Loans and advances overdue for over three months	Total Stage 3 credit impairment allowances	Total Stage 1 and Stage 2 credit impairment allowances
			(HK$'000)		
As at 31 December 2019					
Hong Kong	62,849,908	496,248	427,878	20,500	311,987
Mainland China	7,383,429	60,507	44,913	17,435	11,155
United States	24,185,044	6,675	6,675	—	38,650
Others	4,395,656	3,348	—	—	13,264
	98,814,037	566,778	479,466	37,935	375,056

Note:

(1) This information has been extracted from the unaudited supplementary financial information in the published interim financial disclosure statement of the Group for the six months ended 30 June 2022.

Concentration of Loans and Advances to Customers

The Banking Ordinance generally prohibits any bank incorporated in Hong Kong from maintaining a financial exposure to any single counterparty or group of linked counterparties in excess of 25 per cent. of its Tier 1 capital.

Loans and Advances Analysis

As at 30 June 2022, approximately 84.3 per cent. of the Group's loans and advances to customers had a remaining maturity of five years or less.

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

	Repayable on demand	Up to 1 month	1–3 months	3–12 months	1–5 years	Over 5 years	Indefinite	Total
				(HK$'000)				
Loans and advances to customers								
As at 30 June 2022	4,031,333	7,630,494	9,893,772	22,348,818	37,753,115	14,470,699	716,878	96,845,109
As at 31 December 2021	5,201,816	7,675,293	11,257,024	20,169,940	33,087,724	15,046,431	3,467,998	95,906,226
As at 31 December 2020	5,257,392	6,469,279	9,334,628	28,433,906	34,579,492	17,039,591	133,651	101,247,939
As at 31 December 2019	5,493,495	5,566,299	10,536,189	22,349,213	36,015,386	18,201,327	611,782	98,773,691

As at 30 June 2022, 73 per cent. of the Group's loans and advances (excluding trade bills and other eligible bills) were secured by collateral. The principal collateral types for loans and advances are mortgages over residential properties, charges over business assets such as premises, inventory and accounts receivable and charges over bank deposits and financial instruments such as debt securities and equities. The Group also receives guarantees from guarantors with better financial strength and creditworthiness in relation to certain of its advances to provide credit risk mitigation.

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

Asset Quality

Overview

The performance of the Hong Kong economy is heavily dependent on the property sector, and, as at 30 June 2022, property-related lending in Hong Kong accounted for approximately 11.5 per cent. of the Group's total advances to customers (including trade bills and other eligible bills). As a result, the Group's asset quality is vulnerable to deflation in property prices. The ability of borrowers to make timely repayment of their advances may be adversely affected by rising interest rates or a slowdown in economic growth. The Group's impaired loans amounted to HK$824.5 million or approximately 0.85 per cent. of the Group's total advances to customers.

Loans and Advances Classification

The Group has established control systems that enable the Group to identify, monitor and determine loan loss provisions in a timely manner. In order to measure loan default probabilities and track down credit risk migration, the Group adopted a loan classification system which complies with the HKMA's guidelines. Set out below are the five categories graded in accordance with the HKMA's guidelines.

Grade	Loan	Description
1	"Pass"	Borrowers are current in meeting commitments and full repayment of interest and principal is not in doubt.
2	"Special Mention"	Borrowers are experiencing deficiencies and potential weakness such that if adverse conditions persist, loss of principal or interest for the Bank may occur.
3	"Substandard".....................	Borrowers are displaying a definable weakness that is likely to jeopardise repayment, including rescheduled loans and loans where some loss of principal or interest is possible after taking into account the net realisable value of security.
4	"Doubtful"	Collection in full is improbable and the Group expects to sustain a loss of principal and/or interest after taking into account the net realisable value of security.
5	"Loss"	Considered uncollectible after exhausting all collection efforts such as realisation of collateral, initiation of legal proceedings and need to be fully or partially written off.

Grades 1 and 2 loans are considered to be performing loans, while grades 3 to 5 are classified.

The Group reviews its loan portfolios to assess impairment at least on a monthly basis. In grading loans, the Group considers relevant factors including: (a) the general economic outlook; (b) the borrower's cash flow and expected cash flow; (c) the borrower's financial condition; (d) the management and operation of the borrower's business; (e) the borrower's experience in his/ her business and future business plans; (f) market conditions affecting the borrower's industry; and (g) the borrower's borrowing and repayment records with the Group and with other banks. Loans are reviewed on an ongoing basis and by periodic reviews when the appropriateness of the assigned loan grade and impairment level, if any, is re-examined. The Group also considers relevant factors such as: (a) type of advance; (b) seniority of the advance; and (c) credit mitigation such as collateral and guarantee.

Impairment of Financial Assets

Since 1 January 2018, the Group has adopted HKFRS 9. Under this new standard, the Group assesses on a forward-looking basis expected credit loss ("**ECL**") associated with its financial assets carried at amortised cost and debt instruments measured at FVOCI and with the exposure arising from loan commitments and financial guarantee contracts.

The Group recognises 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.

The Group adopts a "three-stage" model in accordance with HKFRS9 for impairment based on changes in credit quality since initial recognition as summarised below:

- a financial instrument that is not credit-impaired at initial recognition is classified in "Stage 1" and has its credit risk continuously monitored by the Group;
- 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;
- if the financial instrument is credit-impaired, the financial instrument is then moved to "Stage 3";
- financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that result from default events possible within the next 12 months. Instruments in Stages 2 or 3 have their ECL measured based on ECL on a lifetime basis;
- ECL of financial instruments are measured by taking into consideration forward-looking information; and
- purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired at initial recognition. Their ECL is always measured on a lifetime basis (Stage 3).

(a) SICR

The Group considers a financial instrument to have experienced a significant increase in credit risk when one or more of the following quantitative or qualitative criteria have been met:

Quantitative criteria

- the borrower is more than 30 days past due on its contractual payments;
- the financial instrument is downgraded in the internal rating categories and there is an increase in Probability of Default ("**PD**") more than predetermined thresholds since initial recognition; and
- significant increase in credit risk since initial recognition with reference to external rating downgrade after initial recognition for treasury portfolio.

Qualitative criteria

- the financial instrument is downgraded to "Special Mention" in the Loan Classification.

(b) Definition of default and credit-impaired assets

The Group defines a financial instrument as being in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

Quantitative criteria

The borrower is more than 90 days past due on its contractual payments.

Qualitative criteria

The borrower meets the unlikely to pay criteria, which indicates the borrower is in significant financial difficulty. These are instances where:

- the financial instrument is restructured due to financial stress;
- the financial instrument is partially written off;
- the borrower is bankrupt;
- the borrower is unlikely to honour its credit obligation; or
- the defaulted instruments are tagged with "Substandard", "Doubtful" or "Loss" in the Loan Classification.

(c) 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. ECL are the discounted product of the 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.
- EAD is based on the amounts the Group expects to be owed at the time of default.
- LGD represents the Group'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.

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

- The calculation of ECL incorporates forward-looking information. The Group has performed historical analysis and identified the key economic variables impacting credit risk and ECL.
- These economic variables and their associated impact on the PD, EAD and LGD vary by financial instrument. Expert judgement has also been applied in this process.

Modification of loans

If the borrower is in financial difficulty, where the terms of the loan are modified and being substantially different to the original terms, the Group derecognises the original financial asset and recognises 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 purpose, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Group also assesses whether the new financial asset recognised 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 recognised in profit or loss as a gain or loss on derecognition.

Details of the Group's impaired loans are as follows:

	As at 31 December			As at 30 June
	2019	2020	2021	2022
		(HK$'000)		
Stage 3 loans	566,778	168,336	520,501	824,464
Percentage of total advances to customers	0.57%	0.17%	0.54%	0.85%
Stage 3 impairment allowances made in respect of such advances	37,935	45,663	53,457	109,872
Total value of collateral taken into account in respect of the assessment of Stage 3 impairment allowances	1,389,110	392,915	870,897	1,319,590

Debt Securities Investments

The Group's debt securities investments included listed and unlisted debt securities measured at amortised cost or FVOCI. As at 30 June 2022, the book value of these securities was HK$64,568 million, of which over 95 per cent. were of investment grade. These debt securities primarily included Hong Kong dollars, U.S. dollars, Renminbi and Australian dollars denominated bonds and notes.

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

	As at 31 December			As at 30 June
	2019	2020	2021	2022
		(%)		
Debt securities issued by:				
Central governments and central banks	15.1	13.3	11.1	11.5
Banks and other financial institutions	50.3	42.5	44.9	44.7
Corporate entities	34.5	39.8	39.3	39.1
Public sector entities	0.1	4.4	4.7	4.7
Total	100.0	100.0	100.0	100.0

The following table is a breakdown by credit rating of the Group's debt securities investments that are neither past due nor impaired:

	As at 31 December			As at 30 June
	2019	2020	2021	2022
AAA	2.2%	2.4%	5.3%	7.0%
AA– to AA+	25.1%	24.0%	20.8%	22.9%
A– to A+	53.2%	55.3%	58.0%	55.0%
BBB–to BBB+	12.5%	13.3%	10.7%	10.7%
Unrated	7.0%	5.0%	5.2%	4.4%

The following table is a breakdown of the Group's debt securities investments by remaining maturity:

	As at 31 December			As at 30 June
	2019	2020	2021	2022
Up to a month	6.2%	11.5%	5.0%	5.3%
1–3 months	16.7%	9.2%	10.9%	8.0%
3–12 months	34.3%	32.0%	31.1%	25.8%
1–5 years	37.1%	40.5%	48.4%	57.2%
Over 5 years	5.7%	6.8%	4.6%	3.7%
Undated	0.0%	0.0%	0.0%	0.0%

ASSET AND LIABILITY MANAGEMENT

Overview

The Group's objective on asset and liability management is to maximise its net interest income and return on assets and equity while providing for liquidity and effective risk management. Recommendations to management on liquidity, interest rate policy and other significant asset and liability management matters are made by the respective risk and control departments.

One of the key components of the Group's asset and liability management is the management of credit risk, liquidity risk and market risk. Periodic reports on risk exposure and risk management activities are submitted to the Executive Committee and Risk Committee through the Asset and Liability Committee, Credit Committee and Compliance and Operational Risk Management Committee, and ultimately to the Board for monitoring the risk management and internal control systems. The Group's risk management strategies, risk tolerance and risk appetite are reviewed by the Risk Committee and approved by the Board.

Market Risk

Market risk is the risk that interest rates, foreign exchange rates, equity or commodity prices will move relative to positions taken, resulting in profits or losses. In the ordinary course of business, the Group enters into various types of financial instruments, mainly foreign exchange and equity contracts, that comprise transactions initiated for the Group's own account and customer needs. The Group's positions are managed by the Treasury Division under the limits and guidelines laid down in the foreign exchange risk management policy and the policy on allocating transactions of financial instruments to the trading, non-trading or investment book, approved by the Executive Committee. The Risk Management Division is responsible for monitoring the transaction to ensure the activities are within the relevant limits and guidelines.

Foreign Exchange Risk

Foreign exchange risk is the risk that the holding of foreign currencies will affect the Group's position as a result of a change in foreign currency exchange rates. The Group takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Group's foreign exchange risk arises primarily from currency exposures originated by the Group's commercial banking businesses. The foreign exchange risk is managed by the Treasury Division and monitored by the Risk Management Division and the Asset and Liability Committee within position limits set in the foreign exchange risk management policy. Changes to the position limits are approved by the Executive Committee and reviewed by the Risk Committee on a regular basis.

The table below summarises the Group's exposure to foreign currency exchange rate risk as at the indicated timing:

	HKD	USD	RMB	Other	Total
As at 31 December 2019					
Assets	102,778,303	79,276,869	23,052,811	12,904,729	218,012,712
Liabilities	89,832,090	74,090,762	17,644,784	9,912,619	191,480,255
Net on-balance sheet position	12,946,213	5,186,107	5,408,027	2,992,110	26,532,457
Credit commitments	31,000,027	19,953,814	1,538,350	535,247	53,027,438

	HKD	USD	RMB	Other	Total
As at 31 December 2020					
Assets	91,505,661	94,155,402	23,281,935	13,058,902	222,001,900
Liabilities	94,274,830	71,143,599	18,457,922	10,133,340	194,009,691
Net on-balance sheet position	(2,769,169)	23,011,803	4,824,013	2,925,562	27,992,209
Credit commitments	31,204,672	17,687,076	1,917,747	406,455	51,215,950

	HKD	USD	RMB	Other	Total
As at 31 December 2021					
Assets	102,041,423	87,502,509	26,040,713	13,589,356	229,174,001
Liabilities	96,381,422	71,647,524	20,952,248	10,585,476	199,566,670
Net on-balance sheet position	5,660,001	15,854,985	5,088,465	3,003,880	29,607,331
Credit commitments	33,153,575	13,374,134	1,553,013	746,272	48,826,994

As at 31 December 2021, over 72.6 per cent. (2020: over 72.3 per cent.) of the net on-balance sheet position of the Group were denominated in HK dollars and U.S. dollars, and as these two currencies were closely pegged, the foreign exchange risk arising from the translation of foreign-currency denominated financial assets and financial liabilities into HK dollars is manageable.

Interest Rate Risk

The primary forms of interest rate risk in the banking book faced by the Group can be divided into three broad categories.

Gap risk is the risk arising from changes in the interest rates on instruments of different maturities. The extent of gap risk depends on whether changes to the term structure of interest rates occur consistently across the yield curve (parallel risk) or differentially by period (non-parallel risk). Parallel risk is fundamental to banking business and this risk is taken on the balance sheet as part of the strategy to improve earnings. It can, however, affect the income and economic value of the Group as interest rates fluctuate. Non-parallel risk materialises when unanticipated changes in the shape of the yield curve have adverse effects on the Group's income or economic value.

Basis risk arises from imperfect correlation between changes in the rates earned and paid on different instruments with otherwise similar repricing characteristics. As a result of these differences, the cash flows and earnings spread between assets, liabilities and off-balance sheet instruments of similar maturities or repricing frequencies will change.

Option risk arises from interest rate option derivatives or from option elements embedded in the Group's assets, liabilities and/or off-balance sheet instruments, where the customers can alter the level and timing of their cash flows. Option risk can be further characterised into automatic option risk and behavioural option risk. Automatic option risk arises from standalone instruments, such as exchange-traded and over-the-counter option contracts, or options explicitly embedded within an otherwise standard financial instrument, where the option will almost certainly be exercised if it is in the holder's financial interest to do so. Behavioural option risk arises from the flexibility embedded implicitly or within the terms of financial contracts, such that changes in interest rates may affect the behaviour of the customer.

The new standard on interest rate risk in the banking book as set out by the HKMA per Supervisory Policy Manual IR-1 became effective on 1 July 2019 to replace the non-statutory guideline "Interest Rate Risk Management" issued by the HKMA in 2002. This sets out six interest rate shock scenarios (namely interest yield curve parallel up, parallel down, steepener, flattener, short rate up and short rate down) for assessing the impact in economic value of equity and net interest income in respect of interest rate exposures arising from banking book positions.

As at 31 December 2019, the Group's exposure to interest rate risks was as follows:

(All major currencies including HKD)	**Negative impact in economic value of equity**	**Decrease/ (increase) in net interest income**
Scenario		
Parallel up	299,000	(279,000)
Parallel down	100,000	282,000
Steepener	25,000	
Flattener	84,000	
Short rate up	246,000	
Short rate down	70,000	
Maximum loss	299,000	282,000
Tier 1 Capital	27,572,305	

As at 31 December 2020, the Group's exposure to interest rate risks was as follows:

(All major currencies including HKD)	**Negative impact in economic value of equity**	**Decrease/ (increase) in net interest income**
Scenario		
Parallel up	1,179,000	(92,000)
Parallel down	—	94,000
Steepener	57,000	
Flattener	145,000	
Short rate up	616,000	
Short rate down	3,000	
Maximum loss	1,179,000	94,000
Tier 1 Capital	30,087,958	

As at 31 December 2021, the Group's exposure to interest rate risks was as follows:

(All major currencies including HKD)	Negative impact in economic value of equity	Decrease/ (increase) in net interest income
Scenario		
Parallel up	1,720,000	133,000
Parallel down	3,000	(132,000)
Steepener	6,000	
Flattener	472,000	
Short rate up	1,126,000	
Short rate down	10,000	
Maximum loss	1,720,000	133,000
Tier 1 Capital	32,124,445	

Liquidity Risk

Liquidity risk is the risk that the Group is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfil commitments to lend. The average liquidity maintenance ratio was approximately 58.4 per cent. as at 30 June 2022, which is above the statutory minimum ratio of 25 per cent.

The Group's liquidity management process, as carried out within the Group and monitored by management, includes: (a) day-to-day funding, managed by monitoring future cash flows to ensure that requirements can be met; (b) maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow; (c) monitoring liquidity maintenance ratios against internal and regulatory requirements; and (d) managing the concentration and profile of debt maturities. Management also monitors unmatched medium-term assets, the level and type of undrawn lending commitments, the usage of overdraft facilities and the impact of contingent liabilities such as standby letters of credit and guarantees.

The following table sets out the Group's assets and liabilities into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date.

	As at 30 June 2022							
	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
				(unaudited) *(HK$'000)*				
Assets								
Cash and balances with banks	9,145,593	28,369,202	—	—	—	—	—	37,514,795
Placements with banks	—	—	3,757,487	17,578,892	—	—	—	21,336,379
Loans and advances to customers	4,031,333	7,630,494	9,893,772	22,348,818	37,753,115	14,470,699	716,878	96,845,109
Financial assets at FVTPL	—	458,166	3,140	—	—	31,154	369,662	862,122
Derivative financial instruments	—	256,385	198,369	255,813	60,820	—	—	771,387
Investment securities at FVOCI	—	3,303,857	5,064,511	15,395,144	36,440,878	2,384,617	3,498,306	66,087,313

	As at 30 June 2022							
	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
				(*unaudited*) (*HK$'000*)				
Investment securities at amortised cost	—	119,987	102,036	1,244,610	509,448	—	—	1,976,081
Properties for sale	—	—	—	695,914	—	—	—	695,914
Investments in associates and joint venture	—	—	—	—	—	—	449,192	449,192
Properties and equipment	—	9,429	17,328	65,329	87,594	59,932	2,253,121	2,492,733
Investment properties	—	—	—	—	—	—	998,225	998,225
Deferred income tax assets	—	—	—	—	—	—	383,363	383,363
Other assets	827,338	718,540	70,986	266,279	430,789	42,334	3,520	2,359,786
Total assets	14,004,264	40,866,060	19,107,629	57,850,799	75,282,644	16,988,736	8,672,267	232,772,399
Liabilities								
Deposits and balances from banks	1,164,915	3,496,614	3,253,762	386,749	—	—	—	8,302,040
Deposits from customers	78,651,323	37,247,660	48,902,530	19,032,895	169,136	—	—	184,003,544
Derivative financial instruments	—	161,353	194,316	253,183	60,808	—	—	669,660
Subordinated debts	—	—	—	—	—	4,298,361	—	4,298,361
Other liabilities	301,868	1,114,843	236,753	467,569	91,898	59,802	—	2,272,733
Current income tax liabilities	—	—	—	249,054	—	—	—	249,054
Deferred income tax liabilities	—	—	—	—	—	—	5,241	5,241
Total liabilities	80,118,106	42,020,470	52,587,361	20,389,450	321,842	4,358,163	5,241	199,800,633
Net liquidity gap	(66,113,842)	(1,154,410)	(33,479,732)	37,461,349	74,960,802	12,630,573	8,667,026	32,971,766
Of which lease liabilities included in: Other liabilities	—	9,292	18,366	69,038	95,303	59,802	—	251,801

	As at 31 December 2021							
	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
				(*audited*) (*HK$'000*)				
Assets								
Cash and balances with banks	9,430,458	21,255,129	—	—	—	—	—	30,685,587
Placements with banks	—	—	6,246,221	9,232,458	—	—	—	15,478,679
Loans and advances to customers	5,201,816	7,675,293	11,257,024	20,169,940	33,087,724	15,046,431	3,467,998	95,906,226
Financial assets at FVTPL	—	—	64	3,133	31,981	1,648,097	420,658	2,103,933
Derivative financial instruments	—	46,094	141,229	107,847	22,160	—	—	317,330
Investment securities at FVOCI	—	3,953,939	8,543,850	24,383,839	37,015,680	3,603,537	3,938,148	81,438,993
Investment securities at amortised cost	—	—	101,838	218,788	1,253,009	—	—	1,573,635
Properties for sale	—	—	—	—	683,924	—	—	683,924
Investments in associates and joint venture	—	—	—	—	—	—	466,829	466,829
Properties and equipment	—	8,499	16,676	62,134	101,894	62,836	2,298,238	2,550,277

	As at 31 December 2021							
	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
				(audited) *(HK$'000)*				
Investment properties	—	—	—	—	—	—	1,002,672	1,002,672
Deferred income tax assets	—	—	—	—	—	—	55,610	55,610
Other assets	258,443	601,646	93,503	264,881	388,344	49,998	12,803	1,669,618
Total assets	14,890,717	33,540,600	26,400,405	54,443,020	72,584,716	20,410,899	11,662,956	233,933,313
Liabilities								
Deposits and balances from banks	1,160,491	3,067,515	4,315,193	489,351	—	—	—	9,032,550
Deposits from customers	79,024,715	34,199,465	47,228,378	22,895,655	239,032	—	—	183,587,245
Derivative financial instruments	—	63,484	70,074	95,366	22,161	—	—	251,085
Subordinated debts	—	—	—	—	—	4,269,682	—	4,269,682
Other liabilities	634,268	1,085,883	201,614	313,579	128,045	62,719	—	2,426,108
Current income tax liabilities	—	128,133	11,902	—	—	—	—	140,035
Deferred income tax liabilities	—	—	—	—	—	—	5,241	5,241
Total liabilities	80,819,474	38,544,480	51,827,161	23,793,951	389,238	4,332,401	5,241	199,711,946
Net liquidity gap	(65,928,757)	(5,003,880)	(25,426,756)	30,649,069	72,195,478	16,078,498	11,657,715	34,221,367
Of which lease liabilities included in: Other liabilities	—	8,989	17,610	66,753	110,862	62,719	—	266,933

	As at 31 December 2020							
	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
				(audited) *(HK$'000)*				
Assets								
Cash and balances with banks	11,558,058	18,437,196	—	—	—	—	—	29,995,254
Placements with banks	—	—	4,561,410	4,672,687	—	—	—	9,234,097
Loans and advances to customers	5,257,392	6,469,279	9,334,628	28,433,906	34,579,492	17,039,591	133,651	101,247,939
Financial assets at FVTPL	—	14,336	—	38,740	168,479	1,853,040	124,156	2,198,751
Derivative financial instruments	—	55,703	145,140	570,418	70,885	—	—	842,146
Investment securities at FVOCI	—	8,205,014	6,542,749	22,764,819	29,091,129	4,905,101	4,180,231	75,689,043
Investment securities at amortised cost	—	38,760	62,324	243,586	—	—	—	344,670
Properties for sale	—	—	—	—	591,418	—	—	591,418
Investments in associates and joint venture	—	—	—	—	—	—	443,480	443,480
Properties and equipment	—	10,102	19,628	80,803	154,158	69,756	2,322,709	2,657,156
Investment properties	—	—	—	—	—	—	1,010,526	1,010,526
Deferred income tax assets	—	—	—	—	—	—	27,668	27,668
Other assets	389,854	1,294,776	83,188	269,300	345,918	62,776	4,188	2,450,000
Total assets	17,205,304	34,525,166	20,749,067	57,074,259	65,001,479	23,930,264	8,246,609	226,732,148
Liabilities								

	As at 31 December 2020							
	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	(audited)							
	(HK$'000)							
Deposits and balances from banks	1,321,983	3,594,486	2,392,853	531,012	—	—	—	7,840,334
Deposits from customers	70,545,414	34,429,328	48,208,921	24,426,259	187,017	—	—	177,796,939
Derivative financial instruments	—	85,120	168,007	600,657	70,885	—	—	924,669
Subordinated debts	—	—	—	—	—	4,241,480	—	4,241,480
Other liabilities	516,898	1,705,154	368,077	372,273	173,027	70,329	511	3,206,269
Current income tax liabilities	—	97,820	19,967	—	—	—	—	117,787
Deferred income tax liabilities	—	—	—	—	—	—	109,871	109,871
Total liabilities	72,384,295	39,911,908	51,157,825	25,930,201	430,929	4,311,809	110,382	194,237,349
Net liquidity gap	(55,178,991)	(5,386,742)	(30,408,758)	31,144,058	64,570,550	19,618,455	8,136,227	32,494,799
Of which lease liabilities included in: Other liabilities	—	9,803	19,808	84,371	170,069	70,329	—	354,380

	As at 31 December 2019							
	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
	(audited)							
	(HK$'000)							
Assets								
Cash and balances with banks	8,634,242	25,494,372	—	—	—	—	—	34,128,614
Placements with banks	—	—	3,138,599	3,951,957	—	—	—	7,090,556
Loans and advances to customers	5,493,495	5,566,299	10,536,189	22,349,213	36,015,386	18,201,327	611,782	98,773,691
Financial assets at FVTPL	—	2,277	—	7,898	18,179	1,825,087	27,584	1,881,025
Derivative financial instruments	—	48,398	53,318	127,613	55,760	—	—	285,089
Investment securities at FVOCI	—	4,259,517	10,597,303	22,351,737	25,707,988	3,920,188	4,721,813	71,558,546
Investment securities at amortised cost	—	31,104	1,009,042	1,417,323	23,455	—	—	2,480,924
Properties for sale	—	—	—	—	449,462	—	—	449,462
Investments in associates and joint venture	—	—	—	—	—	—	417,663	417,663
Properties and equipment	—	10,318	19,363	76,806	175,116	78,583	2,339,828	2,700,014
Investment properties	—	—	—	—	—	—	1,017,148	1,017,148
Deferred income tax assets	—	—	—	—	—	—	28,115	28,115
Other assets	197,993	789,679	118,179	279,506	348,809	75,787	4,314	1,814,267
Total assets	14,325,730	36,201,964	25,471,993	50,562,053	62,794,155	24,100,972	9,168,247	222,625,114
Liabilities								
Deposits and balances from banks	1,260,751	6,018,335	3,585,042	813,482	—	—	—	11,677,610
Deposits from customers	60,399,842	39,696,628	43,196,509	28,885,935	259,602	—	—	172,438,516
Derivative financial instruments	—	49,274	52,804	134,761	55,760	—	—	292,599
Subordinated debts	—	—	—	—	—	4,257,647	—	4,257,647

	As at 31 December 2019							
	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
				(audited)				
				(HK$'000)				
Other liabilities	311,291	1,135,109	374,909	685,440	226,262	80,262	610	2,813,883
Current income tax liabilities	—	407,914	93,780	—	—	—	—	501,694
Deferred income tax liabilities	—	—	—	—	—	—	18,901	18,901
Total liabilities	61,971,884	47,307,260	47,303,044	30,519,618	541,624	4,337,909	19,511	192,000,850
Net liquidity gap	(47,646,154)	(11,105,296)	(21,831,051)	20,042,435	62,252,531	19,763,063	9,148,736	30,624,264
Of which lease liabilities included in: Other liabilities..	—	9,914	18,793	74,979	192,575	80,262	—	376,523

Risk Management and Credit Policies

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

Risk Management

The Group's activities expose it to a variety of financial risks and those activities involve analysis, evaluation, acceptance and management of some degree of risk or combination of risks. The Group recognises that taking risk is core to its financial business and the operational risks are an inevitable consequence of being in business. The Group's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Group's financial performance.

The Group has in place policies and procedures for the identification, measurement, control and monitoring of credit, liquidity, market, interest rate, foreign exchange and operational risks. One of the major functions of the Board of Directors is to ensure that the Group establishes policies, procedures and controls to manage the various types of risk it faces. The Board of Directors has delegated the supervision of major functional areas to the Risk Committee, the Executive Committee, the Asset and Liability Committee, the Credit Committee and the Compliance and Operational Risk Management Committee.

The Risk Management Division and Credit Division are responsible for monitoring the overall risk management of the Group's operations. Reconciliation procedures are also in place to ensure that the systems capture all necessary data. Prior to the implementation of any new product or service, various analyses, testing, development and planning will be performed and its proposal will be endorsed by the Product/Service Governance Committee and approved by Chief Executive. The Internal Audit Department is responsible for conducting independent review on the effectiveness of the Group's risk management and control environment.

Credit risk management

The Group takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss for the Group by failing to discharge an obligation. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration in the Group's portfolio, could result in losses that are different from those provided for at the reporting date.

The Group has in place credit review, monitoring and control systems including an effective loan classification system that identify, monitor, and determine impairment allowance in a timely manner. The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Limits on the level of credit risk by product, industry sector and by country are approved by the Board from time to time but at least annually.

The exposure to any one counterparty including banks and brokers is further restricted by sub-limits covering on- 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 managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations and by changing these lending limits where appropriate. The Group has in place effective monitoring and control systems to identify, monitor and address problem credits in an accurate and timely manner. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees. The Group further mitigates credit risk by entering into netting arrangements with counterparties such as banks with which it undertakes credit activities.

The Bank has been closely monitoring the situation and carrying out necessary evaluation to assess the level of expected credit loss arising from the adverse economic impact from the COVID-19 pandemic. Relief measures, including those initiated by the regulators and by the Bank such as Pre-approved Principal Payment Holiday Scheme, Special 100% Loan Guarantee under the SME Financing Guarantee Scheme and Principal Moratorium for Mortgage Loans, have been made available for eligible customers and credit assessment has been performed, and there has been no significant increase in credit risk and expected credit loss. The macro-economic variable forecasts have been reviewed and projected by the Bank's economists on a monthly basis to account for the possible evolvement of resulting economy, both within the period of pandemic and the potential recovery afterward, in Hong Kong and other major countries which the Bank's network covers. In addition, the Bank has also performed credit portfolio review to evaluate the credit quality of loans by assessing the customers' repayment ability, and management overlay has been quantified and provided for to cater for the credit quality deterioration identified. Additional measures with various monitoring tools have been applied to identify negatively impacted customers aimed to minimise potential credit loss.

Collateral

The Group employs a range of policies and practices to mitigate credit risk. The most traditional of these methods is the taking of security for funds advanced, which is a common practice. The Group implements guidelines on the acceptability of specific classes of collateral for credit risk mitigation. The Group will also seek for guarantee where appropriate. To minimise credit loss, the Group will seek additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances which are partially secured or unsecured.

Derivatives

The Group maintains strict control limits on net open derivatives positions (i.e. the difference between purchase and sale contracts), by both amount and term. At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets where their fair values are positive), which in relation to derivatives is only a small fraction of the contract or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements.

Credit-related commitments

The Group has issued credit-related commitments including guarantees and letters of credit. These instruments carry similar credit risk as loans. The Group monitors the term to maturity of credit-related commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Liquidity risk management

The Board is ultimately responsible for overseeing the Group's liquidity risk management structure. The Risk Committee is delegated by the Board to oversee the Group's liquidity risk management, including approval of liquidity risk management policies and risk limits. The Asset and Liability Committee is delegated by the Board to oversee the Group's liquidity strategy, policies and practices, liquidity costs, benefits and risks are incorporated in internal pricing, performance measurement and new product approval process for all significant activities, both on- and off- balance sheet. The Risk Management Division is responsible for the day-to-day liquidity risk management. The Group's liquidity is managed by the Treasury Division in accordance with the guidelines and procedures laid down in the liquidity risk management policy. Liquidity risk is managed with regard to a variety of factors, including liquidity maintenance ratio, core funding ratio, loan to deposit ratio, size of liquidity cushion, maturity mismatch profile, the diversity and stability of the deposit base and the ability to borrow in the interbank market to ensure that both the funding liquidity and market liquidity are properly handled.

An adequate stock of high quality liquid assets is maintained at all times, in order to enable the Group to meet deposit withdrawals, to repay interbank borrowings, and to make new loans and investments as and when required in a timely and cost-effective manner under both normal business conditions and emergency situations.

The Group conducts stress testing regularly to analyse liquidity risk. The Group's stress tests are conducted with hypothetical as well as historical assumptions. Both funding and market liquidity risks are assessed. Three stress scenarios including the institution-specific crisis, the general market crisis and the combined crisis are adopted with minimum survival period defined according to Supervisory Policy Manual LM-2 "Sound Systems and Controls for Liquidity Risk Management" of the HKMA.

With reference to the stress-testing results, the Group identifies potential vulnerability within the Group, and formulates a Contingency Funding Plan to describe the Group's strategy for dealing with any liquidity problem and the procedures for making up cash flow deficits in emergency situations. Significant changes to the Contingency Funding Plan are approved by the Risk Committee.

The Group also performs reverse stress-testing in accordance with the HKMA's SPM IC-5 "Stress-testing". It is a process of working backwards from a critical stress event and involves a mix of qualitative and quantitative analyses. The Group uses results of stress-testing and reverse stress-testing to strengthen resilience to liquidity stress. These are supplemented with early-warning triggers for the formulation of management actions and contingency funding plan to mitigate any potential stress and vulnerability which the Group might face.

Market risk management

The Group's positions are managed by the Treasury Division under the limits and guidelines laid down in the foreign exchange risk management policy and the policy on allocating transactions of financial instruments to the trading, non-trading or investment book approved by the Executive Committee. The Risk Management Division is responsible for monitoring the transactions to ensure the activities are within the relevant limits and guidelines.

Interest rate risk management

The Asset and Liability Committee is responsible for monitoring and management of the overall interest rate risk of the Group, reviewing the report on interest rate risk position and reporting regularly on interest rate risk management to the Executive Committee and Risk Committee. The Treasury Division is responsible for the day-to-day management of interest rate risk for the Group including branches of the Bank outside Hong Kong under the guidelines and limits approved by the Executive Committee. The Risk Management Division is responsible for monitoring the day-to-day management of the interest rate risk for the Group including branches of the Bank outside Hong Kong.

Foreign exchange risk management

The foreign exchange risk is managed by the Treasury Division and monitored by the Risk Management Division and the Asset and Liability Committee within position limits set in the foreign exchange risk management policy.

Operational risk management

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

The Compliance and Operational Risk Management Committee oversees the Group's operational risk to ensure the operations are in accordance with the controls and procedures laid down in the operational risk management policy approved by the Risk Committee. The Operational Risk Management Division is responsible for the central operational risk management function. Policies and procedures have been established to control exposures and to identify operational risk factors. Insurance policies are taken to mitigate unforeseeable operational risk. A Business Continuity Plan is established to ensure the Group's ability to operate on an ongoing basis and limit losses in the event of severe business disruption, particularly where the Group's physical, telecommunication, or information technology infrastructures have been damaged or made inaccessible.

Capital management

The Group's objectives when managing capital are as follows:

- To comply with the capital requirements under the Banking (Capital) Rules;
- To safeguard the Group's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders;
- To support the Group's stability and growth;
- To allocate capital in an efficient and risk-based approach to optimise risk adjusted return to shareholders; and
- To maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored daily by the Group's management, employing techniques based on the BCR. The required information is filed with the HKMA periodically. The regulatory capital requirements are strictly observed when managing economic capital.

The HKMA requires each bank or banking group to maintain a ratio of total regulatory capital to risk-weighted asset (the capital adequacy ratio) at or above the statutory minimum ratio. Subsidiaries of the Group are also subject to statutory capital requirements from other regulatory authorities, including the Securities and Futures Commission and the Office of the Commissioner of Insurance.

Fair value of financial assets and liabilities

For financial instruments traded in active markets, the determination of fair values of financial assets and financial liabilities is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges and broker quotes from Bloomberg and Reuters. For all other financial instruments, fair value is determined using valuation techniques. In these techniques, fair values are estimated from observable data in respect of similar financial instruments, using models to estimate the present value of expected future cash flows or other valuation techniques, using inputs (for example, FX rates, volatilities and counterparty spreads) existing at the end of each reporting period.

The Group uses widely recognised valuation models for determining fair values of non-standardised financial instruments of lower complexity, such as options or interest rate and currency swaps. For these financial instruments, inputs into models are generally market-observable.

For more complex instruments, the Group uses developed models, which are usually based on valuation methods and techniques generally recognised as standard within the industry. Valuation models are used primarily to value derivatives transacted in the over-the-counter market, unlisted debt securities (including those with embedded derivatives) and other debt instruments for which markets were or have become illiquid. Some of the inputs to these models may not be market observable and are therefore estimated based on assumptions. Management judgement and estimation are usually required for selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instrument being valued and selection of appropriate discount rates.

Internal Audit

The Group's internal audit function plays an important role as the third line of defence in reinforcing the "Three Lines of Defence" risk management structure of the Group. It provides independent and objective assurance to the Audit Committee and the Board as to whether the risk management and internal control systems of the Group are adequately maintained and effectively operated in compliance with applicable regulatory requirements and established internal processes through adopting a risk-based approach in its auditing activities according to the annual audit plan approved by the Audit Committee. It reports the review results to the Audit Committee regularly, and verifies the rectification and implementation effectiveness taken by the Group on the recommendations made by external auditors and regulatory bodies. To preserve the audit independence, the Audit Charter is established and approved by the Audit Committee to set out the authorities and responsibilities of the Group's internal audit function. The Group Chief Auditor reports directly to the Audit Committee.

Compliance

The Group's Legal and Compliance Division is to assist the Group in ensuring compliance with the statutory provisions and the legal and regulatory requirements applicable to the Group's activities. The Legal and Compliance Division also conducts compliance checks and provides advisory services to other business units of the Group in relation to legal and compliance matters.

BOARD OF DIRECTORS AND EXECUTIVES

The Bank is committed to maintaining high standards of corporate governance. To enhance the overall management quality of the Bank, the Board of Directors (the "**Board**") has put in place governance practices with a special emphasis on maintaining an effective Board, by focusing on leadership and control, sound business ethics and integrity in all business activities.

As at 30 June 2022, the Bank has followed the relevant guidelines set out in the Corporate Governance Code (the "**CG Code**") contained in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. The Bank, which is an authorized institution supervised by the HKMA under the Banking Ordinance, is hence subject to, and has followed, the Supervisory Policy Manual CG-1 on Corporate Governance of Locally Incorporated Authorized Institutions ("**SPM CG-1**") issued by the HKMA.

BOARD OF DIRECTORS

The Board is ultimately responsible for the operations and financial soundness of the Bank. The Board has also established Board-level committees with clear delegation of authority and formal terms of reference setting out the authorities, responsibilities and membership for the oversight of certain major functional areas.

As at 30 November 2022, the Board comprised 13 Directors, including seven Non-executive Directors, one Executive Director and five Independent Non-executive Directors, as set out below:

Name	Title
Mr. Stephen Ching Yen Lee...............................	Chairman & Non-executive Director
Mr. David Sek-chi Kwok, *FHKIB, FCIB*	Deputy Chairman, Managing Director & Chief Executive
Mr. Yih-pin Chen...	Non-executive Director
Mr. Yu Jin	Non-executive Director
Mr. John Con-sing Yung....................................	Non-executive Director
Mr. Jafar Altaf Amin..	Non-executive Director
Ms. Maria Pui Man Kiang.................................	Non-executive Director
Mr. Jun Ye	Non-executive Director
Mr. Johnson Mou Daid Cha	Independent Non-executive Director
Mr. Gordon Che Keung Kwong, *FCA*	Independent Non-executive Director
Mr. E. Michael Fung	Independent Non-executive Director
Mr. Charles Chi Man Ma...................................	Independent Non-executive Director
Mr. Sunny Yiu Tong Cheung.............................	Independent Non-executive Director

MR. STEPHEN CHING YEN LEE
Chairman and Non-executive Director

Mr. Lee has been a Director of the Bank since June 2004 and was elected as the Chairman in April 2016. He has been the Managing Director of The Shanghai Commercial & Savings Bank, Ltd. since 1979 and was appointed as Chairman in July 2021. Mr. Lee has extensive experience in aviation industry, finance, banking and investment. He is also Managing Director of Great Malaysia Textile Investments Private Limited and a Director of CapitaLand Limited and Temasek Holdings (Private) Limited. He was the Chairman of Singapore

Airlines Limited from 2006 to 2016 and a member of the Council of Presidential Advisers of Singapore from 2008 to 2020

MR. DAVID SEK-CHI KWOK, *FHKIB, FCIB*

Deputy Chairman, Managing Director and Chief Executive

Mr. Kwok joined the Bank in October 1971 and was appointed as Deputy Chairman in March 2020. He has been the General Manager of the Bank since July 2004 and was appointed as the Managing Director and Chief Executive in October 2007, and the Chairman of the Executive Committee in November 2007. He is also a director of Bank of Shanghai.

MR. YIH-PIN CHEN

Non-executive Director

Mr. Chen was appointed as a Director of the Bank in April 2006 and had served as an Alternate Director of the Bank from June 2004 to April 2006.

MR. YU JIN

Non-executive Director

Mr. Jin was appointed as a Director of the Bank in January 2016. He is also the Chairman of Bank of Shanghai and a Director of Shanghai United International Investment Limited.

MR. JOHN CON-SING YUNG

Non-executive Director

Mr. Yung was appointed as a Director of the Bank in May 2016 and had served as an Alternate Director of the Bank from March 2013 to May 2016. He is also the Managing Director and Consultant of The Shanghai Commercial & Savings Bank, Ltd., Chairman of AMK Microfinance Institutions Plc. and a Director of Nanyang Holdings Limited.

MR. JAFAR ALTAF AMIN

Non-executive Director

Mr. Amin was appointed as a Director of the Bank in October 2018. He is Executive Vice President, Regional President, Head of Corporate and Investment Banking, Asia Pacific, Wells Fargo & Company. He is also a Director of Wells Fargo International Banking Corporation, Wells Fargo Securities Asia Ltd. and Wells Fargo Securities (Japan) Co., Ltd.

MS. MARIA PUI MAN KIANG

Non-executive Director

Ms. Kiang was appointed as a Director of the Bank in October 2019. She is admitted as a solicitor both in Hong Kong Special Administrative Region and New South Wales, Australia. She is the Assistant General Counsel, Asia Pacific, Legal Department of Wells Fargo Bank N.A.

MR. JUN YE

Non-executive Director

Mr. Ye was appointed as a Director of the Bank in September 2021. He is the Chairman of Shanghai United International Investment Ltd. and Sino-US United MetLife Insurance Co., Ltd. He is also a Director and General Manager of Shanghai Alliance Investment Ltd. and a Director of Bank of Shanghai and Hua Hong Semiconductor Ltd.

MR. JOHNSON MOU DAID CHA

Independent Non-executive Director

Mr. Cha was appointed as a Director of the Bank in September 2001 and Chairman of the Nomination and Remuneration Committee of the Bank in April 2021. He is the Chairman of Hanison Constructions Holdings Ltd. and C.M. Capital Advisors (HK) Ltd., as well as a Director of Mingly Corporation, HKR International Limited and Million Hope Industries Holdings Ltd. Mr. Cha is a board member of Qiu Shi Science & Technologies Foundation. He is also a founding member of Moral Education Concern Group and a member of the Finance Committee and of the Council of The Hong Kong University of Science and Technology.

MR. GORDON CHE KEUNG KWONG, *FCA*

Independent Non-executive Director

Mr. Kwong was appointed as a Director of the Bank in August 2008 and Chairman of the Audit Committee of the Bank in January 2009. Mr. Kwong is a fellow member of the Institute of Chartered Accountants in England and Wales, and the Hong Kong Institute of Certified Public Accountants. He is also an Independent Non-executive Director of a number of locally listed companies, including Chow Tai Fook Jewellery Group Limited, FSE Lifestyle Services Ltd., Henderson Land Development Company Limited, Agile Group Holdings Ltd. and COSCO Shipping International (Hong Kong) Co. Ltd., and was an Independent Non-executive Director of Ping An Insurance (Group) Company of China, Ltd. from 2003 to 2009. He served as a Partner at PricewaterhouseCoopers from 1984 to 1998.

MR. E. MICHAEL FUNG

Independent Non-executive Director

Mr. Fung was appointed as a Director of the Bank in December 2015 and Chairman of the Risk Committee of the Bank in August 2017. He is the Chairman and Principal of SouthBay Investment Advisors Limited, an Independent Non-executive Director of Dickson Concepts (International) Limited and a member of Gleneagles Hong Kong Hospital Advisory Council. Mr. Fung was a member of the Financial Services Development Council, Hong Kong from January 2013 to January 2017, and retired as Chairman, Asia Private Bank of J.P. Morgan Chase Bank, N.A. at the end of 2015.

MR. CHARLES CHI MAN MA

Independent Non-executive Director

Mr. Ma was appointed as a Director of the Bank in October 2019 and Chairman of the Sustainability Committee of the Bank in April 2021. He is also a Consultant of mReferral Corporation (HK) Ltd. and former chief executive of China Construction Bank (Asia) Corporation Ltd., Macau Chinese Bank Ltd. and Bank of Shanghai (Hong Kong) Ltd.

MR. SUNNY YIU TONG CHEUNG

Independent Non-executive Director

Mr. Cheung was appointed as a Director of the Bank from July 2014 to December 2015 and was re-appointed as a Director of the Bank in March 2021. He was appointed as Chairman of the Digital Transformation Committee of the Bank in April 2021. He is also the former chief executive officer of Octopus Holdings Ltd. and Octopus Cards Ltd. He is an Independent Non-executive Director of TransUnion Credit Information Services Ltd., as well as a member of the Corruption Prevention Advisory Committee of The Independent Commission Against Corruption, the Entrepreneurship Committee Advisory Group of CyberPort and the Campaign Committee of The Community Chest of Hong Kong.

SENIOR MANAGEMENT (as at 30 November 2022)

MR. DAVID SEK-CHI KWOK

Deputy Chairman, Managing Director & Chief Executive

For biographical details of Mr. Kwok, please refer to "*Board of Directors and Executives — Board of Directors*".

MR. MONG-TING CHONG

Deputy Chief Executive, Chief of Corporate Banking Group

Mr. Chong joined the Bank in October 2015.

MR. RYAN YUK-LUNG FUNG

Deputy Chief Executive, Chief of Retail & Digital Strategy

Mr. Fung joined the Bank in May 2022.

MR. BURTON CHI-SHAN CHENG

Deputy Chief Executive, Chief of Information Technology & Operations

Mr. Cheng re-joined the Bank in August 1996.

MS. WENDY LI-CHIEN WENG

Chief Financial Controller

Ms. Weng joined the Bank in May 2012.

MR. RICKY CHI-WAI CHAN

Chief of Retail Banking

Mr. Chan joined the Bank in February 2014.

MR. EDMUND KIN-SANG LAI

Chief of Treasury

Mr. Lai joined the Bank in December 2014.

MR. TIMOTHY WAI-TAI LAW

Acting Chief Risk Officer

Mr. Law joined the Bank in May 2016.

MS. CLARA CHOR-HING FUNG

Chief of Human Resources

Ms. Fung joined the Bank in August 2016.

MR. JEROME CHEE-KEONG GOH

Chief of Property Development

Mr. Goh joined the Bank in November 2013.

MS. FENG TIAN

Chief Lending Officer, U.S. Branches

Ms. Tian joined the Bank in August 2018.

MS. MANDY MING-WAI CHAN

Chief Auditor

Ms. Chan joined the Bank in June 2000.

MS. MAY YUEN-LING KWOK
Corporate Secretary
Ms. Kwok joined the Bank in March 1994.

BOARD-LEVEL COMMITTEES

The Bank has established five Board-level committees, namely Executive Committee (and its sub-committee, Digital Transformation Committee), Audit Committee, Nomination and Remuneration Committee, Risk Committee and Sustainability Committee. Each of the Committees has defined terms of reference setting out its duties, powers and functions. The Committees report to the Board and, where appropriate, make recommendations on matters discussed. The Board, in addition to its overall supervisory role, retains specific responsibilities such as approving specific appointments, approving financial accounts and recommending dividend payments.

EXECUTIVE COMMITTEE

As at 30 June 2022, the Executive Committee consisted of one Executive Director, two Non-executive Directors and one Independent Non-executive Director. The current members of the Executive Committee are Mr. David Sek-chi Kwok (Chairman), Mr. Sunny Yiu Tong Cheung, Mr. Jun Ye and Mr. John Con-sing Yung. The Executive Committee has specific written Terms of Reference which deal clearly with its delegated authority and duties to operate as a general management committee under the delegated authority of the Board to oversee the management and performance of the Bank. The Executive Committee provides regular updates to the Board on the business day-to-day running of the Bank by way of presenting monthly reports on financial performance and quarterly progress reports on budgets.

DIGITAL TRANSFORMATION COMMITTEE

The Digital Transformation Committee was established in April 2021. The current members are Mr. Sunny Yiu Tong Cheung (Chairman), the Chief Risk Officer, Chief and Deputy Chief of Divisions or Head of Departments responsible for digital strategy, information technology & operations, retail banking, corporate banking and digital transformation of the Bank. It oversees the formulation and execution of the Bank's digital transformation strategies, also provides regular updates to the Executive Committee.

AUDIT COMMITTEE

The Audit Committee consists of one Non-executive Director and three Independent Non-executive Directors. The Chairman of the Audit Committee is an Independent Non-executive Director who possesses the appropriate accounting qualifications. The current members of the Audit Committee are Mr. Gordon Che Keung Kwong (Chairman), Mr. John Con-sing Yung, Mr. E. Michael Fung and Mr. Charles Chi Man Ma. The Audit Committee has specific written Terms of Reference which deal clearly with its delegated authority and duties to consider the nature and scope of audit reviews, as well as to review the Bank's financial statements, the findings of both internal and external auditors and the effectiveness of the internal control systems of the Bank.

NOMINATION AND REMUNERATION COMMITTEE

The Nomination Committee and the Remuneration Committee merged in April 2021 and was renamed as the Nomination and Remuneration Committee. The Nomination and Remuneration Committee consists of one Non-executive Director and two Independent Non-executive Directors. The current members are Mr. Johnson Mou Daid Cha (Chairman), Mr. Gordon Che Keung Kwong and Mr. Stephen Ching Yen Lee. The Nomination and Remuneration Committee has specific written Terms of Reference which deal clearly with its delegated authority and duties to consider the structure, size and composition of the Board and is responsible for recommending to the Board on matters relevant to appointments, re-appointments, removal and succession planning of Directors and Senior Management in accordance with the Bank's relevant policies, guidelines and business strategies. It also oversees the implementation of sound remuneration policy, including recommending to the Board remuneration of the Directors and Senior Management of the Bank, assisted by independent professional consultants where appropriate. The remuneration policy of the Group is reviewed by the Nomination and Remuneration Committee and approved by the Board. No Director or any of his/her associates is involved in deciding his/her own remuneration.

RISK COMMITTEE

The Risk Committee consists of four Independent Non-executive Directors. The current members of the Risk Committee are Mr. E. Michael Fung (Chairman), Mr. Johnson Mou Daid Cha, Mr. Gordon Che Keung Kwong and Mr. Charles Chi Man Ma. The Risk Committee has specific written Terms of Reference which deal clearly with its delegated authority and duties to oversee and review the Bank's high-level related matters and make recommendations to the Board on risk management strategies as well as risk tolerance and risk appetite of the Bank.

SUSTAINABILITY COMMITTEE

The Sustainability Committee, established in April 2021, consists of one Independent Non-executive Director, one Non-executive Director, Chief Executive and one Deputy Chief Executive. The current members of the Sustainability Committee are Mr. Charles Chi Man Ma (Chairman), Mr. John Con-sing Yung, Mr. David Sek-chi Kwok and Mr. Mong-ting Chong. The Sustainability Committee has specific written Terms of Reference which deal clearly with its delegated authority and duties to oversee the development and implementation of the Bank's sustainability strategy and to make recommendations to the Board on ESG related matters to ensure sustainable growth of the Bank.

REGULATION AND SUPERVISION

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

SUPERVISION OF AUTHORIZED INSTITUTIONS IN HONG KONG

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

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

(b) the HKMA 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 HKMA may require. The HKMA may in certain circumstances also require such information or any return submitted to it to be accompanied by a certificate or report of the authorized institution's auditors (approved by the HKMA for the purpose of preparing the report) confirming compliance with the main provisions of the Banking Ordinance and certain other matters;

(c) authorized institutions may be required to provide information to the HKMA regarding companies in which they have a 20.0 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;

(d) in addition, authorized institutions are obliged to report to the HKMA immediately of their likelihood to become unable to meet their obligations and, in the case of authorized institutions incorporated in Hong Kong, of the commencement of material civil proceedings;

(e) the HKMA may direct an authorized institution to appoint an auditor to report to the HKMA 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 HKMA may reasonably require;

(f) the HKMA 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 HKMA on a regular basis; and

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

EXERCISE OF POWERS OVER AUTHORIZED INSTITUTIONS

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

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

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

(c) if after an examination or an investigation, the HKMA 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 Banking Ordinance; or

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

(d) where the HKMA's power under section 22(1) of the Banking Ordinance to revoke the authorisation of an authorised institution is exercisable (as discussed below); and

(e) where the Financial Secretary advises the HKMA that he considers it in the public interest to do so.

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

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

(b) to direct the authorized institution to seek advice on the management of its affairs, business and property from an Advisor approved by the HKMA;

(c) 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

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

(a) the authorized institution no longer fulfils the criteria for authorization and the requirements for registration;

(b) 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;

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

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

(e) a person has become or continues to be a controller or chief executive or director of the authorised institution after the HKMA has made an objection;

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

(g) the authorized institution is engaging in practices likely to prejudice Hong Kong as an international financial centre or in practices (specified in the HKMA 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 Banking Ordinance, which are enforced by the HKMA 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 capital adequacy ratio ("**CAR**") of at least 8.0 per cent., calculated as the ratio (expressed as a percentage) of its capital base to its risk-weighted exposure as more fully described below. In relation to an authorized institution with subsidiaries, the HKMA may require the ratio to be calculated on a consolidated basis, or on both a consolidated and an unconsolidated basis, or on a consolidated basis only in respect of such subsidiaries of the authorized institution as may be specified by the HKMA. The HKMA 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 HKMA immediately of a failure to maintain the required capital adequacy ratio and to provide the HKMA with such particulars as it may require. It is an indictable offence not to do so, and the HKMA is entitled to prescribe remedial action.

The capital base of 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:

(a) 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);

(b) multiplying the credit conversion factors to various off-balance sheet items (including but not limited to direct credit substitutes, trade-related contingencies, forward asset purchase, other commitments, exchange rate contracts, interest rate contracts and securities financing transactions) to determine their credit equivalent amount;

(c) aggregating the amounts determined pursuant to (a) and (b); and

(d) subtracting from the amount determined pursuant to (c) the value of general provisions not included in the capital base of the authorized institution and the certain amount of reserves on revaluation of real property in accordance with the Banking (Capital) Rules.

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 HKMA.

In December 2010 and June 2011, the Basel Committee issued the Basel III requirements to raise the quality, consistency and transparency of banks' capital base and new global liquidity standards. Among other things, Basel III will increase the minimum 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 requirements rising from 4 per cent. to 6 per cent. The total minimum capital requirement remains unchanged at 8 per cent. The initial stage of these proposed Basel III reforms has been implemented by the government of Hong Kong since the beginning of 2013, and the full implementation of the reform is expected to be completed by 2023. The HKMA has taken steps to implement Basel III in Hong Kong in accordance with the timetable of the Basel Committee.

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

(a) prescribe capital requirements for authorized institutions incorporated in Hong Kong 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) Rules set out the capital requirements applicable to authorised institutions in Hong Kong. These capital requirements were phased in over several years and include:

- the imposition of three minimum risk-weighted capital ratios, namely CET1 capital ratio, Tier 1 capital ratio and total CAR and a non-risk based leverage ratio requirement;
- the introduction of capital buffers, namely the capital conservation buffer, countercyclical capital buffer and in the case authorised institutions considered by the HKMA as systemically important, higher loss absorbency requirements;
- the introduction of the standardised approach for measuring counterparty credit risk exposures; and
- the introduction of Basel III criterions for capital instruments to qualify as regulatory capital, with transitional arrangements for any capital instruments issued prior to 1 January 2013 to phase out their inclusion in authorised institution's capital base over a 10 year period. Basel III liquidity, exposure limits and disclosure requirements have also been implemented in Hong Kong through (i) the Banking (Liquidity) Rules (Cap. 155Q) of Hong Kong, where authorised institutions are required to comply with requirements relating to the liquidity coverage ratio, the net stable funding ratio, the liquidity maintenance ratio and core funding ratio, depending on their categorisation, (ii) the Banking (Exposure Limits) Rules (Cap. 155S) of Hong Kong, effective 1 July 2019, which implements the Basel Committee on Banking Supervision's 2014 large exposures standards and updates on other exposure limits, and (iii) the Banking (Disclosure) Rules (Cap. 155M) of Hong Kong, which sets out certain disclosure requirements.

The Hong Kong Resolution Regime

The FIRO became effective on 7 July 2017. FIRO provides a range of tools to implement and execute the resolution of a failing within scope financial institutions. The HKMA is the relevant resolution authority in relation to the Bank.

The statutory objectives of the FIRO resolution regime in relation to financial institutions, such as the Bank, are: (1) to promote and maintain the stability and effectiveness of the Hong Kong financial system; (2) to protect deposits to no less an extent than they would be protected on a winding up of the financial institution; (3) to protect client assets to no less an extent than they would be protected on a winding up of the financial institution; and (4) subject to the above objectives, to contain the cost of resolution and protect public money.

The HKMA can exercise a number of powers to require within scope financial institutions, such as the Bank, to require proactive planning for resolution, remove impediments to resolution, navigate resolution and, where appropriate, recognise international resolution actions taken by resolution authorities outside Hong Kong.

Prior to initiating the resolution of a within scope financial institution, the HKMA must be satisfied that: (1) the financial institution has ceased or is likely to cease to be viable; (2) it is not reasonably likely that private sector action will be taken (outside resolution) that will result in the financial institution becoming viable within a reasonable period; and (3) the non-viability of the financial institution poses risks to the stability and effectiveness of Hong Kong's financial system and resolution will avoid or mitigate those risks.

Within scope financial institutions are required to include recognition of write-down or conversion in certain contracts, for example, clearing and settlement systems arrangements, netting arrangements, secured arrangements, structured finance arrangement and title transfer arrangements.

The HKMA has certain powers in relation to within scope financial institutions, for example the HKMA can:

- order the financial institution to share certain information;
- undertake a resolvability assessment at any time to determine whether a financial institution needs to take further steps to reduce impediments to resolution;
- impose a levy on within scope financial institutions within the same sector as any financial institution that fails, in order to fund the resolution of that failed financial institution;
- give notice for the financial institution to take certain measures to remove impediments to resolution (such as altering its group structure, assets, liabilities or operations);
- make bail-in orders, which allow it to, amongst other things, write off or conversion of the financial institution's Additional Tier 1 capital instruments or Tier 2 capital instruments, such as the Notes;
- do all things necessary or expedient to perform the functions of resolution authority under FIRO; and
- order the resolution of a within scope financial institution.

Certain liabilities are, however, excluded from the scope of resolution actions by the HKMA under FIRO, for example, secured liabilities (to the extent they are secured), short-term interbank liabilities and deposits.

Institutions that are subject to certain resolution tools (such as a write off or conversion of capital instruments) will automatically have their authorizations to carry on a regulated business suspended.

The Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules (Cap. 628B) of Hong Kong were also enacted in late-2018 to impose loss-absorbing capacity ("**LAC**") requirements on authorised institutions. Such LAC requirements are in addition to, and complement, regulatory capital requirements of the Banking (Capital) Rules and are intended to ensure that within-scope financial institutions have adequate LAC such that the failure of such institutions can be managed in an orderly way. However, the definitive LAC requirements that apply to a particular authorised institution will be determined depending on institution specific circumstances of that authorised institution in a way which supports the preferred resolution strategy of the authorised institution, and imposed in accordance with the LAC Rules, depending on institution-specific circumstances of that authorised institution.

Liquidity

Authorized institutions must maintain at all times a liquidity coverage ratio of not less than 100 per cent. in each calendar month, calculated as the ratio (expressed as a percentage) of the total weighted amount of a category 1 institution's high quality liquid assets (HQLA) to the total weighted amount of its total net cash outflows over 30 calendar days. In relation to an authorized institution with subsidiaries, the HKMA may require that ratio to be calculated on a consolidated basis, or both on a consolidated basis and an unconsolidated basis, or on a consolidated basis only in respect of such subsidiaries of the authorized institution as may be specified by the HKMA. An authorized institution has a duty to inform the HKMA if the ratio requirement is not fulfilled and provide it with such particulars of that contravention as it may require, and it is an indictable offence not to do so; the HKMA is entitled to prescribe remedial action. For the purpose of the liquidity ratio, in the case of an authorized institution which has places of business in Hong Kong and elsewhere, its places of business in Hong Kong are collectively treated as a separate authorized institution to which the liquidity ratio provisions would apply.

The detailed calculation methodology and instructions are set out in the supervisory policy manual of the HKMA.

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 (Cap. 155S) of Hong Kong (the "**BELR**") also provides that:

(a) 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 HKMA, that of their respective holding companies, subsidiaries or fellow subsidiaries of such holding companies); and

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

Restrictions on Investments in Land

Under the BELR, an authorized institution must at all times maintain a land exposure ratio (as defined in the BELR) not exceeding 50.0 per cent. and an adjusted land exposure ratio (as defined in the BELR) not exceeding 25.0 per cent. The HKMA 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 HKMA, 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 institutions to manage those risks and any other factors that the HKMA 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 HKMA agrees to a longer period). Shares held by virtue of underwriting and sub-underwriting commitments are, nevertheless, permitted provided the relevant shares are disposed of within seven working days or such longer period as the HKMA may agree.

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

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 HKMA. The HKMA is empowered by the Banking Ordinance to require financial and other information regarding any such overseas branch to be supplied to it.

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

SHAREHOLDERS, CHIEF EXECUTIVES AND DIRECTORS

Limitations on Shareholders

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

(a) 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

(b) 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

(c) 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 HKMA 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 HKMA of his proposal to that effect and the HKMA consents to his becoming such a controller or does not object within three months.

Within the three-month period, the HKMA may object to the applicant's proposal, unless it is satisfied that the applicant is a fit and proper person to become a controller; that depositors' or potential depositors' interests will not be threatened by that person being such a controller; and having regard to the applicant's likely influence on that institution as a controller, the 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 HKMA may also object to the continuation of a person as a controller on similar grounds as in respect of new controllers.

Where a person becomes a controller (by virtue of being able to exercise or control the exercise of certain voting power in 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 HKMA may notify the controller that until further notice, any specified shares are subject to one or more of the following restrictions:

(a) 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;

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

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

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

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

In the case of an indirect controller who does not have the approval of the HKMA, the person concerned is prohibited from giving directions or instructions to the directors of the 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 HKMA before becoming a chief executive and alternate chief executive.

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

SUPERVISION OF SECURITIES BUSINESS

The Securities and Futures Ordinance (Cap. 571) of Hong Kong (the "**SFO**"), which came into operation in April 2003, introduced a substantial change to the conduct of securities business by banks. Banks are no longer exempted from the relevant regulations when they engage in securities business. Instead they are required to apply for registration with the SFC, which means they will have to meet the Fit and Proper Criteria set by the SFC. Likewise, staff engaged by banks in securities business will have to meet the Fit and Proper Criteria applicable to staff of brokerage firms. It is a statutory condition of registration for banks that each member of staff engaged by them in securities business is a fit and proper person. Banks will also have to comply with the various regulatory requirements set by the SFC in relation to their securities business, including the subsidiary legislation and the business conduct codes. Under the SFO, banks and their securities staff will be subject to the same range of disciplinary actions that are applicable to brokers and their staff in case they are guilty of misconduct or otherwise not fit and proper.

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

TERMS AND CONDITIONS OF THE NOTES

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

The U.S.$350,000,000 6.375 per cent. Tier 2 Subordinated Notes due 2033 (each a "**Note**" and together, the "**Notes**") of Shanghai Commercial Bank Limited (the "**Issuer**") are constituted by, and have the benefit of, a trust deed (such trust deed as amended and/or supplemented and/or restated from time to time, the "**Trust Deed**") dated 28 February 2023 (the "**Issue Date**") and made between the Issuer and The Hongkong and Shanghai Banking Corporation Limited (the "**Trustee**", which expression shall include any successor as Trustee) as trustee for the Noteholders (as defined below). These terms and conditions (the "**Conditions**") include summaries of, and are subject to, the detailed provisions of the Trust Deed, which includes the form of the Notes. The Noteholders (as defined below) are entitled to the benefit of, and are bound by, and are deemed to have notice of, all of the provisions of the Trust Deed, and are deemed to have notice of those provisions applicable to them of the agency agreement (such agency agreement as amended and/or supplemented and/or restated from time to time, the "**Agency Agreement**") dated 28 February 2023 and made between the Issuer, The Hongkong and Shanghai Banking Corporation Limited as principal paying agent (the "**Principal Paying Agent**", which expression shall include any successor thereto) and as transfer agent (the "**Transfer Agent**", which expression shall include any successor thereto), The Hongkong and Shanghai Banking Corporation Limited as registrar (the "**Registrar**", which expression shall include any successor thereto), the other paying agents and transfer agents named therein and the Trustee. References to the "**Paying Agents**" include the Principal Paying Agent and references to the "**Transfer Agents**" include the Transfer Agent. References to the "**Principal Paying Agent**", the "**Registrar**", the "**Transfer Agent**" and the "**Agents**" below are to the principal paying agent, the registrar, the transfer agent and the agents for the time being for the Notes. Copies of the Trust Deed and the Agency Agreement are available for inspection following prior written request and satisfactory proof of holding at all reasonable times during usual business hours at the principal office of the Trustee (being at the Issue Date at Level 24, HSBC Main Building, 1 Queen's Road Central, Hong Kong) and at the specified office of the Principal Paying Agent.

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

1 Form, Denomination and Title

(a) *Form and Denomination*: The Notes are issued in registered form in the denomination of U.S.$250,000 and integral multiples of U.S.$1,000 in excess thereof (referred to as the "**principal amount**" of a Note). The principal amount of a Note is subject to adjustments following the occurrence of a Non-Viability Event (as defined in Condition 5 (*Non-Viability Loss Absorption*)) in accordance with Condition 5 (*Non-Viability Loss Absorption*) and references in these Conditions to the "principal amount" of a Note shall mean the principal amount of a Note as so adjusted. The Notes are represented by registered certificates ("**Certificates**") and each Certificate shall represent the entire holding of Notes by the same holder. Each Certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the register of Noteholders which the Issuer will procure to be kept by the Registrar and at the office of the Issuer.

*Upon issue, the Notes will be represented by a Global Certificate (the "**Global Certificate**") deposited with 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 Notes are not issuable in bearer form.*

(b) *Title*: Title to the Notes passes only by registration in the register that the Issuer shall procure to be kept by the Registrar in accordance with the provisions of the Agency Agreement (the "**Register**"). Except as ordered by a court of competent jurisdiction or as required by law, the holder (as defined below) of any Note shall be deemed to be and may be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or an interest in it, any writing on it (or on the Certificate representing it) or its theft or loss (or that of the related Certificate)) and no person shall be liable for so treating the Noteholder.

In these Conditions, reference to "**Noteholders**" or "**holders**" in relation to any Notes shall mean the persons in whose name the Notes are registered in the Register (or in the case of a joint holding, the first name thereof).

2 Transfers of the Notes

(a) *Transfers of Interests in Notes*: One *or* more Notes may be transferred upon the surrender (at the specified office of the Registrar or any Transfer Agent) of the Certificate representing such Notes to be transferred, together with the form of transfer endorsed on such Certificate, (or another form of transfer substantially in the same form and containing the same representations and certifications (if any), unless otherwise agreed by the Issuer), duly completed and executed and any other evidence as the Registrar or such Transfer Agent may 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 Notes represented by one Certificate, a new Certificate shall be issued to the transferee in respect of the part transferred and a further new Certificate in respect of the balance of the holding not transferred shall be issued to the transferor. All transfers of Notes and entries on the Register will be made subject to the detailed regulations concerning transfers of Notes scheduled to the Agency Agreement. The regulations may be changed by the Issuer, with the prior written approval of the Registrar and the Trustee, and by the Registrar, with the prior written approval of the Trustee. A copy of the current regulations will be made available (free of charge to the Noteholders and at the Issuer's expense) by the Registrar to any Noteholder following prior written request and satisfactory proof of holding.

(b) *Delivery of New Certificates*: Each new Certificate to be issued pursuant to Condition 2(a) (*Transfers of Interests in Notes*) shall be available for delivery within seven business days of receipt of a duly completed form of transfer and surrender of the existing 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(b), "**business day**" means a day, other than a Saturday, Sunday or public holiday, 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).

(c) *Transfers Free of Charge*: Registration of a transfer of Notes and issuance of new Certificates shall be effected without charge by or on behalf of the Issuer or any Agent, but upon (i) payment (or the giving of such indemnity and/or security and/or pre-funding as the Issuer or any Agent may require) of any tax or other governmental charges that may be imposed in relation to such transfer; (ii) the Registrar or the relevant Transfer Agent being satisfied in its absolute discretion with the documents of title or identity of the person making the application; and (iii) the relevant Agent being satisfied that the regulations concerning transfer of Notes have been complied with.

(d) *Closed Periods*: No Noteholder may require the transfer of a Note to be registered (i) during the period of 15 days prior to (and including) the due date of any payment of principal or Interest in respect of the Notes 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 (as defined below).

So long as Notes 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 Note 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).*

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

3 Status, Qualification and Subordination of the Notes

(a) *Status of the Notes*: The Notes constitute direct, unsecured and subordinated obligations of the Issuer and shall at all times rank *pari passu* and without any preference among themselves. The rights and claims of the Noteholders are subordinated in the manner described below.

(b) *Qualification of the Notes:* The Notes are intended to qualify as Tier 2 capital under the Capital Regulations.

(c) *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 of the Noteholders to payment of principal and interest on the Notes, and any other obligations in respect of the Notes, shall rank (i) subordinate and junior in right of payment to, and of all claims of, (a) all unsubordinated creditors of the Issuer (including its depositors), and (b) all other Subordinated Creditors of the Issuer whose claims are stated to rank senior to the Notes or rank senior to the Notes 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, (a) the holders of Junior Obligations, and (b) holders of Tier 1 Capital Instruments (as defined below) of the Issuer, in each case, present and future, in the manner provided in the Trust Deed and, to the extent that such Noteholders did not receive payment in full of principal of and interest on the Notes, such unpaid amounts shall remain payable in full; *provided that* payment of such unpaid amounts shall be subject to the provisions under this Condition 3 and Condition 11(b) and Clause 7 (*Subordination*) and Clause 8.3 (*Enforcement*) of the Trust Deed.

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

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 as issued or implemented by the Monetary Authority.

"**Group**" means the Issuer and its Subsidiaries.

"**Junior Obligation**" means the Shares, and any other class of the Issuer's share capital and any instrument or other obligation (including without limitation any preference shares) issued, entered into or guaranteed by the Issuer that ranks or is expressed to rank junior to the Notes 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 as amended or superseded from time to time or any successor thereto.

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

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

"**Shares**" means the ordinary share capital of the Issuer.

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

"**Subsidiary**" of the Issuer means any entity whose financial statements at any time are required by law or in accordance with generally accepted accounting principles to be fully consolidated with those of the Issuer.

"**Tier 1 Capital Instruments**" means any instrument or other similar obligation issued, entered into or guaranteed by the Issuer that constitutes Tier 1 capital of (x) the Issuer, on an unconsolidated basis, or (y) the Group, on a consolidated basis, pursuant to the Capital Regulations. For the avoidance of doubt, Tier 1 Capital Instruments does not include Shares.

"**Tier 2 Capital Instruments**" means any instrument or other similar obligation issued, entered into or guaranteed by the Issuer that constitutes Tier 2 capital of (x) the Issuer, on an unconsolidated basis, or (y) the Group, on a consolidated basis, pursuant to the Capital Regulations.

"**Winding-Up**" means a final and effective order or resolution by a competent authority in the jurisdiction of the Issuer for the bankruptcy, winding up, liquidation, administrative receivership, or similar proceeding in respect of the Issuer.

(d) *Set-off*: Subject to applicable law, no Noteholder 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 Notes and each Noteholder shall, by virtue of being the Noteholder of any Note be deemed to have waived all such rights of such set-off, counter-claim or retention.

In the event that any Noteholder nevertheless receives (whether by set-off or otherwise) directly in a Winding-Up Proceeding (as defined below) in respect of the Issuer any payment by, or distribution of assets of, the Issuer of any kind or character, whether in cash, property or securities, in respect of any amount owing to it by the Issuer arising under or in connection with the Notes, other than in accordance with this Condition 3(d), such Noteholder shall, subject to applicable law, immediately pay an amount equal to the amount of such payment or discharge to the liquidator for the time being in the winding up of the Issuer for interest and each Noteholder, by virtue of becoming a Noteholder of any Note, 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

(a) *Interest*: The Notes 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, the Issue Date at the applicable Interest Rate, payable semi-annually in arrear on 28 February and 28 August in each year (each a "**Interest Payment Date**") in equal instalments, provided that in respect of the first Interest Payment Date on 28 August 2023 and on each Interest Payment Date thereafter up to but excluding the Reset Date, the interest payable shall be equal to U.S.$31.875 per Calculation Amount.

Unless otherwise provided in these Conditions, each Note will cease to confer the right to receive any interest from the due date for redemption unless, upon surrender of the Certificate representing such Note, 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 Note have been paid; and (b) seven days after the date on which the full amount of moneys payable in respect of such Note has been received by the Principal Paying Agent and notice to that effect has been given to the Noteholders in accordance with Condition 13 (*Notices*) except to the extent that there is failure in the subsequent payment to the relevant Noteholder under these Conditions.

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

(i) in respect of the period from, and including, the Issue Date to, but excluding, 28 February 2028 (the "**Reset Date**"), 6.375 per cent. per annum; and

(ii) in respect of the period from, and including, the Reset Date to, but excluding, 28 February 2033 (the "**Maturity Date**"), the Reset Interest Rate.

For the purposes of these Conditions:

"**Calculation Agent**" means the Principal Paying Agent and shall include any successor as calculation agent.

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

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

"**Comparable Treasury Issue**" means the U.S. Treasury security selected and appointed by the Independent Investment Bank 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 the second Calculation Business Day immediately preceding the Reset Date, the average of three Reference Treasury Dealer Quotations for the second Calculation Business Day immediately preceding the Reset Date.

"**Independent Investment Bank**" means a financial institution of international repute (which is appointed by the Issuer and notified in writing by the Issuer to the Calculation Agent and the Trustee);

"**Reference Treasury Dealer**" means each of the three nationally recognised investment banking firms selected and appointed by the Issuer (at its own cost) that are primary U.S. Government securities dealers.

"**Reference Treasury Dealer Quotations**" means with respect to each Reference Treasury Dealer, 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 Issuer by such Reference Treasury Dealer at 5.00 p.m. (New York City time), on the second Calculation Business Day immediately preceding the Reset Date and then notified in writing by the Issuer to the Calculation Agent and the Trustee.

"**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 2.400 per cent. per annum, which is calculated as (a) 6.521 per cent. per annum (being the yield of the Notes as at 21 February 2023), minus (b) 4.121 per cent.

For information purposes only, part (b) of the above definition is the rate expressed as a percentage per annum equal to the yield on U.S. Treasury securities having a maturity of five years that were utilised at the time of pricing, in accordance with customary financial practice, in pricing new issues of corporate debt securities with a maturity of five years as on 21 February 2023.

"**U.S. Treasury Rate**" means the rate in percentage per annum as notified by the Calculation Agent to the Issuer and the Trustee equal to the yield on U.S. Treasury securities having a maturity of five years as set forth in H.15(519) (at the website: http://www.federalreserve.gov/releases/h15/current/default.htm on the Issue Date) 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. (Hong Kong 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 by an Independent Investment Bank using a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for the second Calculation Business Day immediately preceding the Reset Date and notified to the Issuer, the Trustee and the Calculation Agent.

If there is no Comparable Treasury Price on the second Calculation Business Day immediately preceding the Reset Date for whatever reason, "**U.S. Treasury Rate**" means the rate in per cent. per annum as notified by the Independent Investment Bank to the Issuer, the Trustee and the Calculation Agent equal to the yield on U.S. Treasury securities having a maturity of five years as set forth in H.15(519) 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 Independent Investment Bank), 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 Independent Investment Bank).

(c) *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 Note 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 Note divided by the Calculation Amount, where:

(i) "**Calculation Amount**" means U.S.$1,000 subject to adjustments following occurrence of a Non-Viability Event; and

(ii) "**Day Count Fraction**" means, in respect of any period, the number of days in the relevant period divided by 360 calculated on a formula basis as follows:

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

where:

"Y_1" is the year, expressed as a number, in which the first day of the Calculation Period falls;

"Y_2" is the year, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;

"M_1" is the calendar month, expressed as a number, in which the first day of the Calculation Period falls;

"M_2" is the calendar month, expressed as a number, in which the day immediately following the last day included in the Calculation Period falls;

"D_1" is the first calendar day, expressed as a number, of the Calculation Period, unless (i) that day is the last day of February or (ii) such number would be 31, in which case D_1 will be 30; and

"D_2" is the calendar day, expressed as a number, immediately following the last day included in the Calculation Period, unless (i) that day is the last day of February but not the Maturity Date or (ii) such number would be 31, in which case D_2 will be 30.

The Calculation Agent will, prior to the Reset Date, calculate the Reset Interest Rate payable in respect of each Note. The Calculation Agent will cause the Interest Rate and the Reset Interest Rate determined by it to be promptly notified to the Issuer and the Principal Paying Agent.

All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of this Condition 4(c) by the Calculation Agent will (in the absence of manifest error) be binding on the Issuer, the Principal Paying Agent and the Noteholders and 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 unless caused directly by the fraud, gross negligence or wilful misconduct of the Calculation Agent.

(d) *Publication of Reset Interest Rate*: The Calculation Agent shall cause notice of the Reset Interest Rate to be notified to the Noteholders as soon as reasonably practicable in accordance with Condition 13 (*Notices*) after determination thereof.

(e) *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(e), 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 Notes under this Condition 5 with respect to the clearing and/or settlement of any Notes 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 Notes with respect to the Issuer under this Condition 5 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, upon or prior to the provision of a Non-Viability Event Notice, irrevocably (without the need for the consent of the Noteholders) reduce the then outstanding principal amount of, and cancel any accrued but unpaid interest in respect of, each Note (in each case in whole or in part) by an amount equal to the Non-Viability Event Write-off Amount per Note (such reduction and cancellation, and the reduction and cancellation or conversion of any other Subordinated Capital Instruments 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 (i) a similar notice be given in respect of other Subordinated Capital Instruments in accordance with their terms and (ii) concurrently and rateably with the Write-off of the Notes, the aggregate principal amount of such other Parity Capital Instruments is subject to a Write-off on a pro rata basis with the Notes. Any failure or delay in giving a Non-Viability Event Notice in respect of the Notes or a similar notice in respect of any other Subordinated Capital Instruments will not render the relevant Write-off invalid or affect such Write-off in any respect.

Any Write-off pursuant to this provision will not constitute an Event of Default under the Notes.

Any Note may be subject to one or more Write-offs in part (as the case may be), except where such Note has been Written-off in its entirety. Any references in these Conditions to principal in respect of the Notes shall thereafter refer to the outstanding principal amount of the Notes reduced by any applicable Write-off(s). In the case of a partial Write-off, a new Certificate shall be issued thereafter to each Noteholder in respect of the balance of the holding of Notes not Written-off.

Once the outstanding principal amount of, and any accrued but unpaid interest under, the Notes 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 Noteholder may exercise, claim or plead any right to any amount that has been Written-off, and each Noteholder shall, by virtue of his holding of any Notes, be deemed to have waived all such rights to such amount that has been Written-off.

Each Noteholder shall be deemed to have authorised, ratified, directed (in the case of the Trustee only) and consented to the Trustee and the Agents to take any and all necessary action to give effect to any Write-off following the occurrence of the Non-Viability Event.

The Trustee and the Agents shall not be: (a) responsible or liable to any Noteholder for monitoring or determining whether a Non-Viability Event has occurred or not, (b) responsible for verifying or calculating any amount in connection with a Non-Viability Event or for any Write-off of Notes made pursuant to the Issuer's directions, (c) responsible for preparing any Non-Viability Event Notice, (d) liable to the Noteholders or to any other person or the clearing systems (or its participants, members, broker-dealers or any other third parties) with respect to the notification and/or implementation of any Non-Viability Event by any of them in respect of such Notes.

The Trustee and the Agents have no responsibility for nor liability with respect to actions taken or not taken by the clearing systems or its participants or members or any broker — dealers with respect to the notification or implementation of the Write-off, nor any application of funds or delivery of notices prior to a Write-off, or with respect to the return of any amount that was paid to any Noteholder following a Non-Viability Event in excess of the amount that should have been paid to such Noteholder.

For the purposes of this Condition 5:

"**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 Noteholders, in accordance with Condition 13 (*Notices*), and to the Trustee and the Paying Agents 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 Note and (ii) each other Subordinated Capital Instrument on the Loss Absorption Effective Date in accordance with its terms; and

(c) 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 Notes. As a result, Noteholders will not be able to settle the transfer of any Notes from the commencement of the Suspension Period, and any sale or other transfer of the Notes that a Noteholder 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 Notes — Transfers scheduled to settle through Euroclear and Clearstream (the "Clearing Systems") are expected to be rejected if the scheduled settlement is after any suspension by the Clearing Systems of clearance and settlement of the Notes 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 Clearing Systems 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 Clearing Systems 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 or (ii) are settled through the Clearing Systems 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 interest and/or principal 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 Notes 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 Note will be calculated based on a percentage of the outstanding principal amount of that Note.

"**Parity Capital Instrument**" means any Parity Obligation which contains provisions relating to a write-down or conversion into ordinary shares in respect of its 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.

"**Subordinated Capital Instrument**" 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.

If a Non-Viability Event Notice has been given in respect of the Notes in accordance with this Condition 5, transfers of the Notes shall not be permitted during the Suspension Period (as defined in Condition 2(d) (Closed Periods)). From the date on which a Non-Viability Event Notice in respect of the Notes in accordance with this Condition 5 is provided by the Issuer to the end of the Suspension Period, the Registrar shall not register any attempted transfer of any Notes. As a result, such an attempted transfer will not be effective.

6 Hong Kong Resolution Authority Power

Notwithstanding any other term of the Notes, including without limitation Condition 5 (*Non-Viability Loss Absorption*), or any other agreement or arrangement, each Noteholder and the Trustee shall be subject, and shall be deemed to agree, be bound by and acknowledge that they are each subject, to having the Notes being written off, cancelled, converted or modified, or to having the form of the Notes 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 Notes;

(b) the conversion of all or a part of the outstanding principal amount of, or interest on, the Notes 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 Notes; and

(c) the amendment or alteration of the maturity of the Notes or amendment or alteration of the amount of interest payable on the Notes, 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, 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 Noteholders and the Trustee under the Notes 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 Notes or payment of interest on the Notes 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 Notes, the Issuer shall provide a written notice as soon as practicable regarding such exercise of the Hong Kong Resolution Authority Power to the Noteholders in accordance with Condition 13 (*Notices*) and to the Trustee and the Principal Paying Agent in writing.

Neither the reduction or cancellation, in part or in full, of the outstanding principal amount of, or interest on the Notes, 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 Notes shall constitute an Event of Default under Condition 11(a) (*Events of Default and Winding-up Proceedings*).

For the purposes of this Condition 6:

"**Hong Kong Resolution Authority Power**" means any power which may exist from time to time under the Ordinance or any other laws, regulations, rules or requirements relating to the resolution of 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 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 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.

"**Ordinance**" means the Financial Institutions (Resolution) Ordinance (Cap. 628) of Hong Kong as amended or superseded from time to time.

"**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.

See "Investment Considerations — Considerations Relating to the Notes — The operation of the resolution regime in Hong Kong may override the contractual terms of the Notes".

7 Payments

(a) *Payments in Respect of the Notes*:

(i) Payments of principal in respect of Notes shall be made against presentation and surrender of the relevant Certificates at the specified office of a Paying Agent and in the manner provided in Condition 7(a)(ii) (*Payments in Respect of the Notes*).

(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 Note shall be made in U.S. dollars by cheque drawn on a bank and mailed to the holder (or to the first named of joint holders) of such Note at its address appearing in the Register. Upon application by the holder to the specified office of the Registrar or the Transfer Agent before the Record Date, such payment of interest may be made by transfer to an account in the relevant currency maintained by the payee with a bank.

So long as the Global Certificate is held on behalf of Euroclear and Clearstream or any other clearing system, each payment in respect of the Global Certificate will be made to the person shown as the holder in the Register at the close of business of the relevant clearing system on the Clearing System Business Day before the due date for such payments.

(iii) Noteholders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due on a Note if the due date is not a business day, if the Noteholder is late in surrendering or cannot surrender its Certificate (if required to do so) or if a cheque mailed in accordance with Condition 7(a)(ii) (*Payment in Respect of the Notes*) arrives after the due date for payment.

(b) *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 "**Code**") or otherwise imposed pursuant to Sections 1471 through 1474 of the 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.

(c) *Appointment of Agents*: The Principal Paying Agent, the Registrar, the Transfer Agent and the Calculation Agent initially appointed by the Issuer and their respective specified offices are listed below. The Principal Paying Agent, the Registrar, the Transfer Agent and the Calculation Agent appointed under the Agency Agreement act solely as agents of the Issuer and do not assume any obligation or relationship of agency or trust for or with any Noteholder. The Issuer reserves the right at any time with the prior written approval of the Trustee to vary or terminate the appointment of the Principal Paying Agent, any other Paying Agent, the Registrar, any Transfer Agent or the Calculation Agent and to appoint additional or other Paying Agents or Transfer Agents or Calculation Agents, in each case in accordance with the Agency Agreement, provided that the Issuer shall at all times maintain (i) a Principal Paying Agent, (ii) a Registrar, (iii) a Transfer Agent, (iv) one or more Calculation Agent(s), and (v) such other agents as may be required by any other stock exchange on which the Notes may be listed, in each case, as approved in writing by the Trustee.

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

(d) *Non-Business Days*: If any date for payment in respect of any Note is not a business day, the holder shall not be entitled to payment until the next following business day nor to any interest or other sum in respect of such postponed payment. In this Condition 7, "**business day**" means a day (other than a Saturday or a Sunday 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 Note is required) in 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 New York City and Hong Kong.

8 Redemption and Purchase

(a) *Redemption at Maturity*: Unless previously redeemed or purchased and cancelled as provided below, the Issuer will redeem the Notes at their principal amount on the Maturity Date. The Notes may not be redeemed at the option of the Issuer other than in accordance with these Conditions.

(b) *Redemption for Tax Reasons*: Subject to Condition 8(g) (*Conditions for Redemption and Purchase in Respect of the Notes*), the Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days' notice to the Trustee, the Principal Paying Agent and the Registrar in writing and to the Noteholders in accordance with Condition 13 (*Notices*) (which notice shall be irrevocable and shall specify the date fixed for redemption), if the Issuer satisfies the Trustee immediately before the giving of such notice that (a) it has or will become obliged to pay additional amounts as described under Condition 9 (*Taxation*) 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 the 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 21 February 2023 and (b) such obligation will apply on the occasion of the next payment due in respect of the Notes and cannot be avoided by the Issuer taking reasonable measures available to it (a "**Withholding Tax Event**"); 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 Notes then due.

Prior to giving any notice of redemption pursuant to this Condition 8(b), the Issuer shall deliver to the Trustee (i) a certificate signed by one Authorised Signatory of the Issuer stating that the requirement referred to in (a) above of this Condition 8(b) will apply on the next Interest Payment Date and cannot be avoided by the Issuer taking reasonable measures available to it and (ii) a copy of the written consent of the Monetary Authority as referred to in Condition 8(g) (*Conditions for Redemption and Purchase in Respect of the Notes*); and the Trustee 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 Noteholders.

Notes redeemed pursuant to this Condition 8(b) will be redeemed at their outstanding principal amount together (if appropriate) 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 purposes of these Conditions, "**Authorised Signatory**" means, in relation to the Issuer, any director or any other officer of the Issuer who has been authorised by the Issuer to sign the certificates as contemplated under these Conditions on behalf of, and so as to bind, the Issuer and which the Issuer has notified in writing to the Trustee and the Agents as provided in the Agency Agreement.

(c) *Redemption of the Notes for Tax Deduction Reasons*: Subject to Condition 8(g) (*Redemption and Purchase — Conditions for Redemption and Purchase in Respect of the Notes*), the Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days' notice to the Trustee, the Principal Paying Agent and the Registrar in writing and to the Noteholders in accordance with Condition 13 (*Notices*) (which notice shall be irrevocable, subject to Condition 5 (*Non-Viability Loss Absorption*), and shall specify the date fixed for redemption), following the occurrence of a Tax Deduction Event.

For the purposes of this Condition 8(c), a "**Tax Deduction Event**" occurs if the Issuer satisfies the Trustee immediately before the giving of such notice that:

(i) in respect of the interest payable on the Notes, the Issuer is no longer, or will no longer be, entitled to claim a deduction in respect of computing its taxation liabilities in Hong Kong or any political subdivision or any authority thereof or therein having power to tax 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 or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after 21 February 2023; and

(ii) such non tax deductibility cannot be avoided by the Issuer taking reasonable measures available to it,

provided that: (A) the Conditions for redemption set out in Condition 8(g) (*Redemption and Purchase — Conditions for Redemption and Purchase in Respect of the Notes*) have been satisfied; and (B) no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would cease to be able to claim a tax deduction in respect of the interest payable on the Notes as provided in paragraph (i) above 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 or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after 21 February 2023.

Prior to the publication of any notice of redemption pursuant to this Condition 8(c) (*Redemption of the Notes for Tax Deduction Reasons*), the Issuer shall deliver to the Trustee (i) a certificate signed by one Authorised Signatory of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that: (A) the conditions precedent to the right of the Issuer so to redeem have occurred, and (B) such non tax deductibility cannot be avoided by the Issuer taking reasonable measures available to it and (ii) a copy of the written consent of the Monetary Authority as referred to in Condition 8(g) (*Redemption and Purchase — Conditions for Redemption and Purchase in Respect of the Notes*) and the Trustee 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 Noteholders.

Notes redeemed pursuant to this Condition 8(c) (*Redemption of the Notes for Tax Deduction Reasons*) will be redeemed at their outstanding principal amount together (if appropriate) with interest accrued to (but excluding) the date of redemption, subject to adjustment following the occurrence of a Non-Viability Event in accordance with Condition 5 (*Non-Viability Loss Absorption*).

(d) *Redemption of the Notes for Regulatory Reasons*: Subject to Condition 8(g) (*Conditions for Redemption and Purchase in Respect of the Notes*), the Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time on giving not less than 30 nor more than 60 days' notice to the Trustee, the Principal Paying Agent and the Registrar in writing and to the Noteholders in accordance with Condition 13 (*Notices*) (which notice shall be irrevocable and shall specify the date fixed for redemption) following the occurrence of a Capital Event.

For the purposes of this Condition 8(d), a "**Capital Event**" occurs if immediately before the Issuer gives the notice of redemption referred in this Condition 8(d), the Notes, after having qualified as such, will no longer qualify (in whole or in part) as Tier 2 Capital (or equivalent) of the Issuer (other than non-qualification solely as a result of any discounting or amortisation requirements as to the eligibility of the Notes for such inclusion pursuant to the relevant legislation and supervisory guidance in force from time to time), as a result of a change or amendment in (or any change in the application or official interpretation of) the relevant provisions of the Banking Ordinance (Cap. 155) of Hong Kong, the Capital Regulations, 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 superseded from time to time. 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 has occurred.

Prior to giving any notice of redemption pursuant to this Condition 8(d), the Issuer shall deliver to the Trustee (i) a certificate signed by one Authorised Signatory 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 (ii) a copy of the written consent of the Monetary Authority; and the Trustee 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 Noteholders.

Notes redeemed pursuant to this Condition 8(d) will be redeemed at their outstanding principal amount together (if appropriate) 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*).

(e) *Redemption at the Option of the Issuer*: Subject to Condition 8(g), the Issuer may, having given:

(i) not less than 15 nor more than 45 days' notice to the Noteholders in accordance with Condition 13 (*Notices*); and

(ii) not less than 15 days before the giving of the notice referred to in (i) above of this Condition 8(e), notice in writing to the Trustee, the Principal Paying Agent and the Registrar;

(which notices shall be irrevocable and shall specify the date fixed for redemption), redeem all but not some only of the Notes then outstanding on the Reset Date, at their outstanding principal amount together (if appropriate) 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*).

The Issuer does not provide any undertaking that it will redeem the Notes at any time.

(f) *Purchase and Cancellation*: Subject to Condition 8(g) (*Conditions for Redemption and Purchase in Respect of the Notes*), the Issuer and any of its Subsidiaries may, at any time, purchase Notes in the open market or otherwise at any price. The Notes so purchased, while held by or on behalf of the Issuer or any such Subsidiary, shall not entitle the holder to vote at any meetings of the Noteholders and shall not be deemed to be outstanding for, among other things, the purposes of calculating quorums at meetings of the Noteholders or for the purposes of Condition 12(a) (*Meetings of Noteholders, Modifications and Substitutions*).

All Certificates representing Notes purchased by or on behalf of the Issuer and any of its Subsidiaries shall be surrendered for cancellation to the Transfer Agent or Registrar and, upon surrender thereof, all such Notes 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 Notes shall be discharged.

(g) *Conditions for Redemption and Purchase in Respect of the Notes*: Notwithstanding any other provision in these Conditions, the Issuer shall not redeem any of the Notes (other than pursuant to Condition 11 (*Events of Default and Enforcement*)) and neither the Issuer nor any of its affiliates shall purchase any of the Notes 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 Capital Regulations, 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 superseded from time to time.

This provision shall not apply to the Issuer or any of its Subsidiaries holding the Notes in a purely nominee capacity.

9 Taxation

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

(a) *Other connection*: to, or to a third party on behalf of, a holder who is liable to such taxes, duties, assessments or governmental charges in respect of such Notes by reason of his having some connection with Hong Kong other than the mere holding of such Notes; or

(b) *Presentation more than 30 days after the Relevant Date*: presented (or in respect of which the Certificate representing it is presented) for payment more than 30 days after the Relevant Date except to the extent that the holder of it would have been entitled to such additional amounts on presenting it for payment on the thirtieth day.

Notwithstanding any other provision of these Conditions or the Trust Deed, any amounts to be paid on the Notes by or on behalf of the Issuer, will be paid net of any deduction or withholding imposed or required pursuant to an agreement described in the Code, or otherwise imposed pursuant to Sections 1471 through 1474 of the Code (or any regulations thereunder or official interpretations thereof) or an intergovernmental agreement between the United States and another jurisdiction facilitating the implementation thereof (or any fiscal or regulatory legislation, rules or practices implementing such an intergovernmental agreement) (any such withholding or deduction, a "**FATCA Withholding**"). Neither the Issuer nor any other person will be required to pay any additional amounts in respect of FATCA Withholding.

Neither the Trustee nor any Agent shall be responsible for paying any tax, duty, charges, withholding or other payment referred to in this Condition 9 or for determining whether such amounts are payable or the amount thereof, and none of them shall be responsible or liable for any failure by the Issuer, any Noteholder or any third party to pay such tax, duty, charges, withholding or other payment in any jurisdiction or to provide any notice or information to the Trustee or any Agent that would permit, enable or facilitate the payment of any principal, premium (if any), interest or other amount under or in respect of the Notes without deduction or withholding for or on account of any tax, duty, charge, withholding or other payment imposed by or in any jurisdiction.

As used in these Conditions, "**Relevant Date**" in respect of any Note means the date on which payment in respect of it first becomes due or (if any amount of the money payable is improperly withheld or refused) the date on which payment in full of the amount outstanding is made or (if earlier) the date falling seven days after that on which notice is duly given to the Noteholders that, upon further presentation of the Note (or the relevant Certificate) being made in accordance with these Conditions, such payment will be made, provided that payment is in fact made upon such presentation.

References in these Conditions to "**principal**" and/or "**interest**" shall be deemed to include any Additional Tax Amounts that may be payable under this Condition 9 or any undertaking given in addition to or in substitution for it under the Trust Deed.

10 Prescription

Claims against the Issuer for payment in respect of the Notes shall be prescribed and will become void unless made within a period of 10 years (in the case of principal) or five years (in the case of interest) from the Relevant Date (as defined in Condition 9 (*Taxation*)).

11 Events of Default and Enforcement

(a) *Events of Default and Winding-up Proceedings:*

(i) If default is made in the payment of any amount of principal or interest in respect of the Notes on the due date for payment thereof and such failure continues for a period of seven days in the case of principal or 14 days in the case of interest (each, an "**Event of Default**") then in order to enforce the obligations of the Issuer, the Trustee at its sole discretion may and, if so requested in writing by holders of at least 25 per cent. in aggregate principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution (as defined in the Trust Deed), shall (subject to the Trustee in any such case having been indemnified and/or provided with security and/or put in funds to its satisfaction) institute a Winding-Up Proceeding against the Issuer. Any Write-off pursuant to these Conditions will not constitute an Event of Default under the Notes.

(ii) 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 the Trustee at its sole discretion may and, if so requested in writing by holders of at least 25 per cent. in aggregate principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution, shall (subject to the Trustee in any such case having been indemnified and/or provided with security and/or put in funds to its satisfaction) give written notice to the Issuer declaring the Notes to be immediately due and payable, whereupon they shall become immediately due and payable at their outstanding principal amount together (if appropriate) with interest accrued to (but excluding) the date of actual payment, subject to adjustments following the occurrence of a Non-Viability Event in accordance with Condition 5, without further action or formality.

In these Conditions, "**Winding-Up Proceedings**" means, with respect to the Issuer, proceedings for the bankruptcy, liquidation, winding-up, administrative receivership, or other similar proceeding of the Issuer.

(b) *Enforcement:*

(i) Without prejudice to Condition 11(a) (*Events of Default and Winding-up Proceedings*), the Trustee may subject as provided below, at its discretion and without further notice, take such steps and/or actions and/or institute such proceedings against the Issuer if the Issuer fails to perform, observe or comply with any obligation, condition or provision relating to the Notes binding on it under these Conditions or the Trust Deed (other than any obligation of the Issuer for the payment of any principal or interest in respect of the Notes), provided that the Issuer shall not as a consequence of such steps, actions or proceedings be obliged to pay any sum or sums representing or measured by reference to principal or interest in respect of the Notes sooner than the same would otherwise have been payable by it.

(ii) The Trustee shall not be bound to take action as referred to in Conditions 11(a) (*Events of Default and Winding-up Proceedings*) and 11(b)(i) (*Enforcement*) or any other action under these Conditions or the Trust Deed unless (a) it shall have been so requested in writing by Noteholders holding at least 25 per cent. in aggregate principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution of the Noteholders and (b) it shall have been indemnified and/or secured and/or pre-funded to its satisfaction.

(iii) No Noteholder shall be entitled to proceed directly against the Issuer unless the Trustee, having become bound so to proceed, fails to do so within a reasonable period and such failure is continuing.

(iv) 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(a) (*Events of Default and Winding-up Proceedings*) and Conditions 11(b)(i) (*Enforcement*) and 11(b)(ii) (*Enforcement*) above or submitting a claim in the Winding-Up of the Issuer will be available to the Trustee or the Noteholders.

(v) No Noteholder shall be entitled either to institute proceedings for the Winding- Up of the Issuer or to submit a claim in such Winding-Up, except that if the Trustee, having become bound to institute such proceedings as aforesaid, fails to do so, or, being able and bound to submit a claim in such Winding-Up, fails to do so, in each case within a reasonable period and such failure is continuing, then any such Noteholder may, on giving an indemnity and/or security and/or pre-funding satisfactory to the Trustee in its discretion, in the name of the Trustee (but not otherwise), himself institute Winding-Up Proceedings and/or submit a claim in the Winding-Up of the Issuer to the same extent (but not further or otherwise) that the Trustee would have been entitled to do.

12 Meetings of Noteholders, Modifications and Substitutions

(a) *Meetings of Noteholders*: The Trust Deed contains provisions for convening meetings of Noteholders to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution (as defined in the Trust Deed) of a modification of any of these Conditions or any provisions of the Trust Deed and the Agency Agreement. Such a meeting may be convened by the Issuer or the Trustee and shall be convened by the Trustee if requested in writing to do so by Noteholders holding not less than 10 per cent. in aggregate principal amount of the Notes for the time being outstanding and subject to the Trustee being indemnified and/or secured and/or pre-funded to its satisfaction against all costs and expenses. The quorum for any meeting convened to consider an Extraordinary Resolution shall be two or more persons holding or representing more than 50 per cent. in aggregate principal amount of the Notes for the time being outstanding, or at any adjourned meeting two or more persons being or representing Noteholders whatever the aggregate principal amount of the Notes held or represented, unless the business of such meeting includes consideration of proposals, inter alia, (i) to amend the dates of maturity or redemption of the Notes or any date for payment of interest on the Notes, (ii) to reduce or cancel the principal amount of, or any premium payable on redemption of, the Notes, (iii) to reduce the rate or rates of interest in respect of the Notes or to vary the method or basis of calculating the rate or rates or amount of interest or the basis for calculating any interest in respect of the Notes, (iv) to vary any method of, or basis for, calculating the relevant redemption amount, (v) to vary the currency or currencies of payment or denomination of the Notes, (vi) to amend the subordination or loss absorption provisions in the Trust Deed or (vii) to modify the provisions concerning the quorum required at any meeting of Noteholders or the majority required to pass an Extraordinary Resolution, in which case the necessary quorum shall be two or more persons holding or representing not less than $66\frac{2}{3}$ per cent., or at any adjourned meeting not less than 25 per cent., in aggregate principal amount of the Notes for the time being outstanding. Any Extraordinary Resolution duly passed shall be binding on the Noteholders (whether or not they were present at the meeting at which such resolution was passed).

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

(b) *Modifications and Waivers*:

(i) *Modification*: The Trustee may (but shall not be obliged to) agree, without the consent of the Noteholders, to (a) any modification of any of the provisions of the Trust Deed or these Conditions that is of a formal, minor or technical nature or is made to correct a manifest error or to comply with any mandatory provision of law, and (b) any other modification (except as mentioned in the Trust Deed), and any waiver or authorisation of any breach or proposed breach, of any of the provisions of the Trust Deed and/or these Conditions that is in the opinion of the Trustee not materially prejudicial to the interests of the Noteholders. Any such modification, authorisation or waiver shall be binding on the Noteholders, and unless the Trustee otherwise agrees, such modification, authorisation or waiver shall be notified by the Issuer to the Noteholders as soon as practicable.

(ii) *Substitution*: The Trust Deed contains provisions permitting (but not obliging) the Trustee to agree, subject to such amendment of the Trust Deed and such other conditions as the Trustee may require, but without the consent of the Noteholders, to the substitution of the Issuer's successor in business or any Subsidiary of the Issuer or its successor in business or any holding company of the Issuer or any other subsidiary of any such holding company or their respective successor in business in place of the Issuer, or of any previous substituted company, as principal debtor under the Trust Deed and the Notes. In the case of such a substitution the Trustee may agree, without the consent of the Noteholders, to a change of the law governing the Notes and/or the Trust Deed provided that such change would not in the opinion of the Trustee be materially prejudicial to the interests of the Noteholders.

(c) *Entitlement of the Trustee*: In connection with the exercise of its functions, powers, rights and discretions (including but not limited to those referred to in this Condition 12 (*Meetings of Noteholders, Modifications and Substitutions*)), the Trustee shall have regard to the interests of the Noteholders as a class and shall not have regard to the consequences of such exercise for individual Noteholders and the Trustee, acting for and on behalf of Noteholders, shall not be entitled to require, nor shall any Noteholder be entitled to claim, from the Issuer or the Trustee any indemnification or payment in each case in respect of any tax consequence of any such exercise upon individual Noteholders.

13 Notices

Notices to the holders of the Notes shall be mailed to them at their respective addresses in the Register and deemed to have been given on the fourth weekday (being a day other than a Saturday or a Sunday or a public holiday) after the date of mailing and, so long as the Notes 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 Notes 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 Notes 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.

14 Indemnification of the Trustee

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility and to be paid or reimbursed for any liabilities incurred by it in priority to the claims of the Noteholders. The Trustee is entitled to enter into business transactions with the Issuer and any entity related to the Issuer without accounting for any profit.

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

Whenever the Trustee is required or entitled by the terms of the Trust Deed, the Agency Agreement or these Conditions to exercise any discretion or power, take any action, make any decision or give any direction, the Trustee is entitled, prior to exercising any such discretion or power, taking any such action, making any such decision or giving any such direction, to seek directions from the Noteholders by way of Extraordinary Resolution, and shall have been indemnified and/or provided with security and/or pre-funded to its satisfaction against all action, proceedings, claims and demands to which it may be or become liable and all costs, charges, damages expenses (including but not limited to legal expenses) and liabilities which may be incurred by it in connection therewith, and the Trustee is not responsible for any loss or liability incurred by any person as a result of any delay in it exercising such discretion or power, taking such action, making such decision, or giving such direction or certification where the Trustee is seeking such directions, or in the event that the directions sought are not provided by the Noteholders.

None of the Trustee or any of the Agents shall be responsible for the performance by the Issuer and any other person appointed by the Issuer in relation to the Notes of the duties and obligations on their part expressed in respect of the same and, unless it has written notice from the Issuer to the contrary, the Trustee and each Agent shall be entitled to assume that the same are being duly performed. None of the Trustee or any Agent shall be liable to any Noteholder, the Issuer or any other person for any action taken by the Trustee in accordance with the instructions of the Noteholders. The Trustee shall be entitled to rely on any direction, request or resolution of Noteholders given by Noteholders holding the requisite principal amount of Notes outstanding or passed at a meeting of Noteholders convened and held in accordance with the Trust Deed.

The Trustee shall have no obligation to monitor whether an Event of Default has occurred, and shall not be liable to the Noteholders or any other person for not doing so.

Each Noteholder shall be solely responsible for making and continuing to make its own independent appraisal and investigation into the financial condition, creditworthiness, condition, affairs, status and nature of the Issuer, and the Trustee shall not at any time have any responsibility for the same and each Noteholder shall not rely on the Trustee in respect thereof.

15 Replacement of Certificates

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

16 Contracts (Rights of Third Parties) Act 1999

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

17 Governing Law and Submission to Jurisdiction

(a) *Governing Law*: The Trust Deed, the Notes and any non-contractual obligations arising out of or in connection with the Trust Deed and the Notes are governed by, and shall be construed in accordance with, English law, save that the subordination provisions set out in Condition 3(c) (*Subordination*) and Condition 3(d) (*Set-off*) (and related provisions of the Trust Deed) shall be governed by, and construed in accordance with, the laws of Hong Kong.

(b) *Submission to Jurisdiction*: The Courts of England are to have jurisdiction to settle any disputes that may arise out of or in connection with the Trust Deed or any Notes and accordingly any legal action or proceedings arising out of or in connection with any Notes (a "**Proceeding**") may be brought in such courts. Each of the Issuer and the Trustee has in the Trust Deed irrevocably and unconditionally submitted to the jurisdiction of such courts.

(c) *Appointment of Process Agent*: The Issuer has irrevocably appointed Shanghai Commercial Bank Limited, London Branch at its registered office for the time being in England, currently at 65 Cornhill, London EC3V 3NB, United Kingdom as its agent for service of process in any proceedings before the English courts in relation to any Proceeding, and agrees that, in the event of such agent being unable or unwilling for any reason so to act, it will immediately appoint another person as its agent for service of process in England in respect of any Proceeding and will notify the Trustee of such new process agent within 30 days of the Issuer's such becoming unable or unwilling for any reason so to act. Nothing herein shall affect the right to serve process in any other manner permitted by law.

THE GLOBAL CERTIFICATE

The Global Certificate contains the following provisions which apply to the Notes 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 in paragraphs 1 to 6 below.

1 ACCOUNTHOLDERS

For so long as all of the Notes 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 Notes (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 Notes 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 Notes (and the expression "Noteholders" and references to "holding Notes" and to "holder of Notes" shall be construed accordingly) for all purposes other than with respect to payments on such Notes, the right to which shall be vested, as against the Issuer and the Trustee, 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 Note following its redemption or purchase by the Issuer will be effected by reduction in the aggregate principal amount of the Notes in the register of Noteholders and by the annotation of the appropriate schedule to the Global Certificate.

3 PAYMENTS

Payments of principal and interest in respect of Notes represented by the Global Certificate will be made upon presentation or, if no further payment falls to be made in respect of the Notes, 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. So long as the Notes are represented by the Global Certificate and the Global Certificate is held on behalf of a clearing system, the calculation for payments of principal and interest is made in respect of the total aggregate amount of the Notes represented by the Global Certificate.

Distributions of amounts with respect to book-entry interests in the Notes held through Euroclear or Clearstream will be credited, to the extent received by the Principal 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 Noteholder in the register of Noteholders 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 NOTICES

Notwithstanding Condition 13 *(Notices)*, so long as all the Notes are represented by the Global Certificate and the Global Certificate is held on behalf of a clearing system, notices to Noteholders 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.

6 TRANSFERS

Transfers of book-entry interests in the Notes 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.

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 Notes and does not purport to deal with the tax consequences applicable to all categories of investors, some of which (such as dealers in securities or commodities) may be subject to special rules. Persons considering the purchase of the Notes 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 Notes arising under the laws of any other taxing jurisdiction.

HONG KONG

Withholding Tax

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

Profits tax

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

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

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

(ii) interest on the Notes 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 Notes is received by or accrues to a financial institution (as defined in 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 Notes 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 authorised 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 circumstances. Provided no prospectus involving the issue of Notes is registered under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) of Hong Kong, the issue of the Notes is expected to constitute a deposit to which the above exemption 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 Notes 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 Notes will be subject to Hong Kong profits tax. Sums derived from the sale, disposal or redemption of the Notes will be subject to Hong Kong profits tax where received by or accrued to a person, other than a financial institution, who carries on a trade, profession or business in Hong Kong and the sum has a Hong Kong source unless otherwise exempted. The source of such sums will generally be determined by having regard to the manner in which the Notes 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

No Hong Kong stamp duty will be chargeable upon the issue or subsequent transfer of a Note.

THE PROPOSED EUROPEAN UNION FINANCIAL TRANSACTIONS TAX (THE "FTT")

On 14 February 2013, the European Commission published a proposal (the "**Commission's Proposal**") for a Directive for a common FTT in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the "**participating Member States**"). However, Estonia has since stated that it will not participate.

The Commission's Proposal has very broad scope and could, if introduced, apply to certain dealings in the Notes (including secondary market transactions) in certain circumstances. The issuance and subscription of Notes should, however, be exempt.

Under the Commission's Proposal the FTT could apply in certain circumstances to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in the Notes where at least one party is a financial institution, and at least one party is established in a participating Member State. A financial institution may be, or be deemed to be, "established" in a participating Member State in a broad range of circumstances, including (a) by transacting with a person established in a participating Member State or (b) where the financial instrument which is subject to the dealings is issued in a participating Member State.

However, the FTT proposal remains subject to negotiation between participating Member States. It may therefore be altered prior to any implementation, the timing of which remains unclear. Additional European Union Member States may decide to participate.

Prospective holders of the Notes are advised to seek their own professional advice in relation to the FTT.

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 Notes, including whether withholding would ever be required pursuant to FATCA or an IGA with respect to payments on instruments such as Notes, 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 Notes, 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 Notes 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. Noteholders should consult their own tax advisers regarding how these rules may apply to their investment in the Notes.

SUBSCRIPTION AND SALE

The Joint Lead Managers have, pursuant to a subscription agreement dated 21 February 2023 (the "**Subscription Agreement**"), severally agreed with the Issuer, subject to the satisfaction of certain conditions, to subscribe for the aggregate principal amount of the Notes.

The Issuer has agreed to pay to the Joint Lead Managers a combined commission in connection with their underwriting commitments in accordance with the Subscription Agreement. The Issuer has also agreed to indemnify the Joint Lead Managers against certain liabilities incurred in connection with the issue of the Notes. In addition, the Issuer has agreed to reimburse the Joint Lead Managers for certain of its expenses in connection with the issue of the Notes. 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 Notes issued.

The Issuer has agreed that, from the date of this Offering Circular until the date falling 30 days after the Issue Date, it will ensure that no other international offering of U.S. dollar-denominated subordinated debt instruments or subordinated debt securities (other than certificates of deposit and, for the avoidance of doubt, any financial products offered in the ordinary course of its business by the Issuer to its customers) issued or guaranteed by the Issuer are either placed or syndicated, directly or on its behalf, in any manner which might, in the opinion of the Joint Lead Managers (following consultation with the Issuer, if practicable), have a detrimental effect on the successful placement of the Notes.

The Joint Lead Managers and certain of their respective affiliates may purchase the Notes and be allocated the Notes for asset management and/or proprietary purposes but not with a view to distribution. The Joint Lead Managers and their respective affiliates may also purchase the Notes for their own accounts. In the ordinary course of their various business activities, the Joint Lead Managers and their respective affiliates may make or hold (on their own account, on behalf of clients or in their capacity as investment advisers) a broad array of investments and actively traded 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 and enter into other transactions, including credit derivatives (such as asset swaps, repackaging and credit default swaps) in relation thereto. Such transactions, investments and securities activities may involve securities and instruments of the Issuer or its subsidiaries, associates or associated companies, including the Notes, may be entered into at the same time in the secondary market and be carried out with counterparties that are also purchasers, holders or sellers of the Notes.

UNITED STATES

The Notes have not been and will not be registered under the Securities Act and may not be offered or sold within the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Each Joint Lead Manager has represented, warranted and undertaken that it has not offered or sold, and agreed that it will not offer or sell, any Notes constituting part of its allotment within the United States except in accordance with Rule 903 of Regulation S under the Securities Act. Accordingly, neither it, its affiliates nor any persons acting on its or their behalf have engaged or will engage in any directed selling efforts with respect to the Notes. Terms used in this paragraph have the meaning given to them by Regulation S under the Securities Act.

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 Notes to any retail investor in the European Economic Area. For the purposes of this provision, the expression "retail investor" means a person who is one (or more) of the following:

(a) a retail client as defined in point (11) of Article 4(1) of EU MiFID II; or

(b) a customer within the meaning of the Insurance Distribution Directive, where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of EU MiFID II.

UNITED KINGDOM

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

(a) it has not offered, sold or otherwise made available and will not offer, sell or otherwise make available any Notes to any retail investor in the United Kingdom. For the purposes of this provision, 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 the domestic law by virtue of the EUWA; or

  (ii) a customer within the meaning of the provisions of the FSMA and any rules or regulations made under the FSMA to implement 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;

(b) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of any Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer; and

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

HONG KONG

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

(a) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any Notes other than (i) to "professional investors" as defined in the SFO and any rules made under the SFO; or (ii) 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

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

Important Notice to CMIs (including private banks) pursuant to Paragraph 21 of the SFC Code

This notice to CMIs (including private banks) is a summary of certain obligations the SFC Code imposes on CMIs, which require the attention and cooperation of other CMIs (including private banks). Certain CMIs may also be acting as OCs for this offering and are subject to additional requirements under the SFC Code.

Prospective investors who are the directors, employees or major shareholders of the Issuer, a CMI or its group companies would be considered under the SFC Code as having an Association with the Issuer, the CMI or the relevant group company. CMIs should specifically disclose whether their investor clients have any Association when submitting orders for the Notes. In addition, private banks should take all reasonable steps to identify whether their investor clients may have any Associations with the Issuer or any CMI (including its group companies) and inform the Joint Lead Managers accordingly.

CMIs are informed that the marketing and investor targeting strategy for this offering includes institutional investors, sovereign wealth funds, pension funds, hedge funds, family offices and high net worth individuals, in each case, subject to the selling restrictions and any UK MiFIR product governance language set out elsewhere in this Offering Circular.

CMIs should ensure that orders placed are bona fide, are not inflated and do not constitute duplicated orders (i.e. two or more corresponding or identical orders placed via two or more CMIs). CMIs should enquire with their investor clients regarding any orders which appear unusual or irregular. CMIs should disclose the identities of all investors when submitting orders for the Notes (except for omnibus orders where underlying investor information may need to be provided to any OCs when submitting orders). Failure to provide underlying investor information for omnibus orders, where required to do so, may result in that order being rejected. CMIs should not place "X-orders" into the order book.

CMIs should segregate and clearly identify their own proprietary orders (and those of their group companies, including private banks as the case may be) in the order book and book messages.

CMIs (including private banks) should not offer any rebates to prospective investors or pass on any rebates provided by the Issuer. In addition, CMIs (including private banks) should not enter into arrangements which may result in prospective investors paying different prices for the Notes.

The SFC Code requires that a CMI disclose complete and accurate information in a timely manner on the status of the order book and other relevant information it receives to targeted investors for them to make an informed decision. In order to do this, those Joint Lead Managers in control of the order book should consider disclosing order book updates to all CMIs.

When placing an order for the Notes, private banks should disclose, at the same time, if such order is placed other than on a "principal" basis (whereby it is deploying its own balance sheet for onward selling to investors). Private banks who do not provide such disclosure are hereby deemed to be placing their order on such a "principal" basis. Otherwise, such order may be considered to be an omnibus order pursuant to the SFC Code. Private banks should be aware that placing an order on a "principal" basis may require the relevant affiliated Joint Lead Manager(s) (if any) to categorise it as a proprietary order and apply the "proprietary orders" requirements of the SFC Code to such order.

In relation to omnibus orders, when submitting such orders, CMIs (including private banks) that are subject to the SFC Code should disclose underlying investor information in respect of each order constituting the relevant omnibus order (failure to provide such information may result in that order being rejected). Underlying investor information in relation to omnibus orders should consist of:

- The name of each underlying investor;
- A unique identification number for each investor;
- Whether an underlying investor has any "Associations" (as used in the SFC Code);

- Whether any underlying investor order is a "Proprietary Order" (as used in the SFC Code);
- Whether any underlying investor order is a duplicate order.

Underlying investor information in relation to omnibus order should be sent to: DCM.Omnibus@citi.com and hk_syndicate_omnibus@hsbc.com.hk.

To the extent information being disclosed by CMIs and investors is personal and/or confidential in nature, CMIs (including private banks) agree and warrant: (A) to take appropriate steps to safeguard the transmission of such information to any OCs; and (B) that they have obtained the necessary consents from the underlying investors to disclose such information to any OCs. By submitting an order and providing such information to any OCs, each CMI (including private banks) further warrants that they and the underlying investors have understood and consented to the collection, disclosure, use and transfer of such information by any OCs and/or any other third parties as may be required by the SFC Code, including to the Issuer, relevant regulators and/or any other third parties as may be required by the SFC Code, for the purpose of complying with the SFC Code, during the bookbuilding process for this offering. CMIs that receive such underlying investor information are reminded that such information should be used only for submitting orders in this offering. The Joint Lead Managers may be asked to demonstrate compliance with their obligations under the SFC Code, and may request other CMIs (including private banks) to provide evidence showing compliance with the obligations above (in particular, that the necessary consents have been obtained). In such event, other CMIs (including private banks) are required to provide the relevant Joint Lead Manager with such evidence within the timeline requested.

By placing an order, prospective investors (including any underlying investors in relation to omnibus orders) are deemed to represent to the Joint Lead Managers that it is not a Sanctions Restricted Person. A "**Sanctions Restricted Person**" means an individual or entity (a "**Person**"): (a) that is, or is directly or indirectly owned or controlled by a Person that is, described or designated in (i) the most current "Specially Designated Nationals and Blocked Persons" list (which as of the date hereof can be found at: http://www.treasury.gov/ofac/downloads/sdnlist.pdf) or (ii) the Foreign Sanctions Evaders List (which as of the date hereof can be found at: http://www.treasury.gov/ofac/downloads/fse/fselist.pdf) or (iii) the most current "Consolidated list of persons, groups and entities subject to EU financial sanctions" (which as of the date hereof can be found at: https://eeas.europa.eu/headquarters/headquartershomepage_en/8442/Consolidated%20list%20of%20sanctions); or (b) that is otherwise the subject of any sanctions administered or enforced by any Sanctions Authority, other than solely by virtue of: (i) their inclusion in the most current "Sectoral Sanctions Identifications" list (which as of the date hereof can be found at: https://www.treasury.gov/ofac/downloads/ssi/ssilist.pdf) (the "**SSI List**"), (ii) their inclusion in Annexes 3, 4, 5 and 6 of Council Regulation No. 833/2014, as amended by Council Regulation No. 960/2014 (the "**EU Annexes**"), (iii) their inclusion in any other list maintained by a Sanctions Authority, with similar effect to the SSI List or the EU Annexes, (iv) them being the subject of restrictions imposed by the U.S. Department of Commerce's Bureau of Industry and Security ("**BIS**") under which BIS has restricted exports, re-exports or transfers of certain controlled goods, technology or software to such individuals or entities; (v) them being an entity listed in the Annex to the new Executive Order of 3 June 2021 entitled "Addressing the Threat from Securities Investments that Finance Certain Companies of the People's Republic of China" (known as the Non-SDN Chinese Military-Industrial Complex Companies List), which amends the Executive Order 13959 of 12 November 2020 entitled "Addressing the threat from Securities Investments that Finance Chinese Military Companies"; or (vi) them being subject to restrictions imposed on the operation of an online service, Internet application or other information or communication services in the United States directed at preventing a foreign government from accessing the data of U.S. persons; or (c) that is located, organized or a resident in a comprehensively sanctioned country or territory, including Cuba, Iran, North Korea, Syria, the Crimea region of Ukraine, the Donetsk's People's Republic or Luhansk People's Republic. "**Sanctions Authority**" means: (a) the United States government; (b) the United Nations; (c) the European Union (or any of its member states); (d) the United Kingdom; (e) any other equivalent governmental or regulatory authority, institution or agency which administers economic, financial or trade sanctions; and (f) the respective governmental institutions and agencies of any of the foregoing including, without limitation, the Office of Foreign Assets Control of the U.S. Department of the Treasury, the United States Department of State, the United States Department of Commerce and His Majesty's Treasury.

SINGAPORE

Each Joint Lead Manager has acknowledged that this Offering Circular has not been and will not be registered as a prospectus with the Monetary Authority of Singapore. Accordingly, each Joint Lead Manager has represented, warranted and undertaken that it has not offered or sold any Notes or caused the Notes to be made the subject of an invitation for subscription or purchase and will not offer or sell any Notes or cause the Notes to be made the subject of an invitation for subscription or purchase, and has not circulated or distributed, nor will it circulate or distribute, this Offering Circular or any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the Notes, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor (as defined in Section 4A of the Securities and Futures Act 2001 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 Notes are subscribed or purchased under Section 275 of the SFA by a relevant person which is:

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

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

securities 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 Notes pursuant to an offer made under Section 275 of the SFA except:

(i) 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)(c)(ii) of the SFA;

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

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

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

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

JAPAN

The Notes have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (Act No. 25 of 1948, as amended) (the "**FIEA**") and 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 Notes in Japan or to, or for the benefit of, any resident of Japan, or to others for re-offering or resale, 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 FIEA and other relevant laws and regulations and of Japan. As used in this paragraph, "**resident of Japan**" means any person resident in Japan, including any corporation or other entity organised under the laws of Japan.

TAIWAN

Each Joint Lead Manager understands that the Notes have not been and will not be registered or filed with, or approved by, the Financial Supervisory Commission of Taiwan, the Republic of China ("**Taiwan**") and/or other regulatory authority pursuant to relevant securities laws and regulations and, accordingly, each Joint Lead Manager has represented and undertaken that it will not offer, issue or sell the Notes in Taiwan through a public offering or in circumstances which constitute an offer within the meaning of the Securities and Exchange Act of Taiwan or relevant laws and regulations that require a registration, filing or approval of the Financial Supervisory Commission and/or other regulatory authority of Taiwan.

GENERAL

None of the Issuer or the Joint Lead Managers makes any representation that any action will be taken in any jurisdiction by any Joint Lead Manager or the Issuer that would permit a public offering of the Notes, or possession or distribution of this Offering Circular (in preliminary, proof or final form) or any other offering or publicity material relating to the Notes, 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 Notes 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. None of the Joint Lead Managers is authorised to make any representation or use any information in connection with the issue, subscription and sale of the Notes other than as contained in, or which is consistent with, the Offering Circular or any amendment or supplement to it.

GENERAL INFORMATION

1 **Clearing Systems:** The Legal Entity Identifier ("**LEI**") of the Issuer is 549300DLWZLXC60CXS69. The Notes have been accepted for clearance through Euroclear and Clearstream with the Common Code of 253167289. The International Securities Identification Number ("**ISIN**") for the Notes is XS2531672892.

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

3 **Authorizations:** The Issuer has obtained all necessary consents, approvals and authorizations as may be required in connection with the issue and performance of the Notes, including, but not limited to, approval by the HKMA. The issue of the Notes was authorised by a resolution of the Board of Directors of the Issuer passed on 24 August 2022.

4 **No Material Adverse Change:** Except as disclosed in this Offering Circular, there has been no material adverse change in the financial or trading position of the Issuer since 30 June 2022 and no material adverse change in the financial position or prospects of the Issuer since 30 June 2022.

5 **Available Documents:** For so long as any of the Notes is outstanding, copies of the following documents may be inspected at a specified office of the Issuer: 7/F Shanghai Commercial Bank Tower, 12 Queen's Road Central, Hong Kong:

(a) the Memorandum and Articles of Association of the Issuer;

(b) copies of the auditor's reports of PricewaterhouseCoopers, the Issuer's external auditor, and the audited consolidated financial statements of the Issuer as at and for the years ended 31 December 2020 and 2021 and a copy of the report on review of interim financial information of PricewaterhouseCoopers and the unaudited interim financial disclosure statement as at and for the period ended 30 June 2022;

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

(d) the Trust Deed and the Agency Agreement, each to be dated on or about the Issue Date.

Copies of the auditor's reports and the audited consolidated financial statements referred to above and the most recent annual audited consolidated financial statements of the Issuer and a copy of the report on review of interim financial information of PricewaterhouseCoopers and the unaudited interim financial disclosure statement published by the Issuer, will be made available free of charge at the specified office of the Issuer: 7/F Shanghai Commercial Bank Tower, 12 Queen's Road Central, Hong Kong.

6 **Auditor:** The consolidated financial statements of the Issuer as at and for the years ended 31 December 2020 and 2021 included in this Offering Circular have been audited by PricewaterhouseCoopers, Certified Public Accountants, as stated in the auditor's reports appearing in this Offering Circular in relation to such consolidated financial statements.

The unaudited interim financial information of the Issuer as at and for the period ended 30 June 2022 included in this Offering Circular have been reviewed by PricewaterhouseCoopers, Certified Public Accountants, as stated in the auditor's reports appearing in this Offering Circular in relation to such unaudited interim financial information.

PricewaterhouseCoopers has given and not withdrawn its written consent to the issue of this Offering Circular with references to its auditor's reports on the published annual consolidated financial statements of the Issuer for the years ended 31 December 2020 and 2021 and the report on review of interim financial information of PricewaterhouseCoopers and the unaudited interim financial disclosure statement of the Issuer for the period ended 30 June 2022, in the form and context in which they appear.

7 **Listing of Notes:** Application has been made to the Hong Kong Stock Exchange for the listing of, and permission to deal in, the Notes by way of debt issues to Professional Investors only and such permission is expected to become effective on or about 1 March 2023.

INDEX TO FINANCIAL STATEMENTS

UNAUDITED INTERIM FINANCIAL DISCLOSURE STATEMENTS OF THE BANK FOR THE SIX MONTHS ENDED 30 JUNE 2022

AUDITED FINANCIAL STATEMENTS OF THE BANK FOR THE YEAR ENDED 31 DECEMBER 2021

AUDITED FINANCIAL STATEMENTS OF THE BANK FOR THE YEAR ENDED 31 DECEMBER 2020

Notes:

(1) The Report on Review of Interim Financial Information on the Bank's unaudited interim financial information for the period ended 30 June 2022 set out herein are reproduced from the Group's interim financial disclosure statement for the period ended 30 June 2022. Page reference referred to in the abovenamed report refer to pages set out in such interim financial disclosure statement.

(2) The independent auditor's reports on the Bank's consolidated financial statements for the years ended 31 December 2020 and 2021 set out herein are reproduced from the Bank's annual reports for the years ended 31 December 2020 and 2021. Page reference referred to in the abovenamed reports refer to pages set out in such annual reports.

(All amounts in HK dollar thousands unless otherwise stated)

CONDENSED CONSOLIDATED STATEMENT OF PROFIT OR LOSS

	Note	**Six months ended 30 June 2022 (unaudited)**	Six months ended 30 June 2021 (unaudited)
Interest income	6	**2,421,714**	2,420,338
Interest expense	6	**(627,646)**	(555,812)
Net interest income		**1,794,068**	1,864,526
Fee and commission income	7	**362,631**	473,261
Fee and commission expense	7	**(23,925)**	(29,217)
Net fee and commission income	7	**338,706**	444,044
Net trading income	8	**244,817**	161,539
Net gains from disposal of investment securities at fair value through other comprehensive income		**22,128**	79,621
Dividend income from investment securities at fair value through other comprehensive income		**2,525**	4,354
Other operating income	9	**61,830**	70,397
Net earned insurance premium	10	**18,008**	17,971
Net insurance claims incurred and movement in policyholders' liabilities	10	**(13,043)**	(12,361)
Operating expenses	11	**(880,787)**	(857,226)
Credit impairment losses	12	**(46,348)**	(44,221)
Operating profit		**1,541,904**	1,728,644
Share of net profits of associates and joint venture		**37,619**	54,142
Profit before income tax		**1,579,523**	1,782,786
Income tax expense	13	**(328,144)**	(336,076)
Profit for the period		**1,251,379**	1,446,710
Attributable to:			
Equity holders of the Bank		**1,249,098**	1,443,398
Non-controlling interests		**2,281**	3,312
		1,251,379	1,446,710

(All amounts in HK dollar thousands unless otherwise stated)

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Six months ended 30 June 2022 (unaudited)	Six months ended 30 June 2021 (unaudited)
Profit for the period	**1,251,379**	1,446,710
Other comprehensive income		
Items that may be reclassified to profit or loss		
Currency translation difference arising from overseas operations	**(67,210)**	21,916
Investment securities at fair value through other comprehensive income		
– Change in fair value	**(1,922,895)**	(164,710)
– Change in credit impairment losses recognised in profit or loss	**(4,325)**	6,744
– Fair value changes transferred to profit or loss on disposal	**(22,128)**	(79,621)
– Deferred income tax	**320,929**	40,314
Share of reserves of associates and joint venture	**(51,311)**	3,786
Items that will not be reclassified to profit or loss		
Equity investments at fair value through other comprehensive income		
– Change in fair value	**(439,843)**	230,079
– Deferred income tax	**(1,007)**	(2,443)
Share of reserves of associates and joint venture	**290**	161
Other comprehensive income for the period, net of tax	**(2,187,500)**	56,226
Total comprehensive income for the period	**(936,121)**	1,502,936
Attributable to:		
Equity holders of the Bank	**(938,772)**	1,499,624
Non-controlling interests	**2,651**	3,312
Total comprehensive income for the period	**(936,121)**	1,502,936

(All amounts in HK dollar thousands unless otherwise stated)

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Note	**30 June 2022 (unaudited)**	31 December 2021 (audited)
ASSETS			
Cash and balances with banks	14	**37,514,795**	30,685,587
Placements with banks	15	**21,336,379**	15,478,679
Loans and advances to customers	16	**96,845,109**	95,906,226
Financial assets at fair value through profit or loss	22(b)	**862,122**	2,103,933
Derivative financial instruments	17	**771,387**	317,330
Investment securities at fair value through other comprehensive income	22(b)	**66,087,313**	81,438,993
Investment securities at amortised cost		**1,976,081**	1,573,635
Properties for sale	18	**695,914**	683,924
Investments in associates and joint venture		**449,192**	466,829
Properties and equipment	19	**2,492,733**	2,550,277
Investment properties	20	**998,225**	1,002,672
Deferred income tax assets	24	**383,363**	55,610
Other assets		**2,359,786**	1,669,618
TOTAL ASSETS		**232,772,399**	233,933,313
LIABILITIES			
Deposits and balances from banks		**8,302,040**	9,032,550
Deposits from customers	21	**184,003,544**	183,587,245
Derivative financial instruments	17	**669,660**	251,085
Subordinated debts	23	**4,298,361**	4,269,682
Other liabilities		**2,272,733**	2,426,108
Current income tax liabilities		**249,054**	140,035
Deferred income tax liabilities	24	**5,241**	5,241
TOTAL LIABILITIES		**199,800,633**	199,711,946
EQUITY			
CAPITAL AND RESERVES ATTRIBUTABLE TO EQUITY HOLDERS			
Share capital		**2,000,000**	2,000,000
Retained earnings		**22,545,035**	21,608,831
Reserves	25	**8,327,933**	10,515,909
		32,872,968	34,124,740
Non-controlling interests in equity		**98,798**	96,627
TOTAL EQUITY		**32,971,766**	34,221,367
TOTAL EQUITY AND LIABILITIES		**232,772,399**	233,933,313

(All amounts in HK dollar thousands unless otherwise stated)

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Note	Attributable to equity holders			Non-controlling interests	Total equity
		Share capital	Reserves	Retained earnings (including proposed dividends)		
As at 1 January 2021		2,000,000	11,426,064	18,977,170	91,565	32,494,799
Profit for the period		–	–	1,443,398	3,312	1,446,710
Other comprehensive income net of tax						
Net change in fair value of investment securities at fair value through other comprehensive income		–	30,363	–	–	30,363
Currency translation difference arising from overseas operations		–	9,314	12,602	–	21,916
Share of reserves of associates and joint venture		–	3,947	–	–	3,947
Total other comprehensive income		–	43,624	12,602	–	56,226
Payment of dividend relating to 2020		–	–	(313,000)	(480)	(313,480)
As at 30 June 2021 (unaudited)		2,000,000	11,469,688	20,120,170	94,397	33,684,255
As at 1 January 2022		**2,000,000**	**10,515,909**	**21,608,831**	**96,627**	**34,221,367**
Profit for the period		**–**	**–**	**1,249,098**	**2,281**	**1,251,379**
Other comprehensive income net of tax						
Net change in fair value of investment securities at fair value through other comprehensive income	25	**–**	**(2,069,639)**	**–**	**370**	**(2,069,269)**
Currency translation difference arising from overseas operations	25	**–**	**(67,316)**	**106**	**–**	**(67,210)**
Share of reserves of associates and joint venture	25	**–**	**(51,021)**	**–**	**–**	**(51,021)**
Total other comprehensive income		**–**	**(2,187,976)**	**106**	**370**	**(2,187,500)**
Payment of dividend relating to 2021		**–**	**–**	**(313,000)**	**(480)**	**(313,480)**
As at 30 June 2022 (unaudited)		**2,000,000**	**8,327,933**	**22,545,035**	**98,798**	**32,971,766**

(All amounts in HK dollar thousands unless otherwise stated)

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

	Note	**Six months ended 30 June 2022 (unaudited)**	Six months ended 30 June 2021 (unaudited)
Cash flows from operating activities			
Profit before income tax		**1,579,523**	1,782,786
Share of net profits of associates and joint venture		**(37,619)**	(54,142)
Credit impairment losses	12	**46,348**	44,221
Depreciation expenses		**120,400**	119,330
Net gains from disposal of equipment	9	**(6)**	(5)
Net gains from disposal of investment securities at fair value through other comprehensive income		**(22,128)**	(79,621)
Interest income on investment securities at amortised cost and at fair value through other comprehensive income	6	**(569,110)**	(609,705)
Interest expense on subordinated debts	6	**97,011**	96,342
Interest expense on lease liabilities	6	**1,321**	458
Dividend income on investment securities at fair value through other comprehensive income		**(2,525)**	(4,354)
Hong Kong profits tax paid		**(86,476)**	(105,305)
Overseas tax paid		**(160,745)**	(181,091)
Effect of exchange rate changes		**205,796**	152,080
Cash flows from operating activities before changes in operating assets and liabilities		**1,171,790**	1,160,994
Changes in operating assets and liabilities:			
– Net (increase)/decrease in balances with banks with original maturity beyond 3 months		**(928,353)**	2,948,687
– Net (increase)/decrease in placements with banks with original maturity beyond 3 months		**(6,615,347)**	918,060
– Net decrease/(increase) in financial assets at fair value through profit or loss		**1,241,811**	(52,832)
– Net increase in derivative financial instruments		**(35,482)**	(173,198)
– Net (increase)/decrease in loans and advances to customers		**(1,549,150)**	1,130,658
– Net (increase)/decrease in right-of-use assets		**(41,732)**	4,961
– Net (increase)/decrease in other assets		**(778,206)**	582,455
– Net (decrease)/increase in deposits and balances from banks		**(526,661)**	1,942,834
– Net increase in deposits from customers		**1,292,675**	1,795,331
– Net increase/(decrease) in lease liabilities		**41,532**	(5,984)
– Net (decrease)/increase in other liabilities		**(154,207)**	435,624
Net cash (used in)/generated from operating activities		**(6,881,330)**	10,687,590

(All amounts in HK dollar thousands unless otherwise stated)

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

	Six months ended 30 June 2022 (unaudited)	Six months ended 30 June 2021 (unaudited)
Cash flows from investing activities		
Interest received on investment securities at amortised cost and at fair value through other comprehensive income	**732,536**	626,979
Dividends received on investment securities at fair value through other comprehensive income	**2,525**	4,354
Dividends received from associates and joint venture	**4,235**	4,235
Purchases of properties and equipment	**(19,170)**	(52,592)
Additions of investment properties	**–**	(1,040)
Additions of properties for sale	**(13,109)**	(66,623)
Proceeds from sale of equipment	**16**	10
Purchases of investment securities at amortised cost and at fair value through other comprehensive income	**(14,703,969)**	(38,896,284)
Proceeds from sale and redemption of investment securities at amortised cost and at fair value through other comprehensive income	**26,866,012**	34,852,381
Net cash generated from/(used in) investing activities	**12,869,076**	(3,528,580)
Cash flows from financing activities		
Interest paid on subordinated debts	**(95,280)**	(94,444)
Payment of lease liabilities	**(57,954)**	(57,922)
Dividend paid to equity holders	**(313,000)**	(313,000)
Dividend paid to non-controlling interests	**(480)**	(480)
Net cash used in financing activities	**(466,714)**	(465,846)
Net increase in cash and cash equivalents	**5,521,032**	6,693,164
Cash and cash equivalents as at 1 January	**30,342,667**	27,999,639
Effect of exchange rate changes on cash and cash equivalents	**(548,254)**	34,947
Cash and cash equivalents as at 30 June	**35,315,445**	34,727,750
Represented by:		
Cash and balances with banks with less than 3 months' original maturity	**34,328,926**	32,439,771
Placements with banks with less than 3 months' original maturity	**986,519**	2,132,795
Debt securities – Exchange Fund Bills with less than 3 months' original maturity	**–**	155,184
	35,315,445	34,727,750
Cash flows from operating, investing and financing activities included:		
Interest received	**2,509,243**	2,533,524
Interest paid	**(477,820)**	(530,646)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

1 General information

Shanghai Commercial Bank Limited (the "Bank") and its subsidiaries (together, the "Group") are engaged in the provision of banking and related financial services in Hong Kong, United States, United Kingdom and the People's Republic of China.

The Bank is a financial institution incorporated in Hong Kong. The address of its registered office is Shanghai Commercial Bank Tower, 12 Queen's Road Central, Hong Kong.

The ultimate holding company is The Shanghai Commercial & Savings Bank, Ltd., which is incorporated in Taiwan.

This Group Interim Financial Disclosure Statement is presented in thousands of units of Hong Kong Dollars (HK$'000), unless otherwise stated and was approved for issue by the Board of Directors on 24 August 2022.

2 Basis of preparation

This Group Interim Financial Disclosure Statement for the six months ended 30 June 2022 has been prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34 "Interim financial reporting". The Group Interim Financial Disclosure Statement should be read in conjunction with the annual financial statements for the year ended 31 December 2021, which have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs").

The financial information relating to the year ended 31 December 2021 that is included in the 2022 Group Interim Financial Disclosure Statement as comparative information does not constitute the Group's statutory annual consolidated financial statements for that year but is derived from those financial statements.

The Group has delivered the financial statements for the year ended 31 December 2021 to the Registrar of Companies as required by section 662(3) of, and Part 3 of Schedule 6 to, the Hong Kong Companies Ordinance (Cap. 622).

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

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

3 Accounting policies

The accounting policies applied in the preparation of the 2022 Group Interim Financial Disclosure Statement are consistent with those used and described in the Group's audited annual financial statements for the year ended 31 December 2021. The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

(a) Amended standards adopted by the Group for the period ended 30 June 2022

	Effective for accounting periods beginning on or after
Amendments to HKAS 37 – Onerous Contracts – Cost of Fulfilling a Contract	1 January 2022
Amendments to HKFRS – Annual Improvement to HKFRS Standards 2018–2020	1 January 2022

The adoption of the above amendments does not have significant impact to the financial statements of the Group.

(b) Impact of new and amended standards issued but not yet applied by the Group

	Effective for accounting periods beginning on or after
HKFRS 17 "Insurance Contracts"	1 January 2023
Amendments to HKAS 1 – Classification of Liabilities as Current or Non-current	1 January 2023
Amendments to HKAS 1 and HKFRS Practice Statement 2 – Disclosure of Accounting Policies	1 January 2023
Amendments to HKAS 8 – Definition of Accounting Estimates	1 January 2023
Amendments to HKAS 12 – Deferred Tax related to Assets and Liabilities arising from a single transaction	1 January 2023

The Hong Kong Institute of Certified Public Accountants has issued a few amendments and new standards which are not yet effective for the period ended 30 June 2022 and which have not been adopted in these consolidated financial statements. The key new standard which may be relevant to the Group is HKFRS 17 "Insurance Contracts".

HKFRS 17 "Insurance Contracts" is effective for the accounting periods beginning on or after 1 January 2023. It establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard and to replace the HKFRS 4 "Insurance contracts". The objective of HKFRS 17 is to ensure that an entity provides relevant information that faithfully represents those contracts. HKFRS 17 defines clear and consistent rules that will significantly increase the comparability of financial statements. The general model under HKFRS 17 requires an entity to measure an insurance contract at initial recognition at the total of the fulfilment cash flows and the contractual service margin. Aside from this general model, the standard provides, as a simplification, the premium allocation approach. The Group is in the process of assessing the financial and disclosure impact on the adoption of the standard.

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

4 Estimates

The preparation of the Group Interim Financial Disclosure Statement 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. Actual results may differ from these estimates.

In preparing this Group Interim Financial Disclosure Statement, the significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the Group's audited annual financial statements for the year ended 31 December 2021.

5 Basis of consolidation

(a) Subsidiaries

Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

5 Basis of consolidation (Continued)

(a) Subsidiaries (Continued)

The following is a list of the subsidiaries as at 30 June 2022:

Name	Place of incorporation	Principal activities and place of operation	Particulars of issued share capital	Percentage of ordinary share capital held	30 June 2022 Total assets	30 June 2022 Total equity	31 December 2021 Total assets	31 December 2021 Total equity
Shanghai Commercial Bank (Nominees) Limited	Hong Kong	Nominee services Hong Kong	100 ordinary shares	100%[1]	**10**	**10**	10	10
Shanghai Commercial Bank Trustee Limited	Hong Kong	Trustee services Hong Kong	1,000 ordinary shares	60%[2]	**15,154**	**14,769**	15,926	15,727
Shacom Futures Limited	Hong Kong	Advising and dealing in futures contracts Hong Kong	600,000 ordinary shares	100%[1]	**111,192**	**55,172**	93,674	56,092
Shacom Investment Limited	Hong Kong	Investment in Exchange Fund Bills and Notes Hong Kong	10,000 ordinary shares	100%[1]	**3,304,709**	**12,375**	3,243,581	11,620
Shacom Property Holdings (BVI) Limited	British Virgin Islands	Property holding United Kingdom	2 ordinary shares of US$1 each	100%[1]	**27,613**	**4,295**	30,745	4,503
Shacom Property (NY), Inc.	United States of America	Property holding United States of America	10 ordinary shares of US$1 each	100%[1]	**5,567**	**5,567**	5,533	5,533
Shacom Property (CA), Inc.	United States of America	Property holding United States of America	10 ordinary shares of US$1 each	100%[1]	**2,690**	**2,690**	2,669	2,669
Shacom Assets Investments Limited	Hong Kong	Investment in notes and bonds Hong Kong	10,000 ordinary shares	100%[1]	**1,083,107**	**1,190**	1,082,282	357
Infinite Financial Solutions Limited	Hong Kong	I.T. application services provider Hong Kong	500,000 ordinary shares	100%[1]	**29,605**	**20,558**	29,246	22,143
Shacom Insurance Brokers Limited	Hong Kong	Insurance broker Hong Kong	1,000,000 ordinary shares	100%[1]	**4,180**	**2,045**	3,682	1,908
Shacom Securities Limited	Hong Kong	Securities brokerage services Hong Kong	2,000,000 ordinary shares	100%[1]	**314,703**	**268,734**	387,246	266,846
Hai Kwang Property Management Company Limited	Hong Kong	Property management Hong Kong	2 ordinary shares	100%[1]	**935**	**634**	911	607
Paofoong Insurance Company (Hong Kong) Limited	Hong Kong	Insurance Hong Kong	500,000 ordinary shares	60%[2]	**353,470**	**231,308**	335,194	225,846
Right Honour Investments Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of US$1 each	100%[1]	**3**	**(188)**	6	(180)
Glory Step Westpoint Investments Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of US$1 each	100%	**389,739**	**(27,022)**	386,297	(25,403)
Silver Wisdom Westpoint Investments Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of US$1 each	100%	**1,162,278**	**(47,497)**	1,148,006	(40,902)
KCC 23F Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of HK$1 each	100%[1]	**333,418**	**150,843**	305,267	122,662
KCC 25F Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of HK$1 each	100%[1]	**335,010**	**152,362**	306,274	123,596
KCC 26F Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of HK$1 each	100%[1]	**336,246**	**153,738**	307,260	124,722

1 Ordinary share capital is held directly by the Bank.

2 60% of ordinary share capital is held directly by the Bank and 40% of ordinary share capital is held by non-controlling interests in equity.

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

5 Basis of consolidation (Continued)

(b) Transactions with non-controlling interests

The Group treats transactions with non-controlling interests as transactions with equity owners of the Group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

When the Group ceases to have control or significant influence, any retained interest in the entity is remeasured to its fair value, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

(c) Associates and joint ventures

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

A joint venture is an arrangement whereby the Group and other parties contractually agree to share control of the arrangement and have right to the net assets of the arrangement.

Investments in associates and joint ventures are accounted for using the equity method, and are initially recognised in the consolidated statement of financial position at cost and adjusted thereafter to recognise the Group's share of the post-acquisition profits or losses and movements in other comprehensive income. When the Group's share of losses in an associate or a joint venture equals or exceeds its interests in the associate or joint venture (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate or joint venture), the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate or joint venture.

When the Group transacts with its associates or joint ventures, profits and losses resulting from such transactions are recognised in the Group's consolidated financial statements only to the extent of interests in the associates or joint ventures that are not related to the Group. Unrealised losses arising from the transactions between the Group and the associates or joint ventures are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

6 Net interest income

	Six months ended 30 June 2022 (unaudited)	Six months ended 30 June 2021 (unaudited)
Interest income		
Balances with banks and placements with banks	**152,821**	81,547
Investment securities at amortised cost	**2,855**	423
Investment securities at fair value through other comprehensive income	**566,255**	609,282
Loans and advances to customers	**1,697,250**	1,725,900
Others	**2,533**	3,186
Interest income on financial assets that are not measured at fair value through profit or loss	**2,421,714**	2,420,338
Interest expense		
Deposits and balances from banks	**54,226**	26,404
Deposits from customers	**474,183**	431,789
Subordinated debts	**97,011**	96,342
Lease liabilities	**1,321**	458
Others	**905**	819
Interest expense on financial liabilities that are not measured at fair value through profit or loss	**627,646**	555,812

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

7 Net fee and commission income

	Six months ended 30 June 2022 (unaudited)	Six months ended 30 June 2021 (unaudited)
Fee and commission income		
Bills	**30,770**	35,472
Nominees, custodian and securities brokerage	**100,183**	164,835
Investment products	**56,168**	88,581
Remittance	**27,568**	28,842
Credit cards	**19,542**	21,016
Retail banking	**23,047**	25,571
Insurance	**11,397**	23,207
Loans and advances and facility fees	**92,602**	84,235
Trust and other commissions	**1,354**	1,502
Total fee and commission income	**362,631**	473,261
Less: fee and commission expense	**(23,925)**	(29,217)
Net fee and commission income	**338,706**	444,044
Of which:		
Net fee and commission income arising from financial assets or financial liabilities that are not measured at fair value through profit or loss		
– fee and commission income	**142,914**	140,723
– fee and commission expense	**3,511**	6,346
Net fee and commission income on trust and other fiduciary activities		
– fee and commission income	**10,711**	11,154

8 Net trading income

	Six months ended 30 June 2022 (unaudited)	Six months ended 30 June 2021 (unaudited)
Foreign exchange	**322,103**	140,501
Interest rate instruments	**(24,947)**	10,955
Equity instruments:		
– Trading (losses)/gains	**(55,488)**	12,282
– Dividend income	**2,863**	1,849
Other trading income	**286**	(4,048)
	244,817	161,539

"Foreign exchange" trading income includes gains and losses from spot, forward and option contracts, swaps and translated foreign currency assets and liabilities, which are not designated as qualifying hedging relationship. "Interest rate instruments" trading income includes the results of trading in government securities, corporate debt securities, money market instruments and interest rate swaps. "Equity instruments" include equity securities and equity derivatives.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

9 Other operating income

	Six months ended 30 June 2022 (unaudited)	Six months ended 30 June 2021 (unaudited)
Gross rental income from investment properties	**26,400**	34,572
Net gains from disposal of equipment	**6**	5
Others	**35,424**	35,820
	61,830	70,397

Direct operating expenses arising from investment properties of HK$699,000 (six months ended 30 June 2021: HK$11,000) are included in premises management expenses (Note 11).

10 Net earned insurance premium and net insurance claims incurred and movement in policyholders' liabilities

	Six months ended 30 June 2022 (unaudited)	Six months ended 30 June 2021 (unaudited)
Insurance premium revenue	**23,834**	23,365
Insurance premium ceded to reinsurers	**(5,826)**	(5,394)
	18,008	17,971

The related net insurance claims incurred and movement in policyholders' liabilities of HK$13,043,000 (six months ended 30 June 2021: HK$12,361,000) were shown after being netted off with the insurance claims and loss adjustment expenses recovered from reinsurers of HK$664,000 (six months ended 30 June 2021: HK$386,000).

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

11 Operating expenses

	Six months ended 30 June 2022 (unaudited)	Six months ended 30 June 2021 (unaudited)
Auditor's remuneration		
Audit services (Note a)	**5,882**	4,420
Non-audit-related services (Note b)	**4,307**	2,799
Premises management expenses	**23,414**	21,933
Depreciation expenses		
Properties and equipment	**61,968**	59,696
Right-of-use assets	**53,985**	55,187
Investment properties	**4,447**	4,447
Employee benefit expenses		
Wages and salaries and other costs (Note c)	**515,905**	515,922
Pension costs – defined contribution schemes	**35,334**	35,382
Expenses relating to short-term and low-value leases	**1,028**	1,223
Information technology and communications	**47,029**	42,780
Legal and consultancy	**23,247**	7,626
Printing, stationery and postage	**11,068**	11,365
Promotion and advertising	**17,149**	17,738
Others	**76,024**	76,708
	880,787	857,226

Note a: The above auditor's remuneration for audit services represents the fee for the audit of the Group's financial information for the interim and annual period to comply with the statutory and regulatory requirements in Hong Kong and Taiwan and is accrued on a pro-rata basis.

Note b: The above fee for non-audit-related services includes the fee for the review under Hong Kong Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" for the first quarter results of the Group in accordance with the regulatory requirements of the ultimate holding company in Taiwan and is accrued on a pro-rata basis.

Note c: Employee benefit expenses include directors' emoluments. The number of employees of the Group as at 30 June 2022 was 1,796 (30 June 2021: 1,868).

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

12 Credit impairment losses

	Six months ended 30 June 2022 (unaudited)	Six months ended 30 June 2021 (unaudited)
Loans and advances to customers	**32,748**	32,702
Balances with banks and placements with banks	**123**	684
Investment securities	**(4,334)**	6,746
Other assets	**2,233**	365
Loan commitments and financial guarantee contracts	**15,578**	3,724
	46,348	44,221

13 Income tax expense

Hong Kong profits tax has been provided at the rate of 16.5% (six months ended 30 June 2021: 16.5%) on the estimated assessable profits for the six months ended 30 June 2022. Taxation on overseas profits has been calculated on the estimated assessable profits for the six months ended 30 June 2022 at the rates of taxation prevailing in the countries in which the Group operates.

The amount of taxation charged to the statement of profit or loss represents:

	Six months ended 30 June 2022 (unaudited)	Six months ended 30 June 2021 (unaudited)
Current income tax:		
– Hong Kong profits tax	**177,950**	201,383
– Overseas taxation	**158,155**	153,677
– Under/(over) provisions in respect of prior years	**248**	(22,345)
Total current income tax	**336,353**	332,715
Deferred income tax:		
– Hong Kong deferred tax	**577**	(3,666)
– Overseas deferred tax	**(8,786)**	7,027
Total deferred income tax	**(8,209)**	3,361
Income tax expense	**328,144**	336,076

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

14 Cash and balances with banks

	30 June 2022 (unaudited)	31 December 2021 (audited)
Cash in hand	**723,363**	817,858
Balances with central banks and Hong Kong Monetary Authority	**2,697,795**	2,904,044
Balances with banks	**34,095,463**	26,965,504
	37,516,621	30,687,406
Less: Stage 1 credit impairment allowances	**(1,826)**	(1,819)
	37,514,795	30,685,587

Included in the above amounts, HK$219,678,000 (31 December 2021: HK$261,734,000) were deposited in central banks or designated banks as at 30 June 2022, to comply with the statutory requirements of respective jurisdiction in which the Group is operating the business. In addition, financial assets amounted to HK$974,223,000 as at 30 June 2022 (31 December 2021: HK$1,967,256,000) comprising balances with banks of HK$484,904,000 (31 December 2021: HK$287,104,000) and financial assets at fair value through profit or loss of HK$489,319,000 (31 December 2021: HK$1,680,152,000) were under a collateral arrangement with a shareholder of the Bank for its provision of the credit facilities of HK$784,795,000 (31 December 2021: HK$779,830,000) to the Bank's branches in the United States.

15 Placements with banks

	30 June 2022 (unaudited)	31 December 2021 (audited)
Placements with banks maturing between 1 and 12 months	**21,337,438**	15,479,622
Less: Stage 1 credit impairment allowances	**(1,059)**	(943)
	21,336,379	15,478,679

Included in the above amounts, HK$289,852,000 (31 December 2021: HK$335,327,000) were deposited with designated banks in the People's Republic of China as at 30 June 2022, to comply with the local statutory requirements.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

16 Loans and advances to customers

	30 June 2022 (unaudited)	31 December 2021 (audited)
Gross loans and advances to customers	**97,389,982**	96,422,010
Less: credit impairment allowances		
– Stage 1	**(226,021)**	(288,298)
– Stage 2	**(208,980)**	(174,029)
– Stage 3	**(109,872)**	(53,457)
	96,845,109	95,906,226
Gross trade bills and other eligible bills, included within gross loans and advances to customers	**714,551**	484,716
Less: credit impairment allowances		
– Stage 1	**(798)**	(361)
– Stage 2	**(108)**	(32)
	713,645	484,323

The Group accepted listed securities at fair value of HK$2,566,240,000 as at 30 June 2022 (31 December 2021: HK$2,971,636,000) as collateral for shares financing facilities. These securities are permitted to be sold or re-pledged in the event of default by the borrowers.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

16 Loans and advances to customers (Continued)

(a) Loans and advances (excluding trade bills and other eligible bills) by industry sector

The following table shows the breakdown of the Group's loans and advances (excluding trade bills and other eligible bills) by industry sector according to the usage of loans based on the categories and definitions set by the Hong Kong Monetary Authority.

	30 June 2022 (unaudited)		31 December 2021 (audited)	
	Balance	**% covered by collateral**	Balance	% covered by collateral
Loans for use in Hong Kong				
Industrial, commercial and financial				
– Property development	**2,646,525**	**46%**	2,944,336	53%
– Property investment	**4,891,807**	**91%**	5,048,305	94%
– Financial concerns	**2,661,295**	**20%**	2,723,750	13%
– Stockbrokers	**184,600**	**100%**	424,980	88%
– Wholesale and retail trade	**1,234,405**	**61%**	1,337,980	54%
– Manufacturing	**842,484**	**65%**	898,676	66%
– Transport and transport equipment	**393,668**	**34%**	593,337	57%
– Recreational activities	**2,482,408**	**13%**	2,239,583	11%
– Information technology – telecommunication	**4,815**	**100%**	4,773	100%
– Hotels, boarding houses and catering	**2,190,470**	**91%**	1,950,340	91%
– Others	**15,868,544**	**41%**	12,573,081	57%
Individuals				
– Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme or their respective successor schemes	**59,499**	**100%**	64,374	99%
– Loans for the purchase of other residential properties	**3,600,047**	**100%**	3,744,094	100%
– Credit card advances	**157,670**	**0%**	194,080	0%
– Others	**5,990,104**	**96%**	6,673,119	96%
Trade financing	**8,101,954**	**59%**	8,763,904	58%
Loans for use outside Hong Kong	**45,365,136**	**87%**	45,758,582	87%
	96,675,431	**73%**	95,937,294	76%

As at 30 June 2022 and 31 December 2021, the Bank did not have exposures to individual industry sector constituting 10% or more of the Group's total amount of loans and advances.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

16 Loans and advances to customers (Continued)

(b) Loans and advances (excluding trade bills and other eligible bills) by geographical area

The information concerning the breakdown of the gross amount of loans and advances to customers (excluding trade bills and other eligible bills) by country or geographical area is derived according to the location of the customers after taking into account any transfer of risk. In general, such transfer of risk takes place if the loans and advances are guaranteed by a party in a country which is different from that of the customers.

As at 30 June 2022 (unaudited)	**Balance**	**Stage 3 balance**	**Balance overdue for over 3 months**	**Total Stage 3 credit impairment allowances**	**Total Stage 1 and Stage 2 credit impairment allowances**
Hong Kong	**59,332,024**	**132,475**	**63,144**	**26,913**	**354,891**
Mainland China	**5,781,176**	**276,357**	**276,357**	**82,959**	**15,019**
United States	**27,568,856**	**415,632**	**256,625**	**–**	**45,094**
Others	**3,993,375**	**–**	**–**	**–**	**19,091**
	96,675,431	**824,464**	**596,126**	**109,872**	**434,095**
% of total loans and advances to customers		**0.85**			
Fair value of collateral		**1,319,590**			

As at 31 December 2021 (audited)	Balance	Stage 3 balance	Balance overdue for over 3 months	Total Stage 3 credit impairment allowances	Total Stage 1 and Stage 2 credit impairment allowances
Hong Kong	58,712,390	84,439	33,463	16,642	383,190
Mainland China	6,367,989	73,629	73,629	36,815	17,204
United States	26,817,058	362,433	–	–	41,200
Others	4,039,857	–	–	–	20,340
	95,937,294	520,501	107,092	53,457	461,934
% of total loans and advances to customers		0.54			
Fair value of collateral		870,897			

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

16 Loans and advances to customers (Continued)

(c) Loans and advances (excluding trade bills and other eligible bills) overdue for more than 3 months

	30 June 2022 (unaudited)		31 December 2021 (audited)	
		% of gross loans and advances to customers		% of gross loans and advances to customers
Balances which have been overdue for:				
– 6 months or less but over 3 months	**250,614**	**0.26**	14,997	0.02
– 1 year or less but over 6 months	**271,494**	**0.28**	25,023	0.03
– over 1 year	**74,018**	**0.07**	67,072	0.07
	596,126	**0.61**	107,092	0.12
Current market value of collateral	**899,403**		188,907	
Covered portion by collateral	**570,145**		91,701	
Uncovered portion by collateral	**25,981**		15,391	
Credit impairment allowances	**108,834**		52,751	

Collateral held against such loans and advances mainly include mortgages over properties.

(d) Rescheduled loans and advances (net of amounts included in loans and advances overdue for more than 3 months)

	30 June 2022 (unaudited)		31 December 2021 (audited)	
		% of gross loans and advances to customers		% of gross loans and advances to customers
Rescheduled loans and advances	**25,866**	**0.03**	27,868	0.03

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

17 Derivative financial instruments

		Fair values	
As at 30 June 2022 (unaudited)	**Contract amount**	**Assets**	**Liabilities**
Derivatives held for trading			
Exchange rate contracts	**191,507,220**	**771,301**	**(668,837)**
Interest rate contracts	**80,000**	**86**	**(86)**
Equity contracts	**33,353**	**–**	**(737)**
Total recognised derivative assets/(liabilities)		**771,387**	**(669,660)**

		Fair values	
As at 31 December 2021 (audited)	Contract amount	Assets	Liabilities
Derivatives held for trading			
Exchange rate contracts	88,109,435	316,699	(250,945)
Interest rate contracts	80,000	140	(140)
Equity contracts	34,686	491	–
Total recognised derivative assets/(liabilities)		317,330	(251,085)

	Credit risk weighted amount	
	30 June 2022 (unaudited)	31 December 2021 (audited)
Derivatives held for trading	**1,964,366**	909,736

The contract amounts of these instruments indicate the volume of transactions outstanding as at the end of the reporting period, they do not represent the amounts at risk.

The credit risk weighted amounts are calculated in accordance with the standardised (counterparty credit risk) approach as stipulated in the Banking (Capital) Rules.

The above fair values have not taken into account the effect of bilateral netting arrangements and accordingly the amounts disclosed are shown on a gross basis.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

17 Derivative financial instruments (Continued)

The Group uses the following derivative strategies:

– Trading purposes (customer needs)

The Group offers its customers derivatives in connection with their risk management actions to transfer, modify or reduce their interest rate, foreign exchange and other market/credit risks or for their own trading purposes. As part of this process, the Group considers the customers' suitability for the risk involved, and the business purpose for the transaction. The Group also manages its derivative-risk positions through offsetting trade activities, controls focused on price verification, and daily reporting of positions to senior managers.

– Trading purposes (own account)

The Group trades derivatives for its own account. These derivatives are entered into in order to take proprietary positions. Trading limits and price verification controls are key aspects of this activity.

18 Properties for sale

	30 June 2022 (unaudited)	31 December 2021 (audited)
Property development		
Leasehold land held for development for sale	**381,188**	381,188
Building development cost	**314,726**	302,736
	695,914	683,924

The Group has undertaken a project to redevelop the properties located in West Point. As at 30 June 2022, the net book amount of land and building incurred for this project were HK$873,275,000 (31 December 2021: HK$855,458,000), of which HK$695,914,000 (31 December 2021: HK$683,924,000) were classified as properties for sale while the remaining HK$177,361,000 (31 December 2021: HK$171,534,000) as bank premises under development (Note 19) in accordance with the redevelopment plan.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

19 Properties and equipment

				Property under development			
	Leasehold land	Bank premises	Furniture, fittings and equipment	Leasehold land	Development cost	Right-of-use assets	Total
As at 1 January 2021							
Cost	1,391,522	1,079,650	929,474	97,823	48,022	692,639	4,239,130
Accumulated depreciation	(195,633)	(332,666)	(694,517)	(966)	–	(358,192)	(1,581,974)
Net book amount	1,195,889	746,984	234,957	96,857	48,022	334,447	2,657,156
Year ended 31 December 2021							
Opening net book amount	1,195,889	746,984	234,957	96,857	48,022	334,447	2,657,156
Additions	–	1,952	69,502	–	26,767	62,654	160,875
Adjustments	–	–	–	–	–	(34,341)	(34,341)
Disposals/write-off/expiry							
Cost	–	–	(10,466)	–	–	(77,522)	(87,988)
Accumulated depreciation	–	–	10,444	–	–	77,522	87,966
Depreciation charge	(17,432)	(25,602)	(79,904)	(112)	–	(110,637)	(233,687)
Exchange adjustments	–	423	(43)	–	–	(84)	296
Closing net book amount	1,178,457	723,757	224,490	96,745	74,789	252,039	2,550,277
As at 31 December 2021 (audited)							
Cost	1,391,522	1,082,228	988,917	97,823	74,789	643,891	4,279,170
Accumulated depreciation	(213,065)	(358,471)	(764,427)	(1,078)	–	(391,852)	(1,728,893)
Net book amount	1,178,457	723,757	224,490	96,745	74,789	252,039	2,550,277
Six months ended 30 June 2022							
Opening net book amount	**1,178,457**	**723,757**	**224,490**	**96,745**	**74,789**	**252,039**	**2,550,277**
Additions	**–**	**–**	**13,287**	**–**	**5,883**	**42,721**	**61,891**
Adjustments	**–**	**–**	**–**	**–**	**–**	**(989)**	**(989)**
Disposals/write-off/expiry							
Cost	**–**	**–**	**(10)**	**–**	**–**	**(63,684)**	**(63,694)**
Accumulated depreciation	**–**	**–**	**–**	**–**	**–**	**63,684**	**63,684**
Depreciation charge	**(8,716)**	**(12,911)**	**(40,285)**	**(56)**	**–**	**(53,985)**	**(115,953)**
Exchange adjustments	**–**	**(1,421)**	**(888)**	**–**	**–**	**(174)**	**(2,483)**
Closing net book amount	**1,169,741**	**709,425**	**196,594**	**96,689**	**80,672**	**239,612**	**2,492,733**
As at 30 June 2022 (unaudited)							
Cost	**1,391,522**	**1,079,976**	**999,104**	**97,823**	**80,672**	**621,134**	**4,270,231**
Accumulated depreciation	**(221,781)**	**(370,551)**	**(802,510)**	**(1,134)**	**–**	**(381,522)**	**(1,777,498)**
Net book amount	**1,169,741**	**709,425**	**196,594**	**96,689**	**80,672**	**239,612**	**2,492,733**

The Group has undertaken a project to redevelop the properties located in West Point. As at 30 June 2022, the net book amount of land and building incurred for this project were HK$873,275,000 (31 December 2021: HK$855,458,000), of which HK$695,914,000 (31 December 2021: HK$683,924,000) were classified as properties for sale (Note 18) while the remaining HK$177,361,000 (31 December 2021: HK$171,534,000) as bank premises under development in accordance with the redevelopment plan.

As at 30 June 2022, interests in freehold land outside Hong Kong amounted to HK$33,257,000 (31 December 2021: HK$34,623,000) were included as bank premises above.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

20 Investment properties

	Leasehold land	Buildings	Total
As at 1 January 2021			
Cost	725,305	334,626	1,059,931
Accumulated depreciation	(11,270)	(38,135)	(49,405)
Net book amount	714,035	296,491	1,010,526
Year ended 31 December 2021			
Opening net book amount	714,035	296,491	1,010,526
Additions	–	1,040	1,040
Depreciation charge	(866)	(8,028)	(8,894)
Closing net book amount	713,169	289,503	1,002,672
As at 31 December 2021 (audited)			
Cost	725,305	335,666	1,060,971
Accumulated depreciation	(12,136)	(46,163)	(58,299)
Net book amount	713,169	289,503	1,002,672
Six months ended 30 June 2022			
Opening net book amount	**713,169**	**289,503**	**1,002,672**
Depreciation charge	**(433)**	**(4,014)**	**(4,447)**
Closing net book amount	**712,736**	**285,489**	**998,225**
As at 30 June 2022 (unaudited)			
Cost	**725,305**	**335,666**	**1,060,971**
Accumulated depreciation	**(12,569)**	**(50,177)**	**(62,746)**
Net book amount	**712,736**	**285,489**	**998,225**

As at 30 June 2022, the Group's investment properties were valued at HK$2,544,900,000 (31 December 2021: HK$2,843,000,000) by an independent firm of Jones Lang LaSalle Limited (31 December 2021: Cushman & Wakefield Limited), who has among their staff Fellows of the Hong Kong Institute of Surveyors with recent experience in the location and category of properties being valued. The valuations were performed on an open market value basis.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

20 Investment properties (Continued)

Operating lease commitments as a lessor

Where a group company is the lessor, the future minimum lease receivables under non-cancellable leases are as follows:

	30 June 2022 (unaudited)	31 December 2021 (audited)
Not later than 1 year	**51,644**	41,945
1 to 2 years	**40,470**	26,112
2 to 5 years	**31,876**	18,167
	123,990	86,224

The Group leases its investment properties under operating lease arrangements, with leases typically for a period from 2 to 5 years. The terms of the leases generally require the tenants to pay security deposits and provide for rent adjustments according to the prevailing market conditions at the expiration of the lease.

21 Deposits from customers

	30 June 2022 (unaudited)	31 December 2021 (audited)
Demand deposits and current accounts	**22,086,111**	19,764,787
Savings deposits	**55,333,561**	57,883,620
Time, call and notice deposits	**106,191,474**	105,548,923
Deposits from Hong Kong Government Exchange Fund	**392,398**	389,915
	184,003,544	183,587,245

22 Fair value of financial assets and liabilities

(a) Financial instruments not measured at fair value

(i) Balances with banks and placements with banks

Balances with banks and placements with banks include inter-bank placements and are stated net of impairment allowances. The maturities of these financial assets are within one year. The carrying amount at the reporting date approximates their fair value.

(ii) Loans and advances to customers

Loans and advances are stated net of impairment allowances. An insignificant portion of loans and advances to customers bears interest at fixed rate. The carrying amount at the reporting date approximates their fair value.

(iii) Investment securities at amortised cost

The fair value for investment securities at amortised cost is based on market prices or broker/dealer price quotations. Where this information is not available, fair value is estimated using quoted market prices for securities with similar credit, maturity and yield characteristics. The fair value of investment securities at amortised cost is classified under Level 1 (30 June 2022: HK$1,760,356,000; 31 December 2021: HK$1,369,774,000) in the fair value hierarchy. Please refer to Note 22(b) for the definition of fair value hierarchy.

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

22 Fair value of financial assets and liabilities (Continued)

(a) Financial instruments not measured at fair value (Continued)

(iv) Deposits and balances from banks and deposits from customers

Substantially all the deposits and balances from banks and deposits from customers will mature within 1 year from the reporting date. Hence, the carrying amount at the reporting date approximates their fair value.

(v) Subordinated debts

The fair value of subordinated debts of HK$4,320,979,000 (31 December 2021: HK$4,429,411,000) is classified under Level 2 in the fair value hierarchy.

(b) Fair value hierarchy

Valuation governance

The Group has in place fair valuation policy to ensure adequate governance and control processes for the designation and valuation of financial instruments to be measured at fair value for financial reporting, risk management and regulatory capital purposes. The valuation process is conducted by control units independent of risk taking units.

The Group is to recognise transfers into and transfers out of fair value hierarchy levels as of that date of the event or change in circumstances that caused the transfer.

HKFRS 13 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Group's market assumptions. These two types of inputs have created the following fair value hierarchy:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities, funds and debt securities on exchanges, exchange-traded derivative contracts and paper gold.

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the assets or liabilities, either directly (that is, as prices) or indirectly (that is, derived from prices). This level includes instruments such as over-the-counter derivative contracts and unlisted debt securities. Observable parameters that are used as input include market data such as interest rate yield curves and exchange rate implied volatilities.

Level 3 – Inputs for the assets or liabilities that are not based on observable market data (unobservable inputs). This level includes unlisted equity securities and unlisted debt securities with significant unobservable components.

This hierarchy requires the use of observable market data when available. The Group considers relevant and observable market prices in its valuations where possible.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

22 Fair value of financial assets and liabilities (Continued)

(b) Fair value hierarchy (Continued)

Recurring fair value measurement

As at 30 June 2022 (unaudited)	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets at fair value through profit or loss				
Debt securities (Note a)	**491,447**	**1,013**	**–**	**492,460**
Equity securities	**359,438**	**–**	**10,224**	**369,662**
Derivative financial instruments				
Exchange rate contracts	**–**	**771,301**	**–**	**771,301**
Interest rate contracts	**–**	**86**	**–**	**86**
Equity contracts	**–**	**–**	**–**	**–**
Investment securities at fair value through other comprehensive income				
Debt securities	**33,012,950**	**29,576,058**	**2,874**	**62,591,882**
Equity securities (Note b)	**3,431,231**	**–**	**64,200**	**3,495,431**
Total Assets	**37,295,066**	**30,348,458**	**77,298**	**67,720,822**
Derivative financial instruments				
Exchange rate contracts	**–**	**668,837**	**–**	**668,837**
Interest rate contracts	**–**	**86**	**–**	**86**
Equity contracts	**737**	**–**	**–**	**737**
Total Liabilities	**737**	**668,923**	**–**	**669,660**

As at 31 December 2021 (audited)	Level 1	Level 2	Level 3	Total
Financial assets at fair value through profit or loss				
Debt securities (Note a)	3,123	1,680,152	–	1,683,275
Equity securities	410,434	–	10,224	420,658
Derivative financial instruments				
Exchange rate contracts	–	316,699	–	316,699
Interest rate contracts	–	140	–	140
Equity contracts	491	–	–	491
Investment securities at fair value through other comprehensive income				
Debt securities	37,308,504	40,192,341	2,874	77,503,719
Equity securities (Note b)	3,869,194	–	66,080	3,935,274
Total Assets	41,591,746	42,189,332	79,178	83,860,256
Derivative financial instruments				
Exchange rate contracts	–	250,945	–	250,945
Interest rate contracts	–	140	–	140
Equity contracts	–	–	–	–
Total Liabilities	–	251,085	–	251,085

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

22 Fair value of financial assets and liabilities (Continued)

(b) Fair value hierarchy (Continued)

Note a: Financial assets amounted to HK$974,223,000 as at 30 June 2022 (31 December 2021: HK$1,967,256,000) comprising balances with banks of HK$484,904,000 (31 December 2021: HK$287,104,000) and financial assets at fair value through profit or loss of HK$489,319,000 (31 December 2021: HK$1,680,152,000) were under a collateral arrangement with a shareholder of the Bank for its provision of the credit facilities of HK$784,795,000 (31 December 2021: HK$779,830,000) to the Bank's branches in the United States.

Note b: As at 30 June 2022, equity securities designated at fair value through other comprehensive income amounting to HK$3,495,431,000 (31 December 2021: HK$3,935,274,000) were for long term investment purpose, of which HK$3,271,758,000 (31 December 2021: HK$3,717,703,000) were the fair value of the Bank's investment in Bank of Shanghai, China.

There were no significant transfers of financial assets or liabilities between level 1 and level 2 fair value hierarchy classifications.

Level 2 fair values of unlisted debt securities are determined based on quotes from brokers. The most significant input is discount rate of the instrument.

Level 2 fair values of foreign exchange rate contracts and interest rate contracts are determined using the appropriate foreign exchange rates, interest rate yield curves and where applicable, the implied option volatility at the reporting date, with the expected cash-flow discounted back to present value.

Level 3 fair values of unlisted equity securities and debentures are determined based on valuation techniques using significant unobservable inputs, which includes the market comparison approach and the dividend discount approach. The fair value is affected by the price to book ratio of appropriate comparables or dividend growth rate.

If the significant unobservable inputs would be shifted by +/– 5%, the impact on other comprehensive income would be increased by HK$1,708,000 (31 December 2021: HK$1,732,000) or decreased by HK$1,692,000 (31 December 2021: HK$1,716,000) and profit or loss would be increased/decreased by HK$511,000 (31 December 2021: HK$511,000) respectively.

The following table presents the changes in level 3 instruments for the period ended 30 June 2022 and year ended 31 December 2021 respectively.

	Financial assets at fair value through profit or loss		Investment securities at fair value through other comprehensive income		
	Equity securities	Total	Equity securities	Debt securities	Total
As at 1 January 2021	8,722	8,722	64,474	2,874	67,348
Total gains					
– Profit	1,502	1,502	–	–	–
– Other comprehensive income	–	–	710	–	710
Exchange adjustments	–	–	896	–	896
As at 31 December 2021 (audited) and 1 January 2022	**10,224**	**10,224**	**66,080**	**2,874**	**68,954**
Total gains					
– Profit	**–**	**–**	**–**	**–**	**–**
– Other comprehensive income	**–**	**–**	**(14)**	**–**	**(14)**
Exchange adjustments	**–**	**–**	**(1,866)**	**–**	**(1,866)**
As at 30 June 2022 (unaudited)	**10,224**	**10,224**	**64,200**	**2,874**	**67,074**

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

23 Subordinated debts

	30 June 2022 (unaudited)	31 December 2021 (audited)
US$250 million fixed rate subordinated notes issued due 2027 at amortised cost (Note a)	**1,952,850**	1,939,939
US$300 million fixed rate subordinated notes issued due 2029 at amortised cost (Note b)	**2,345,511**	2,329,743
	4,298,361	4,269,682

Note a: This represents US$250,000,000 Basel III compliant 10-year subordinated fixed rate notes qualifying as Tier 2 capital of the Bank in accordance with the Banking (Capital) Rules ("BCR"), which are listed on the Hong Kong Stock Exchange. The notes will mature on 29 November 2027 with an optional redemption date falling on 29 November 2022. Interest at 3.75% p.a. is payable semi-annually from the issue date to the optional redemption date. Thereafter, if the notes are not redeemed, the interest rate will be reset and the notes will bear interest at the prevailing 5-year U.S. Treasury Rate plus 170.5 basis points. The Bank may, subject to receiving the prior approval of the Hong Kong Monetary Authority ("HKMA"), redeem the notes at the option of the Bank in whole but not in part, at par either on the optional redemption date or for tax or regulatory reasons at any time prior to maturity of the notes.

Note b: This represents US$300,000,000 Basel III compliant 10-year subordinated fixed rate notes qualifying as Tier 2 capital of the Bank in accordance with the BCR, which are listed on the Hong Kong Stock Exchange. The notes will mature on 17 January 2029 with an optional redemption date falling on 17 January 2024. Interest at 5.00% p.a. is payable semi-annually from the issue date to the optional redemption date. Thereafter, if the notes are not redeemed, the interest rate will be reset and the notes will bear interest at the prevailing 5-year U.S. Treasury Rate plus 250 basis points. The Bank may, subject to receiving the prior approval of the HKMA, redeem the notes at the option of the Bank in whole but not in part, at par either on the optional redemption date or for tax or regulatory reasons at any time prior to maturity of the notes.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

24 Deferred income tax

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. The offset amounts are shown below:

Deferred income tax assets	Credit impairment allowances	Accelerated tax depreciation	Fair value (gains)/losses on investment securities at fair value through other comprehensive income	Others	Total
As at 1 January 2021	26,836	(11,264)	(3)	12,099	27,668
(Charged)/credited to the statement of profit or loss	(1,377)	739	–	729	91
Exchange adjustments	651	–	–	77	728
Reclassified from/(to) deferred income tax liabilities	71,373	(40,711)	(3,597)	58	27,123
As at 31 December 2021 (audited) and 1 January 2022	**97,483**	**(51,236)**	**(3,600)**	**12,963**	**55,610**
Credited/(charged) to the statement of profit or loss	**14,894**	**363**	**–**	**(7,048)**	**8,209**
Exchange adjustments	**(1,448)**	**1,005**	**–**	**65**	**(378)**
Credited to other comprehensive income	**–**	**–**	**319,922**	**–**	**319,922**
As at 30 June 2022 (unaudited)	**110,929**	**(49,868)**	**316,322**	**5,980**	**383,363**

Deferred income tax liabilities	Credit impairment allowances	Accelerated tax depreciation	Fair value (gains)/losses on investment securities at fair value through other comprehensive income	Others	Total
As at 1 January 2021	67,301	(51,197)	(137,108)	11,133	(109,871)
Credited/(charged) to the statement of profit or loss	4,073	(5,038)	–	(793)	(1,758)
Credited to other comprehensive income	–	–	133,511	–	133,511
Reclassified (to)/from deferred income tax assets	(71,373)	40,711	3,597	(58)	(27,123)
As at 31 December 2021 (audited) and 30 June 2022 (unaudited)	**1**	**(15,524)**	**–**	**10,282**	**(5,241)**

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

25 Reserves attributable to equity holders

	Regulatory reserve (Note a)	Investment revaluation reserve	General and other reserves	Total
As at 1 January 2021	940,271	3,214,926	7,270,867	11,426,064
Net change in fair value of investment securities at fair value through other comprehensive income (Note b)	–	(934,596)	–	(934,596)
Currency translation difference arising from overseas operations	2,040	–	31,970	34,010
Share of reserves of associates and joint venture	–	(9,268)	(301)	(9,569)
As at 31 December 2021 (audited) and 1 January 2022	**942,311**	**2,271,062**	**7,302,536**	**10,515,909**
Net change in fair value of investment securities at fair value through other comprehensive income (Note b)	**–**	**(2,069,639)**	**–**	**(2,069,639)**
Currency translation difference arising from overseas operations	**(3,359)**	**–**	**(63,957)**	**(67,316)**
Share of reserves of associates and joint venture	**–**	**(51,113)**	**92**	**(51,021)**
As at 30 June 2022 (unaudited)	**938,952**	**150,310**	**7,238,671**	**8,327,933**

Note a: The regulatory reserve is maintained to satisfy the provisions of the Hong Kong Banking Ordinance and local regulatory requirements of overseas branches for prudent supervision purpose. Any movements in the regulatory reserve for Hong Kong operations are made in consultation with the Hong Kong Monetary Authority.

Note b: For the six months ended 30 June 2022, net change in fair value of investment securities at fair value through other comprehensive income was a loss of HK$2,069,639,000 (for the year ended 31 December 2021: loss of HK$934,596,000) due to the decrease in net fair value of HK$440,850,000 (for the year ended 31 December 2021: HK$246,012,000) on equities holdings and HK$1,628,789,000 (for the year ended 31 December 2021: HK$688,584,000) from debt securities portfolio mainly attributable to the adverse market sentiment on interest rate hikes during the first half of 2022. As at 30 June 2022, the debt securities at fair value through other comprehensive income had 96% (31 December 2021: 95%) in investment grade or above based on Standard & Poor's ratings or their equivalents while 86% (31 December 2021: 84%) of the portfolio maturing within 3 years.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

26 Contingent liabilities and commitments

(a) Credit commitments

The contract and credit risk weighted amounts of the Group's off-balance sheet financial instruments that commit it to extend credit to customers are as follows:

Contract amounts	**30 June 2022 (unaudited)**	31 December 2021 (audited)
Direct credit substitutes	**2,044,941**	2,263,738
Trade-related contingencies	**2,110,634**	1,893,706
Forward forward deposits placed	**313,918**	230,917
Other commitments with an original maturity of:		
– under 1 year	**3,294,439**	1,162,198
– 1 year and over	**5,566,606**	6,199,238
– unconditionally cancellable	**33,194,683**	37,077,197
	46,525,221	48,826,994
Credit risk weighted amounts	**4,760,668**	4,958,710

Contingent liabilities and commitments are credit-related instruments which include acceptances, letters of credit, guarantees and commitments to extend credit. The risk involved is essentially the same as the credit risk involved in extending loan facilities to customers. These transactions are therefore subject to the same credit origination, portfolio maintenance and collateral requirements as for customers applying for loans.

(b) Capital commitments

Capital expenditure for the acquisition of properties and equipment outstanding as at the reporting date but not yet incurred is as follows:

	30 June 2022 (unaudited)	31 December 2021 (audited)
Contracted but not provided for	**162,932**	260,250

(c) Other contingent liabilities

The Group is involved in legal actions which are in relation to its normal business operations. No material provision was made for those actions against the Group because the management believes that the Group has adequate grounds to defend against the claimants or the amounts involved in those actions are not expected to be material.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

27 Maturity analysis

The table below analyses the Group's assets and liabilities into relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date.

As at 30 June 2022 (unaudited)	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
Assets								
Cash and balances with banks	9,145,593	28,369,202	–	–	–	–	–	37,514,795
Placements with banks	–	–	3,757,487	17,578,892	–	–	–	21,336,379
Loans and advances to customers	4,031,333	7,630,494	9,893,772	22,348,818	37,753,115	14,470,699	716,878	96,845,109
Financial assets at fair value through profit or loss	–	458,166	3,140	–	–	31,154	369,662	862,122
Derivative financial instruments	–	256,385	198,369	255,813	60,820	–	–	771,387
Investment securities at fair value through other comprehensive income	–	3,303,857	5,064,511	15,395,144	36,440,878	2,384,617	3,498,306	66,087,313
Investment securities at amortised cost	–	119,987	102,036	1,244,610	509,448	–	–	1,976,081
Properties for sale	–	–	–	695,914	–	–	–	695,914
Investments in associates and joint venture	–	–	–	–	–	–	449,192	449,192
Properties and equipment	–	9,429	17,328	65,329	87,594	59,932	2,253,121	2,492,733
Investment properties	–	–	–	–	–	–	998,225	998,225
Deferred income tax assets	–	–	–	–	–	–	383,363	383,363
Other assets	827,338	718,540	70,986	266,279	430,789	42,334	3,520	2,359,786
Total assets	14,004,264	40,866,060	19,107,629	57,850,799	75,282,644	16,988,736	8,672,267	232,772,399
Liabilities								
Deposits and balances from banks	1,164,915	3,496,614	3,253,762	386,749	–	–	–	8,302,040
Deposits from customers	78,651,323	37,247,660	48,902,530	19,032,895	169,136	–	–	184,003,544
Derivative financial instruments	–	161,353	194,316	253,183	60,808	–	–	669,660
Subordinated debts	–	–	–	–	–	4,298,361	–	4,298,361
Other liabilities	301,868	1,114,843	236,753	467,569	91,898	59,802	–	2,272,733
Current income tax liabilities	–	–	–	249,054	–	–	–	249,054
Deferred income tax liabilities	–	–	–	–	–	–	5,241	5,241
Total liabilities	80,118,106	42,020,470	52,587,361	20,389,450	321,842	4,358,163	5,241	199,800,633
Net liquidity gap	(66,113,842)	(1,154,410)	(33,479,732)	37,461,349	74,960,802	12,630,573	8,667,026	32,971,766
Of which lease liabilities included in:								
Other liabilities	–	9,292	18,366	69,038	95,303	59,802	–	251,801

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

27 Maturity analysis (Continued)

As at 31 December 2021 (audited)	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
Assets								
Cash and balances with banks	9,430,458	21,255,129	–	–	–	–	–	30,685,587
Placements with banks	–	–	6,246,221	9,232,458	–	–	–	15,478,679
Loans and advances to customers	5,201,816	7,675,293	11,257,024	20,169,940	33,087,724	15,046,431	3,467,998	95,906,226
Financial assets at fair value through profit or loss	–	–	64	3,133	31,981	1,648,097	420,658	2,103,933
Derivative financial instruments	–	46,094	141,229	107,847	22,160	–	–	317,330
Investment securities at fair value through other comprehensive income	–	3,953,939	8,543,850	24,383,839	37,015,680	3,603,537	3,938,148	81,438,993
Investment securities at amortised cost	–	–	101,838	218,788	1,253,009	–	–	1,573,635
Properties for sale	–	–	–	–	683,924	–	–	683,924
Investments in associates and joint venture	–	–	–	–	–	–	466,829	466,829
Properties and equipment	–	8,499	16,676	62,134	101,894	62,836	2,298,238	2,550,277
Investment properties	–	–	–	–	–	–	1,002,672	1,002,672
Deferred income tax assets	–	–	–	–	–	–	55,610	55,610
Other assets	258,443	601,646	93,503	264,881	388,344	49,998	12,803	1,669,618
Total assets	14,890,717	33,540,600	26,400,405	54,443,020	72,584,716	20,410,899	11,662,956	233,933,313
Liabilities								
Deposits and balances from banks	1,160,491	3,067,515	4,315,193	489,351	–	–	–	9,032,550
Deposits from customers	79,024,715	34,199,465	47,228,378	22,895,655	239,032	–	–	183,587,245
Derivative financial instruments	–	63,484	70,074	95,366	22,161	–	–	251,085
Subordinated debts	–	–	–	–	–	4,269,682	–	4,269,682
Other liabilities	634,268	1,085,883	201,614	313,579	128,045	62,719	–	2,426,108
Current income tax liabilities	–	128,133	11,902	–	–	–	–	140,035
Deferred income tax liabilities	–	–	–	–	–	–	5,241	5,241
Total liabilities	80,819,474	38,544,480	51,827,161	23,793,951	389,238	4,332,401	5,241	199,711,946
Net liquidity gap	(65,928,757)	(5,003,880)	(25,426,756)	30,649,069	72,195,478	16,078,498	11,657,715	34,221,367
Of which lease liabilities included in: Other liabilities	–	8,989	17,610	66,753	110,862	62,719	–	266,933

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

28 Related party transactions

A number of banking transactions were entered into with related parties by the Group in the normal course of business and at arm's length basis. The outstanding balances of the related party transactions at the reporting date, and related expense and income for the period were as follows:

As at 30 June 2022 (unaudited)	**Ultimate holding company and fellow subsidiaries**	**Associates and joint venture**	**Key management personnel (Note a)**	**Other related parties (Note b)**	**Total**
Aggregate amounts outstanding at the period end					
– Loans and advances	**–**	**–**	**40,609**	**–**	**40,609**
– Cash and balances with banks	**13,365**	**–**	**–**	**533,371**	**546,736**
– Deposits and balances from banks and customers	**272,824**	**517,906**	**397,773**	**2,911,116**	**4,099,619**
– Investment securities at fair value through other comprehensive income	**159,473**	**–**	**–**	**–**	**159,473**
– Stage 1 and Stage 2 credit impairment allowances	**1**	**3**	**99**	**26**	**129**
– Contingent liabilities and other commitments	**–**	**2,000**	**61,310**	**–**	**63,310**
Six months ended 30 June 2022 (unaudited)					
Interest income received from related parties	**16**	**–**	**537**	**1,495**	**2,048**
Interest expenses paid to related parties	**526**	**1,531**	**3,314**	**12,615**	**17,986**
Net fee and commission income/(expense) from/(to) related parties	**(426)**	**24,161**	**2**	**(847)**	**22,890**
Net other operating income/(expense) from/(to) related parties	**15**	**(2,672)**	**(175)**	**–**	**(2,832)**

As at 31 December 2021 (audited)	Ultimate holding company and fellow subsidiaries	Associates and joint venture	Key management personnel (Note a)	Other related parties (Note b)	Total
Aggregate amounts outstanding at the year end					
– Loans and advances	–	–	34,876	–	34,876
– Cash and balances with banks	14,270	–	–	456,761	471,031
– Deposits and balances from banks and customers	211,617	1,450,922	1,334,881	2,981,816	5,979,236
– Investment securities at fair value through other comprehensive income	151,491	–	–	–	151,491
– Stage 1 and Stage 2 credit impairment allowances	1	3	63	26	93
– Contingent liabilities and other commitments	–	2,000	45,496	–	47,496
Six months ended 30 June 2021 (unaudited)					
Interest income received from related parties	19	–	549	864	1,432
Interest expenses paid to related parties	923	644	2,897	6,789	11,253
Net fee and commission income/(expense) from/(to) related parties	(242)	29,738	–	(73)	29,423
Net other operating income/(expense) from/(to) related parties	16	(2,557)	(150)	(2,763)	(5,454)

Note a: Include key management personnel and Directors of the Bank and the ultimate holding company, their close family members and entities that are controlled or jointly controlled, directly or indirectly, by key management personnel or Directors.

Note b: Include other shareholders of the Group.

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

28 Related party transactions (Continued)

Key management personnel compensation

The compensation for Directors and key management personnel of the Bank is as follows:

	Six months ended 30 June 2022 (unaudited)	Six months ended 30 June 2021 (unaudited)
Salaries and other short-term employee benefits	**41,233**	32,411

29 Segment reporting

(a) By operating segment

Operating segments, and the amounts of each segment item reported in the Group Interim Financial Disclosure Statement, are identified from the financial information provided regularly to the Group's most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

For the purpose of assessing performance of business activity by class, the allocation of revenue, besides the direct revenue generated by the business, also includes the benefits of funding resources derived from the other businesses by way of internal fund transfer pricing mechanisms. Cost allocation is based on the direct cost incurred by the class of business and internal allocation of management overheads. Asset allocation is based on the assets directly attributable to the class of business and internal allocation of assets.

The Group is engaged predominantly in banking and related financial activities. It comprises retail and corporate banking, trade finance, treasury and other classes of business.

Retail and corporate banking – incorporating banking services to individual and corporate customers such as current accounts, savings accounts, fixed deposits, safe deposit box, credit cards, loans and other credit facilities.

Trade finance – incorporating import and export bills services, invoice discounting/receivable financing and ECIC supported export finance for small and medium enterprises.

Treasury – conducting treasury operations for trading and investment purposes such as foreign exchange, money market and capital market activities and providing treasury products such as yield enhancement and hedging products to retail and corporate customers.

The business activities under "Others" mainly comprise remittance, share dealing, provisions of trustee, wealth management and insurance services, and support services for operations not directly identified under other reportable segments.

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

29 Segment reporting (Continued)

(a) By operating segment (Continued)

	Six months ended 30 June 2022 (unaudited)				
	Retail and corporate banking	**Trade finance**	**Treasury**	**Others**	**Total**
Net interest income	**1,721,106**	**19,707**	**25,349**	**27,906**	**1,794,068**
Non-interest income	**140,523**	**37,788**	**266,945**	**229,715**	**674,971**
Operating income	**1,861,629**	**57,495**	**292,294**	**257,621**	**2,469,039**
Operating expenses	**(464,019)**	**(44,511)**	**(58,293)**	**(313,964)**	**(880,787)**
Operating profit/(loss) before credit impairment losses	**1,397,610**	**12,984**	**234,001**	**(56,343)**	**1,588,252**
Credit impairment losses	**(49,377)**	**(1,249)**	**4,012**	**266**	**(46,348)**
Operating profit/(loss) after credit impairment losses	**1,348,233**	**11,735**	**238,013**	**(56,077)**	**1,541,904**
Share of net profits of associates and joint venture	**–**	**–**	**–**	**37,619**	**37,619**
Profit/(loss) before income tax (after taking into account internal fund transfers and cost allocation)	**1,348,233**	**11,735**	**238,013**	**(18,458)**	**1,579,523**
Income tax expense	**301,815**	**1,843**	**33,972**	**(9,486)**	**328,144**
Depreciation expenses	**50,989**	**4,903**	**7,407**	**57,101**	**120,400**
As at 30 June 2022 (unaudited):					
Total assets	**96,875,473**	**4,008,706**	**126,200,045**	**5,688,175**	**232,772,399**
Total liabilities	**184,791,854**	**75,078**	**13,644,240**	**1,289,461**	**199,800,633**

	Six months ended 30 June 2021 (unaudited)				
	Retail and corporate banking	Trade finance	Treasury	Others	Total
Net interest income	1,678,098	27,275	151,134	8,019	1,864,526
Non-interest income	141,977	42,452	241,159	339,977	765,565
Operating income	1,820,075	69,727	392,293	347,996	2,630,091
Operating expenses	(463,176)	(45,382)	(57,151)	(291,517)	(857,226)
Operating profit before credit impairment losses	1,356,899	24,345	335,142	56,479	1,772,865
Credit impairment losses	(30,833)	(6,197)	(7,131)	(60)	(44,221)
Operating profit after credit impairment losses	1,326,066	18,148	328,011	56,419	1,728,644
Share of net profits of associates and joint venture	–	–	–	54,142	54,142
Profit before income tax (after taking into account internal fund transfers and cost allocation)	1,326,066	18,148	328,011	110,561	1,782,786
Income tax expense	295,472	1,739	53,979	(15,114)	336,076
Depreciation expenses	53,262	5,130	6,465	54,473	119,330
As at 31 December 2021 (audited):					
Total assets	96,266,483	3,726,559	128,253,615	5,686,656	233,933,313
Total liabilities	184,295,313	65,690	14,203,556	1,147,387	199,711,946

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

29 Segment reporting (Continued)

(b) By geographical regions

The following tables provide segment information by geographical area determined with reference to the location of the principal operations of the branches and subsidiaries of the Group.

	As at 30 June 2022 (unaudited)			**Six months ended 30 June 2022 (unaudited)**		
	Total assets	**Total liabilities**	**Contingent liabilities and commitments**	**Total operating income**	**Profit before income tax**	**Capital expenditure**
Hong Kong and Mainland China	**198,173,724**	**185,891,294**	**44,100,971**	**1,896,701**	**1,099,591**	**59,669**
United States	**29,591,810**	**11,530,189**	**2,266,606**	**525,055**	**448,805**	**1,467**
United Kingdom	**5,006,865**	**2,379,150**	**157,644**	**47,283**	**31,127**	**755**
Total	**232,772,399**	**199,800,633**	**46,525,221**	**2,469,039**	**1,579,523**	**61,891**

	As at 31 December 2021 (audited)			Six months ended 30 June 2021 (unaudited)		
	Total assets	Total liabilities	Contingent liabilities and commitments	Total operating income	Profit before income tax	Capital expenditure
Hong Kong and Mainland China	199,368,542	183,221,333	44,450,230	2,038,092	1,244,412	73,381
United States	29,056,681	12,729,630	4,234,800	547,196	504,751	1,860
United Kingdom	5,508,090	3,760,983	141,964	44,803	33,623	467
Total	233,933,313	199,711,946	48,826,994	2,630,091	1,782,786	75,708

(All amounts in HK dollar thousands unless otherwise stated)

NOTES TO THE GROUP INTERIM FINANCIAL DISCLOSURE STATEMENT

30 International claims

The following table shows the Group's international claims by major country or geographical segment, each representing 10% or more of the Group's total international claims. International claims refer to exposures to counterparties on which the ultimate risk lies, and are derived according to the location of the counterparties after taking into account any recognised risk transfer. In general, transfer of risk from one country to another is recognised if the claims against a counterparty are guaranteed by another party in a different country or if the claims are on an overseas branch of a bank whose head office is located in a different country.

			Non-bank private sector		
As at 30 June 2022 (unaudited)	**Banks**	**Official sector**	**Non-bank financial institutions**	**Non-financial private sector**	**Total**
Developed countries	**26,578,000**	**2,104,000**	**135,000**	**2,322,000**	**31,139,000**
Offshore centres	**12,087,000**	**573,000**	**3,227,000**	**26,842,000**	**42,729,000**
– of which Hong Kong	**8,177,000**	**573,000**	**2,765,000**	**23,815,000**	**35,330,000**
Developing Asia-Pacific	**44,750,000**	**527,000**	**1,388,000**	**7,362,000**	**54,027,000**
– of which China	**29,689,000**	**527,000**	**1,388,000**	**5,685,000**	**37,289,000**

			Non-bank private sector		
As at 31 December 2021 (audited)	Banks	Official sector	Non-bank financial institutions	Non-financial private sector	Total
Developed countries	19,143,000	391,000	1,712,000	3,283,000	24,529,000
Offshore centres	9,883,000	660,000	3,694,000	29,363,000	43,600,000
– of which Hong Kong	7,292,000	660,000	3,016,000	26,333,000	37,301,000
Developing Asia-Pacific	47,424,000	657,000	1,526,000	8,783,000	58,390,000
– of which China	31,758,000	657,000	1,526,000	6,745,000	40,686,000

REPORT ON REVIEW OF INTERIM FINANCIAL INFORMATION

TO THE BOARD OF DIRECTORS OF SHANGHAI COMMERCIAL BANK LIMITED
(Incorporated in Hong Kong with limited liability)

Introduction

We have reviewed the interim financial information set out on pages 1 to 40 which comprises the interim condensed consolidated statement of financial position of Shanghai Commercial Bank Limited (the "Bank") and its subsidiaries (together, the "Group") as at 30 June 2022 and the interim condensed consolidated statement of profit or loss, the interim condensed consolidated statement of comprehensive income, the interim condensed consolidated statement of changes in equity and the interim condensed consolidated statement of cash flows for the six-month period then ended, and notes, comprising significant accounting policies and other explanatory information. The directors of the Bank are responsible for the preparation and presentation of this interim financial information in accordance with Hong Kong Accounting Standard 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants. Our responsibility is to express a conclusion on this interim financial information based on our review and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Scope of Review

We conducted our review in accordance with Hong Kong Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Hong Kong Institute of Certified Public Accountants. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the interim financial information of the Group is not prepared, in all material respects, in accordance with Hong Kong Accounting Standard 34 "Interim Financial Reporting".

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 24 August 2022

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SHANGHAI COMMERCIAL BANK LIMITED

(Incorporated in Hong Kong with limited liability)

Opinion

What we have audited

The consolidated financial statements of Shanghai Commercial Bank Limited (the "Bank") and its subsidiaries (the "Group"), which are set out on pages 54 to 142, comprise:

– the consolidated statement of financial position as at 31 December 2021;

– the consolidated statement of profit or loss for the year then ended;

– the consolidated statement of comprehensive income for the year then ended;

– the consolidated statement of changes in equity for the year then ended;

– the consolidated statement of cash flows for the year then ended; and

– the notes to the consolidated financial statements, which include significant accounting policies and other explanatory notes.

Our opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2021, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

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

We 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 Group in accordance with the HKICPA's Code of Ethics for Professional Accountants ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. The key audit matter identified in our audit is related to the measurement of expected credit losses of loans and advances to customers.

Key Audit Matters (Continued)

Measurement of expected credit losses ("ECL") of loans and advances to customers

As at 31 December 2021, the Group recorded loan impairment allowances of HK$516 million, with HK$289 million as stage 1 impairment allowances, HK$174 million as stage 2 impairment allowances and HK$53 million as stage 3 impairment allowances in respect of the total gross loan balance of HK$96,422 million. The details of impairment allowances of loans and advances to customers are elaborated in Notes 3.1 and 18.

The Group established governance processes and controls for the measurement of ECL. Management had assessed the overall ECL methodology and determined the methodology remains appropriate since initial adoption. Management continues to determine the staging for its financial assets based on changes in credit quality since initial recognition by identifying Significant Increase in Credit Risk ("SICR") and default events. ECL is measured by the calculation model depending on the stage of the financial assets, which incorporated forward-looking key macroeconomic variables. Management also concluded that post model adjustments, i.e., the management overlay, are required to address certain limitation in its ECL model methodology, including catering potential credit quality deterioration of vulnerable sectors as a result of the ongoing COVID-19 pandemic.

How our audit addressed the Key Audit Matter

We obtained an understanding of the management's internal control and processes behind ECL and assessed the inherent risk of material misstatement by considering the degree of estimation uncertainty and level of other inherent risk factors such as complexity, subjectivity, changes, and susceptibility to management bias or fraud.

Our audit focused on the measurement of ECL of loans and advances to customers due to significant judgements applied by management. Specifically we focused on the following:

(1) ECL methodology and it remains appropriate;

(2) Staging of the financial assets, including management's determination of SICR and default;

(3) Economic indicators for forward-looking measurement, and the application of economic scenarios and weightings; and

(4) Management overlay adjustments due to model constraints or data limitation not covered in the models.

Key Audit Matters (Continued)

How our audit addressed the Key Audit Matter (Continued)

We obtained an understanding, evaluated and tested the controls that management has established to support their measurement of ECL. Furthermore we performed substantive audit procedures to assess the significant judgements, assumptions and disclosures. Our key procedures are set out below:

– We observed and inspected evidence of management governance and ongoing monitoring over ECL models. We further assessed major ECL model methodologies and assumptions used for stage 1 and 2 ECL calculation, including reasonableness of the portfolio segmentation and key parameters estimation which remains appropriate;

– We observed and inspected evidence of Credit Committee's oversight and regular monitoring of the overall credit quality including internal credit rating assignment. In addition we observed and inspected regular post draw-down monitoring of credit quality by monitoring units which are independent from the loan initiation units, including identification of SICR and defaults. We tested on a sample basis, management's post draw-down credit reviews and assessed the appropriateness of management's identification of SICR or defaults by considering financial information and non-financial information of the borrowers, relevant external evidence and other factors. Our samples included the results of the thematic portfolio analysis performed by management in response to changes in external market environments over the credit quality of certain loan portfolios;

– Inspected evidence of regular review and approval of key management judgements including forward-looking and management overlay adjustments. Additionally, we evaluated and challenged management's forward-looking measurement, including management's analysis of their selection of economic indicators, economic scenarios and weightings employed, assessed the reasonableness of the prediction of economic indicators, and performed sensitivity analysis on the probability weightings. We assessed the reasonableness of management's selection of uncertain factors and examined the accuracy of the relevant mathematical calculations;

– We tested, on a sample basis, the ECL calculation of stage 3 loans by challenging management's assumptions in deriving the future cashflows based on borrowers' circumstances, objective evidence of inputs for impairment calculation (including valuation of collateral and macroeconomic variable estimates) and our industry knowledge;

– We assessed the adequacy of the disclosures related to ECL of loans and advances to customers in the Annual Report 2021 in the context of the applicable financial reporting framework.

Based on the results of the above testing, we considered that management's judgements and assumptions applied in determining the ECL of loans and advances to customers were supportable by the evidence obtained and procedures performed.

Other Information

The Directors of the Bank are responsible for the other information. The other information comprises all of the information included in the annual report other than the consolidated financial statements and our auditor's report thereon.

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

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

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

Responsibilities of Directors and the Audit Committee for the Consolidated Financial Statements

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

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

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

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. 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 consolidated financial statements.

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

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

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

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

– Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.

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

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

– Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

We also provide the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, 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 consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Ms. NG Wai Ying.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 9 March 2022

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

(All amounts in HK dollar thousands unless otherwise stated)

	Note	Year ended 31 December 2021	2020
Interest income	6	**4,756,976**	5,679,681
Interest expense	6	**(1,104,411)**	(2,128,022)
Net interest income		**3,652,565**	3,551,659
Fee and commission income	7	**840,187**	879,829
Fee and commission expense	7	**(53,630)**	(56,923)
Net fee and commission income	7	**786,557**	822,906
Net trading income	8	**300,323**	206,951
Net gains from disposal of investment securities at fair value through other comprehensive income		**105,200**	131,656
Dividend income from investment securities at fair value through other comprehensive income		**217,705**	196,954
Other operating income	9	**133,690**	148,295
Net earned insurance premium	10	**37,815**	43,592
Net insurance claims incurred and movement in policyholders' liabilities	10	**(25,957)**	(32,058)
Operating expenses	11	**(1,696,656)**	(1,621,139)
Credit impairment losses	12	**(29,410)**	(125,440)
Operating profit		**3,481,832**	3,323,376
Share of net profits of associates and joint venture	25	**61,393**	45,609
Profit before income tax		**3,543,225**	3,368,985
Income tax expense	14	**(637,595)**	(626,938)
Profit for the year		**2,905,630**	2,742,047
Attributable to:			
Equity holders of the Bank		**2,900,088**	2,736,368
Non-controlling interests		**5,542**	5,679
		2,905,630	2,742,047

The notes on pages 60 to 142 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(All amounts in HK dollar thousands unless otherwise stated)

	Year ended 31 December	
	2021	2020
Profit for the year	**2,905,630**	2,742,047
Other comprehensive income		
Items that may be reclassified to profit or loss		
Currency translation difference arising from overseas operations	**78,583**	118,057
Investment securities at fair value through other comprehensive income		
– Changes in fair value	**(727,767)**	715,324
– Change in credit impairment losses recognised in profit or loss	**6,943**	4,509
– Fair value changes transferred to profit or loss on disposal	**(105,200)**	(131,656)
– Deferred income tax	**137,440**	(96,305)
Share of reserves of associates and joint venture	**(9,173)**	6,343
Items that will not be reclassified to profit or loss		
Equity investments at fair value through other comprehensive income		
– Changes in fair value	**(242,083)**	(550,754)
– Deferred income tax	**(3,929)**	3,450
Share of reserves of associates and joint venture	**(396)**	–
Other comprehensive income for the year, net of tax	**(865,582)**	68,968
Total comprehensive income for the year	**2,040,048**	2,811,015
Attributable to:		
Equity holders of the Bank	**2,034,506**	2,805,349
Non-controlling interests	**5,542**	5,666
Total comprehensive income for the year	**2,040,048**	2,811,015

The notes on pages 60 to 142 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(All amounts in HK dollar thousands unless otherwise stated)

	Note	As at 31 December 2021	2020
ASSETS			
Cash and balances with banks	16	30,685,587	29,995,254
Placements with banks	17	15,478,679	9,234,097
Loans and advances to customers	18	95,906,226	101,247,939
Financial assets at fair value through profit or loss	19	2,103,933	2,198,751
Derivative financial instruments	20	317,330	842,146
Investment securities at fair value through other comprehensive income	21	81,438,993	75,689,043
Investment securities at amortised cost	22	1,573,635	344,670
Properties for sale	23	683,924	591,418
Investments in associates and joint venture	25	466,829	443,480
Properties and equipment	26	2,550,277	2,657,156
Investment properties	27	1,002,672	1,010,526
Deferred income tax assets	32	55,610	27,668
Other assets	28	1,669,618	2,450,000
TOTAL ASSETS		233,933,313	226,732,148
LIABILITIES			
Deposits and balances from banks		9,032,550	7,840,334
Deposits from customers	29	183,587,245	177,796,939
Derivative financial instruments	20	251,085	924,669
Subordinated debts	30	4,269,682	4,241,480
Other liabilities	31	2,426,108	3,206,269
Current income tax liabilities		140,035	117,787
Deferred income tax liabilities	32	5,241	109,871
TOTAL LIABILITIES		199,711,946	194,237,349
EQUITY			
CAPITAL AND RESERVES ATTRIBUTABLE TO EQUITY HOLDERS			
Share capital	33	2,000,000	2,000,000
Retained earnings		21,608,831	18,977,170
Reserves	34	10,515,909	11,426,064
		34,124,740	32,403,234
Non-controlling interests in equity		96,627	91,565
TOTAL EQUITY		34,221,367	32,494,799
TOTAL EQUITY AND LIABILITIES		233,933,313	226,732,148

Approved and authorised for issue by the Board of Directors on 9 March 2022.

Stephen Ching Yen LEE
Chairman

John Con-sing YUNG
Director

Gordon Che Keung KWONG
Director

David Sek-chi KWOK
Managing Director & Chief Executive

The notes on pages 60 to 142 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(All amounts in HK dollar thousands unless otherwise stated)

		Attributable to equity holders			Non-controlling interests	Total equity
	Note	Share capital	Reserves	Retained earnings (including proposed dividends)		
As at 1 January 2020		2,000,000	11,378,917	17,158,968	86,379	30,624,264
Profit for the year		–	–	2,736,368	5,679	2,742,047
Other comprehensive income net of tax		–	47,147	21,834	(13)	68,968
Net change in fair value of investment securities at fair value through other comprehensive income	34	–	(55,419)	–	(13)	(55,432)
Currency translation difference arising from overseas operations	34	–	96,223	21,834	–	118,057
Share of reserves of associates and joint venture	34	–	6,343	–	–	6,343
Total comprehensive income		–	47,147	2,758,202	5,666	2,811,015
Payment of dividend relating to 2019		–	–	(940,000)	(480)	(940,480)
As at 31 December 2020 and 1 January 2021		**2,000,000**	**11,426,064**	**18,977,170**	**91,565**	**32,494,799**
Profit for the year		**–**	**–**	**2,900,088**	**5,542**	**2,905,630**
Other comprehensive income net of tax		**–**	**(910,155)**	**44,573**	**–**	**(865,582)**
Net change in fair value of investment securities at fair value through other comprehensive income	34	**–**	**(934,596)**	**–**	**–**	**(934,596)**
Currency translation difference arising from overseas operations	34	**–**	**34,010**	**44,573**	**–**	**78,583**
Share of reserves of associates and joint venture	34	**–**	**(9,569)**	**–**	**–**	**(9,569)**
Total comprehensive income		**–**	**(910,155)**	**2,944,661**	**5,542**	**2,040,048**
Payment of dividend relating to 2020		**–**	**–**	**(313,000)**	**(480)**	**(313,480)**
As at 31 December 2021		**2,000,000**	**10,515,909**	**21,608,831**	**96,627**	**34,221,367**

	Year ended 31 December	
	2021	2020
Proposed dividend included in retained earnings	**313,000**	313,000

The notes on pages 60 to 142 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

(All amounts in HK dollar thousands unless otherwise stated)

	Note	Year ended 31 December 2021	2020
Cash flows from operating activities			
Profit before income tax		3,543,225	3,368,985
Share of net profits of associates and joint venture	25	(61,393)	(45,609)
Credit impairment losses	12	29,410	125,440
Depreciation expenses		242,581	245,702
Net losses from disposal of equipment	9	5	176
Net gains from disposal of investment securities at fair value through other comprehensive income		(105,200)	(131,656)
Interest income on investment securities at amortised cost and fair value through other comprehensive income	6	(1,213,676)	(1,514,320)
Interest expense on subordinated debts	6	192,791	190,413
Interest expense on lease liabilities	6	4,076	8,702
Dividend income		(217,705)	(196,954)
Hong Kong profits tax paid		(297,367)	(735,123)
Overseas tax paid		(319,739)	(271,426)
Effect of exchange rate changes		(73,338)	280,233
Cash flows from operating activities before changes in operating assets and liabilities		1,723,670	1,324,563
Changes in operating assets and liabilities:			
– Net decrease/(increase) in balances with banks with original maturity beyond 3 months		1,335,624	(2,861,205)
– Net increase in placements with banks with original maturity beyond 3 months		(5,261,586)	(2,330,521)
– Net decrease/(increase) in financial assets at fair value through profit or loss		94,818	(317,726)
– Net (increase)/decrease in derivative financial instruments		(148,768)	75,013
– Net decrease/(increase) in loans and advances to customers		5,689,432	(2,590,103)
– Net increase in right-of-use assets		(28,313)	(97,180)
– Net decrease/(increase) in other assets		826,289	(657,007)
– Net increase/(decrease) in deposits and balances from banks		1,127,601	(3,837,276)
– Net increase in deposits from customers		5,289,660	4,405,644
– Net increase in lease liabilities		27,406	97,405
– Net (decrease)/increase in other liabilities		(665,501)	393,680
Net cash generated from/(used in) operating activities		10,010,332	(6,394,713)

CONSOLIDATED STATEMENT OF CASH FLOWS

(All amounts in HK dollar thousands unless otherwise stated)

	Note	Year ended 31 December 2021	2020
Cash flows from investing activities			
Interest received on investment securities at amortised cost and fair value through other comprehensive income		1,292,676	1,504,894
Dividends received on investment securities at fair value through other comprehensive income		217,705	196,954
Dividends received from associates and joint venture	25	28,475	26,135
Purchases of properties and equipment		(98,221)	(87,411)
Additions of investment properties	27	(1,040)	(2,272)
Additions of properties for sale		(120,194)	(141,956)
Proceeds from sale of equipment		17	172
Purchases of investment securities at amortised cost and fair value through other comprehensive income		(64,685,360)	(83,279,631)
Proceeds from sale and redemption of investment securities at fair value through other comprehensive income		56,012,427	74,910,289
Proceeds from redemption of investment securities at amortised cost		342,200	2,469,019
Net cash used in investing activities		(7,011,315)	(4,403,807)
Cash flows from financing activities			
Interest paid on subordinated debts		(188,924)	(189,212)
Payment of lease liabilities		(119,146)	(128,429)
Dividend paid to equity holders		(313,000)	(940,000)
Dividend paid to non-controlling interests		(480)	(480)
Net cash used in financing activities		(621,550)	(1,258,121)
Net increase/(decrease) in cash and cash equivalents		2,377,467	(12,056,641)
Cash and cash equivalents at beginning of the year		27,999,639	39,812,613
Effect of exchange rate changes on cash and cash equivalents		(34,439)	243,667
Cash and cash equivalents at end of the year		30,342,667	27,999,639
Represented by:			
Cash and balances with banks with less than 3 months' original maturity	16	28,428,064	26,401,234
Placements with banks with less than 3 months' original maturity	17	1,914,603	1,098,403
Debt securities – Exchange Fund Bills with less than 3 months' original maturity		–	500,002
		30,342,667	27,999,639
Cash flows from operating, investing and financing activities included:			
Interest received		4,891,232	5,773,296
Interest paid		(993,595)	(2,272,843)

The notes on pages 60 to 142 are an integral part of these consolidated financial statements.

1 GENERAL INFORMATION

Shanghai Commercial Bank Limited (the "Bank") and its subsidiaries (together, the "Group") are engaged in the provision of banking and related financial services in Hong Kong, the United States, the United Kingdom and the People's Republic of China.

The Bank is a financial institution incorporated in Hong Kong. The address of its registered office is Shanghai Commercial Bank Tower, 12 Queen's Road Central, Hong Kong.

The ultimate holding company is The Shanghai Commercial & Savings Bank, Ltd., which is incorporated in the Republic of China (Taiwan).

These consolidated financial statements are presented in thousands of units of Hong Kong Dollars (HK$'000), unless otherwise stated and were approved for issue by the Board of Directors on 9 March 2022.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs") and the requirements of the Hong Kong Companies Ordinance Cap. 622. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of investment securities at fair value through other comprehensive income, financial assets at fair value through profit or loss and derivative financial instruments, which are carried at fair value.

The preparation of financial statements in conformity with HKFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgements in the process of applying the Group's accounting policies. The areas involving a higher degree of judgments or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

(a) New and amended standards adopted by the Group for the year ended 31 December 2021

	Effective for accounting periods beginning on or after
Amendments to HKFRS 9, HKAS 39, HKFRS 7, HKFRS 4 and HKFRS 16 - Interest Rate Benchmark Reform Phase 2	1 January 2021
HKFRS 16 (Amendments) - Covid-19 Related Rent Concessions	1 April 2021

The adoption of the above new and amended standards does not have significant impact to the financial statements of the Group.

(All amounts in HK dollar thousands unless otherwise stated)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1 Basis of preparation (Continued)

(a) New and amended standards adopted by the Group for the year ended 31 December 2021 (Continued)

Amendments to HKFRS 9, HKAS 39, HKFRS 7, HKFRS 4 and HKFRS 16 - Interest Rate Benchmark Reform Phase 2

Amendments to HKFRS 9, HKAS 39, HKFRS 7, HKFRS 4 and HKFRS 16 - Interest Rate Benchmark Reform Phase 2 are effective for the accounting periods beginning on or after 1 January 2021. These amendments address the issues that might affect financial reporting when an entity replaces an interest rate benchmark with an alternative benchmark rate as a result of the interest rate benchmark reform. The amendments complement those issued in November 2019 and provide a number of reliefs and additional disclosures. The key reliefs are as follows:

– **Changes to contractual cash flows.** An entity will not have to derecognise or adjust the carrying amount of financial instruments for changes that are direct consequence of the reform and occur on an economically equivalent basis, but will instead update the effective interest rate to reflect the change to the alternative benchmark rate.

– **Hedge accounting.** The hedge accounting reliefs allow most hedge relationships that are directly affected by the reform to continue. For the year 2021, the Group did not enter into any accounting hedge transaction.

The amendments have been applied retrospectively without restating comparative information. For details of the interest rate benchmark reform transition, please refer to Note 3.7.

(b) Amendments, new standards and interpretations issued but not yet effective for the year ended 31 December 2021

	Effective for accounting periods beginning on or after
Amendments to HKAS 37 – Onerous Contracts – Cost of Fulfilling a Contract	1 January 2022
Amendments to HKFRS – Annual Improvement to HKFRS Standards 2018 - 2020	1 January 2022
HKFRS 17 – Insurance Contracts	1 January 2023
Amendments to HKAS 1 – Classification of Liabilities as Current or Non-current	1 January 2023
Amendments to HKAS 1 and HKFRS Practice Statement 2 – Disclosure of Accounting Policies	1 January 2023
Amendments to HKAS 8 – Definition of Accounting Estimates	1 January 2023
Amendments to HKAS 12 – Deferred Tax related to Assets and Liabilities arising from a single transaction	1 January 2023

The Hong Kong Institute of Certified Public Accountants has issued a few amendments, new standards and interpretations which are not yet effective for the year ended 31 December 2021 and which have not been adopted in these consolidated financial statements. The key new standard which may be relevant to the Group is HKFRS 17 "Insurance Contracts".

HKFRS 17 "Insurance contracts" is effective for the accounting periods beginning on or after 1 January 2023. It establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard and to replace the HKFRS 4 "Insurance contracts". The objective of HKFRS 17 is to ensure that an entity provides relevant information that faithfully represents those contracts. HKFRS 17 defines clear and consistent rules that will significantly increase the comparability of financial statements. The general model under HKFRS 17 requires an entity to measure an insurance contract at initial recognition at the total of the fulfilment cash flows and the contractual service margin. Aside from this general model, the standard provides, as a simplification, the premium allocation approach. The Group is in the process of assessing the financial and disclosure impact on the adoption of the standard.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.2 Consolidation

The consolidated financial statements include the financial statements of the Bank and all its subsidiaries made up to 31 December 2021.

(a) Subsidiaries

Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(b) Transactions with non-controlling interests

The Group treats transactions with non-controlling interests as transactions with equity owners of the Group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

When the Group ceases to have control or significant influence, any retained interest in the entity is remeasured to its fair value, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

(c) Associates and joint ventures

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

A joint venture is an arrangement whereby the Group and other parties contractually agree to share control of the arrangement and have right to the net assets of the arrangement.

Investments in associates and joint ventures are accounted for using the equity method, and are initially recognised in the consolidated statement of financial position at cost and adjusted thereafter to recognise the Group's share of the post-acquisition profits or losses and movements in other comprehensive income. When the Group's share of losses in an associate or a joint venture equals or exceeds its interests in the associate or joint venture (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate or joint venture), the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate or joint venture.

When the Group transacts with its associates or joint ventures, profits and losses resulting from such transactions are recognised in the Group's consolidated financial statements only to the extent of interests in the associates or joint ventures that are not related to the Group. Unrealised losses arising from the transactions between the Group and the associates and joint ventures are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.3 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in thousands of units of Hong Kong Dollars (HK$'000), which is the Bank's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions that are transactions denominated, or that require settlement, in a foreign currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions.

Monetary items denominated in foreign currency are translated with the closing rate as at the reporting date. Non-monetary items measured at historical cost denominated in a foreign currency are translated with the exchange rate as at the date of initial recognition; non-monetary items in a foreign currency that are measured at fair value are translated using the exchange rate at the date when the fair value was determined.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at exchange rates at the reporting date of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of profit or loss.

All foreign exchange gains and losses recognised in the statement of profit or loss are presented net in the statement of profit or loss within the corresponding item. Foreign exchange gains and losses on other comprehensive income items are presented in other comprehensive income within the corresponding item.

In the case of changes in the fair value of monetary assets denominated in foreign currency classified as fair value through other comprehensive income ("FVOCI"), a distinction is made between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security.

Translation differences related to changes in the amortised cost are recognised in profit or loss, and other changes in the carrying amount, except impairment, are recognised in other comprehensive income.

Translation differences on non-monetary financial instruments, such as equities held at fair value through profit or loss ("FVTPL"), are reported as part of the fair value gain or loss. Translation differences on non-monetary financial instruments, such as equities classified as FVOCI investments, are included in other comprehensive income.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.3 Foreign currency translation (Continued)

(c) Group companies and overseas branches

The results and financial positions of all the Group's entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

– Assets and liabilities for each statement of financial position presented are translated at the closing rate at the reporting date;

– Income and expenses for each statement of profit or loss are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

– All resulting exchange differences are recognised in other comprehensive income.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, are taken to other comprehensive income. When a foreign operation is disposed of, or partially disposed of, such exchange differences that were recorded in equity are recognised in the statement of profit or loss as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

2.4 Fee and commission income and expense

Fee and commission income is recognised when the service has been provided. Loan fees for servicing a loan are recognised as fee income. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually over the tenor of the contract.

2.5 Dividend income

Dividends are recognised in the statement of profit or loss when the entity's right to receive payment is established.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.6 Financial assets, financial liabilities, interest income and expense

Measurement methods

Initial recognition and measurement

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognised on trade-date, the date on which the Group commits to purchase or sell the asset.

At initial recognition, the Group 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, expected credit loss ("ECL") is recognised for financial assets measured at amortised cost or measured at FVOCI, which results in an accounting loss being recognised 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 Group recognises 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 recognised 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 amortised over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or realised through settlement.

Classification and subsequent measurement

The Group classifies its financial assets into the following measurement categories:

– Amortised cost;

– FVOCI; or

– FVTPL.

Debt instruments

Classification and subsequent measurement of debt instruments depend on:

(i) the Group's business model for managing the asset; and

(ii) the cash flow characteristics of the asset.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.6 Financial assets, financial liabilities, interest income and expense (Continued)

Classification and subsequent measurement (Continued)

Debt instruments (Continued)

There are three measurement categories into which the Group classifies its debt instruments:

(a) Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ("SPPI"), and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by ECL recognised. Interest income from these financial assets is included in "Net interest income" using the effective interest rate method.

(b) FVOCI: 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 FVTPL, are measured at FVOCI. Movements in the carrying amount are taken through other comprehensive income, except for the recognition of impairment gains or losses, interest income and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss. Interest income from these financial assets is included in "Net interest income" using the effective interest rate method.

(c) FVTPL: Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVTPL. A gain or loss on a debt instrument that is subsequently measured at FVTPL is recognised in profit or loss and presented net in the statement of profit or loss within "Net trading income" in the period in which it arises.

Business model: the business model reflects how the Group manages the assets in order to generate cash flows. That is, whether the Group's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of "other" business model and measured at FVTPL. Factors considered by the Group in determining the business model for a group of assets include past experience on how the cash flows for these assets 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 Group assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the "SPPI test"). In making this assessment, the Group considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending, the related financial asset is classified and measured at fair value through profit or loss.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.6 Financial assets, financial liabilities, interest income and expense (Continued)

Classification and subsequent measurement (Continued)

Equity instruments

The Group subsequently measures equity instruments at FVTPL, except where the Group's management has elected, at initial recognition, to irrevocably designate an equity security at FVOCI. Where the Group's management has elected to present fair value gains and losses on equity instruments in other comprehensive income, there is no subsequent reclassification of fair value gains and losses to profit or loss following the derecognition of the instruments. Dividends from such instruments continue to be recognised in profit or loss as dividend income when the Group's right to receive payments is established.

Gains and losses on equity instruments at FVTPL are included in the "Net trading income" in the statement of profit or loss.

Modification of financial assets

If the borrower is in financial difficulty, where the terms of the financial assets are modified and being substantially different to the original terms, the Group derecognises the original financial asset and recognises 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 purpose, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Group also assesses whether the new financial asset recognised 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. Difference in the carrying amount is also recognised 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, the financial asset continues to be subject to the same assessments for significant increase in credit risk relative to initial recognition and credit-impairment.

Derecognition other than on a modification

Financial assets, or a portion thereof, are derecognised when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either (i) the Group transfers substantially all the risks and rewards of ownership, or (ii) the Group neither transfers nor retains substantially all the risks and rewards of ownership and the Group has not retained control.

The Group 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 Group:

(i) does not have 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 furnished by the Group under standard repurchase agreements and securities lending and borrowing transactions are not derecognised because the Group retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.6 Financial assets, financial liabilities, interest income and expense (Continued)

Impairment of financial assets

The Group assesses on a forward-looking basis ECL associated with its financial assets carried at amortised cost and debt instruments measured at FVOCI and with the exposure arising from loan commitments and financial guarantee contracts. The Group recognises 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.

Note 3.1.1 provides more detail of how the ECL is measured.

Financial liabilities

Classification and subsequent measurement

The Group classifies its financial liabilities at amortised cost, except for:

(a) financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading 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). Should such a presentation 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; and

(b) financial liabilities arising from the transfer of financial assets which did not qualify for derecognition: when the transfer of financial asset did not qualify for derecognition, a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Group recognises any expense incurred on the financial liability.

Derecognition

Financial liabilities are derecognised when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.6 Financial assets, financial liabilities, interest income and expense (Continued)

Interest income and expense

Interest income and expense for all interest-bearing financial instruments, except for those classified as financial assets or financial liabilities at fair value through profit or loss, are recognised within "interest income" and "interest expense" in the statement of profit or loss using the effective interest method.

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 amortised cost before any impairment allowance) or to the amortised cost of a financial liability. The calculation does not consider ECL and includes the 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 at initial recognition – the Group calculates the credit-adjusted effective interest rate, which is calculated based on the amortised cost of the financial asset instead of its gross carrying amount and incorporates the impact of ECL in estimated future cash flows.

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 amortised cost of the financial asset.

(b) Financial assets that have subsequently become credit-impaired (or "Stage 3"), for which interest income is calculated by applying the effective interest rate to their amortised cost (i.e. net of the ECL provision).

2.7 Derivative financial instruments

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

Certain derivatives are embedded in hybrid contracts, such as the equity option in an equity linked instrument. If the hybrid contract contains a host that is a financial asset, then the Group assesses the entire contract as described in the financial assets section above for classification and measurement purposes.

2.8 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 other bodies on behalf of customers to secure loans, overdrafts and other banking facilities.

The fair value of the financial guarantee contracts is initially recognised as the premium received in accordance with HKFRS 15. Subsequent to initial recognition, the Group has taken into account the amount of expected credit loss under HKFRS 9.

Loan commitments provided by the Group are measured as the amount of the loss allowance (calculated as described in Note 3.1.1). The Group 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 financial guarantee contracts and loan commitments, the loss allowance is recognised as a provision. However, for contracts that include both a loan and an undrawn commitment and the Group 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 recognised together with the loss allowance for the loan.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.9 Determination of fair value

For financial instruments traded in active markets, the determination of fair values of financial assets and financial liabilities is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges and broker quotes from Bloomberg and Reuters.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indications that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

For all other financial instruments, fair value is determined using valuation techniques. In these techniques, fair values are estimated from observable data in respect of similar financial instruments, using models to estimate the present value of expected future cash flows or other valuation techniques, using inputs (for example, yield curves, FX rates, volatilities and counterparty spreads) existing at the end of each reporting period.

The Group uses widely recognised valuation models for determining fair values of non-standardised financial instruments of lower complexity, such as options or interest rate and currency swaps. For these financial instruments, inputs into models are generally market-observable.

For more complex instruments, the Group uses developed models, which are usually based on valuation methods and techniques generally recognised as standard within the industry. Valuation models are used primarily to value derivatives transacted in the over-the-counter market, unlisted debt securities (including those with embedded derivatives) and other debt instruments for which markets were or have become illiquid. Some of the inputs to these models may not be market observable and are therefore estimated based on assumptions.

The output of a model is always an estimate or approximation of a value that cannot be determined with certainty, and valuation techniques employed may not fully reflect all factors relevant to the positions the Group holds. Valuations are therefore adjusted, where appropriate, to allow for additional factors including model risks, liquidity risk and counterparty risk. Based on the established fair value model governance policies, and related controls and procedures applied, management believes that these valuation techniques are necessary and appropriate to fairly state the values of financial instruments carried at fair value in the statement of financial position. Price data and parameters used in the measurement procedures applied are generally reviewed carefully and adjusted, if necessary, particularly in view of the current market developments.

The fair values of contingent liabilities and irrevocable loan commitments correspond to their carrying amounts.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.10 Properties and equipment

(a) Land and bank premises

Land and buildings comprise mainly branches and offices. Leasehold land classified as finance lease and buildings are stated at historical cost, which includes expenditure that is directly attributable to the acquisition of the items, less accumulated depreciation and impairment losses. Depreciation of land and buildings is provided annually by charging a sum sufficient to write down the cost of the land and buildings systematically. The land is depreciated over the lease term. The depreciation of the buildings is based on management's appraisal of their conditions, which includes estimations of the remaining useful lives, which are not expected to exceed 40 years.

Interest in freehold land is stated at cost.

(b) Furniture, fittings and equipment

Furniture, fittings and equipment are stated at historical cost less accumulated depreciation and impairment losses. Depreciation of furniture, fittings and equipment are calculated to write off the costs of the assets over their estimated useful lives on a straight line basis over 4 to 10 years.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the statement of profit or loss during the financial period in which they are incurred.

(c) Property under development

Leasehold land for property under development is stated at historical cost, less accumulated depreciation and impairment losses, and development expenditure is stated at the aggregate amount of costs incurred up to the date of completion. For depreciation of leasehold land for properties under development, please refer to Note 2.10(a) above.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.14). The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

Gains or losses on disposals are determined by comparing proceeds and the carrying amount of the relevant assets and are recognised in the statement of profit or loss.

2.11 Investment properties

Property that is held for long-term rental yields or for capital appreciation or both is classified as investment property. Investment properties are land and office buildings. Investment properties are measured at cost less subsequent accumulated depreciation and any accumulated impairment losses. Depreciation is charged so as to write off the cost of investment properties using the straight-line method over the unexpired period of the lease term for land and the shorter of the leases or 40 years for buildings.

2.12 Properties for sale

Properties for sale are carried at the lower of cost and net realisable value. Net realisable value takes into account the price ultimately expected to be realised and the anticipated costs to completion.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.13 Leases

The Group's leasing activities and how these are accounted for

The Group leases various properties, equipment and motor vehicles. Rental contracts are typically made for fixed periods of 2 to 5 years but may have extension options. 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.

Leases are recognised as a right-of-use asset and a corresponding liability on the date when the leased asset is available for use by the Group. Each lease payment is allocated between the liability and finance cost (i.e. interest on lease liabilities). 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. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

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;

– amounts expected to be payable by the lessee under residual value guarantees;

– the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and

– payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

The lease payments are discounted using the Group's incremental borrowing rate, being the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions.

Right-of-use assets are measured at cost comprising the following:

– the amount of the initial measurement of lease liabilities;

– any lease payments made at or before the commencement date less any lease incentives received;

– any initial direct costs; and

– restoration costs.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less. Low-value assets comprise IT equipment and small items of office furniture.

The accounting for leasehold land previously classified as finance lease remains the same. Please refer to Note 2.10(a) for details.

Extension and termination options

Extension and termination options are included in a number of property and equipment leases across the Group. 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 Group and not by the respective lessor.

Where the Group is a lessor

Rental income from operating leases where the Group is a lessor is recognised in income on a straight-line basis over the lease term. The respective leased assets are included in the consolidated statement of financial position based on their nature.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.14 Impairment of investment in subsidiaries, associates, joint ventures and non-financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.15 Current and deferred income tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in the statement of profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the reporting date in the countries where the Group's entities operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted at the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

The principal temporary differences arise from depreciation of properties and equipment, revaluation of certain financial assets and liabilities including derivative contracts, provisions for pensions and other post-retirement benefits and tax losses carried forward; and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not be reversed in the foreseeable future.

Deferred income tax related to fair value re-measurement of FVOCI debt investments, which is charged or credited to other comprehensive income, is also credited or charged to other comprehensive income and is subsequently recognised in the statement of profit or loss together with the deferred gain or loss upon disposal.

Deferred income tax related to fair value re-measurement of FVOCI equity investments, which is charged or credited to other comprehensive income, will remain in reserves and will not be subsequently recognised in the statement of profit or loss upon disposal.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.16 Employee benefits

(a) Retirement benefit costs

The Group operates 2 retirement benefit schemes comprising of a Mandatory Provident Fund Scheme and a defined benefit scheme that are available to the Group's employees. However, the principal scheme that the Group contributes to is the Mandatory Provident Fund Scheme. The assets of the Group's Mandatory Provident Fund Scheme and the defined benefit scheme are held separately from those of the Group in independently administered funds.

The Group's contributions to the Mandatory Provident Fund Scheme are charged to the statement of profit or loss.

The defined benefit scheme is funded by payments from the Group by taking recommendations of independent qualified actuaries. The defined benefit costs are assessed using the Attained Age Method and the cost of providing the benefit is charged to the statement of profit or loss so as to spread the regular cost over the service lives of employees in accordance with the advice of qualified actuaries, who value the scheme once every 3 years.

(b) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. Employee entitlements to sick leave and maternity leave are recognised when the absences occur.

(c) Termination benefits

Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed: a termination when the entity has a detailed formal plan to terminate the employment of current employees without possibility of withdrawal or when the entity recognises costs for a restructuring that is within the scope of HKAS 37 and involves payment of termination benefits. In the case of an offer made to encourage voluntary redundancy the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the reporting date are discounted to present value.

2.17 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is recognised as interest expense.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.18 Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if that party controls, jointly controls or has significant influence over the Group; is a member of the same financial reporting group, such as parents, subsidiaries and fellow subsidiaries; is an associate or a joint venture of the Group or parent reporting group; is a key management personnel of the Group or parents, or where the Group and the party are subject to common control. Related parties may be individuals or entities.

2.19 Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with less than 3 months' maturity from the date of acquisition including cash, balances with banks, placements with banks, treasury bills and certificates of deposit that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

2.20 Fiduciary activities

The Group commonly acts as trustees and in other fiduciary capacities, for a fee and commission income, that result in the holding or placing of assets on behalf of individuals, trusts and other institutions. These assets and income arising thereon are excluded from these financial statements, as they are not assets of the Group.

2.21 Segment reporting

Operating segments, and the amounts of each segment item reported in the consolidated financial statements, are identified from the financial information provided regularly to the Group's most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

Individually material operating segments are not aggregated for financial reporting purposes unless the segments have similar economic characteristics and are similar in respect of the nature of products and services, the nature of production processes, the type or class of customers, the methods used to distribute the products or provide the services, and the nature of the regulatory environment. Operating segments which are not individually material may be aggregated if they share a majority of these criteria.

3 FINANCIAL RISK MANAGEMENT

The Group's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the financial business, and the operational risks are an inevitable consequence of being in business. The Group's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse impacts on the Group's financial performance.

The Group'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 Group regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practice.

The Group has in place policies and procedures for the identification, measurement, control and monitoring of credit, liquidity, market, interest rate, foreign exchange and operational risks. One of the major functions of the Board of Directors is to ensure that the Group establishes policies, procedures and controls to manage the various types of risk it faces. The Board of Directors has delegated its powers to the Risk Committee, the Executive Committee, the Asset and Liability Committee, the Credit Committee and the Compliance and Operational Risk Management Committee for the oversight of major functional areas. While the risk appetite of the Group is approved by the Board of Directors, risk control limits are approved, reviewed, and monitored regularly by various Board-level specialized committees. Risk Committee is further responsible for assisting the Board in ensuring adequate oversight of bank-wide risks, and advising the Board on high-level risk related matters, risk management strategies and risk governance of the Group, within the framework of the Group's policies. Senior management is always watchful for changes in economic, political and market conditions in which the Group operates and the inherent risks the Group faces.

The Risk Management Division and Credit Division are responsible for monitoring the overall risk management of the Group's operations. Reconciliation procedures are also in place to ensure that the systems capture all necessary data. Prior to implementation of any new product or service, various analyses, testing, development and planning will be performed and its proposal will be endorsed by the Product/Service Governance Committee and approved by Chief Executive. All of the above arrangements ensure that the risk management processes are operating effectively.

The Internal Audit Department is responsible for conducting independent review on the effectiveness of the Group's risk management and control environment.

3.1 Credit risk

The Group takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss for the Group by failing to discharge an obligation. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration in the Group's portfolio, could result in losses that are different from those provided for at the reporting date.

The Group has in place effective credit review, monitoring and control systems including an effective loan classification system that identify, monitor, and determine impairment allowance in a timely manner. Management therefore carefully manages the exposure to credit risk.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Limits on the level of credit risk by product, industry sector and by country are reviewed and approved by the Board of Directors from time to time but at least annually.

The exposure to any one counterparty including banks and brokers is further restricted by sub-limits covering on- 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.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations and by changing these lending limits where appropriate. The Group has in place effective monitoring and control systems to identify, monitor and address problem credits in an accurate and timely manner. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees. The Group further mitigates credit risk by entering into netting arrangements with counterparties such as banks with which it undertakes credit activities.

Arising from the adverse economic impact from the Covid-19 pandemic, the Bank has been closely monitoring the situation and carrying out necessary evaluation to assess the level of expected credit loss. Relief measures, including those initiated by the regulators and by the Bank such as Pre-approved Principal Payment Holiday Scheme, Special 100% Loan Guarantee under the SME Financing Guarantee Scheme and Principal Moratorium for Mortgage Loans, have been made available for eligible customers and credit assessment has been performed, and there has been no significant increase in credit risk and expected credit loss. The macro-economic variable forecasts have been reviewed and projected by the Bank's economists on a monthly basis to account for the possible evolvement of resulting economy, both within the period of pandemic and the potential recovery afterward, in Hong Kong and other major countries which the Bank's network covers. In addition, the Bank has also performed credit portfolio review to evaluate the credit quality of loans by assessing the customers' repayment ability, and management overlay has been quantified and provided for to cater for the credit quality deterioration identified. Additional measures with various monitoring tools have been applied to identify negatively impacted customers aimed to minimize potential credit loss.

3.1.1 Expected credit loss measurement

The Group adopts a "three-stage" model in accordance with HKFRS 9 for impairment based on changes in credit quality since initial recognition as summarised below:

- A financial instrument that is not credit-impaired at initial recognition is classified as "Stage 1" and has its credit risk continuously monitored by the Group;
- If a significant increase in credit risk ("SICR") since initial recognition is identified, the financial instrument is moved to "Stage 2" though it has not yet deemed to be credit-impaired;
- If the financial instrument is credit-impaired, it will be allocated to "Stage 3";
- Financial instruments in Stage 1 have their expected credit loss ("ECL") measured at an amount equal to the portion of lifetime ECL that result from default events possible within the next 12 months. Instruments at Stages 2 or 3 have their ECL measured on lifetime basis;
- ECL of financial instruments are measured by taking into consideration forward-looking information; and
- Purchased or originated credit-impaired ("POCI") financial assets are those financial assets that are credit-impaired at initial recognition. Their ECL are always measured on lifetime basis (Stage 3).

The Group adopts the approach that utilises the Probability of Default ("PD"), Exposure at Default ("EAD") and Loss Given Default ("LGD") to estimate ECL of financial instruments. Simplified alternatives are applied to portfolios with small exposures or having difficulties in adopting this approach, such as other receivable.

To estimate PD, EAD and LGD, exposures are first segmented according to their product types and customer types so that each group contains exposures with similar risk characteristics and product specifications. The factors used for segmentation are outlined below:

(i) Customers' characteristics
(ii) Product types
(iii) Facilities' utilization
(iv) Loan to collateral ratios

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.1 Expected credit loss measurement (Continued)

The modelling approaches used for different segments vary and with the consideration of the following factors:

(i) Portfolio size
(ii) Historical behavioural data
(iii) Data sufficiency

In assessing the ECL of financial instrument classified as Stage 3, the values of property-related collaterals are adjusted to the expected point of sales to reflect the probability weighted recoveries from the sales of properties. When ECL is not provided against the unsecured exposure, the rationale must be sufficient and clearly documented. For assessing the ECL for credit card advances in Stage 3, ECL shall be estimated by using their EAD and LGD.

Management overlay and judgements

For HKFRS 9 ECL calculation, the Group has implemented and applied management overlay above the modeled ECL. The management overlay methodologies and amounts are subject to regular robust review and governance processes to assess the adequacy and relevancy of such overlay. The management overlay includes items that are inevitably not precisely quantifiable and necessitate involvement of expert judgments, so as to account for model constraints, data limitation, exceptional events, etc. The management overlay methodologies constitute of allowing for reasonably sufficient impairment to the portfolios of the overseas branches and marginal Stage 1 loans, and accounting for other uncertainty factors on data, models, and events that might impact the ECL computation. In addition, arising from various major incidences during the year such as ongoing Covid-19 outbreak and US-China trade tensions, the Group continued to maintain the additional management overlay to cater for potential credit quality deterioration of vulnerable sectors.

The key judgements and assumptions adopted by the Group in addressing the requirements of the standard are discussed below:

3.1.1.1 SICR

The Group considers a financial instrument to have experienced a significant increase in credit risk when one or more of the following criteria have been met:

– The borrower is more than 30 days past due on its contractual payments;
– The financial instrument is downgraded in the internal rating categories and there is an increase in PD more than predetermined thresholds since initial recognition; and
– Significant increase in credit risk since initial recognition with reference to external rating downgrade after initial recognition for treasury portfolio.

The Group applies practical expedient for treasury traded instruments that have low credit risk at the reporting date. The Group does not recognize the instrument's lifetime ECL when it is with low credit risk, overdue not more than 30 days and its issuer acquires satisfactory internal credit assessment on credit quality, irrespective of the change in credit risk from initial recognition.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.1 Expected credit loss measurement (Continued)

3.1.1.2 Definition of default and credit-impaired assets

The Group 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:

Quantitative criteria

The borrower is more than 90 days past due on its contractual payments.

Qualitative criteria

The borrower meets unlikeliness-to-pay criteria, which indicates the borrower is in significant financial difficulty. These could be instances where:

– The financial instrument is restructured due to financial stress;
– The financial instrument is partially written off;
– The borrower is bankrupt;
– The borrower is unlikely to honour its credit obligation; and
– The instrument is tagged with Substandard, Doubtful or Loss in reference to the HKMA Loan Classification.

3.1.1.3 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. ECL is calculated as the discounted product of the PD, EAD and LGD, defined as follows:

– PD represents the likelihood of a borrower defaulting on its financial obligation.
– EAD is based on the amounts the Group expects to be owed at the time of default.
– LGD represents the Group'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.

There have been no significant changes in estimation technique or model assumptions made during the reporting period. The changes in ECL ratios were mainly resulted from the changes in asset quality, macro-economic variables forecasts and characteristics of financial instruments.

3.1.1.4 Forward-looking information incorporated in the ECL models

The calculation of ECL incorporates forward-looking information by considering key economic variables identified by the Group that have impact on credit risk and ECL for the Group's portfolios.

These economic variables and their associated impact on the PD, EAD and LGD vary by the type of financial instruments. Expert judgement has also been applied in this process. Forecasts of these economic variables (the "base economic scenario") are provided by the Group's Treasury Research team on a monthly basis as a projection of how the global economy will evolve over the next four years. Beyond these four years, the average portfolio default rate is adopted as the PD of the facilities and the last forecasted LGD is adopted for the remaining lifetime of the instrument.

In addition to the base economic scenario, the Group's Treasury Research team also provides two other plausible scenarios along with the assigned weightings as probability of occurrence under the current economic environment. The scenarios and their corresponding weightings are determined by a combination of model-based analysis and expert judgement, taking into account the range of possible outcomes each chosen scenario is representative of. The probability weighted ECL is determined by applying each scenario on the financial instruments through running the relevant ECL models and multiplying the resulted ECLs by the appropriate scenario weighting.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.1 Expected credit loss measurement (Continued)

3.1.1.4 Forward-looking information incorporated in the ECL models (Continued)

Economic variable assumptions

The most significant economic variable assumptions used for the ECL estimate as at 31 December 2021 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios.

		4Q2021	2022	2023	2024	2025
Hong Kong Gross Domestic Product ("GDP")	Base	2.8%	1.2% to 3.6%	1.0% to 3.8%	2.8% to 3.6%	2.8% to 3.6%
	Upside	4.2%	3.0% to 5.5%	1.4% to 4.1%	3.0% to 3.7%	3.0% to 3.7%
	Downside	–0.6%	–2.4% to 2.9%	–0.6% to 2.4%	2.1% to 3.3%	1.1% to 3.3%
United States GDP	Base	4.5%	1.5% to 4.0%	1.5% to 1.5%	1.5% to 1.5%	1.5% to 1.5%
	Upside	5.5%	1.8% to 4.5%	1.8% to 1.8%	1.8% to 1.8%	1.8% to 1.8%
	Downside	0.9%	–2.4% to 1.0%	1.0% to 1.0%	1.0% to 1.0%	1.0% to 1.0%
Hong Kong unemployment rate	Base	5.1%	5.1% to 5.3%	4.9% to 5.2%	4.3% to 4.7%	4.0% to 4.7%
	Upside	4.9%	5.0% to 5.3%	4.6% to 5.0%	4.1% to 4.4%	3.8% to 4.4%
	Downside	5.5%	5.5% to 5.9%	6.0% to 6.3%	6.3% to 6.3%	6.3% to 6.3%
United States unemployment rate	Base	5.1%	4.9% to 5.0%	5.0% to 5.3%	5.4% to 5.7%	5.8% to 5.7%
	Upside	4.2%	4.0% to 4.1%	4.1% to 4.1%	4.1% to 4.1%	4.1% to 4.1%
	Downside	7.0%	5.5% to 7.5%	6.0% to 6.9%	7.1% to 7.6%	7.7% to 7.6%
Hong Kong property price index	Base	2.6%	0.0% to 2.2%	3.0% to 3.0%	3.0% to 3.0%	3.0% to 3.0%
	Upside	6.0%	2.0% to 2.9%	5.0% to 5.0%	4.0% to 4.0%	4.0% to 4.0%
	Downside	–3.0%	–24.5% to –13.0%	0.0% to 0.0%	0.0% to 0.0%	0.0% to 0.0%
United States house price index	Base	8.4%	2.0% to 4.1%	2.0% to 2.0%	2.0% to 2.0%	2.0% to 2.0%
	Upside	9.5%	2.4% to 5.2%	2.4% to 2.4%	2.4% to 2.4%	2.4% to 2.4%
	Downside	–11.2%	–15.0% to 0.8%	0.8% to 0.8%	0.8% to 0.8%	0.8% to 0.8%
United Kingdom house price index	Base	2.9%	–0.4% to 2.4%	0.9% to 1.2%	1.2% to 1.2%	1.2% to 1.2%
	Upside	5.2%	0.8% to 4.6%	1.0% to 1.7%	1.9% to 2.0%	2.0% to 2.0%
	Downside	–7.3%	–16.8% to –7.9%	–3.0% to 0.0%	0.0% to 0.0%	0.0% to 0.0%
People's Republic of China house price index	Base	4.7%	–2.7% to 2.0%	2.0% to 2.0%	2.0% to 2.0%	2.0% to 2.0%
	Upside	5.7%	3.0% to 3.0%	3.0% to 3.0%	3.0% to 3.0%	3.0% to 3.0%
	Downside	0.0%	–13.3% to 0.0%	0.0% to 0.0%	0.0% to 0.0%	0.0% to 0.0%
Hong Kong commercial building price index	Base	2.6%	0.0% to 2.2%	3.0% to 3.0%	3.0% to 3.0%	3.0% to 3.0%
	Upside	6.0%	2.0% to 2.9%	5.0% to 5.0%	4.0% to 4.0%	4.0% to 4.0%
	Downside	–3.0%	–24.5% to –13.0%	0.0% to 0.0%	0.0% to 0.0%	0.0% to 0.0%

The weightings assigned to each economic scenario as at 31 December 2021 were as follows:

	Base	Upside	Downside
All portfolios	60%	20%	20%

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.1 Expected credit loss measurement (Continued)

3.1.1.4 Forward-looking information incorporated in the ECL models (Continued)

Economic variable assumptions (Continued)

The most significant economic variable assumptions used for the ECL estimate as at 31 December 2020 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios.

		4Q2020	2021	2022	2023	2024
Hong Kong GDP	Base	–1.9%	0.4% to 4.4%	2.4% to 3.1%	3.1% to 3.5%	2.6% to 2.9%
	Upside	1.0%	1.7% to 5.7%	2.6% to 3.6%	3.5% to 3.9%	2.9% to 3.1%
	Downside	–4.3%	–1.4% to 5.4%	–0.2% to 1.3%	1.6% to 2.7%	1.8% to 2.2%
United States GDP	Base	–1.4%	–3.2% to 5.5%	1.5% to 1.5%	1.5% to 1.5%	1.5% to 1.5%
	Upside	1.0%	2.0% to 7.0%	1.8% to 1.8%	1.8% to 1.8%	1.8% to 1.8%
	Downside	–6.1%	–6.9% to 2.7%	1.0% to 1.6%	1.0% to 1.0%	1.0% to 1.0%
Hong Kong unemployment rate	Base	6.9%	6.6% to 6.9%	6.5% to 6.7%	6.3% to 6.6%	5.8% to 6.1%
	Upside	6.4%	6.2% to 6.4%	5.9% to 6.2%	5.5% to 5.9%	5.0% to 5.3%
	Downside	7.2%	7.2% to 7.4%	7.2% to 7.6%	7.7% to 8.0%	8.0% to 8.0%
United States unemployment rate	Base	7.5%	4.7% to 8.0%	4.8% to 5.1%	5.2% to 5.5%	5.6% to 5.8%
	Upside	7.0%	3.6% to 6.0%	3.7% to 3.8%	3.8% to 3.8%	3.8% to 3.8%
	Downside	9.0%	10.5% to 12.5%	6.5% to 8.5%	7.4% to 8.3%	8.5% to 8.8%
Hong Kong property price index	Base	–1.2%	–1.7% to 6.5%	0.0% to 0.0%	3.0% to 3.0%	3.0% to 3.0%
	Upside	1.8%	2.7% to 8.9%	2.0% to 2.0%	5.0% to 5.0%	4.0% to 4.0%
	Downside	–2.9%	–23.5% to –9.1%	–13.7% to 6.1%	0.0% to 0.0%	0.0% to 0.0%
United States house price index	Base	7.0%	2.7% to 6.6%	2.0% to 2.0%	2.0% to 2.0%	2.0% to 2.0%
	Upside	10.5%	2.2% to 8.5%	2.3% to 2.4%	2.4% to 2.4%	2.4% to 2.4%
	Downside	–0.1%	–14.5% to –5.8%	–5.3% to 1.6%	0.8% to 0.8%	0.8% to 0.8%
United Kingdom house price index	Base	0.4%	–4.5% to 0.3%	–0.4% to 0.8%	0.9% to 1.2%	1.2% to 1.2%
	Upside	4.4%	0.5% to 5.4%	0.8% to 0.8%	1.0% to 1.4%	1.4% to 1.4%
	Downside	–0.7%	–13.3% to –5.0%	–5.9% to 0.0%	0.0% to 0.0%	0.0% to 0.0%
People's Republic of China house price index	Base	4.0%	–0.5% to 5.0%	2.0% to 2.0%	2.0% to 2.0%	2.0% to 2.0%
	Upside	6.1%	3.0% to 7.7%	3.0% to 3.0%	3.0% to 3.0%	3.0% to 3.0%
	Downside	–0.3%	–14.2% to –4.8%	0.0% to 0.0%	0.0% to 0.0%	0.0% to 0.0%
Hong Kong commercial building price index	Base	–1.2%	–1.7% to 6.5%	0.0% to 0.0%	3.0% to 3.0%	3.0% to 3.0%
	Upside	1.8%	2.7% to 8.9%	2.0% to 2.0%	5.0% to 5.0%	4.0% to 4.0%
	Downside	–2.9%	–23.5% to –9.1%	–13.7% to 6.1%	0.0% to 0.0%	0.0% to 0.0%

The weightings assigned to each economic scenario as at 31 December 2020 were as follows:

	Base	Upside	Downside
All portfolios	60%	20%	20%

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.1 Expected credit loss measurement (Continued)

3.1.1.5 Sensitivity analysis

The output of the Group's ECL model takes into consideration forward-looking information and scenarios based on the market analysis prepared by the Group's Treasury Research team. The Group has applied appropriate weightings to the base case, upside and downside scenarios which are sources of sensitivity. Two additional sensitivity scenarios (scenarios 1 and 2 below) have been drawn up. Should the weightings applied by the Group be changed to those of the sensitivity scenarios as follows, the impact to ECL amount would be immaterial.

2021	Base	Upside	Downside
Weightings applied by the Group	60%	20%	20%
Sensitivity scenario 1	40%	30%	30%
Sensitivity scenario 2	80%	10%	10%

2020	Base	Upside	Downside
Weightings applied by the Group	60%	20%	20%
Sensitivity scenario 1	40%	30%	30%
Sensitivity scenario 2	80%	10%	10%

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.2 Loss allowance

The loss allowance recognised in the period is impacted by a variety of factors, as described below:

- Transfers between Stage 1, Stage 2 and Stage 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 recognised during the period, as well as releases for financial instruments de-recognised 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;
- Impact on the measurement of ECL due to changes made to models and assumptions;
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis;
- Foreign exchange retranslations for assets denominated in foreign currencies and other movements; and
- Write-offs of allowances related to assets that were written off during the period.

Summary of financial instruments to which the impairment requirements in HKFRS 9 are applied:

For the year ended 31 December 2021			
	Gross carrying/ nominal amount	Credit impairment allowances	Credit impairment losses charged to/ (released from) profit or loss
Financial assets measured at amortised cost:			
Loans and advances to customers	96,422,010	(515,784)	21,126
Balances with banks and placements with banks	45,349,170	(2,762)	1,522
Loan commitments and financial guarantees	48,826,994	(14,718)	(83)
Investment securities	1,573,691	(56)	51
Other assets measured at amortised cost	1,514,698	(1,405)	(149)
	193,686,563	(534,725)	22,467

	Fair value	Credit impairment allowances	Credit impairment losses charged to profit or loss
Debt securities at fair value through other comprehensive income*	77,503,719	(19,411)	6,943

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.2 Loss allowance (Continued)

For the year ended 31 December 2020

	Gross carrying/ nominal amount	Credit impairment allowances	Credit impairment losses charged to/ (released from) profit or loss
Financial assets measured at amortised cost:			
Loans and advances to customers	101,738,494	(490,555)	111,238
Balances with banks and placements with banks	38,504,225	(6,689)	6,080
Loan commitments and financial guarantees	51,215,950	(14,801)	2,698
Investment securities	344,675	(5)	(15)
Other assets measured at amortised cost	2,307,977	(1,553)	930
	194,111,321	(513,603)	120,931

	Fair value	Credit impairment allowances	Credit impairment losses charged to profit or loss
Debt securities at fair value through other comprehensive income*	71,511,686	(12,468)	4,509

* Debt securities at fair value through other comprehensive income continue to be measured at fair value with the credit impairment allowances being recognized in Investment Revaluation Reserve. Change in credit impairment allowances is recognized in "Credit impairment losses" in the consolidated statement of profit or loss.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.2 Loss allowance (Continued)

Reconciliation of gross carrying amount and allowances for loans and advances to customers are as follows:

	Stage 1		Stage 2		Stage 3		Originated credit-impaired		Total	
	Gross carrying amount	Credit impairment allowances	Gross carrying amount	Credit impairment allowances	Gross carrying amount	Credit impairment allowances	Gross carrying amount	Credit impairment allowances	Gross carrying amount	Credit impairment allowances
As at 1 January 2021	92,296,890	326,031	9,273,268	118,861	129,933	32,327	38,403	13,336	101,738,494	490,555
Transfer to lifetime ECL	(1,112,938)	(9,508)	1,112,938	20,367	–	–	–	–	–	10,859
Transfer to credit impaired loans and advances	(18,364)	(33)	(312,274)	(5,521)	330,638	913	–	–	–	(4,641)
Transfer to 12-month ECL	660,643	7,641	(660,458)	(18,518)	(185)	(96)	–	–	–	(10,973)
Loans derecognised or repayments	(27,912,301)	(66,979)	(1,278,223)	(10,888)	(14,423)	(112)	(1,009)	–	(29,205,956)	(77,979)
New loans originated and further lending	22,433,970	40,317	1,183,875	6,534	36,687	814	1,771	–	23,656,303	47,665
Change in PDs/LGDs/EADs	–	(21,540)	–	39,822	–	6,697	–	(150)	–	24,829
Write-offs	–	–	–	–	(1,352)	(1,352)	–	–	(1,352)	(1,352)
Foreign exchange and other movements	226,962	12,369	7,521	23,372	3,763	998	(3,725)	82	234,521	36,821
As at 31 December 2021	86,574,862	288,298	9,326,647	174,029	485,061	40,189	35,440	13,268	96,422,010	515,784

	Stage 1		Stage 2		Stage 3		Originated credit-impaired		Total	
	Gross carrying amount	Credit impairment allowances	Gross carrying amount	Credit impairment allowances	Gross carrying amount	Credit impairment allowances	Gross carrying amount	Credit impairment allowances	Gross carrying amount	Credit impairment allowances
As at 1 January 2020	93,710,236	302,185	4,908,463	73,280	537,331	24,144	31,061	13,791	99,187,091	413,400
Transfer to lifetime ECL	(6,028,906)	(22,503)	6,028,906	56,082	–	–	–	–	–	33,579
Transfer to credit impaired loans and advances	(66,068)	(64)	(34,531)	(632)	100,599	29,120	–	–	–	28,424
Transfer to 12-month ECL	1,191,994	12,635	(1,178,508)	(23,215)	(13,486)	(140)	–	–	–	(10,720)
Loans derecognised or repayments	(23,254,563)	(62,419)	(1,300,459)	(9,731)	(476,119)	(7)	(14,380)	–	(25,045,521)	(72,157)
New loans originated and further lending	26,375,560	61,371	845,578	7,920	4,856	40	21,800	29	27,247,794	69,360
Change in PDs/LGDs/EADs	–	29,744	–	(8,365)	–	18,774	–	(470)	–	39,683
Write-offs	–	–	–	–	(40,983)	(40,983)	–	–	(40,983)	(40,983)
Foreign exchange and other movements	368,637	5,082	3,819	23,522	17,735	1,379	(78)	(14)	390,113	29,969
As at 31 December 2020	92,296,890	326,031	9,273,268	118,861	129,933	32,327	38,403	13,336	101,738,494	490,555

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.3 Write-off policy

The Group writes off financial assets in whole 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 (i) ceasing enforcement activity and (ii) the shortfall amount after realization of collateral.

The Group seeks to recover amounts that are legally owed in full, but it writes off financial assets in part when the recovery method is realization of collateral and the value of the collateral is such that there is no reasonable expectation of recovering amounts that are legally owed in full.

3.1.4 Risk limit control and mitigation policies

(a) Collateral

The Group employs a range of policies and practices to mitigate credit risk. The most traditional of these methods is the taking of security for funds advanced, which is a common practice. The Group implements guidelines on the acceptability of specific classes of collateral for credit risk mitigation. Guideline is in place to govern the management of collateral acceptable by the Group and the guideline is reviewed periodically.

The Group closely monitors collateral held for financial assets which are considered to be credit-impaired in order to mitigate potential losses.

The principal collateral types for loans and advances are:

– Mortgages over residential properties;
– Charges over business assets such as premises, inventory and accounts receivable; and
– Charges over bank deposits and financial instruments such as debt securities and equities.

In addition to the above, the Group will also seek for guarantee where appropriate. To minimise credit loss, the Group will seek additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances which are partially secured or unsecured.

(b) Derivatives

The Group maintains strict control limits on net open derivatives positions (i.e. the difference between purchase and sale contracts), by both amount and term. At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets where their fair values are positive), which in relation to derivatives is only a small fraction of the contract or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements. Collateral or other security is not usually obtained for credit risk exposures on these instruments, except where the Group requires margin deposits from counterparties.

(c) Credit-related commitments

The Group has issued credit related commitments including guarantees and letters of credit. These instruments carry similar credit risk as loans. The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit – which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties – carry the same credit risk as loans. Documentary and commercial letters of credit – which are written undertakings by the Group on behalf of a customer authorising a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions – are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct loan.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.5 Maximum exposure to credit risk

	Maximum exposure	
	2021	2020
Financial instruments subject to impairment		
Credit risk exposures relating to on-balance sheet assets are as follows:		
Loans and advances	**95,906,226**	101,247,939
Balances with banks and placements with banks	**45,346,408**	38,497,536
Investment securities	**79,077,354**	71,856,356
Other assets	**1,513,293**	2,306,424
Credit risk exposures relating to off-balance sheet items are as follows:		
Financial guarantees	**2,260,190**	2,316,753
Off-balance sheet commitments and other credit related contingent liabilities	**46,552,086**	48,884,396
Financial instruments not subject to impairment		
Financial assets at fair value through profit or loss	**1,683,275**	2,074,595
Derivative financial instruments	**317,330**	842,146

The following table contains an analysis of the credit risk exposure of financial instruments for which a credit impairment allowance is recognised. The gross carrying amount of financial assets below also represents the Group's maximum exposure to credit risk on these assets, without taking account of any collateral held or other credit enhancements attached.

2021	Loans and advances				
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Originated credit-impaired	Total
Credit grade					
Pass	86,089,900	3,107,261	71	551	89,197,783
Special Mention	484,946	6,219,341	–	–	6,704,287
Substandard	16	45	401,138	21,802	423,001
Doubtful	–	–	81,405	12,725	94,130
Loss	–	–	2,447	362	2,809
Gross carrying amount	86,574,862	9,326,647	485,061	35,440	96,422,010
Credit impairment allowances	(288,298)	(174,029)	(40,189)	(13,268)	(515,784)
Net carrying amount	86,286,564	9,152,618	444,872	22,172	95,906,226

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.5 Maximum exposure to credit risk (Continued)

2020

	Loans and advances				
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Originated credit-impaired	Total
Credit grade					
Pass	91,811,702	2,894,601	90	–	94,706,393
Special Mention	485,180	6,378,567	–	931	6,864,678
Substandard	8	100	74,882	24,021	99,011
Doubtful	–	–	52,344	13,089	65,433
Loss	–	–	2,617	362	2,979
Gross carrying amount	92,296,890	9,273,268	129,933	38,403	101,738,494
Credit impairment allowances	(326,031)	(118,861)	(32,327)	(13,336)	(490,555)
Net carrying amount	91,970,859	9,154,407	97,606	25,067	101,247,939

As at 31 December 2021, 99% (2020: 98%) of the off-balance sheet items are "Pass" and 1% (2020: 2%) are "Special Mention". The amount classified as "Substandard", "Doubtful" or "Loss" is immaterial. Majority of the credit impairment allowances are provided on Stage 1 (2020: Stage 1).

"Pass" represents loans for which borrowers are current in meeting commitments and full repayment of interest and principal is not in doubt.

"Special Mention" represents loans with deficiencies and potential weakness such that if adverse conditions persist, loss of principal or interest for the Bank may occur.

"Substandard" represents loans in which borrowers are displaying a definable weakness that is likely to jeopardise repayment. These loans include rescheduled loans and loans where some losses of principal or interest are possible.

"Doubtful" represents loans which the Group expects to sustain a loss of interest and/or principal.

"Loss" represents loans which considered as uncollectible after exhausting all collection efforts such as realisation of collateral, initiation of legal proceedings and need to be fully or partially written off.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.5 Maximum exposure to credit risk (Continued)

The table below presents an analysis of debt securities by rating agency designation for the respective issues as at 31 December, based on Standard & Poor's ratings or their equivalent. In the absence of such issue ratings, the ratings designated for the issuers are reported.

	Investment securities					
	2021			2020		
	Investment securities at fair value through other comprehensive income	Investment securities at amortised cost	Total	Investment securities at fair value through other comprehensive income	Investment securities at amortised cost	Total
Credit grade						
AAA	4,151,267	–	4,151,267	1,695,278	–	1,695,278
AA– to AA+	15,107,337	1,373,899	16,481,236	16,939,790	344,675	17,284,465
A– to A+	45,686,626	199,792	45,886,418	39,776,072	–	39,776,072
BBB– to BBB+	8,476,154	–	8,476,154	9,532,774	–	9,532,774
Unrated	4,082,335	–	4,082,335	3,567,772	–	3,567,772
Gross carrying amount	77,503,719	1,573,691	79,077,410	71,511,686	344,675	71,856,361
Stage 1 credit impairment allowances	19,411	56	19,467	12,468	5	12,473

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.6 Concentration of credit risk of financial assets

International claims

The following table shows the Group's international claims by major country or geographical segment, each representing 10% or more of the Group's total international claims. International claims refer to exposures to counterparties on which the ultimate risk lies, and are derived according to the location of the counterparties after taking into account any recognised risk transfer. In general, transfer of risk from one country to another is recognised if the claims against a counterparty are guaranteed by another party in a different country or if the claims are on an overseas branch of a bank whose head office is located in a different country.

As at 31 December 2021

			Non-bank private sector		
	Banks	Official sector	Non-bank financial institutions	Non-financial private sector	Total
Developed countries	19,143,000	391,000	1,712,000	3,283,000	24,529,000
Offshore centres	9,883,000	660,000	3,694,000	29,363,000	43,600,000
– of which Hong Kong	7,292,000	660,000	3,016,000	26,333,000	37,301,000
Developing Asia-Pacific	47,424,000	657,000	1,526,000	8,783,000	58,390,000
– of which China	31,758,000	657,000	1,526,000	6,745,000	40,686,000

As at 31 December 2020

			Non-bank private sector		
	Banks	Official sector	Non-bank financial institutions	Non-financial private sector	Total
Developed countries	18,392,000	5,464,000	1,814,000	1,234,000	26,904,000
Offshore centres	5,720,000	–	3,067,000	29,230,000	38,017,000
– of which Hong Kong	3,882,000	–	2,237,000	25,644,000	31,763,000
Developing Asia-Pacific	40,950,000	117,000	1,104,000	9,916,000	52,087,000
– of which China	29,498,000	117,000	1,104,000	7,934,000	38,653,000

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.7 Loans and advances (excluding trade bills and other eligible bills)

(a) Loans and advances by industry sector

The following table shows the breakdown of the Group's loans and advances (excluding trade bills and other eligible bills) by industry sector according to the usage of loans based on the categories and definitions set by the Hong Kong Monetary Authority.

	2021		2020	
	Balance	% covered by collateral	Balance	% covered by collateral
Loans for use in Hong Kong				
Industrial, commercial and financial				
– Property development	2,944,336	53%	3,307,366	61%
– Property investment	5,048,305	94%	6,340,395	93%
– Financial concerns	2,723,750	13%	2,157,314	7%
– Stockbrokers	424,980	88%	817,691	74%
– Wholesale and retail trade	1,337,980	54%	1,696,627	48%
– Manufacturing	898,676	66%	1,113,524	63%
– Transport and transport equipment	593,337	57%	638,595	59%
– Recreational activities	2,239,583	11%	2,442,598	18%
– Information technology – telecommunication	4,773	100%	4,884	100%
– Hotels, boarding houses and catering	1,950,340	91%	2,089,880	91%
– Others	12,573,081	57%	13,422,363	58%
Individuals				
– Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme or their respective successor schemes	64,374	99%	73,510	100%
– Loans for the purchase of other residential properties	3,744,094	100%	4,199,453	100%
– Credit card advances	194,080	0%	166,720	0%
– Others	6,673,119	96%	7,151,373	98%
Trade financing	8,763,904	58%	7,941,981	61%
Loans for use outside Hong Kong	45,758,582	87%	47,743,633	85%
	95,937,294	76%	101,307,907	77%

As at 31 December 2021 and 2020, the Bank did not have exposures to individual industry sector constituting 10% or more of the Group's total amount of loans and advances.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.7 Loans and advances (excluding trade bills and other eligible bills) (Continued)

(b) Loans and advances by geographical area

The information concerning the breakdown of the gross amount of loans and advances to customers (excluding trade bills and other eligible bills) by country or geographical area is derived according to the location of the customers after taking into account any transfer of risk. In general, such transfer of risk takes place if the loans and advances are guaranteed by a party in a country which is different from that of the customers.

As at 31 December 2021	Balance	Stage 3 balance	Balance overdue for over 3 months	Total Stage 3 credit impairment allowances	Total Stage 1 and Stage 2 credit impairment allowances
Hong Kong	58,712,390	84,439	33,463	16,642	383,190
Mainland China	6,367,989	73,629	73,629	36,815	17,204
United States	26,817,058	362,433	–	–	41,200
Others	4,039,857	–	–	–	20,340
	95,937,294	520,501	107,092	53,457	461,934
% of gross loans and advances to customers		0.54			
Fair value of collateral		870,897			

As at 31 December 2020	Balance	Stage 3 balance	Balance overdue for over 3 months	Total Stage 3 credit impairment allowances	Total Stage 1 and Stage 2 credit impairment allowances
Hong Kong	62,915,349	71,610	24,287	15,749	375,327
Mainland China	7,155,458	71,751	47,907	29,914	14,799
United States	26,557,550	22,066	–	–	39,718
Others	4,679,550	2,909	2,804	–	14,767
	101,307,907	168,336	74,998	45,663	444,611
% of gross loans and advances to customers		0.17			
Fair value of collateral		392,915			

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.7 Loans and advances (excluding trade bills and other eligible bills) (Continued)

(c) Loans and advances overdue for more than 3 months

	2021		2020	
		% of gross loans and advances to customers		% of gross loans and advances to customers
Balances which have been overdue for:				
– 6 months or less but over 3 months	14,997	0.02	6,086	0.01
– 1 year or less but over 6 months	25,023	0.03	5,507	–
– over 1 year	67,072	0.07	63,405	0.06
	107,092	0.12	74,998	0.07
Current market value of collateral	188,907		160,761	
Covered portion by collateral	91,701		61,945	
Uncovered portion by collateral	15,391		13,053	
Credit impairment allowances	52,751		37,520	

Collateral held against such loans and advances mainly include mortgages over properties.

(d) Rescheduled loans and advances (net of amounts included in loans and advances overdue for more than 3 months)

	2021		2020	
		% of gross loans and advances to customers		% of gross loans and advances to customers
Rescheduled loans and advances	27,868	0.03	30,760	0.03

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk

Market risk is the risk that interest rates, foreign exchange rates, equity or commodity prices will move relative to positions taken, resulting in profits or losses. In the ordinary course of business, the Group enters into various types of financial instruments, mainly foreign exchange and equity contracts, that comprise transactions initiated for the Group's own account and customer needs. The Group's positions are managed by the Treasury Division under the limits and guidelines laid down in the foreign exchange risk management policy and the policy on allocating transactions of financial instruments to the trading, non-trading or investment book, approved by the Executive Committee. The Risk Management Division is responsible for monitoring the transactions to ensure the activities are within the relevant limits and guidelines.

3.2.1 Market risk measurement techniques

The measuring procedures and limit structure used for market risk management have been approved by the Executive Committee. Limits on notional, stop loss and sensitivity are set for trading positions which are marked-to-market daily.

Stress tests provide an indication of the potential size of losses that could arise in extreme conditions. The stress testing is tailored to the business and typically uses scenario analysis. The results of the stress tests are reviewed by management, the Asset and Liability Committee, the Risk Committee and the Board of Directors.

3.2.2 Market risk sensitivity summary

The Group uses different types of derivatives to manage foreign exchange and interest rate sensitivity primarily by hedging its underlying positions. The derivatives used by the Group including foreign exchange rate and interest rate contracts which are typically made over-the-counter and are managed within limits approved by the Executive Committee.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.3 Foreign exchange risk

Foreign exchange risk is the risk that the holding of foreign currencies will affect the Group's position as a result of a change in foreign currency exchange rates. The Group takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Group's foreign exchange risk arises primarily from currency exposures originated by the Group's commercial banking businesses. The foreign exchange risk is managed by the Treasury Division and monitored by the Risk Management Division and the Asset and Liability Committee within position limits set in the foreign exchange risk management policy. Changes to the position limits are approved by the Executive Committee and reviewed by the Risk Committee on a regular basis. The table below summarises the Group's exposure to foreign currency exchange rate risk as at 31 December. Included in the table are the Group's financial instruments at carrying amounts, categorised by currency.

Concentrations of currency risk: on- and off-balance sheet financial instruments

As at 31 December 2021	HKD	USD	RMB	Other	Total
Assets					
Cash and balances with banks	12,701,893	9,708,245	3,216,027	5,059,422	30,685,587
Placements with banks	8,359,057	6,558,370	428,184	133,068	15,478,679
Loans and advances to customers	45,720,248	37,240,178	6,630,228	6,315,572	95,906,226
Financial assets at fair value through profit or loss	355,331	1,748,602	–	–	2,103,933
Derivative financial instruments	317,330	–	–	–	317,330
Investment securities at fair value through other comprehensive income	32,509,153	31,407,032	15,529,004	1,993,804	81,438,993
Investment securities at amortised cost	1,229,159	344,476	–	–	1,573,635
Other assets	849,252	495,606	237,270	87,490	1,669,618
Total	102,041,423	87,502,509	26,040,713	13,589,356	229,174,001
Liabilities					
Deposits and balances from banks	1,073,562	4,517,407	1,810,776	1,630,805	9,032,550
Deposits from customers	93,292,982	62,412,138	18,960,891	8,921,234	183,587,245
Derivative financial instruments	251,085	–	–	–	251,085
Subordinated debts	–	4,269,682	–	–	4,269,682
Other liabilities	1,763,793	448,297	180,581	33,437	2,426,108
Total	96,381,422	71,647,524	20,952,248	10,585,476	199,566,670
Net on-balance sheet position	5,660,001	15,854,985	5,088,465	3,003,880	29,607,331
Credit commitments	33,153,575	13,374,134	1,553,013	746,272	48,826,994

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.3 Foreign exchange risk (Continued)

As at 31 December 2020	HKD	USD	RMB	Other	Total
Assets					
Cash and balances with banks	7,744,948	13,482,017	5,136,465	3,631,824	29,995,254
Placements with banks	1,279,702	6,661,186	1,013,336	279,873	9,234,097
Loans and advances to customers	51,529,682	36,366,214	6,676,062	6,675,981	101,247,939
Financial assets at fair value through profit or loss	92,811	2,105,940	–	–	2,198,751
Derivative financial instruments	842,146	–	–	–	842,146
Investment securities at fair value through other comprehensive income	28,418,575	34,563,579	10,325,699	2,381,190	75,689,043
Investment securities at amortised cost	–	344,670	–	–	344,670
Other assets	1,597,797	631,796	130,373	90,034	2,450,000
Total	91,505,661	94,155,402	23,281,935	13,058,902	222,001,900
Liabilities					
Deposits and balances from banks	1,370,008	2,680,300	2,032,805	1,757,221	7,840,334
Deposits from customers	90,155,471	63,694,103	15,602,339	8,345,026	177,796,939
Derivative financial instruments	924,669	–	–	–	924,669
Subordinated debts	–	4,241,480	–	–	4,241,480
Other liabilities	1,824,682	527,716	822,778	31,093	3,206,269
Total	94,274,830	71,143,599	18,457,922	10,133,340	194,009,691
Net on-balance sheet position	(2,769,169)	23,011,803	4,824,013	2,925,562	27,992,209
Credit commitments	31,204,672	17,687,076	1,917,747	406,455	51,215,950

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.4 Interest rate risk in the banking book ("IRRBB")

General information about IRRBB

The primary forms of IRRBB faced by the Group can be divided into three broad categories:

– Gap risk is the risk arising from changes in the interest rates on instruments of different maturities. The extent of gap risk depends on whether changes to the term structure of interest rates occur consistently across the yield curve (parallel risk) or differentially by period (non-parallel risk). Parallel risk is fundamental to banking business and this risk is taken on the balance sheet as part of the strategy to improve earnings. It can, however, affect the income and economic value of the Group as interest rates fluctuate. Non-parallel risk materialises when unanticipated changes in the shape of the yield curve have adverse effects on the Group's income or economic value.

– Basis risk arises from imperfect correlation between changes in the rates earned and paid on different instruments with otherwise similar repricing characteristics. As a result of these differences, the cash flows and earnings spread between assets, liabilities and off-balance sheet instruments of similar maturities or repricing frequencies will change.

– Option risk arises from interest rate option derivatives or from option elements embedded in the Group's assets, liabilities and/or off-balance sheet instruments, where the customers can alter the level and timing of their cash flows. Option risk can be further characterised into automatic option risk and behavioural option risk. Automatic option risk arises from standalone instruments, such as exchange-traded and over-the-counter option contracts, or options explicitly embedded within an otherwise standard financial instrument, where the option will almost certainly be exercised if it is in the holder's financial interest to do so. Behavioural option risk arises from the flexibility embedded implicitly or within the terms of financial contracts, such that changes in interest rates may affect the behaviour of the customer.

Apart from the three sources of risks listed above, which are directly linked to IRRBB, credit spread risk in the banking book ("CSRBB") is a related risk that is monitored and assessed within interest rate risk management framework. CSRBB refers to any kind of asset/liability spread risk of credit-risky instruments that is not explained by IRRBB or by the expected credit risk or jump to default risk.

Governance of IRRBB risk management

The Group's IRRBB risk management framework follows a hierarchy structure:

The Executive Committee and Risk Committee are delegated by the Board to be responsible for ensuring that an appropriate interest rate risk management structure, which identifies the lines of authorities and responsibilities for different levels of management is established, maintaining continued awareness of the Group's performance and overall interest rate risk, and ensuring the interest rate risk is adequately managed and controlled within the established risk management framework.

The Asset and Liability Committee is responsible for monitoring and management of the overall interest rate risk of the Group, reviewing the report on interest rate risk position and reporting regularly on interest rate risk management to the Executive Committee and Risk Committee.

The Treasury Division is responsible for the day-to-day management of interest rate risk for the Group including branches of the Bank outside Hong Kong under the guidelines and limits approved by the Executive Committee.

The Risk Management Division is responsible for monitoring the day-to-day management of the interest rate risk for the Group including branches of the Bank outside Hong Kong, reporting identified irregularities and taking appropriate remedial actions. It is also responsible for conducting regular stress test on interest rate risk and reviewing the IRRBB behavioural assumption on a periodic basis.

The Internal Audit Department is responsible for conducting periodic review on the adequacy and effectiveness of the Group's internal control and risk management process for interest rate risk.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.4 Interest rate risk in the banking book ("IRRBB") (Continued)

IRRBB risk measure

The IRRBB is assessed daily with risk indicators, such as the repricing gap and the sensitivity of the net interest income ("NII") and economic value of equity ("EVE") under interest rate shock and stress scenarios.

Six interest rate shock scenarios prescribed by the Hong Kong Monetary Authority ("HKMA") under the completion instruction for the "Return of Interest Rate Risk in the Banking Book" are applied to the Group's banking book. They include parallel shifts up and down of the interest rate curves, and non-parallel shifts such as a steepening or flattening of the interest rate curves, as well as shifting the short rate up and down relative to the long rate. The sensitivity of the EVE is specified as the maximum decrease of the banking book economic value under the six interest rate shock scenarios. Likewise, the sensitivity of the NII is specified as the maximum reduction in NII under the parallel shifts up and down scenarios, compared to the base scenario, over a period of 12 months. Additional scenarios are also applied for Internal Capital Adequacy Assessment Process purposes, which make reference to historical scenarios such as the Asian Financial Crisis in 1997 and the Global Financial Crisis in 2008, to estimate the IRRBB capital charge under those stressed scenarios.

IRRBB related hedging decisions are made by the Asset and Liability Committee and executed in the market by the Treasury Division. The Group has not designated any derivatives in any hedge relationship for the application of hedge accounting.

Key modelling and parametric assumptions

For EVE change/impact, commercial margins and other spread components have been included in the cash flow profiling, while the discount curves used are risk-free yield curves without spread components.

For Non-maturity deposits ("NMDs"), these are segmented into several sub-portfolios according to entity (such as head office and overseas branches), customer type and transaction type (such as retail and non-retail accounts, and transactional and non-transactional accounts), currency, and product type (such as current and savings accounts). It is assumed that customer behaviours within the same sub-portfolio are homogeneous. For each sub-portfolio, the average repricing maturity is determined after:

– Stable NMDs over a 10-year historical horizon are identified;

– The Core Deposit Ratio is estimated based on historical interest rate changes; and

– Slotting rates for NMDs repricing, which are subject to average repricing maturity caps in accordance with the customer types, are constructed.

The average and longest repricing maturity of the NMDs of major currencies as at 31 December 2021 were 0.71 years and 8.33 years (2020: 0.78 years and 8.33 years) respectively.

For fixed rate loan prepayment, a statistical behavioural model is developed using the historical data for retail fixed rate loans, which are segmented into sub-portfolios by product type and branches and further by homogeneous groups with similar prepayment behaviour categorized by currency, customer type, tenor, etc. This allows the conditional prepayment rates ("CPR") to be estimated. The parameters are then applied in cash flow slotting for reporting.

For early withdrawal of time deposits, a statistical behavioural model is developed using the historical data for retail term deposits to estimate early withdrawal rates. The term deposit portfolio is segmented into sub-portfolios by currency and tenor group with homogeneous early redemption behaviour for modelling.

The model assumptions and parameters are updated, reviewed and validated regularly or when necessary in response to change of market conditions.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.4 Interest rate risk in the banking book ("IRRBB") (Continued)

Quantitative disclosure

The IRRBB introduces six interest rate shock scenarios (namely interest yield curve parallel up, parallel down, steepener, flattener, short rate up and short rate down) for assessing the impact in economic value of equity ("EVE") and net interest income ("NII") in respect of the interest rate exposures arising from banking book positions.

The table below shows the negative impact in economic value of equity ("ΔEVE") and changes in net interest income ("ΔNII") over next 12 months under the six prescribed interest rate shock scenarios for banking books provided by the HKMA per Supervisory Policy Manual IR-1 comprising major currencies based on the financial positions as at 31 December 2021 and 31 December 2020. As at 31 December 2021, the maximum losses among the six scenarios on EVE and NII would have been HK$1,720 million and HK$133 million (2020: HK$1,179 million and HK$94 million) respectively.

(All major currencies) in HK dollar thousands		(a)	(b)	(c)	(d)
		ΔEVE*		ΔNII**	
	Period	31 December 2021	31 December 2020	31 December 2021	31 December 2020
1	Parallel up	1,720,000	1,179,000	133,000	(92,000)
2	Parallel down	3,000	–	(132,000)	94,000
3	Steepener	6,000	57,000		
4	Flattener	472,000	145,000		
5	Short rate up	1,126,000	616,000		
6	Short rate down	10,000	3,000		
7	Maximum loss	1,720,000	1,179,000	133,000	94,000
	Period	31 December 2021		31 December 2020	
8	Tier 1 capital	32,124,445		30,087,958	

* Positive value indicates negative impact in EVE

** Negative value indicates increase in NII, positive value indicates decrease in NII

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfil commitments to lend. The Board is ultimately responsible for overseeing the Group's liquidity risk management structure. The Risk Committee is delegated by the Board to oversee the Group's liquidity risk management, including approval of liquidity risk management policies and risk limits. The Asset and Liability Committee is delegated by the Board to oversee the Group's liquidity strategy, policies and practices, liquidity costs, benefits and risks are incorporated in the internal pricing, performance measurement and new product approval process for all significant activities, both on- and off-balance sheet. The Risk Management Division is responsible for the day-to-day liquidity risk management. The Group's liquidity is managed by the Treasury Division in accordance with the guidelines and procedures laid down in the liquidity risk management policy.

Liquidity risk is managed with regard to a variety of factors, including the liquidity maintenance ratio, core funding ratio, loan to deposit ratio, size of the liquidity cushion, maturity mismatch profile, the diversity and stability of the deposit base, and the ability to borrow in the interbank market to ensure that both the funding liquidity and market liquidity are properly handled. An adequate stock of high quality liquid assets is maintained at all times in order to enable the Group to meet deposit withdrawals, to repay interbank borrowings, and to make new loans and investments as and when required in a timely and cost effective manner under both normal business conditions and emergency situations.

3.3.1 Liquidity risk management process

The Group's liquidity management process, as carried out within the Group and monitored by management, includes:

- Day-to-day funding, managed by monitoring future cash flows to ensure that requirements can be met. This includes replenishment of funds as they mature or are borrowed by customers. The Group maintains an active presence within the global money markets to enable this to happen;
- Maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- Monitoring liquidity maintenance and core funding ratios against internal and regulatory requirements; and
- Managing the concentration and profile of debt maturities.

A cash-flow approach is adopted to managing liquidity risk by ensuring that a net positive cash-flow position is maintained or otherwise sufficient cash can be generated from assets or funding sources to cover any funding shortfalls. The starting point for the projection is an analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets (Note 3.3.4). The projection is forward-looking and covers liquidity risks stemming from on-balance sheet assets and liabilities and off-balance sheet positions. Cash-flow projection is made over daily time bands of up to 7 days ahead and wider time bands of up to 1 year ahead. Internal limits are set to control the size of the cumulative net mismatch positions for the shorter-term time bands. Cash-flow projection covers positions in HK dollar and in all currencies in aggregate. Separate cash-flow projections are also performed for individual foreign currencies in which there are significant positions, such as US dollar and the renminbi.

Management also monitors unmatched medium-term assets, the level and type of undrawn lending commitments, the usage of overdraft facilities and the impact of contingent liabilities such as standby letters of credit and guarantees.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.1 Liquidity risk management process (Continued)

The Group conducts stress testing regularly to analyse liquidity risk. The Group's stress tests are conducted with hypothetical as well as historical assumptions. Both funding and market liquidity risks are addressed. Three stress scenarios including an institution-specific crisis, a general market crisis and a combined crisis are adopted with minimum survival period defined according to the Supervisory Policy Manual: LM-2 "Sound Systems and Controls for Liquidity Risk Management" of the Hong Kong Monetary Authority ("HKMA").

With reference to the stress-testing results, the Group identifies potential vulnerability within the Group, and formulates a Contingency Funding Plan, which itself is a component of the Group's Business Continuity Plan, to describe the Group's strategy for dealing with any liquidity problem and the procedures for making up cash flow deficits in emergency situations.

An annual drill test is conducted and the Contingency Funding Plan is subject to regular review in order to cope with changes in the business environment. Significant changes to the Contingency Funding Plan are approved by the Risk Committee.

The Group also performs reverse stress-testing in accordance with the HKMA's Supervisory Policy Manual: IC-5 "Stress-testing". It is a process of working backwards from a critical stress event and involves a mix of qualitative and quantitative analyses. The Group uses the stress-testing and reverse stress-testing results to strengthen its resilience to liquidity stress. These are supplemented with early-warning triggers for the formulation of management actions and contingency funding plan to mitigate any potential stress and vulnerability which the Group might face.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.2 Maturity analysis

The table below analyses the Group's assets and liabilities into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date.

As at 31 December 2021	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
Assets								
Cash and balances with banks	9,430,458	21,255,129	–	–	–	–	–	30,685,587
Placements with banks	–	–	6,246,221	9,232,458	–	–	–	15,478,679
Loans and advances to customers	5,201,816	7,675,293	11,257,024	20,169,940	33,087,724	15,046,431	3,467,998	95,906,226
Financial assets at fair value through profit or loss	–	–	64	3,133	31,981	1,648,097	420,658	2,103,933
Derivative financial instruments	–	46,094	141,229	107,847	22,160	–	–	317,330
Investment securities at fair value through other comprehensive income	–	3,953,939	8,543,850	24,383,839	37,015,680	3,603,537	3,938,148	81,438,993
Investment securities at amortised cost	–	–	101,838	218,788	1,253,009	–	–	1,573,635
Properties for sale	–	–	–	–	683,924	–	–	683,924
Investments in associates and joint venture	–	–	–	–	–	–	466,829	466,829
Properties and equipment	–	8,499	16,676	62,134	101,894	62,836	2,298,238	2,550,277
Investment properties	–	–	–	–	–	–	1,002,672	1,002,672
Deferred income tax assets	–	–	–	–	–	–	55,610	55,610
Other assets	258,443	601,646	93,503	264,881	388,344	49,998	12,803	1,669,618
Total assets	14,890,717	33,540,600	26,400,405	54,443,020	72,584,716	20,410,899	11,662,956	233,933,313
Liabilities								
Deposits and balances from banks	1,160,491	3,067,515	4,315,193	489,351	–	–	–	9,032,550
Deposits from customers	79,024,715	34,199,465	47,228,378	22,895,655	239,032	–	–	183,587,245
Derivative financial instruments	–	63,484	70,074	95,366	22,161	–	–	251,085
Subordinated debts	–	–	–	–	–	4,269,682	–	4,269,682
Other liabilities	634,268	1,085,883	201,614	313,579	128,045	62,719	–	2,426,108
Current income tax liabilities	–	128,133	11,902	–	–	–	–	140,035
Deferred income tax liabilities	–	–	–	–	–	–	5,241	5,241
Total liabilities	80,819,474	38,544,480	51,827,161	23,793,951	389,238	4,332,401	5,241	199,711,946
Net liquidity gap	(65,928,757)	(5,003,880)	(25,426,756)	30,649,069	72,195,478	16,078,498	11,657,715	34,221,367
Of which lease liabilities included in: Other liabilities	–	8,989	17,610	66,753	110,862	62,719	–	266,933

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.2 Maturity analysis (Continued)

As at 31 December 2020	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
Assets								
Cash and balances with banks	11,558,058	18,437,196	–	–	–	–	–	29,995,254
Placements with banks	–	–	4,561,410	4,672,687	–	–	–	9,234,097
Loans and advances to customers	5,257,392	6,469,279	9,334,628	28,433,906	34,579,492	17,039,591	133,651	101,247,939
Financial assets at fair value through profit or loss	–	14,336	–	38,740	168,479	1,853,040	124,156	2,198,751
Derivative financial instruments	–	55,703	145,140	570,418	70,885	–	–	842,146
Investment securities at fair value through other comprehensive income	–	8,205,014	6,542,749	22,764,819	29,091,129	4,905,101	4,180,231	75,689,043
Investment securities at amortised cost	–	38,760	62,324	243,586	–	–	–	344,670
Properties for sale	–	–	–	–	591,418	–	–	591,418
Investments in associates and joint venture	–	–	–	–	–	–	443,480	443,480
Properties and equipment	–	10,102	19,628	80,803	154,158	69,756	2,322,709	2,657,156
Investment properties	–	–	–	–	–	–	1,010,526	1,010,526
Deferred income tax assets	–	–	–	–	–	–	27,668	27,668
Other assets	389,854	1,294,776	83,188	269,300	345,918	62,776	4,188	2,450,000
Total assets	17,205,304	34,525,166	20,749,067	57,074,259	65,001,479	23,930,264	8,246,609	226,732,148
Liabilities								
Deposits and balances from banks	1,321,983	3,594,486	2,392,853	531,012	–	–	–	7,840,334
Deposits from customers	70,545,414	34,429,328	48,208,921	24,426,259	187,017	–	–	177,796,939
Derivative financial instruments	–	85,120	168,007	600,657	70,885	–	–	924,669
Subordinated debts	–	–	–	–	–	4,241,480	–	4,241,480
Other liabilities	516,898	1,705,154	368,077	372,273	173,027	70,329	511	3,206,269
Current income tax liabilities	–	97,820	19,967	–	–	–	–	117,787
Deferred income tax liabilities	–	–	–	–	–	–	109,871	109,871
Total liabilities	72,384,295	39,911,908	51,157,825	25,930,201	430,929	4,311,809	110,382	194,237,349
Net liquidity gap	(55,178,991)	(5,386,742)	(30,408,758)	31,144,058	64,570,550	19,618,455	8,136,227	32,494,799
Of which lease liabilities included in:								
Other liabilities	–	9,803	19,808	84,371	170,069	70,329	–	354,380

3.3.3 Funding approach

Sources of liquidity are regularly reviewed by management to maintain a wide diversification of sources based on currency, geography, provider, product and term.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.4 Non-derivative financial liabilities and assets held for managing liquidity risk

The table below presents the cash flows payable by the Group under non-derivative financial liabilities and assets held for managing liquidity risk by remaining contractual maturities at the reporting date. The amounts disclosed in the table are the contractual undiscounted cash flow, whereas the Group manages the liquidity risk based on a different basis, they do not result in a significantly different analysis.

As at 31 December 2021	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities						
Deposits and balances from banks	4,231,692	4,328,325	495,540	–	–	9,055,557
Deposits from customers	113,293,491	47,336,564	23,108,082	258,040	–	183,996,177
Subordinated debts	58,487	–	131,597	760,334	4,635,227	5,585,645
Other liabilities	1,647,559	58,969	275,188	129,310	63,205	2,174,231
Total	119,231,229	51,723,858	24,010,407	1,147,684	4,698,432	200,811,610
Assets held for managing liquidity risk	47,819,559	26,682,178	56,118,105	76,726,298	32,513,768	239,859,908

As at 31 December 2020	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities						
Deposits and balances from banks	4,923,822	2,399,466	532,969	–	–	7,856,257
Deposits from customers	105,075,619	48,364,228	24,690,681	204,673	–	178,335,201
Subordinated debts	58,142	–	130,818	755,840	4,793,824	5,738,624
Other liabilities	2,127,831	186,083	314,205	177,384	70,855	2,876,358
Total	112,185,414	50,949,777	25,668,673	1,137,897	4,864,679	194,806,440
Assets held for managing liquidity risk	50,332,521	21,164,945	58,427,429	69,602,048	33,512,689	233,039,632

The Group's policy defines the size and composition of the liquidity cushion, which includes but is not limited to high quality government securities such as Exchange Fund papers and United States Treasury securities.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.5 Derivative liabilities

The table below analyses the Group's derivative financial liabilities that will be settled on a net basis, together with all derivative financial instruments that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. Contractual maturities are assessed to be essential for an understanding of the timing of the cashflows on all derivatives. Some of the Group's derivatives are subject to collateral requirements. Cash flows for those derivatives could occur earlier than the contractual maturity. The amounts disclosed in the table are the contractual undiscounted cash flows.

As at 31 December 2021	Up to 1 month	1-3 months	3-12 months	1-5 years	Total
Derivatives held for trading settled on a net basis:					
Exchange rate contracts					
– Outflow	(2,294)	(2,370)	(1,094)	–	(5,758)
Derivatives held for trading settled on a gross basis:					
Exchange rate contracts					
– Outflow	(13,558,973)	(12,234,419)	(23,766,742)	(7,333)	(49,567,467)
– Inflow	13,534,255	12,302,492	23,785,750	7,332	49,629,829
Interest rate contracts					
– Outflow	–	(697)	(1,497)	–	(2,194)
– Inflow	–	697	1,497	–	2,194

As at 31 December 2020	Up to 1 month	1-3 months	3-12 months	1-5 years	Total
Derivatives held for trading settled on a net basis:					
Exchange rate contracts					
– Inflow/(Outflow)	–	–	–	–	–
Derivatives held for trading settled on a gross basis:					
Exchange rate contracts					
– Outflow	(23,016,331)	(10,958,673)	(32,065,178)	(108,494)	(66,148,676)
– Inflow	22,987,545	10,936,541	32,035,467	108,494	66,068,047
Interest rate contracts					
– Outflow	–	(1,195)	(3,293)	(2,160)	(6,648)
– Inflow	–	1,195	3,293	2,160	6,648

3.3.6 Off-balance sheet items

The contractual maturity profile of off-balance sheet items including contingent liabilities and commitments is included in Note 35.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Fair value of financial assets and liabilities

(a) Financial instruments not measured at fair value

(i) Balances with banks and placements with banks

Balances with banks and placements with banks include inter-bank placements and are stated net of impairment allowances. The maturities of these financial assets are within one year. The carrying amount at the reporting date approximates their fair value.

(ii) Loans and advances to customers

Loans and advances are stated net of impairment allowances. An insignificant portion of loans and advances to customers bears interest at fixed rate. The carrying amount at the reporting date approximates their fair value.

(iii) Investment securities at amortised cost

The fair value for investment securities at amortised cost is based on market prices or broker/dealer price quotations. Where this information is not available, fair value is estimated using quoted market prices for securities with similar credit, maturity and yield characteristics. For the carrying value of investment securities at amortised cost, please refer to Note 22. The fair value of investment securities at amortised cost is classified under Level 1 (2021: HK$1,369,774,000, 2020: HK$344,486,000) and Level 2 (2021: HK$196,986,000, 2020: Nil) in the fair value hierarchy. Please refer to Note 3.4(b) for the definition of fair value hierarchy.

(iv) Deposits and balances from banks and deposits from customers

Substantially all the deposits and balances from banks and deposits from customers will mature within 1 year from the reporting date. Hence, the carrying amount at the reporting date approximates their fair value.

(v) Subordinated debts

The fair value of subordinated debts of HK$4,429,411,000 (2020: HK$4,496,447,000) is classified under Level 2 in the fair value hierarchy.

(b) Fair value hierarchy

Valuation governance

The Group has in place fair valuation policy to ensure adequate governance and control processes for the designation and valuation of financial instruments to be measured at fair value for financial reporting, risk management and regulatory capital purposes. The valuation process is conducted by control units independent of risk taking units.

The Group is to recognise transfers into and transfers out of fair value hierarchy levels as of that date of the event or change in circumstances that caused the transfer.

HKFRS 13 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Group’s market assumptions. These two types of inputs have created the following fair value hierarchy:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities, funds and debt securities on exchanges, exchange-traded derivative contracts and paper gold.

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the assets or liabilities, either directly (that is, as prices) or indirectly (that is, derived from prices). This level includes instruments such as over-the-counter derivative contracts and unlisted debt securities. Observable parameters that are used as input include market data such as interest rate yield curves and exchange rate implied volatilities.

Level 3 – Inputs for the assets or liabilities that are not based on observable market data (unobservable inputs). This level includes unlisted equity securities and unlisted debt securities with significant unobservable components.

This hierarchy requires the use of observable market data when available. The Group considers relevant and observable market prices in its valuations where possible.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Fair value of financial assets and liabilities (Continued)

(b) Fair value hierarchy (Continued)

Recurring fair value measurement

As at 31 December 2021	Level 1	Level 2	Level 3	Total
Financial assets at fair value through profit or loss				
Debt securities	3,123	1,680,152	–	1,683,275
Equity securities	410,434	–	10,224	420,658
Funds	–	–	–	–
Others	–	–	–	–
Derivative financial instruments				
Exchange rate contracts	–	316,699	–	316,699
Interest rate contracts	–	140	–	140
Equity contracts	491	–	–	491
Investment securities at fair value through other comprehensive income				
Debt securities	37,308,504	40,192,341	2,874	77,503,719
Equity securities	3,869,194	–	66,080	3,935,274
Total Assets	41,591,746	42,189,332	79,178	83,860,256
Derivative financial instruments				
Exchange rate contracts	–	250,945	–	250,945
Interest rate contracts	–	140	–	140
Equity contracts	–	–	–	–
Total Liabilities	–	251,085	–	251,085

As at 31 December 2020	Level 1	Level 2	Level 3	Total
Financial assets at fair value through profit or loss				
Debt securities	144,854	1,929,741	–	2,074,595
Equity securities	101,696	–	8,722	110,418
Funds	13,735	–	–	13,735
Others	3	–	–	3
Derivative financial instruments				
Exchange rate contracts	–	841,615	–	841,615
Interest rate contracts	–	531	–	531
Equity contracts	–	–	–	–
Investment securities at fair value through other comprehensive income				
Debt securities	40,641,517	30,867,295	2,874	71,511,686
Equity securities	4,112,883	–	64,474	4,177,357
Total Assets	45,014,688	33,639,182	76,070	78,729,940
Derivative financial instruments				
Exchange rate contracts	–	923,745	–	923,745
Interest rate contracts	–	531	–	531
Equity contracts	393	–	–	393
Total Liabilities	393	924,276	–	924,669

There were no significant transfers of financial assets or liabilities between level 1 and level 2 fair value hierarchy classifications.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Fair value of financial assets and liabilities (Continued)

(b) Fair value hierarchy (Continued)

Level 2 fair values of unlisted debt securities are determined based on quotes from brokers. The most significant input is discount rate of the instruments.

Level 2 fair values of foreign exchange rate contracts and interest rate contracts are determined using the appropriate foreign exchange rates, interest rate yield curves and where applicable, the implied option volatility at the reporting date, with the expected cash-flow discounted back to present value.

Level 3 fair values of unlisted equity securities and debentures are determined based on valuation techniques using significant unobservable inputs, which includes the market comparison approach and the dividend discount approach. The fair value is affected by the price to book ratio of appropriate comparables or dividend growth rate.

If the significant unobservable inputs would be shifted by +/– 5%, the impact on other comprehensive income would be increased by HK$1,732,000 (2020: HK$995,000) or decreased by HK$1,716,000 (2020: HK$794,000) and profit or loss would be increased/decreased by HK$511,000 (2020: HK$436,000) respectively.

The following table presents the changes in level 3 instruments for the years ended 31 December 2020 and 2021 respectively.

	Financial assets at fair value through profit or loss		Investment securities at fair value through other comprehensive income		
	Equity securities	Total	Equity securities	Debt securities	Total
As at 1 January 2020	7,194	7,194	61,118	2,874	63,992
Total gains					
– Profit	1,528	1,528	–	–	–
– Other comprehensive income	–	–	695	–	695
Exchange adjustments	–	–	2,661	–	2,661
As at 31 December 2020 and 1 January 2021	8,722	8,722	64,474	2,874	67,348
Total gains					
– Profit	1,502	1,502	–	–	–
– Other comprehensive income	–	–	710	–	710
Exchange adjustments	–	–	896	–	896
As at 31 December 2021	10,224	10,224	66,080	2,874	68,954

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.5 Capital management

The Group's policy is to maintain a strong capital base to support the development of the Group's business and to ensure compliance with the statutory capital adequacy ratio requirement, a requirement used to assess the capital adequacy of banks. Capital is allocated to the various activities of the Group depending on the risk taken by each business division. Where the subsidiaries or branches are directly regulated by other regulators, they are required to maintain capital according to the rules of those regulators.

The Group's objectives when managing capital, which is a broader concept than the "equity" on the face of statement of financial position, are:

- To comply with the capital requirements under the Banking (Capital) Rules ("BCR") of the Banking Ordinance;
- To safeguard the Group's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders;
- To support the Group's stability and growth;
- To allocate capital in an efficient and risk based approach to optimise risk adjusted return to the shareholders; and
- To maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored daily by the Group's management, employing techniques based on the BCR. The required information is filed with the Hong Kong Monetary Authority ("HKMA") periodically.

The HKMA requires each bank or banking group to maintain a ratio of total regulatory capital to the risk-weighted asset (the capital adequacy ratio) at or above the statutory minimum ratio. Subsidiaries of the Group are also subject to statutory capital requirements from other regulatory authorities, such as the Securities and Futures Commission.

The regulatory capital requirements are strictly observed when managing economic capital. The regulatory capital of the Group comprises the following:

- Common Equity Tier 1 ("CET1") capital and Tier 1 capital: share capital, general reserve, investment revaluation reserve and retained earnings; and
- Tier 2 capital: subordinated debts, Stage 1 and Stage 2 credit impairment allowances and regulatory reserve.

	2021	2020
CET1 capital ratio	18.2%	16.9%
Tier 1 capital ratio	18.2%	16.9%
Total capital ratio	21.5%	20.1%

3.6 Operational risk management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It is inherent in all material products, activities, processes and systems. The Compliance and Operational Risk Management Committee oversees the Group's operational risk to ensure the operations are in accordance with the controls and procedures laid down in the operational risk management policy approved by the Risk Committee. The Operational Risk Management Department is responsible for the central operational risk management function. Policies and procedures have been established to control exposures and to identify operational risk factors. Insurance policies are taken to mitigate unforeseeable operational risk. A Business Continuity Plan is established to ensure the Group's ability to operate on an ongoing basis and limit losses in the event of severe business disruption, particularly where the Group's physical, telecommunication, or information technology infrastructures have been damaged or made inaccessible.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.7 Interest rate benchmark reform transition

Preparation for the transition

Following the decision by global regulators to phase out interbank offered rates ("IBORs") and replace them with risk-free rates as alternative reference rates ("ARRs"), the Group put in place detailed plans, processes and procedures for a smooth transition from IBOR to ARR products. An IBOR Transition Task Force has been established to execute the measures in preparation for the cessation of IBOR.

For all legacy IBOR-linked contracts with maturity after the expected IBOR cessation, the Group has revised agreements with clients to the contract amendment for fallback clauses or replacement of IBOR benchmarks by ARR or other eligible rates. Starting from 2022, the Group will no longer grant new IBOR contracts.

The Group has been developing its product capabilities to offer ARR products during the year. The Group has since launched ARR-referenced trade finance, loans and debt securities products. Necessary systems and operational changes to facilitate an orderly transition have been implemented to enable the Group to meet the regulatory milestones.

Risk for the transition

The Group is exposed to various risks arising from the IBOR Reform as the Group brings about the transition away from IBOR, including but not limited to the following:

- Conduct Risk arising from negotiations with clients and market counterparties to amend existing transactions or contracts, and potentially also leads to Legal and Reputational Risk.

- Financial Risk arising from the potential economic loss to both the Group and the clients due to the market disruption and legal actions caused by IBOR Reform.

- Valuation Risk and Liquidity Risk arising from the potential market illiquidity if the IBOR markets become less liquid and the ARR markets are yet to become liquid and observable.

- Operational Risk arising from the changes to and operational readiness of the Information Technology and trading systems and new processes, and the potential risk of payment disruption.

The Group continues to monitor, address and mitigate all such risks arising from this industry-wide transition.

Exposures to Interbank Offered Rates

The table below shows the outstanding amounts of financial instruments referencing the interest rate benchmarks that have yet to transit to ARR as at 31 December 2021, excluding the financial instruments that will expire before the transition date.

As at 31 December 2021			
	Gross amount / Notional amount		
(In HK dollar thousands)	Non-derivatives financial assets	Non-derivatives financial liabilities	Derivative contracts
USD LIBOR	9,086,000	–	–

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Group's financial statements and its financial results are influenced by accounting policies, assumptions, estimates, and management judgements which necessarily have to be made in the course of preparation of the consolidated financial statements.

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events.

Accounting policies and management's judgements for certain items are especially critical for the Group's results and financial situation due to their materiality in amount.

Measurement of the expected credit loss ("ECL") allowance

The measurement of the ECL allowance for financial assets measured at amortised 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 behaviour (e.g. the likelihood of customers defaulting and the resulting losses). Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in Note 3.1.1, which also sets out key sensitivities of the ECL to changes in these elements.

A number of significant judgements are 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;
- Establishing groups of similar financial assets for the purposes of measuring ECL; and
- Assessing data limitation and model uncertainty, and determining post model adjustments.

Determining the lease term of a right-of-use asset

In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option, or not to 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).

The assessment is reviewed if a significant event or a significant change in circumstances occurs which affects this assessment and that is within the control of the lessee. During the current financial period, no revisions were made to the lease terms to reflect the effect of exercising extension and termination options.

5 SEGMENT REPORTING

(a) By operating segment

Operating segments, and the amounts of each segment item reported in the consolidated financial statements, are identified from the financial information provided regularly to the Group's most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

For the purpose of assessing performance of business activity by class, the allocation of revenue, besides the direct revenue generated by the business, also includes the benefits of funding resources derived from the other businesses by way of internal fund transfer pricing mechanisms. Cost allocation is based on the direct cost incurred by the class of business and internal allocation of management overheads. Asset allocation is based on the assets directly attributable to the class of business and internal allocation of assets.

The Group is engaged predominantly in banking and related financial activities. It comprises retail and corporate banking, trade finance, treasury and other classes of business.

Retail and corporate banking – incorporating banking services to individual and corporate customers such as current accounts, savings accounts, time deposits, safe deposit box, credit and debit cards, loans and other credit facilities.

Trade finance – incorporating import and export bills services, invoice financing and invoice discounting.

Treasury – conducting treasury operations for trading and investment purposes such as foreign exchange, money market and capital market activities and providing treasury products such as yield enhancement and hedging products to retail and corporate customers.

The "Others" business mainly comprises remittance, share dealing, provision of trustee, wealth management and insurance services.

(All amounts in HK dollar thousands unless otherwise stated)

5 SEGMENT REPORTING (CONTINUED)

(a) By operating segment (Continued)

2021

	Retail and corporate banking	Trade finance	Treasury	Others	Total
Net interest income	3,317,304	51,657	267,567	16,037	3,652,565
Non-interest income	249,097	84,504	405,523	816,209	1,555,333
Operating income	3,566,401	136,161	673,090	832,246	5,207,898
Operating expenses	(992,568)	(99,100)	(141,181)	(463,807)	(1,696,656)
Operating profit before credit impairment losses	2,573,833	37,061	531,909	368,439	3,511,242
Credit impairment losses	(16,826)	(4,060)	(8,263)	(261)	(29,410)
Operating profit after credit impairment losses	2,557,007	33,001	523,646	368,178	3,481,832
Share of net profits of associates and joint venture	–	–	–	61,393	61,393
Profit before income tax (after taking into account internal fund transfers and cost allocation)	2,557,007	33,001	523,646	429,571	3,543,225
Income tax expense	566,441	3,322	89,060	(21,228)	637,595
Depreciation expenses	106,644	10,349	14,504	111,084	242,581
Total assets	96,266,483	3,726,559	128,253,615	5,686,656	233,933,313
Total liabilities	184,295,313	65,690	14,203,556	1,147,387	199,711,946

2020

	Retail and corporate banking	Trade finance	Treasury	Others	Total
Net interest income	2,703,009	56,631	728,178	63,841	3,551,659
Non-interest income	308,714	84,251	338,607	786,724	1,518,296
Operating income	3,011,723	140,882	1,066,785	850,565	5,069,955
Operating expenses	(876,132)	(86,798)	(107,936)	(550,273)	(1,621,139)
Operating profit before credit impairment losses	2,135,591	54,084	958,849	300,292	3,448,816
Credit impairment losses	(121,186)	1,241	(5,242)	(253)	(125,440)
Operating profit after credit impairment losses	2,014,405	55,325	953,607	300,039	3,323,376
Share of net profits of associates and joint venture	–	–	–	45,609	45,609
Profit before income tax (after taking into account internal fund transfers and cost allocation)	2,014,405	55,325	953,607	345,648	3,368,985
Income tax expense	453,367	7,135	164,367	2,069	626,938
Depreciation expenses	90,683	9,940	9,957	135,122	245,702
Total assets	101,947,517	3,415,378	114,868,008	6,501,245	226,732,148
Total liabilities	178,700,531	62,743	13,566,895	1,907,180	194,237,349

(All amounts in HK dollar thousands unless otherwise stated)

5 SEGMENT REPORTING (CONTINUED)

(b) By geographical area

The following tables provide information by geographical area, which is determined with reference to the location of the principal operations of the branches and subsidiaries of the Group.

2021	Total assets	Total liabilities	Contingent liabilities and commitments	Total operating income	Profit before income tax	Capital expenditure
Hong Kong and Mainland China	199,368,542	183,221,333	44,450,230	4,027,942	2,497,041	152,020
United States	29,056,681	12,729,630	4,234,800	1,087,363	973,996	3,481
United Kingdom	5,508,090	3,760,983	141,964	92,593	72,188	9,173
Total	233,933,313	199,711,946	48,826,994	5,207,898	3,543,225	164,674

2020	Total assets	Total liabilities	Contingent liabilities and commitments	Total operating income	Profit before income tax	Capital expenditure
Hong Kong and Mainland China	191,902,931	181,056,433	44,027,519	3,948,293	2,418,235	183,880
United States	29,344,970	10,593,085	6,721,216	1,038,638	899,514	2,934
United Kingdom	5,484,247	2,587,831	467,215	83,024	51,236	274
Total	226,732,148	194,237,349	51,215,950	5,069,955	3,368,985	187,088

6 NET INTEREST INCOME

Interest income	2021	2020
Balances with banks and placements with banks	148,168	410,197
Investment securities at amortised cost	1,335	16,572
Investment securities at fair value through other comprehensive income	1,212,341	1,497,748
Loans and advances to customers	3,389,336	3,748,904
Others	5,796	6,260
Interest income on financial assets that are not measured at fair value through profit or loss	4,756,976	5,679,681

Interest expense	2021	2020
Deposits and balances from banks	74,313	148,655
Deposits from customers	831,795	1,778,146
Subordinated debts	192,791	190,413
Lease liabilities	4,076	8,702
Others	1,436	2,106
Interest expense on financial liabilities that are not measured at fair value through profit or loss	1,104,411	2,128,022

(All amounts in HK dollar thousands unless otherwise stated)

7 NET FEE AND COMMISSION INCOME

	2021	2020
Fee and commission income		
Bills	71,463	69,258
Nominees, custodian and securities brokerage	283,756	278,895
Investment products	134,474	132,452
Remittance	60,257	60,653
Credit cards	45,627	38,271
Retail banking	48,522	48,856
Insurance	46,933	39,009
Loans and advances and facility fees	145,676	208,981
Trust and other commissions	3,479	3,454
Total fee and commission income	840,187	879,829
Less: fee and commission expense	(53,630)	(56,923)
Net fee and commission income	786,557	822,906
Of which:		
Net fee and commission income, other than amounts included in determining the effective interest rate, arising from financial assets or financial liabilities that are not measured at fair value through profit or loss		
– fee and commission income	262,766	316,510
– fee and commission expense	7,293	11,263
Net fee and commission income on trust and other fiduciary activities		
– fee and commission income	24,288	22,801

(All amounts in HK dollar thousands unless otherwise stated)

8 NET TRADING INCOME

	2021	2020
Foreign exchange	316,226	158,091
Interest rate instruments	11,237	20,606
Equities	(26,790)	19,875
Other trading income	(350)	8,379
	300,323	206,951

"Foreign exchange" trading income includes gains and losses from spot, forward and option contracts, swaps and translated foreign currency assets and liabilities, which are not designated as qualifying hedging relationship. "Interest rate instruments" trading income includes the results of trading in government securities, corporate debt securities, money market instruments and interest rate swaps. "Equities" trading income includes the results of trading in equity securities and derivatives.

9 OTHER OPERATING INCOME

	2021	2020
Gross rental income from investment properties	59,879	71,794
Net losses from disposal of equipment	(5)	(176)
Others	73,816	76,677
	133,690	148,295

Direct operating expenses arising from investment properties of HK$24,000 (2020: HK$869,000) are included in premises management expenses (Note 11).

10 NET EARNED INSURANCE PREMIUM AND NET INSURANCE CLAIMS INCURRED AND MOVEMENT IN POLICYHOLDERS' LIABILITIES

	2021	2020
Insurance premium revenue	48,168	54,962
Insurance premium ceded to reinsurers	(10,353)	(11,370)
	37,815	43,592

The related net insurance claims incurred and movement in policyholders' liabilities of HK$25,957,000 (2020: HK$32,058,000) were shown after being netted off with the insurance claims and loss adjustment expenses recovered from reinsurers of HK$1,974,000 (2020: HK$3,524,000).

(All amounts in HK dollar thousands unless otherwise stated)

11 OPERATING EXPENSES

	2021	2020
Auditor's remuneration		
Audit services (Note a)	10,692	9,879
Non-audit-related services (Note b)	6,870	4,146
Premises management expenses	45,158	44,499
Depreciation expenses		
Properties and equipment	123,050	113,554
Right-of-use assets	110,637	123,254
Investment properties	8,894	8,894
Employee benefit expenses		
Wages and salaries and other costs (Note c)	1,010,439	930,789
Pension costs – defined contribution schemes	68,662	70,807
Expenses relating to short-term and low-value leases	2,138	2,441
Information technology and communications	87,507	72,061
Legal and consultancy	15,740	32,335
Printing, stationery and postage	22,315	23,313
Promotion and advertising	34,562	41,524
Others	149,992	143,643
	1,696,656	1,621,139

Note a: The above auditor's remuneration for audit services represents the fee for the audit of the Group's financial information for the interim and annual period to comply with the statutory and regulatory requirements in Hong Kong and Taiwan.

Note b: The above fee for non-audit-related services includes the fee for the review under Hong Kong Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" for the first and third quarter results of the Group in accordance with the regulatory requirements of the ultimate holding company in Taiwan.

Note c: Employee benefit expenses include directors' emoluments (Note 13(a)). In 2021, the Group received a subsidy from Financial Industry Recruitment Scheme for Tomorrow under the Hong Kong Government's Antiepidemic Fund amounting to HK$2,620,000 which was applied to salaries expenses for the year. In 2020, the Bank received a subsidy from the Employment Support Scheme granted by the Hong Kong Government amounting to HK$44,771,000 which was applied to salaries expenses for the period from September 2020 to November 2020.

(All amounts in HK dollar thousands unless otherwise stated)

12 CREDIT IMPAIRMENT LOSSES

	2021	2020
Loans and advances to customers	21,126	111,238
Balances with banks and placements with banks	1,522	6,080
Investment securities	6,994	4,494
Other assets	(149)	930
Loan commitments and financial guarantee contracts	(83)	2,698
	29,410	125,440

13 BENEFITS AND INTERESTS OF DIRECTORS

(a) Directors' emoluments

The emoluments of the Directors of the Bank disclosed pursuant to section 383 of the Hong Kong Companies Ordinance (Cap. 622) and the Companies (Disclosure of Information about Benefits of Directors) Regulation (Cap. 622G) are set out below:

	2021	2020
Fees	8,800	8,250
Basic salaries, allowances and bonus	29,365	26,732
Contributions to retirement benefits schemes	1,307	1,307
	39,472	36,289

(b) Directors' material interests in transactions, arrangements or contracts

In 2019, the Bank entered into a contract with Hanison Contractors Limited ("Hanison") as the main contractor for a sum of HK$452,880,000 relating to the redevelopment of West Point Branch where Mr. Johnson M. D. Cha is a common director of the Bank and Hanison Construction Holdings Ltd., the holding company of Hanison.

(All amounts in HK dollar thousands unless otherwise stated)

14 INCOME TAX EXPENSE

Hong Kong profits tax has been provided at the rate of 16.5% (2020: 16.5%) on the estimated assessable profits for the year. Taxation on overseas profits has been calculated on the estimated assessable profits for the year at the rates of taxation prevailing in the countries in which the Group operates.

The amount of taxation charged to the statement of profit or loss represents:

	2021	2020
Current income tax:		
– Hong Kong profits tax	351,908	349,678
– Overseas taxation	313,901	282,822
– Over provisions in respect of prior years	(29,881)	(4,458)
Total current income tax	635,928	628,042
Deferred income tax:		
– Hong Kong deferred tax	1,744	(1,937)
– Overseas deferred tax	(77)	833
Total deferred income tax	1,667	(1,104)
Income tax expense	637,595	626,938

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the tax rates of the countries in which the Group operates as follows:

	2021	2020
Profit before tax	3,543,225	3,368,985
Tax calculated at domestic tax rates applicable to profits in the respective countries	738,484	688,686
Tax effects of:		
Income not subject to tax	(86,070)	(72,160)
Expenses not deductible for tax purposes	15,062	14,870
Over provisions in respect of prior years	(29,881)	(4,458)
Income tax expense	637,595	626,938

15 DIVIDEND

The dividends paid in 2021 and 2020 were HK$313,000,000 (HK$15.65 per share) and HK$940,000,000 (HK$47 per share) respectively. A dividend in respect of the year ended 31 December 2021 of HK$15.65 per share, amounting to a total dividend of HK$313,000,000, is to be proposed at the Annual General Meeting on 20 April 2022. These financial statements do not reflect this dividend proposed.

	2021	2020
Proposed final dividend of HK$15.65 (2020: HK$15.65) per ordinary share	313,000	313,000

(All amounts in HK dollar thousands unless otherwise stated)

16 CASH AND BALANCES WITH BANKS

	2021	2020
Cash in hand	817,858	731,815
Balances with central banks and the Hong Kong Monetary Authority	2,904,044	4,223,675
Balances with banks	26,965,504	25,040,710
	30,687,406	29,996,200
Less: Stage 1 credit impairment allowances	(1,819)	(946)
	30,685,587	29,995,254
Gross amount of cash and balances with banks	30,687,406	29,996,200
Less: Amount with an original maturity beyond 3 months	(2,259,342)	(3,594,966)
Amount included in cash and cash equivalents	28,428,064	26,401,234

Included in the gross amount of cash and balances with banks, HK$261,734,000 (2020: HK$299,931,000) were deposited in central banks or designated banks as at 31 December 2021, to comply with the statutory requirements of respective jurisdiction in which the Group is operating the business, of which HK$137,896,000 (2020: HK$119,607,000) were included in cash and cash equivalents.

17 PLACEMENTS WITH BANKS

	2021	2020
Placements with banks maturing between 1 and 12 months	15,479,622	9,239,840
Less: credit impairment allowances		
– Stage 1	(943)	(298)
– Stage 3	–	(5,445)
	15,478,679	9,234,097
Gross amount of placements with banks	15,479,622	9,239,840
Less: Amount with an original maturity beyond 3 months	(13,565,019)	(8,141,437)
Amount included in cash and cash equivalents	1,914,603	1,098,403

Included in the gross amount of placements with banks, HK$335,327,000 (2020: HK$319,886,000) were deposited with designated banks in the People's Republic of China as at 31 December 2021, to comply with the local statutory requirement, of which HK$335,327,000 (2020: HK$186,053,000) were included in cash and cash equivalents.

As at 31 December 2021, no placement with bank (2020: HK$5,445,000) was classified as Stage 3.

(All amounts in HK dollar thousands unless otherwise stated)

18 LOANS AND ADVANCES TO CUSTOMERS

	2021	2020
Gross loans and advances to customers	96,422,010	101,738,494
Less: credit impairment allowances		
– Stage 1	(288,298)	(326,031)
– Stage 2	(174,029)	(118,861)
– Stage 3	(53,457)	(45,663)
	95,906,226	101,247,939
Gross trade bills and other eligible bills, included within gross loans and advances to customers	484,716	430,587
Less: credit impairment allowances on trade bills		
– Stage 1	(361)	(234)
– Stage 2	(32)	(47)
	484,323	430,306

The Group accepted listed securities at fair value of HK$2,971,636,000 (2020: HK$3,347,508,000) as collateral for shares financing facilities. These securities are permitted to be sold or re-pledged in the event of default by the borrowers.

19 FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2021	2020
Debt securities		
Listed in Hong Kong	–	23,361
Listed outside Hong Kong	3,123	121,493
Unlisted	1,680,152	1,929,741
Total debt securities	1,683,275	2,074,595
Equity securities		
Listed in Hong Kong	345,107	70,354
Listed outside Hong Kong	65,327	31,342
Unlisted	10,224	8,722
Total equity securities	420,658	110,418
Funds		
Listed in Hong Kong	–	13,735
Total funds	–	13,735
Others	–	3
Total	2,103,933	2,198,751
Type of issuer:		
Sovereigns	–	80,230
Public sector entities	20,334	17,682
Banks	5,933	18,560
Corporates	2,077,666	2,082,279
	2,103,933	2,198,751

As at 31 December 2021, financial assets at fair value through profit or loss amounting to HK$1,680,152,000 (2020: HK$1,891,002,000) have been pledged to a shareholder of the Bank for its provision of the credit facilities of HK$779,830,000 (2020: HK$1,550,440,000) to the Bank's branches in the United States.

(All amounts in HK dollar thousands unless otherwise stated)

20 DERIVATIVE FINANCIAL INSTRUMENTS

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on 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 Group'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 contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable, and thus 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 below.

As at 31 December 2021

		Fair values	
	Contract amount	Assets	Liabilities
Derivatives held for trading			
Exchange rate contracts	88,109,435	316,699	(250,945)
Interest rate contracts	80,000	140	(140)
Equity contracts	34,686	491	–
Total recognised derivative assets/(liabilities)		317,330	(251,085)

As at 31 December 2020

		Fair values	
	Contract amount	Assets	Liabilities
Derivatives held for trading			
Exchange rate contracts	138,532,505	841,615	(923,745)
Interest rate contracts	140,000	531	(531)
Equity contracts	13,217	–	(393)
Total recognised derivative assets/(liabilities)		842,146	(924,669)

	Credit risk weighted amount	
	2021	2020
Derivatives held for trading	909,736	1,564,575

The contract amounts of these instruments indicate the volume of transactions outstanding as at the reporting date, they do not represent the amounts at risk.

The credit risk weighted amounts as at 31 December 2021 are calculated in accordance with the standardised (counterparty credit risk) approach (31 December 2020: current exposure method) as stipulated in the Banking (Capital) Rules.

The above fair values have not taken into account the effect of bilateral netting arrangements and accordingly the amounts disclosed are shown on a gross basis.

(All amounts in HK dollar thousands unless otherwise stated)

20 DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

The Group uses the following derivative strategies:

– Trading purposes (customer needs)
The Group offers its customers derivatives in connection with their risk management actions to transfer, modify or reduce their interest rate, foreign exchange and other market/credit risks or for their own trading purposes. As part of this process, the Group considers the customers' suitability for the risk involved, and the business purpose for the transaction. The Group also manages its derivative-risk positions through offsetting trade activities, controls focused on price verification, and daily reporting of positions to senior managers.

– Trading purposes (own account)
The Group trades derivatives for its own account. These derivatives entered into in order to take proprietary positions. Trading limits and price verification controls are key aspects of this activity.

21 INVESTMENT SECURITIES AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	2021	2020
Debt securities		
Listed in Hong Kong	15,298,122	16,029,366
Listed outside Hong Kong	14,735,126	19,517,159
Unlisted	47,470,471	35,965,161
Total debt securities	77,503,719	71,511,686
Equity securities		
Listed outside Hong Kong	3,869,194	4,112,883
Unlisted	66,080	64,474
Total equity securities	3,935,274	4,177,357
Total	81,438,993	75,689,043
Type of issuer:		
Sovereigns	7,409,943	9,195,653
Public sector entities	3,724,581	3,198,389
Banks	39,396,395	34,634,305
Corporates	30,908,074	28,660,696
	81,438,993	75,689,043

Note: As at 31 December 2021, equity securities designated at fair value through other comprehensive income amounting to HK$3,935,274,000 (2020: HK$4,177,357,000) were for long term investment purpose, of which HK$3,717,703,000 (2020: HK$3,983,598,000) were the fair value of the Bank's investment in Bank of Shanghai, China. In addition, unlisted Exchange Fund Bills at fair value through other comprehensive income of HK$5,997,615,000 (2020: HK$3,999,737,000) were pledged to the Hong Kong Monetary Authority to facilitate settlement operations. There were no related liabilities at the year end.

(All amounts in HK dollar thousands unless otherwise stated)

22 INVESTMENT SECURITIES AT AMORTISED COST

	2021	2020
Debt securities		
Listed in Hong Kong	1,029,409	–
Listed outside Hong Kong	344,490	344,675
Unlisted	199,792	–
	1,573,691	344,675
Less: Stage 1 credit impairment allowances	(56)	(5)
	1,573,635	344,670
Type of issuer:		
Sovereigns	1,373,885	344,670
Corporates	199,750	–
	1,573,635	344,670

As at 31 December 2021, certain of the Bank's branches in the United States have pledged investment securities at amortised cost amounting to HK$344,490,000 (2020: HK$344,675,000) to the State of California and with the Office of the Comptroller of the Currency in compliance with local regulatory requirements. In addition, listed Exchange Fund Notes at amortised cost of HK$1,029,409,000 (2020: Nil) were pledged to the Hong Kong Monetary Authority to facilitate settlement operations. There were no related liabilities at the year end.

23 PROPERTIES FOR SALE

	2021	2020
Property development		
Leasehold land held for development for sale	381,188	381,188
Building development cost	302,736	210,230
	683,924	591,418

The Group has undertaken a project to redevelop the properties located in West Point. As at 31 December 2021, the net book amount of land and building incurred for this project were HK$855,458,000 (2020: HK$736,297,000), of which HK$683,924,000 (2020: HK$591,418,000) were classified as properties held for sale while the remaining HK$171,534,000 (2020: HK$144,879,000) as bank premises under development (Note 26) in accordance with the redevelopment plan.

(All amounts in HK dollar thousands unless otherwise stated)

24 SUBSIDIARIES

The following is a list of the subsidiaries as at 31 December 2021:

Name	Place of incorporation	Principal activities and place of operation	Particulars of issued share capital	Percentage of ordinary share capital held	2021 Total assets	2021 Total equity	2020 Total assets	2020 Total equity
Shanghai Commercial Bank (Nominees) Limited	Hong Kong	Nominee services Hong Kong	100 ordinary shares	100%[1]	10	10	10	10
Shanghai Commercial Bank Trustee Limited	Hong Kong	Trustee services Hong Kong	1,000 ordinary shares	60%[2]	15,926	15,727	15,865	15,643
Shacom Futures Limited	Hong Kong	Advising and dealing in futures contracts Hong Kong	600,000 ordinary shares	100%[1]	93,674	56,092	105,785	56,750
Shacom Investment Limited	Hong Kong	Investment in Exchange Fund Bills and Notes Hong Kong	10,000 ordinary shares	100%[1]	3,243,581	11,620	3,015,962	11,186
Shacom Property Holdings (BVI) Limited	British Virgin Islands	Property holding United Kingdom	2 ordinary shares of US$1 each	100%[1]	30,745	4,503	26,340	3,645
Shacom Property (NY), Inc.	United States of America	Property holding United States of America	10 ordinary shares of US$1 each	100%[1]	5,533	5,533	5,533	5,533
Shacom Property (CA), Inc.	United States of America	Property holding United States of America	10 ordinary shares of US$1 each	100%[1]	2,669	2,669	2,677	2,677
Shacom Assets Investments Limited	Hong Kong	Investment in notes and bonds Hong Kong	10,000 ordinary shares	100%[1]	1,082,282	357	1,081,921	(29)
Infinite Financial Solutions Limited	Hong Kong	I.T. application services provider Hong Kong	500,000 ordinary shares	100%[1]	29,246	22,143	29,608	21,987
Shacom Insurance Brokers Limited	Hong Kong	Insurance broker Hong Kong	1,000,000 ordinary shares	100%[1]	3,682	1,908	2,755	1,882
Shacom Securities Limited	Hong Kong	Securities brokerage services Hong Kong	2,000,000 ordinary shares[3]	100%[1]	387,246	266,846	420,520	165,686
Hai Kwang Property Management Company Limited	Hong Kong	Property management Hong Kong	2 ordinary shares	100%[1]	911	607	835	589

(All amounts in HK dollar thousands unless otherwise stated)

24 SUBSIDIARIES (CONTINUED)

Name	Place of incorporation	Principal activities and place of operation	Particulars of issued share capital	Percentage of ordinary share capital held	2021 Total assets	2021 Total equity	2020 Total assets	2020 Total equity
Paofoong Insurance Company (Hong Kong) Limited	Hong Kong	Insurance Hong Kong	500,000 ordinary shares	60%[2]	335,194	225,846	328,707	213,276
Right Honour Investments Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of US$1 each	100%[1]	6	(180)	6	(163)
Glory Step Westpoint Investments Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of US$1 each	100%	386,297	(25,403)	360,593	(21,462)
Silver Wisdom Westpoint Investments Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of US$1 each	100%	1,148,006	(40,902)	1,041,801	(24,857)
KCC 23F Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of HK$1 each	100%[1]	305,267	122,662	310,013	118,441
KCC 25F Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of HK$1 each	100%[1]	306,274	123,596	310,998	119,356
KCC 26F Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of HK$1 each	100%[1]	307,260	124,722	311,960	120,463

1 Ordinary share capital is held directly by the Bank.

2 60% of ordinary share capital is held directly by the Bank and 40% of ordinary share capital is held by non-controlling interests in equity.

3 On 27 September 2021, the share capital of Shacom Securities Limited increased by HK$100,000,000 to HK$200,000,000 and the Bank subscribed its new capital to maintain 100% of equity interests and voting rights of Shacom Securities Limited.

(All amounts in HK dollar thousands unless otherwise stated)

25 INVESTMENTS IN ASSOCIATES AND JOINT VENTURE

Movement in investments in associates and joint venture

	2021			2020		
	Investment in associates	Investment in joint venture	Total	Investment in associates	Investment in joint venture	Total
As at 1 January	404,759	38,721	443,480	378,779	38,884	417,663
Share of profits, net of tax	61,587	(194)	61,393	45,737	(128)	45,609
Dividends paid	(28,440)	(35)	(28,475)	(26,100)	(35)	(26,135)
Other equity movement	(9,240)	(329)	(9,569)	6,343	–	6,343
As at 31 December	428,666	38,163	466,829	404,759	38,721	443,480

The Group's interests in its associates and joint venture for the years ended 2021 and 2020, which are unlisted, are as follows:

Name of entity	Principle activities	Place of incorporation and operation	Proportion of voting power	% of ownership interest	Nature of relationship
Bank Consortium Holding Limited	Investment holding and provision of trustee, administration and custodian services for retirement schemes	Hong Kong	14.29% of "A" shares	13.33%	Associate
BC Reinsurance Limited	Underwriting of general reinsurance business	Hong Kong	21%	21%	Associate
Hong Kong Life Insurance Limited	Underwriting of life insurance business	Hong Kong	16.67%	16.67%	Associate
Joint Electronic Teller Services Limited	Provision of ATM network services	Hong Kong	20% of "A" shares	2.74% (2020: 2.67%)	Joint venture

(All amounts in HK dollar thousands unless otherwise stated)

25 INVESTMENTS IN ASSOCIATES AND JOINT VENTURE (CONTINUED)

Summarised financial information for associates and joint venture which are accounted for using the equity method is set out below:

2021

Name	Assets	Liabilities	Revenue	Profit/(loss)	Other comprehensive loss	Total comprehensive income/(loss)	Dividends received
Bank Consortium Holding Limited	1,124,997	93,806	904,665	259,225	–	259,225	24,240
BC Reinsurance Limited	956,343	399,821	161,467	50,853	(320)	50,533	4,200
Hong Kong Life Insurance Limited	16,610,768	15,419,509	1,855,572	98,064	(55,034)	43,030	–
Joint Electronic Teller Services Limited	400,841	51,712	105,673	(7,145)	(12,000)	(19,145)	35
	19,092,949	15,964,848	3,027,377	400,997	(67,354)	333,643	28,475

2020

Name	Assets	Liabilities	Revenue	Profit/(loss)	Other comprehensive income	Total comprehensive income/(loss)	Dividends received
Bank Consortium Holding Limited	1,049,484	97,517	813,925	250,263	–	250,263	24,000
BC Reinsurance Limited	918,920	392,931	158,911	51,935	824	52,759	2,100
Hong Kong Life Insurance Limited	19,457,368	18,309,139	2,770,151	8,776	37,018	45,794	–
Joint Electronic Teller Services Limited	430,271	47,668	111,977	(103)	–	(103)	35
	21,856,043	18,847,255	3,854,964	310,871	37,842	348,713	26,135

Note: The balances with the associates and joint venture arise from normal business transactions and are included in Note 38.

(All amounts in HK dollar thousands unless otherwise stated)

26 PROPERTIES AND EQUIPMENT

	Leasehold land	Bank premises	Furniture, fittings and equipment	Property under development: Leasehold land	Property under development: Development cost	Right-of-use assets	Total
As at 1 January 2020							
Cost	1,391,652	1,075,785	888,175	96,278	16,716	691,488	4,160,094
Accumulated depreciation	(178,204)	(307,555)	(642,172)	(847)	–	(331,302)	(1,460,080)
Net book amount	1,213,448	768,230	246,003	95,431	16,716	360,186	2,700,014
Year ended 31 December 2020							
Opening net book amount	1,213,448	768,230	246,003	95,431	16,716	360,186	2,700,014
Additions	–	3,338	60,247	–	23,826	97,405	184,816
Transfers							
Cost	(130)	–	–	1,545	7,480	–	8,895
Accumulated depreciation	3	–	–	(9)	–	–	(6)
Disposals/write-off/expiry							
Cost	–	–	(20,517)	–	–	(98,334)	(118,851)
Accumulated depreciation	–	–	20,170	–	–	98,109	118,279
Depreciation charge	(17,432)	(24,905)	(71,107)	(110)	–	(123,254)	(236,808)
Exchange adjustments	–	321	161	–	–	335	817
Closing net book amount	1,195,889	746,984	234,957	96,857	48,022	334,447	2,657,156
As at 31 December 2020							
Cost	1,391,522	1,079,650	929,474	97,823	48,022	692,639	4,239,130
Accumulated depreciation	(195,633)	(332,666)	(694,517)	(966)	–	(358,192)	(1,581,974)
Net book amount	1,195,889	746,984	234,957	96,857	48,022	334,447	2,657,156
Year ended December 2021							
Opening net book amount	1,195,889	746,984	234,957	96,857	48,022	334,447	2,657,156
Additions	–	1,952	69,502	–	26,767	62,654	160,875
Adjustments	–	–	–	–	–	(34,341)	(34,341)
Disposals/write-off/expiry							
Cost	–	–	(10,466)	–	–	(77,522)	(87,988)
Accumulated depreciation	–	–	10,444	–	–	77,522	87,966
Depreciation charge	(17,432)	(25,602)	(79,904)	(112)	–	(110,637)	(233,687)
Exchange adjustments	–	423	(43)	–	–	(84)	296
Closing net book amount	1,178,457	723,757	224,490	96,745	74,789	252,039	2,550,277
As at 31 December 2021							
Cost	1,391,522	1,082,228	988,917	97,823	74,789	643,891	4,279,170
Accumulated depreciation	(213,065)	(358,471)	(764,427)	(1,078)	–	(391,852)	(1,728,893)
Net book amount	1,178,457	723,757	224,490	96,745	74,789	252,039	2,550,277

The Group has undertaken a project to redevelop the properties located in West Point. As at 31 December 2021, the net book amount of land and building incurred for this project were HK$855,458,000 (2020: HK$736,297,000), of which HK$683,924,000 (2020: HK$591,418,000) were classified as properties held for sale (Note 23) while the remaining HK$171,534,000 (2020: HK$144,879,000) as bank premises under development in accordance with the redevelopment plan.

As at 31 December 2021, interests in freehold land outside Hong Kong amounted to HK$34,623,000 (2020: HK$34,552,000) are included as bank premises above.

(All amounts in HK dollar thousands unless otherwise stated)

27 INVESTMENT PROPERTIES

	Leasehold land	Buildings	Total
As at 1 January 2020			
Cost	725,305	332,354	1,057,659
Accumulated depreciation	(10,405)	(30,106)	(40,511)
Net book amount	714,900	302,248	1,017,148
Year ended December 2020			
Opening net book amount	714,900	302,248	1,017,148
Additions	–	2,272	2,272
Depreciation charge	(865)	(8,029)	(8,894)
Closing net book amount	714,035	296,491	1,010,526
As at 31 December 2020			
Cost	725,305	334,626	1,059,931
Accumulated depreciation	(11,270)	(38,135)	(49,405)
Net book amount	714,035	296,491	1,010,526
Year ended December 2021			
Opening net book amount	**714,035**	**296,491**	**1,010,526**
Additions	**–**	**1,040**	**1,040**
Depreciation charge	**(866)**	**(8,028)**	**(8,894)**
Closing net book amount	**713,169**	**289,503**	**1,002,672**
As at 31 December 2021			
Cost	**725,305**	**335,666**	**1,060,971**
Accumulated depreciation	**(12,136)**	**(46,163)**	**(58,299)**
Net book amount	**713,169**	**289,503**	**1,002,672**

(a) Fair value measurement of investment properties

As at 31 December 2021, the Group's investment properties were valued at HK$2,843,000,000 (2020: HK$2,967,000,000) by an independent firm of chartered surveyors, Cushman & Wakefield Limited, who has among their staff Fellows of the Hong Kong Institute of Surveyors with recent experience in the location and category of properties being valued. The valuations were performed on an open market value basis.

The basis of the valuation of property was market value which is consistent with the definition of fair value under HKFRS 13 "Fair value measurement" and takes into account the highest and best use of the property from the perspective of market participants.

The major key input used in valuing the investment properties was the unit sale rate taking into account of time, location, and individual factors such as size and levels of buildings, which ranged from HK$27,000 (2020: HK$27,000) to HK$82,000 (2020: HK$84,000) per square foot. A decrease in unit sale rate would result in the decrease in fair value measurement of the investment properties by the same percentage and vice versa.

Investment properties are classified as Level 3 under the fair value hierarchy as defined in HKFRS 13 "Fair value measurement" as at 31 December 2021 and 2020.

(All amounts in HK dollar thousands unless otherwise stated)

27 INVESTMENT PROPERTIES (CONTINUED)

(b) Information about Level 3 fair value measurement

	Valuation technique(s)	Unobservable input(s)	Range 2021	Range 2020
Investment properties	Income capitalisation approach	Market yields	2.5% to 2.75%	2.5% to 2.75%
		Market rental	HK$61 to HK$187 per square foot	HK$62 to HK$192 per square foot

For investment properties of which the fair value is determined using the income capitalisation approach, the assessment is conducted on the basis of capitalisation of net income with due allowance for outgoings and reversionary income potential. The fair value measurement is positively correlated to the market rental and inversely correlated to the market yields.

(c) Operating lease commitments as a lessor

Where a group company is the lessor, the future minimum lease receivables under non-cancellable leases are as follows:

	2021	2020
Not later than 1 year	41,945	63,072
1 to 2 years	26,112	32,434
2 to 5 years	18,167	4,280
	86,224	99,786

The Group leases its investment properties under operating lease arrangements, with leases typically for a period from 2 to 5 years. The terms of the leases generally require the tenants to pay security deposits and provide for rent adjustments according to the prevailing market conditions at the expiration of the lease.

28 OTHER ASSETS

	2021	2020
Accounts receivable and prepayments	751,808	1,537,782
Interest receivable	694,300	707,122
Others	224,915	206,649
	1,671,023	2,451,553
Less: credit impairment allowances		
– Stage 1	(1,405)	(1,532)
– Stage 3	–	(21)
	1,669,618	2,450,000

29 DEPOSITS FROM CUSTOMERS

	2021	2020
Demand deposits and current accounts	19,764,787	18,003,831
Savings deposits	57,883,620	51,696,337
Time, call and notice deposits	105,548,923	107,709,161
Deposits from Hong Kong Government Exchange Fund	389,915	387,610
	183,587,245	177,796,939

(All amounts in HK dollar thousands unless otherwise stated)

30 SUBORDINATED DEBTS

	2021	2020
US$250 million fixed rate subordinated notes issued due 2027 at amortised cost (Note a)	1,939,939	1,927,368
US$300 million fixed rate subordinated notes issued due 2029 at amortised cost (Note b)	2,329,743	2,314,112
	4,269,682	4,241,480

Note a: This represents US$250,000,000 Basel III compliant 10-year subordinated fixed rate notes qualifying as Tier 2 capital of the Bank in accordance with the Banking (Capital) Rules ("BCR"), which are listed on the Hong Kong Stock Exchange. The notes will mature on 29 November 2027 with an optional redemption date falling on 29 November 2022. Interest at 3.75% p.a. is payable semi-annually from the issue date to the optional redemption date. Thereafter, if the notes are not redeemed, the interest rate will be reset and the notes will bear interest at the prevailing 5-year U.S. Treasury Rate plus 170.5 basis points. The Bank may, subject to receiving the prior approval of the Hong Kong Monetary Authority ("HKMA"), redeem the notes at the option of the Bank in whole but not in part, at par either on the optional redemption date or for tax or regulatory reasons at any time prior to maturity of the notes.

Note b: This represents US$300,000,000 Basel III compliant 10-year subordinated fixed rate notes qualifying as Tier 2 capital of the Bank in accordance with the BCR, which are listed on the Hong Kong Stock Exchange. The notes will mature on 17 January 2029 with an optional redemption date falling on 17 January 2024. Interest at 5.00% p.a. is payable semi-annually from the issue date to the optional redemption date. Thereafter, if the notes are not redeemed, the interest rate will be reset and the notes will bear interest at the prevailing 5-year U.S. Treasury Rate plus 250 basis points. The Bank may, subject to receiving the prior approval of the HKMA, redeem the notes at the option of the Bank in whole but not in part, at par either on the optional redemption date or for tax or regulatory reasons at any time prior to maturity of the notes.

31 OTHER LIABILITIES

	2021	2020
Accounts payable and accruals	580,420	1,283,202
Deferred income	120,108	126,208
Interest payable	255,400	340,501
Lease liabilities	266,933	354,380
Liabilities for insurance contracts (Note)	104,261	109,689
Margin deposits	308,270	278,607
Stage 1 and Stage 2 credit impairment allowances for undrawn commitments and financial guarantees	14,718	14,801
Others	775,998	698,881
	2,426,108	3,206,269

Note: Amounts recoverable from reinsurance of liabilities under insurance contracts issued amounting to HK$9,212,000 (2020: HK$10,400,000) are included in "Others" in Note 28.

(All amounts in HK dollar thousands unless otherwise stated)

32 DEFERRED INCOME TAX

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. The offset amounts are as follows:

Deferred income tax assets

	Credit impairment allowances	Accelerated tax depreciation	Fair value gains on investment securities at fair value through other comprehensive income	Others	Total
As at 1 January 2020	14,945	(3,941)	(3)	17,114	28,115
Credited/(charged) to the statement of profit or loss	10,976	(6,814)	–	(4,946)	(784)
Exchange adjustments	913	(510)	–	(69)	334
Reclassified from deferred income tax liabilities	2	1	–	–	3
As at 31 December 2020 and 1 January 2021	26,836	(11,264)	(3)	12,099	27,668
(Charged)/credited to the statement of profit or loss	(1,377)	739	–	729	91
Exchange adjustments	651	–	–	77	728
Reclassified from/(to) deferred income tax liabilities	71,373	(40,711)	(3,597)	58	27,123
As at 31 December 2021	97,483	(51,236)	(3,600)	12,963	55,610

Deferred income tax liabilities

	Credit impairment allowances	Accelerated tax depreciation	Fair value (gains)/losses on investment securities at fair value through other comprehensive income	Others	Total
As at 1 January 2020	56,422	(45,183)	(44,253)	14,113	(18,901)
Credited/(charged) to the statement of profit or loss	10,881	(6,013)	–	(2,980)	1,888
Charged to equity	–	–	(92,855)	–	(92,855)
Reclassified to deferred income tax assets	(2)	(1)	–	–	(3)
As at 31 December 2020 and 1 January 2021	67,301	(51,197)	(137,108)	11,133	(109,871)
Credited/(charged) to the statement of profit or loss	4,073	(5,038)	–	(793)	(1,758)
Credited to equity	–	–	133,511	–	133,511
Reclassified (to)/from deferred income tax assets	(71,373)	40,711	3,597	(58)	(27,123)
As at 31 December 2021	1	(15,524)	–	10,282	(5,241)

33 SHARE CAPITAL

	2021	2020
Issued and fully paid: 20,000,000 shares	2,000,000	2,000,000

(All amounts in HK dollar thousands unless otherwise stated)

34 RESERVES ATTRIBUTABLE TO EQUITY HOLDERS

	Regulatory reserve	Investment revaluation reserve	General and other reserves	Total
As at 1 January 2020	935,294	3,264,175	7,179,448	11,378,917
Investment securities at fair value through other comprehensive income	–	(55,419)	–	(55,419)
Currency translation difference arising from overseas operations	4,977	–	91,246	96,223
Share of reserves of associates and joint venture	–	6,170	173	6,343
As at 31 December 2020 and 1 January 2021	**940,271**	**3,214,926**	**7,270,867**	**11,426,064**
Investment securities at fair value through other comprehensive income	**–**	**(934,596)**	**–**	**(934,596)**
Currency translation difference arising from overseas operations	**2,040**	**–**	**31,970**	**34,010**
Share of reserves of associates and joint venture	**–**	**(9,268)**	**(301)**	**(9,569)**
As at 31 December 2021	**942,311**	**2,271,062**	**7,302,536**	**10,515,909**

Nature and purpose of reserves:

(a) Regulatory reserve

The regulatory reserve is maintained to satisfy the provisions of the Hong Kong Banking Ordinance and local regulatory requirements of overseas branches for prudent supervision purpose. Any movements in the regulatory reserve for Hong Kong operations are made in consultation with the Hong Kong Monetary Authority.

As at 31 December 2021, the regulatory reserves for Hong Kong and overseas branches operations were HK$812,455,000 (2020: HK$812,455,000) and HK$129,856,000 (2020: HK$127,816,000) respectively.

(b) Investment revaluation reserve

Investment revaluation reserve represents the cumulative net change in the fair value of investment securities at fair value through other comprehensive income until these investments are derecognised or impaired as stated in the accounting policy for financial assets (Note 2.6).

(c) General and other reserves

General and other reserves comprise previous years' transfers from retained earnings and translation reserve arising from translation of foreign operations during consolidation and share of changes in equity of associates and joint venture.

(All amounts in HK dollar thousands unless otherwise stated)

35 CONTINGENT LIABILITIES AND COMMITMENTS

(a) Credit commitments

The contract and credit risk weighted amounts of the Group's off-balance sheet financial instruments that commit it to extend credit to customers are as follows:

Contract amounts	2021	2020
Direct credit substitutes	2,263,738	2,319,494
Trade-related contingencies	1,893,706	2,238,682
Forward forward deposits placed	230,917	–
Other commitments with an original maturity of:		
– under 1 year	1,162,198	1,857,689
– 1 year and over	6,199,238	8,421,031
– unconditionally cancellable	37,077,197	36,379,054
	48,826,994	51,215,950

The contractual maturity profile of credit commitments is analysed as follows:

	2021	2020
No later than 1 year	44,569,609	46,021,692
Later than 1 year and no later than 5 years	2,573,986	3,283,126
Later than 5 years	1,683,399	1,911,132
	48,826,994	51,215,950

	2021	2020
Credit risk weighted amounts	4,958,710	6,222,945

(b) Capital commitments

Capital expenditure for the acquisition of properties and equipment outstanding as at the reporting date but not yet incurred is as follows:

	2021	2020
Contracted but not provided for	260,250	488,368

(c) Other contingent liabilities

The Group is involved in legal actions which are in relation to its normal business operations. No material provision was made for those actions against the Group because the management believes that the Group has adequate grounds to defend against the claimants or the amounts involved in those actions are not expected to be material.

(All amounts in HK dollar thousands unless otherwise stated)

36 OFFSETTING FINANCIAL INSTRUMENTS

The following tables present details of financial instruments subject to offsetting, enforceable master netting arrangements and similar agreements.

As at 31 December 2021

	Gross amounts of recognised financial assets	Gross amounts of recognised 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 set off in the statement of financial position: Financial instruments	Related amounts not set off in the statement of financial position: Cash collateral received	Net amounts
Assets						
Derivative financial instruments	290,600	–	290,600	(179,219)	(84,395)	26,986
Other assets	230,089	(110,209)	119,880	–	–	119,880
Total	520,689	(110,209)	410,480	(179,219)	(84,395)	146,866

	Gross amounts of recognised financial liabilities	Gross amounts of recognised 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 set off in the statement of financial position: Financial instruments	Related amounts not set off in the statement of financial position: Cash collateral pledged	Net amounts
Liabilities						
Derivative financial instruments	243,356	–	243,356	(179,219)	(52,761)	11,376
Other liabilities	110,263	(110,209)	54	–	–	54
Total	353,619	(110,209)	243,410	(179,219)	(52,761)	11,430

(All amounts in HK dollar thousands unless otherwise stated)

36 OFFSETTING FINANCIAL INSTRUMENTS (CONTINUED)

As at 31 December 2020

	Gross amounts of recognised financial assets	Gross amounts of recognised 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 set off in the statement of financial position		Net amounts
				Financial instruments	Cash collateral received	
Assets						
Derivative financial instruments	518,783	–	518,783	(426,019)	(74,809)	17,955
Other assets	911,567	(700,793)	210,774	–	–	210,774
Total	1,430,350	(700,793)	729,557	(426,019)	(74,809)	228,729

	Gross amounts of recognised financial liabilities	Gross amounts of recognised 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 set off in the statement of financial position		Net amounts
				Financial instruments	Cash collateral pledged	
Liabilities						
Derivative financial instruments	771,893	–	771,893	(426,019)	(263,652)	82,222
Other liabilities	742,441	(700,793)	41,648	–	–	41,648
Total	1,514,334	(700,793)	813,541	(426,019)	(263,652)	123,870

Derivative financial instruments disclosed above are recorded on a gross basis in the statement of financial position. Since master netting agreements have been entered into for these derivative financial instruments, the net settlement amounts if an event of default or other precedent events occurred are disclosed under "Net amounts" to comply with the accounting requirements.

(All amounts in HK dollar thousands unless otherwise stated)

36 OFFSETTING FINANCIAL INSTRUMENTS (CONTINUED)

The tables below reconcile the amounts of derivative financial instruments, net amounts of other assets and other liabilities presented in the statement of financial position.

	2021	2020
Assets		
Net amounts of derivative financial instruments after offsetting as stated above	290,600	518,783
Derivative financial instruments not in scope of offsetting disclosures	26,730	323,363
Total derivative financial instruments	317,330	842,146
Net amounts of other assets after offsetting as stated above	119,880	210,774
Other assets not in scope of offsetting disclosures	1,549,738	2,239,226
Total other assets	1,669,618	2,450,000
Liabilities		
Net amounts of derivative financial instruments after offsetting as stated above	243,356	771,893
Derivative financial instruments not in scope of offsetting disclosures	7,729	152,776
Total derivative financial instruments	251,085	924,669
Net amounts of other liabilities after offsetting as stated above	54	41,648
Other liabilities not in scope of offsetting disclosures	2,426,054	3,164,621
Total other liabilities	2,426,108	3,206,269

37 INFORMATION ABOUT LOANS, QUASI-LOANS AND OTHER DEALINGS IN FAVOUR OF DIRECTORS, CONTROLLED BODIES CORPORATE AND CONNECTED ENTITIES

Balances below are disclosed pursuant to Section 383 of the Hong Kong Companies Ordinance (Cap. 622) and Companies (Disclosure of Information about Benefits of Directors) Regulation (Cap. 622G).

	Balance outstanding as at 31 December		Maximum balance during the year	
	2021	2020	2021	2020
Aggregate amount outstanding in respect of principal and interest	36,286	62,904	71,001	68,253

(All amounts in HK dollar thousands unless otherwise stated)

38 RELATED PARTY TRANSACTIONS

A number of banking transactions were entered into with related parties by the Group in the normal course of business and at arm's length basis. The outstanding balances of the related party transactions at the reporting date, and related expense and income for the year are as follows:

2021	Ultimate holding company and fellow subsidiaries	Associates and joint venture	Key management personnel (Note a)	Other related parties (Note b)	Total
Aggregate amounts outstanding at the year end					
– Loans and advances	–	–	34,876	–	34,876
– Cash and balances with banks	14,270	–	–	456,761	471,031
– Deposits and balances from banks and customers	211,617	1,450,922	1,334,881	2,981,816	5,979,236
– Investment securities at fair value through other comprehensive income	151,491	–	–	–	151,491
– Stage 1 and Stage 2 credit impairment allowances	1	3	63	26	93
– Contingent liabilities and other commitments	–	2,000	45,496	–	47,496
Interest income received from related parties	26	–	980	1,562	2,568
Interest expenses paid to related parties	1,811	2,486	5,784	11,500	21,581
Net fee and commission (expense)/income (to)/from related parties	(1,653)	61,813	–	(919)	59,241
Net other operating income/(expense) from/(to) related parties	31	(3,285)	(300)	(4,629)	(8,183)

(All amounts in HK dollar thousands unless otherwise stated)

38 RELATED PARTY TRANSACTIONS (CONTINUED)

2020

	Ultimate holding company and fellow subsidiaries	Associates and joint venture	Key management personnel (Note a)	Other related parties (Note b)	Total
Aggregate amounts outstanding at the year end					
– Loans and advances	–	–	297,828	–	297,828
– Cash and balances with banks	10,003	–	–	134,825	144,828
– Deposits and balances from banks and customers	457,155	385,642	1,353,581	1,944,110	4,140,488
– Investment securities at fair value through other comprehensive income	129,285	–	–	79,351	208,636
– Stage 1 and Stage 2 credit impairment allowances	–	2	515	18	535
– Contingent liabilities and other commitments	–	2,000	237,608	–	239,608
Interest income received from related parties	136	–	9,437	1,781	11,354
Interest expenses paid to related parties	4,499	5,071	11,875	31,720	53,165
Net fee and commission (expense)/income (to)/from related parties	(2,983)	51,792	–	(1,090)	47,719
Net other operating income/ (expense) from/ (to) related parties	33	(2,768)	(300)	(6,477)	(9,512)

Note a: Include key management personnel and Directors of the Bank and the ultimate holding company, their close family members and entities that are controlled or jointly controlled, directly or indirectly, by key management personnel or Directors.

Note b: Include other shareholders of the Group.

Key management personnel compensation

The compensation for Directors and key management personnel of the Bank is as follows:

	2021	2020
Salaries and other short-term employee benefits	113,040	109,792

(All amounts in HK dollar thousands unless otherwise stated)

39 STATEMENT OF FINANCIAL POSITION AND RESERVE MOVEMENT OF THE BANK

(a) Statement of Financial Position of the Bank

	As at 31 December	
	2021	2020
ASSETS		
Cash and balances with banks	30,684,194	29,993,830
Placements with banks	15,478,679	9,234,097
Loans and advances to customers	95,906,226	101,247,939
Financial assets at fair value through profit or loss	2,063,083	2,174,451
Derivative financial instruments	317,330	842,146
Investment securities at fair value through other comprehensive income	81,438,993	75,689,043
Investment securities at amortised cost	344,476	344,670
Investments in associates and joint venture	188,000	188,000
Investments in and net amounts due from subsidiaries	3,166,451	1,786,584
Properties and equipment	1,857,120	1,917,237
Investment properties	1,031,818	1,040,100
Deferred income tax assets	57,520	27,662
Other assets	1,573,821	2,322,525
TOTAL ASSETS	234,107,711	226,808,284
LIABILITIES		
Deposits and balances from banks	9,032,550	7,840,334
Deposits from customers	183,587,245	177,796,939
Derivative financial instruments	251,085	924,669
Subordinated debts	4,269,682	4,241,480
Other liabilities	2,329,854	3,007,766
Current income tax liabilities	139,925	117,504
Deferred income tax liabilities	–	104,966
TOTAL LIABILITIES	199,610,341	194,033,658
EQUITY		
CAPITAL AND RESERVES ATTRIBUTABLE TO EQUITY HOLDERS		
Share capital	2,000,000	2,000,000
Retained earnings	21,994,071	19,370,754
Reserves	10,503,299	11,403,872
	34,497,370	32,774,626
TOTAL EQUITY AND LIABILITIES	234,107,711	226,808,284

Approved and authorised for issue by the Board of Directors on 9 March 2022.

Stephen Ching Yen LEE
Chairman

John Con-sing YUNG
Director

Gordon Che Keung KWONG
Director

David Sek-chi KWOK
Managing Director & Chief Executive

(All amounts in HK dollar thousands unless otherwise stated)

39 STATEMENT OF FINANCIAL POSITION AND RESERVE MOVEMENT OF THE BANK (CONTINUED)

(b) Reserve movement of the Bank

	Regulatory reserve	Investment revaluation reserve	General reserve	Total
As at 1 January 2020	935,294	3,249,664	7,178,149	11,363,107
Investment securities at fair value through other comprehensive income	–	(55,400)	–	(55,400)
Currency translation difference arising from overseas operations	4,977	–	91,188	96,165
As at 31 December 2020 and 1 January 2021	**940,271**	**3,194,264**	**7,269,337**	**11,403,872**
Investment securities at fair value through other comprehensive income	**–**	**(934,596)**	**–**	**(934,596)**
Currency translation difference arising from overseas operations	**2,040**	**–**	**31,983**	**34,023**
As at 31 December 2021	**942,311**	**2,259,668**	**7,301,320**	**10,503,299**

Opinion

What we have audited

The consolidated financial statements of Shanghai Commercial Bank Limited (the "Bank") and its subsidiaries (the "Group") set out on pages 56 to 139, which comprise:

– the consolidated statement of financial position as at 31 December 2020;

– the consolidated statement of profit or loss for the year then ended;

– the consolidated statement of comprehensive income for the year then ended;

– the consolidated statement of changes in equity for the year then ended;

– the consolidated statement of cash flows for the year then ended; and

– the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Our opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2020, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

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

We 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 Group in accordance with the HKICPA's Code of Ethics for Professional Accountants ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. The key audit matter identified in our audit is related to the measurement of expected credit losses of loans and advances to customers.

Key Audit Matters (Continued)

Measurement of expected credit losses ("ECL") of loans and advances to customers

As at 31 December 2020, the Group recorded loan impairment allowances of HK$491 million, with HK$326 million as Stage 1 impairment allowances, HK$119 million as Stage 2 impairment allowances and HK$46 million as Stage 3 impairment allowances in respect of the total gross loan balance of HK$101,738 million. The impairment allowances of loans and advances to customers are elaborated in Notes 3.1 and 18.

For the calculation of ECL, management judgement is required in determining impairment methodology, various model inputs and post model adjustments. Significant judgement is also required to determine the credit ratings, probabilities of defaults and the future recoverability of credit impaired corporate loans and advances.

Management is required to establish a methodology to determine the stage for its financial assets based on changes in credit quality since initial recognition by identifying Significant Increase in Credit Risk ("SICR") and default events. ECL is measured from the calculation model depending on the stage of the financial assets. Management is also required to incorporate in ECL models the forward-looking information, where it identifies the key macroeconomic variables impacting credit risk and expected credit loss for each portfolio. Management also concluded that post model adjustments, i.e., the management overlay, are required to address certain limitation in its ECL model methodology. The Group established governance processes and controls for the measurement of ECL.

The ongoing COVID-19 pandemic increases the inherent risk of material misstatement and estimation uncertainty in determining ECL. In response, the forward-looking information have been adjusted by the Bank's economists; a supplemental management overlay has also been applied in ECL.

Our audit is focused on the measurement of ECL of loans and advances to customers due to significant judgements applied by management. Specifically we focused on the following:

(1) Criteria for determining whether or not there was a significant increase in credit risk, or a default or impairment loss was incurred;

(2) Economic indicators for forward-looking measurement, and the application of economic scenarios and weightings;

(3) Management overlay adjustments due to model constraints or data limitation not covered in the models;

(4) The determination of credit ratings and probabilities of default; and

(5) The discounted cash flows for corporate loans and advances in Stage 3.

How our audit addressed the Key Audit Matter

We obtained an understanding of the management's internal control and assessment process of ECL and assessed the inherent risk of material misstatement by considering the degree of estimation uncertainty and level of other inherent risk factors such as complexity, subjectivity, and changes and susceptibility to management bias or fraud. This included understanding management's actions in response to the economic impact from the COVID-19 pandemic.

Key Audit Matters (Continued)

How our audit addressed the Key Audit Matter (Continued)

In response to risk assessed and likely sources of material misstatements identified, we have performed a combination of test of controls and substantive procedures as part of our audit, including

– We assessed governance over ECL models approval and ongoing monitoring, the applicability and appropriateness of major ECL model methodologies and assumptions used for Stage 1 and 2 ECL calculation;

– We tested Credit Committee's oversight and regular monitoring of the overall credit quality;

– We evaluated regular post draw-down monitoring of the grading of credit quality by monitoring units which are independent from the loan initiation units and key controls over management's assessment of criteria for determining significant increase in credit risk;

– We tested, on a sample basis, management's post draw-down credit reviews and assessed the appropriateness of management's determination of credit ratings and probabilities of default, and identification of significant increase in credit risk, defaults and credit-impaired loans. These were performed by considering financial information and non-financial information of the borrowers, relevant external evidence and other factors. We examined and challenged the results of the thematic portfolio analysis, including the "Portfolio Review – Outbreak of Coronavirus" performed by management in response to changes in external market environments over the credit quality of certain loan portfolios;

– We assessed regular review and approval of key management judgements including forward-looking and management overlay adjustments;

– We evaluated and challenged management's forward-looking measurement, including management's analysis of their selection of economic indicators and economic scenarios, assessed the reasonableness of the prediction of economic indicators and performed sensitivity analysis of probability weightings;

– We assessed the reasonableness of management's selection of uncertain factors and analysis of data limitations and model constraints, as well as their application and measurement in the management overlay adjustments, and examined the accuracy of the relevant mathematical calculations;

– We tested, on a sample basis, the ECL calculation of Stage 3 loans by challenging management's assumptions in deriving the future cashflows based on borrowers' circumstances, objective evidence of inputs for impairment calculation (including valuation of collateral and macroeconomic variable estimates) and our industry knowledge;

– We considered whether the judgements made in selecting the significant assumptions would give rise to indicators of possible management bias, for instance, we have developed an auditor's range of ECL estimates to assess the appropriateness of ECL made against a sample of material loan; and

– We assessed the adequacy of the disclosures related to ECL of loans and advances to customers in the Annual Report 2020 in the context of the applicable financial reporting framework.

Based on the results of the above testing, we considered that management's judgements and assumptions applied in determining ECL of loans and advances to customers were supportable by the evidence obtained and procedures performed.

Other Information

The Directors of the Bank are responsible for the other information. The other information comprises all of the information included in the annual report other than the consolidated financial statements and our auditor's report thereon.

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

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

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

Responsibilities of Directors and the Audit Committee for the Consolidated Financial Statements

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

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

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

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. 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 consolidated financial statements.

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

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

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

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

– Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.

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

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

– Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

The engagement partner on the audit resulting in this independent auditor's report is Ms. NG Wai Ying.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 16 March 2021

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

(All amounts in HK dollar thousands unless otherwise stated)

		Year ended 31 December	
	Note	2020	2019
Interest income	6	5,679,681	6,746,101
Interest expense	6	(2,128,022)	(2,768,808)
Net interest income		3,551,659	3,977,293
Fee and commission income	7	879,829	870,836
Fee and commission expense	7	(56,923)	(55,159)
Net fee and commission income	7	822,906	815,677
Net trading income	8	206,951	225,226
Net gains from disposal of investment securities at fair value through other comprehensive income		131,656	60,685
Dividend income from investment securities at fair value through other comprehensive income		196,954	176,872
Other operating income	9	148,295	164,937
Net earned insurance premium	10	43,592	50,388
Net insurance claims incurred and movement in policyholders' liabilities	10	(32,058)	(38,152)
Operating expenses	11	(1,621,139)	(1,649,253)
Credit impairment losses	12	(125,440)	(60,504)
Operating profit		3,323,376	3,723,169
Share of net profits of associates and joint venture	25	45,609	36,519
Profit before income tax		3,368,985	3,759,688
Income tax expense	14	(626,938)	(737,705)
Profit for the year		2,742,047	3,021,983
Attributable to:			
Equity holders of the Bank		2,736,368	3,016,086
Non-controlling interests		5,679	5,897
		2,742,047	3,021,983

The notes on pages 62 to 139 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(All amounts in HK dollar thousands unless otherwise stated)

	Year ended 31 December	
	2020	2019
Profit for the year	2,742,047	3,021,983
Other comprehensive income		
Items that may be reclassified to profit or loss		
Exchange differences on translation of overseas operations	118,057	(53,855)
Investment securities at fair value through other comprehensive income		
– Changes in fair value	715,324	431,430
– Change in credit impairment losses recognised in profit or loss	4,509	(1,083)
– Fair value changes transferred to profit or loss on disposal	(131,656)	(60,685)
– Deferred income tax	(96,305)	(61,173)
Share of reserves of associates and joint venture	6,343	18,245
Items that will not be reclassified to profit or loss		
Equity investments at fair value through other comprehensive income		
– Changes in fair value	(550,754)	379,998
– Deferred income tax	3,450	(6,168)
Share of reserves of associates and joint venture	–	(13)
Other comprehensive income for the year, net of tax	68,968	646,696
Total comprehensive income for the year	2,811,015	3,668,679
Attributable to:		
Equity holders of the Bank	2,805,349	3,662,761
Non-controlling interests	5,666	5,918
Total comprehensive income for the year	2,811,015	3,668,679

The notes on pages 62 to 139 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(All amounts in HK dollar thousands unless otherwise stated)

	Note	As at 31 December 2020	2019
ASSETS			
Cash and balances with banks	16	29,995,254	34,128,614
Placements with banks	17	9,234,097	7,090,556
Loans and advances to customers	18	101,247,939	98,773,691
Financial assets at fair value through profit or loss	19	2,198,751	1,881,025
Derivative financial instruments	20	842,146	285,089
Investment securities at fair value through other comprehensive income	21	75,689,043	71,558,546
Investment securities at amortised cost	22	344,670	2,480,924
Properties for sale	23	591,418	449,462
Investments in associates and joint venture	25	443,480	417,663
Properties and equipment	26	2,657,156	2,700,014
Investment properties	27	1,010,526	1,017,148
Deferred income tax assets	32	27,668	28,115
Other assets	28	2,450,000	1,814,267
TOTAL ASSETS		226,732,148	222,625,114
LIABILITIES			
Deposits and balances from banks		7,840,334	11,677,610
Deposits from customers	29	177,796,939	172,438,516
Derivative financial instruments	20	924,669	292,599
Subordinated debts	30	4,241,480	4,257,647
Other liabilities	31	3,206,269	2,813,883
Current income tax liabilities		117,787	501,694
Deferred income tax liabilities	32	109,871	18,901
TOTAL LIABILITIES		194,237,349	192,000,850
EQUITY			
CAPITAL AND RESERVES ATTRIBUTABLE TO EQUITY HOLDERS			
Share capital	33	2,000,000	2,000,000
Retained earnings		18,977,170	17,158,968
Reserves	34	11,426,064	11,378,917
		32,403,234	30,537,885
Non-controlling interests in equity		91,565	86,379
TOTAL EQUITY		32,494,799	30,624,264
TOTAL EQUITY AND LIABILITIES		226,732,148	222,625,114

Approved and authorised for issue by the Board of Directors on 16 March 2021.

Stephen Ching Yen LEE
Chairman

Hung-ching YUNG
Director

Gordon Che Keung KWONG
Director

David Sek-chi KWOK
Managing Director & Chief Executive

The notes on pages 62 to 139 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(All amounts in HK dollar thousands unless otherwise stated)

	Note	Attributable to equity holders			Non-controlling interests	Total equity
		Share capital	Reserves	Retained earnings (including proposed dividends)		
As at 1 January 2019		2,000,000	10,503,623	15,311,501	80,861	27,895,985
Profit for the year		–	–	3,016,086	5,897	3,021,983
Other comprehensive income net of tax		–	675,294	(28,619)	21	646,696
Net change in fair value of investment securities at fair value through other comprehensive income	34	–	682,298	–	21	682,319
Currency translation difference arising from overseas operations	34	–	(25,236)	(28,619)	–	(53,855)
Share of reserves of associates and joint venture	34	–	18,232	–	–	18,232
Total comprehensive income		–	675,294	2,987,467	5,918	3,668,679
Transfer from retained earnings	34	–	200,000	(200,000)	–	–
Payment of dividend relating to 2018		–	–	(940,000)	(400)	(940,400)
As at 31 December 2019		2,000,000	11,378,917	17,158,968	86,379	30,624,264
As at 1 January 2020		**2,000,000**	**11,378,917**	**17,158,968**	**86,379**	**30,624,264**
Profit for the year		**–**	**–**	**2,736,368**	**5,679**	**2,742,047**
Other comprehensive income net of tax		**–**	**47,147**	**21,834**	**(13)**	**68,968**
Net change in fair value of investment securities at fair value through other comprehensive income	34	**–**	**(55,419)**	**–**	**(13)**	**(55,432)**
Currency translation difference arising from overseas operations	34	**–**	**96,223**	**21,834**	**–**	**118,057**
Share of reserves of associates and joint venture	34	**–**	**6,343**	**–**	**–**	**6,343**
Total comprehensive income		**–**	**47,147**	**2,758,202**	**5,666**	**2,811,015**
Payment of dividend relating to 2019		**–**	**–**	**(940,000)**	**(480)**	**(940,480)**
As at 31 December 2020		**2,000,000**	**11,426,064**	**18,977,170**	**91,565**	**32,494,799**

	Year ended 31 December	
	2020	2019
Proposed dividend included in retained earnings	**313,000**	940,000

The notes on pages 62 to 139 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

(All amounts in HK dollar thousands unless otherwise stated)

	Note	Year ended 31 December 2020	2019
Cash flows from operating activities			
Profit before income tax		**3,368,985**	3,759,688
Share of net profits of associates and joint venture	25	**(45,609)**	(36,519)
Credit impairment losses	12	**125,440**	60,504
Depreciation expenses		**245,702**	231,307
Net losses/(gains) from disposal of equipment	9	**176**	(50)
Net gains from disposal of investment securities at fair value through other comprehensive income		**(131,656)**	(60,685)
Interest income on investment securities at amortised cost	6	**(16,572)**	(44,250)
Interest income on investment securities at fair value through other comprehensive income	6	**(1,497,748)**	(1,784,182)
Interest expense on subordinated debts	6	**190,413**	189,413
Interest expense on lease liabilities	6	**8,702**	11,759
Dividend income		**(196,954)**	(176,872)
Hong Kong profits tax paid		**(735,123)**	(1,611)
Overseas tax paid		**(271,426)**	(336,411)
Effect of exchange rate changes		**280,233**	448,103
Cash flows from operating activities before changes in operating assets and liabilities		**1,324,563**	2,260,194
Changes in operating assets and liabilities:			
– Net (increase)/decrease in balances with banks with original maturity beyond 3 months		**(2,861,205)**	2,129,736
– Net (increase)/decrease in placements with banks with original maturity beyond 3 months		**(2,330,521)**	1,992,874
– Net increase in financial assets at fair value through profit or loss		**(317,726)**	(22,041)
– Net decrease in derivative financial instruments		**75,013**	15,099
– Net increase in loans and advances to customers		**(2,590,103)**	(12,107,771)
– Net increase in right-of-use assets		**(97,180)**	(136,717)
– Net increase in other assets		**(657,007)**	(361,312)
– Net (decrease)/increase in deposits and balances from banks		**(3,837,276)**	1,332,622
– Net increase in deposits from customers		**4,405,644**	17,823,798
– Net increase in lease liabilities		**97,405**	135,201
– Net increase/(decrease) in other liabilities		**393,680**	(28,192)
Net cash (used in)/generated from operating activities		**(6,394,713)**	13,033,491

CONSOLIDATED STATEMENT OF CASH FLOWS

(All amounts in HK dollar thousands unless otherwise stated)

	Note	Year ended 31 December 2020	2019
Cash flows from investing activities			
Interest received on investment securities at amortised cost and fair value through other comprehensive income		1,504,894	1,638,832
Dividends received on investment securities at fair value through other comprehensive income		196,954	176,872
Dividends received from associates and joint venture	25	26,135	25,535
Purchases of properties and equipment		(87,411)	(104,654)
Additions of investment properties	27	(2,272)	(150)
Additions of properties for sale		(141,956)	(33,116)
Proceeds from sale of equipment		172	157
Purchases of investment securities at fair value through other comprehensive income		(82,007,059)	(59,218,760)
Purchases of investment securities at amortised cost		(1,272,572)	(8,254,942)
Proceeds from sale and redemption of investment securities at fair value through other comprehensive income		74,910,289	48,058,270
Proceeds from redemption of investment securities at amortised cost		2,469,019	8,850,041
Net cash used in investing activities		(4,403,807)	(8,861,915)
Cash flows from financing activities			
Issue of subordinated debts	35	–	2,338,326
Interest paid on subordinated debts		(189,212)	(132,088)
Payment of lease liabilities		(128,429)	(115,406)
Dividend paid to equity holders		(940,000)	(940,000)
Dividend paid to non-controlling interests		(480)	(400)
Net cash (used in)/generated from financing activities		(1,258,121)	1,150,432
Net (decrease)/increase in cash and cash equivalents		(12,056,641)	5,322,008
Cash and cash equivalents at beginning of the year		39,812,613	34,702,607
Effect of exchange rate changes on cash and cash equivalents		243,667	(212,002)
Cash and cash equivalents at end of the year		27,999,639	39,812,613
Represented by:			
Cash and balances with banks with less than 3 months' original maturity	16	26,401,234	33,395,356
Placements with banks with less than 3 months' original maturity	17	1,098,403	1,279,747
Debt securities - Exchange Fund Bills with less than 3 months' original maturity		500,002	5,137,510
		27,999,639	39,812,613
Cash flows from operating, investing and financing activities included:			
Interest received		5,773,296	6,757,234
Interest paid		(2,272,843)	(2,502,045)

The notes on pages 62 to 139 are an integral part of these consolidated financial statements.

1 GENERAL INFORMATION

Shanghai Commercial Bank Limited (the "Bank") and its subsidiaries (together, the "Group") are engaged in the provision of banking and related financial services in Hong Kong, the United States, the United Kingdom and the People's Republic of China.

The Bank is a financial institution incorporated in Hong Kong. The address of its registered office is Shanghai Commercial Bank Tower, 12 Queen's Road Central, Hong Kong.

The ultimate holding company is The Shanghai Commercial & Savings Bank, Ltd., which is incorporated in the Republic of China (Taiwan).

These consolidated financial statements are presented in thousands of units of Hong Kong Dollars (HK$'000), unless otherwise stated and were approved for issue by the Board of Directors on 16 March 2021.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs") and the requirements of the Hong Kong Companies Ordinance Cap. 622. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of investment securities at fair value through other comprehensive income, financial assets at fair value through profit or loss and derivative financial instruments, which are carried at fair value.

The preparation of financial statements in conformity with HKFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgements in the process of applying the Group's accounting policies. The areas involving a higher degree of judgments or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

(a) New and amended standards adopted by the Group for the year ended 31 December 2020

	Effective for accounting periods beginning on or after
Definition of Material – Amendments to HKAS 1 and HKAS 8	1 January 2020
Definition of a Business – Amendments to HKFRS 3	1 January 2020
Interest Rate Benchmark Reform – Amendments to HKFRS 7, HKFRS 9 and HKAS 39	1 January 2020
Revised Conceptual Framework for Financial Reporting	1 January 2020
Covid-19-related Rent Concessions – Amendments to HKFRS 16	1 June 2020

The adoption of the above new and amended standards does not have significant impact to the financial statements of the Group.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.1 Basis of preparation (Continued)

(b) Amendments, new standards and interpretations issued but not yet effective for the year ended 31 December 2020

The HKICPA has issued a few amendments, new standards and interpretations which are not yet effective for the year ended 31 December 2020 and which have not been adopted in these consolidated financial statements. The key new standard which may be relevant to the Group is HKFRS 17 "Insurance Contracts".

HKFRS 17 "Insurance contracts" is effective for the accounting period beginning on or after 1 January 2023. It establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard and to replace the HKFRS 4 "Insurance contracts". The objective of HKFRS 17 is to ensure that an entity provides relevant information that faithfully represents those contracts. HKFRS 17 defines clear and consistent rules that will significantly increase the comparability of financial statements. The general model under HKFRS 17 requires an entity to measure an insurance contract at initial recognition at the total of the fulfilment cash flows and the contractual service margin. Aside from this general model, the standard provides, as a simplification, the premium allocation approach. The Group is in the process of assessing the financial and disclosure impact on the adoption of the standard.

2.2 Consolidation

The consolidated financial statements include the financial statements of the Bank and all its subsidiaries made up to 31 December 2020.

(a) Subsidiaries

Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(b) Transactions with non-controlling interests

The Group treats transactions with non-controlling interests as transactions with equity owners of the Group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

When the Group ceases to have control or significant influence, any retained interest in the entity is remeasured to its fair value, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.2 Consolidation (Continued)

(c) Associates and joint ventures

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

A joint venture is an arrangement whereby the Group and other parties contractually agree to share control of the arrangement and have right to the net assets of the arrangement.

Investments in associates and joint ventures are accounted for using the equity method, and are initially recognised in the consolidated statement of financial position at cost and adjusted thereafter to recognise the Group's share of the post-acquisition profits or losses and movements in other comprehensive income. When the Group's share of losses in an associate or a joint venture equals or exceeds its interests in the associate or joint venture (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate or joint venture), the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate or joint venture.

When the Group transacts with its associates or joint ventures, profits and losses resulting from such transactions are recognised in the Group's consolidated financial statements only to the extent of interests in the associates or joint ventures that are not related to the Group. Unrealised losses arising from the transactions between the Group and the associates and joint ventures are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

2.3 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in thousands of units of Hong Kong Dollars (HK$'000), which is the Bank's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions that are transactions denominated, or that require settlement, in a foreign currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions.

Monetary items denominated in foreign currency are translated with the closing rate as at the reporting date. Non-monetary items measured at historical cost denominated in a foreign currency are translated with the exchange rate as at the date of initial recognition; non-monetary items in a foreign currency that are measured at fair value are translated using the exchange rate at the date when the fair value was determined.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at exchange rates at the reporting date of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of profit or loss.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.3 Foreign currency translation (Continued)

(b) Transactions and balances (Continued)

All foreign exchange gains and losses recognised in the statement of profit or loss are presented net in the statement of profit or loss within the corresponding item. Foreign exchange gains and losses on other comprehensive income items are presented in other comprehensive income within the corresponding item.

In the case of changes in the fair value of monetary assets denominated in foreign currency classified as fair value through other comprehensive income ("FVOCI"), a distinction is made between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security.

Translation differences related to changes in the amortised cost are recognised in profit or loss, and other changes in the carrying amount, except impairment, are recognised in other comprehensive income.

Translation differences on non-monetary financial instruments, such as equities held at fair value through profit or loss ("FVTPL"), are reported as part of the fair value gain or loss. Translation differences on non-monetary financial instruments, such as equities classified as FVOCI investments, are included in other comprehensive income.

(c) Group companies and overseas branches

The results and financial positions of all the Group's entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

– Assets and liabilities for each statement of financial position presented are translated at the closing rate at the reporting date;

– Income and expenses for each statement of profit or loss are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

– All resulting exchange differences are recognised in other comprehensive income.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, are taken to other comprehensive income. When a foreign operation is disposed of, or partially disposed of, such exchange differences that were recorded in equity are recognised in the statement of profit or loss as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

2.4 Fee and commission income and expense

Fee and commission income is recognised when the service has been provided. Loan fees for servicing a loan are recognised as fee income. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually over the tenor of the contract.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.5 Dividend income

Dividends are recognised in the statement of profit or loss when the entity's right to receive payment is established.

2.6 Financial assets, financial liabilities, interest income and expense

Measurement methods

Initial recognition and measurement

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognised on trade-date, the date on which the Group commits to purchase or sell the asset.

At initial recognition, the Group 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, expected credit loss ("ECL") is recognised for financial assets measured at amortised cost or measured at FVOCI, which results in an accounting loss being recognised 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 Group recognises 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 recognised 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 amortised over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or realised through settlement.

Classification and subsequent measurement

The Group classifies its financial assets into the following measurement categories:

- Amortised cost;
- FVOCI; or
- FVTPL.

Debt instruments

Classification and subsequent measurement of debt instruments depend on:

(i) the Group's business model for managing the asset; and

(ii) the cash flow characteristics of the asset.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.6 Financial assets, financial liabilities, interest income and expense (Continued)

Classification and subsequent measurement (Continued)

Debt instruments (Continued)

There are three measurement categories into which the Group classifies its debt instruments:

(a) Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ("SPPI"), and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by ECL recognised. Interest income from these financial assets is included in "Net interest income" using the effective interest rate method.

(b) FVOCI: 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 FVTPL, are measured at FVOCI. Movements in the carrying amount are taken through other comprehensive income, except for the recognition of impairment gains or losses, interest income and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss. Interest income from these financial assets is included in "Net interest income" using the effective interest rate method.

(c) FVTPL: Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVTPL. A gain or loss on a debt instrument that is subsequently measured at FVTPL is recognised in profit or loss and presented net in the statement of profit or loss within "Net trading income" in the period in which it arises.

Business model: the business model reflects how the Group manages the assets in order to generate cash flows. That is, whether the Group's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of "other" business model and measured at FVTPL. Factors considered by the Group in determining the business model for a group of assets include past experience on how the cash flows for these assets 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 Group assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the "SPPI test"). In making this assessment, the Group considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending, the related financial asset is classified and measured at fair value through profit or loss.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.6 Financial assets, financial liabilities, interest income and expense (Continued)

Classification and subsequent measurement (Continued)

Equity instruments

The Group subsequently measures equity instruments at FVTPL, except where the Group's management has elected, at initial recognition, to irrevocably designate an equity security at FVOCI. Where the Group's management has elected to present fair value gains and losses on equity instruments in other comprehensive income, there is no subsequent reclassification of fair value gains and losses to profit or loss following the derecognition of the instruments. Dividends from such instruments continue to be recognised in profit or loss as dividend income when the Group's right to receive payments is established.

Gains and losses on equity instruments at FVTPL are included in the "Net trading income" in the statement of profit or loss.

Modification of financial assets

If the borrower is in financial difficulty, where the terms of the financial assets are modified and being substantially different to the original terms, the Group derecognises the original financial asset and recognises 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 purpose, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Group also assesses whether the new financial asset recognised 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. Difference in the carrying amount is also recognised 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, the financial asset continues to be subject to the same assessments for significant increase in credit risk relative to initial recognition and credit-impairment.

Derecognition other than on a modification

Financial assets, or a portion thereof, are derecognised when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either (i) the Group transfers substantially all the risks and rewards of ownership, or (ii) the Group neither transfers nor retains substantially all the risks and rewards of ownership and the Group has not retained control.

The Group 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 Group:

(i) does not have 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 furnished by the Group under standard repurchase agreements and securities lending and borrowing transactions are not derecognised because the Group retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.6 Financial assets, financial liabilities, interest income and expense (Continued)

Impairment of financial assets

The Group assesses on a forward-looking basis ECL associated with its financial assets carried at amortised cost and debt instruments measured at FVOCI and with the exposure arising from loan commitments and financial guarantee contracts. The Group recognises 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.

Note 3.1.1 provides more detail of how the ECL is measured.

Financial liabilities

Classification and subsequent measurement

The Group classifies its financial liabilities at amortised cost, except for:

(a) financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading 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). Should such a presentation 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; and

(b) financial liabilities arising from the transfer of financial assets which did not qualify for derecognition: when the transfer of financial asset did not qualify for derecognition, a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Group recognises any expense incurred on the financial liability.

Derecognition

Financial liabilities are derecognised when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.6 Financial assets, financial liabilities, interest income and expense (Continued)

Interest income and expense

Interest income and expense for all interest-bearing financial instruments, except for those classified as financial assets or financial liabilities at fair value through profit or loss, are recognised within "interest income" and "interest expense" in the statement of profit or loss using the effective interest method.

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 amortised cost before any impairment allowance) or to the amortised cost of a financial liability. The calculation does not consider ECL and includes the 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 at initial recognition – the Group calculates the credit-adjusted effective interest rate, which is calculated based on the amortised cost of the financial asset instead of its gross carrying amount and incorporates the impact of ECL in estimated future cash flows.

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 amortised cost of the financial asset.

(b) Financial assets that have subsequently become credit-impaired (or "Stage 3"), for which interest income is calculated by applying the effective interest rate to their amortised cost (i.e. net of the ECL provision).

2.7 Derivative financial instruments

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

Certain derivatives are embedded in hybrid contracts, such as the equity option in an equity linked instrument. If the hybrid contract contains a host that is a financial asset, then the Group assesses the entire contract as described in the financial assets section above for classification and measurement purposes.

2.8 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 other bodies on behalf of customers to secure loans, overdrafts and other banking facilities.

The fair value of the financial guarantee contracts is initially recognised as the premium received in accordance with HKFRS 15. Subsequent to initial recognition, the Group has taken into account the amount of expected credit loss under HKFRS 9.

Loan commitments provided by the Group are measured as the amount of the impairment allowance.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.9 Determination of fair value

For financial instruments traded in active markets, the determination of fair values of financial assets and financial liabilities is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges and broker quotes from Bloomberg and Reuters.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indications that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

For all other financial instruments, fair value is determined using valuation techniques. In these techniques, fair values are estimated from observable data in respect of similar financial instruments, using models to estimate the present value of expected future cash flows or other valuation techniques, using inputs (for example, LIBOR yield curve, FX rates, volatilities and counterparty spreads) existing at the end of each reporting period.

The Group uses widely recognised valuation models for determining fair values of non-standardised financial instruments of lower complexity, such as options or interest rate and currency swaps. For these financial instruments, inputs into models are generally market-observable.

For more complex instruments, the Group uses developed models, which are usually based on valuation methods and techniques generally recognised as standard within the industry. Valuation models are used primarily to value derivatives transacted in the over-the-counter market, unlisted debt securities (including those with embedded derivatives) and other debt instruments for which markets were or have become illiquid. Some of the inputs to these models may not be market observable and are therefore estimated based on assumptions.

The output of a model is always an estimate or approximation of a value that cannot be determined with certainty, and valuation techniques employed may not fully reflect all factors relevant to the positions the Group holds. Valuations are therefore adjusted, where appropriate, to allow for additional factors including model risks, liquidity risk and counterparty risk. Based on the established fair value model governance policies, and related controls and procedures applied, management believes that these valuation techniques are necessary and appropriate to fairly state the values of financial instruments carried at fair value in the statement of financial position. Price data and parameters used in the measurement procedures applied are generally reviewed carefully and adjusted, if necessary, particularly in view of the current market developments.

The fair values of contingent liabilities and irrevocable loan commitments correspond to their carrying amounts.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.10 Properties and equipment

(a) Land and bank premises

Land and buildings comprise mainly branches and offices. Leasehold land classified as finance lease and buildings are stated at historical cost, which includes expenditure that is directly attributable to the acquisition of the items, less accumulated depreciation and impairment losses. Depreciation of land and buildings is provided annually by charging a sum sufficient to write down the cost of the land and buildings systematically. The land is depreciated over the lease term. The depreciation of the buildings is based on management's appraisal of their conditions, which includes estimations of the remaining useful lives, which are not expected to exceed 40 years.

Interest in freehold land is stated at cost.

(b) Furniture, fittings and equipment

Furniture, fittings and equipment are stated at historical cost less accumulated depreciation and impairment losses. Depreciation of furniture, fittings and equipment are calculated to write off the costs of the assets over their estimated useful lives on a straight line basis over 4 to 10 years.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the statement of profit or loss during the financial period in which they are incurred.

(c) Property under development

Leasehold land for property under development is stated at historical cost, less accumulated depreciation and impairment losses, and development expenditure is stated at the aggregate amount of costs incurred up to the date of completion. For depreciation of leasehold land for properties under development, please refer to Note 2.10(a) above.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.14). The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

Gains or losses on disposals are determined by comparing proceeds and the carrying amount of the relevant assets and are recognised in the statement of profit or loss.

2.11 Investment properties

Property that is held for long-term rental yields or for capital appreciation or both is classified as investment property. Investment properties are land and office buildings. Investment properties are measured at cost less subsequent accumulated depreciation and any accumulated impairment losses. Depreciation is charged so as to write off the cost of investment properties using the straight-line method over the unexpired period of the lease term for land and the shorter of the leases or 40 years for buildings.

2.12 Properties for sale

Properties for sale are carried at the lower of cost and net realisable value. Net realisable value takes into account the price ultimately expected to be realised and the anticipated costs to completion.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.13 Leases

The Group's leasing activities and how these are accounted for

The Group leases various properties, equipment and motor vehicles. Rental contracts are typically made for fixed periods of 2 to 5 years but may have extension options. 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.

Leases are recognised as a right-of-use asset and a corresponding liability on the date when the leased asset is available for use by the Group. Each lease payment is allocated between the liability and finance cost (i.e. interest on lease liabilities). 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. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

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;

– amounts expected to be payable by the lessee under residual value guarantees;

– the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and

– payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

The lease payments are discounted using the Group's incremental borrowing rate, being the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions.

Right-of-use assets are measured at cost comprising the following:

– the amount of the initial measurement of lease liabilities;

– any lease payments made at or before the commencement date less any lease incentives received;

– any initial direct costs; and

– restoration costs.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less. Low-value assets comprise IT equipment and small items of office furniture.

The accounting for leasehold land previously classified as finance lease remains the same. Please refer to Note 2.10 (a) for details.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.13 Leases (Continued)

Extension and termination options

Extension and termination options are included in a number of property and equipment leases across the Group. 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 Group and not by the respective lessor.

Where the Group is a lessor

Rental income from operating leases where the Group is a lessor is recognised in income on a straight-line basis over the lease term. The respective leased assets are included in the consolidated statement of financial position based on their nature.

2.14 Impairment of investment in subsidiaries, associates, joint ventures and non-financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.15 Current and deferred income tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in the statement of profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the reporting date in the countries where the Group's entities operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted at the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

The principal temporary differences arise from depreciation of properties and equipment, revaluation of certain financial assets and liabilities including derivative contracts, provisions for pensions and other post-retirement benefits and tax losses carried forward; and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not be reversed in the foreseeable future.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.15 Current and deferred income tax (Continued)

Deferred income tax related to fair value re-measurement of FVOCI debt investments, which is charged or credited to other comprehensive income, is also credited or charged to other comprehensive income and is subsequently recognised in the statement of profit or loss together with the deferred gain or loss upon disposal.

Deferred income tax related to fair value re-measurement of FVOCI equity investments, which is charged or credited to other comprehensive income, will remain in reserves and will not be subsequently recognised in the statement of profit or loss upon disposal.

2.16 Employee benefits

(a) Retirement benefit costs

The Group operates 2 retirement benefit schemes comprising of a Mandatory Provident Fund Scheme and a defined benefit scheme that are available to the Group's employees. However, the principal scheme that the Group contributes to is the Mandatory Provident Fund Scheme. The assets of the Group's Mandatory Provident Fund Scheme and the defined benefit scheme are held separately from those of the Group in independently administered funds.

The Group's contributions to the Mandatory Provident Fund Scheme are charged to the statement of profit or loss.

The defined benefit scheme is funded by payments from the Group by taking recommendations of independent qualified actuaries. The defined benefit costs are assessed using the Attained Age Method and the cost of providing the benefit is charged to the statement of profit or loss so as to spread the regular cost over the service lives of employees in accordance with the advice of qualified actuaries, who value the scheme once every 3 years.

(b) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. Employee entitlements to sick leave and maternity leave are recognised when the absences occur.

(c) Termination benefits

Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed: a termination when the entity has a detailed formal plan to terminate the employment of current employees without possibility of withdrawal or when the entity recognises costs for a restructuring that is within the scope of HKAS 37 and involves payment of termination benefits. In the case of an offer made to encourage voluntary redundancy the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the reporting date are discounted to present value.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.17 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is recognised as interest expense.

2.18 Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if that party controls, jointly controls or has significant influence over the Group; is a member of the same financial reporting group, such as parents, subsidiaries and fellow subsidiaries; is an associate or a joint venture of the Group or parent reporting group; is a key management personnel of the Group or parents, or where the Group and the party are subject to common control. Related parties may be individuals or entities.

2.19 Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with less than 3 months' maturity from the date of acquisition including cash, balances with banks, placements with banks, treasury bills and certificates of deposit that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

2.20 Fiduciary activities

The Group commonly acts as trustees and in other fiduciary capacities, for a fee and commission income, that result in the holding or placing of assets on behalf of individuals, trusts and other institutions. These assets and income arising thereon are excluded from these financial statements, as they are not assets of the Group.

2.21 Segment reporting

Operating segments, and the amounts of each segment item reported in the consolidated financial statements, are identified from the financial information provided regularly to the Group's most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

Individually material operating segments are not aggregated for financial reporting purposes unless the segments have similar economic characteristics and are similar in respect of the nature of products and services, the nature of production processes, the type or class of customers, the methods used to distribute the products or provide the services, and the nature of the regulatory environment. Operating segments which are not individually material may be aggregated if they share a majority of these criteria.

3 FINANCIAL RISK MANAGEMENT

The Group's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the financial business, and the operational risks are an inevitable consequence of being in business. The Group's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse impacts on the Group's financial performance.

The Group'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 Group regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practice.

The Group has in place policies and procedures for the identification, measurement, control and monitoring of credit, liquidity, market, interest rate, foreign exchange and operational risks. One of the major functions of the Board of Directors is to ensure that the Group establishes policies, procedures and controls to manage the various types of risk it faces. The Board of Directors has delegated its powers to the Risk Committee, the Executive Committee, the Asset and Liability Committee, the Credit Committee and the Compliance and Operational Risk Management Committee for the oversight of major functional areas. While the risk appetite of the Group is approved by the Board of Directors, risk control limits are approved, reviewed, and monitored regularly by various Board-level specialized committees. Risk Committee is further responsible for assisting the Board in ensuring adequate oversight of bank-wide risks, and advising the Board on high-level risk related matters, risk management strategies and risk governance of the Group, within the framework of the Group's policies. Senior management is always watchful for changes in economic, political and market conditions in which the Group operates and the inherent risks the Group faces.

The Risk Management Division and Credit Division are responsible for monitoring the overall risk management of the Group's operations. Reconciliation procedures are also in place to ensure that the systems capture all necessary data. Prior to implementation of any new product or service, various analyses, testing, development and planning will be performed and its proposal will be endorsed by the Product/Service Governance Committee and approved by Chief Executive. All of the above arrangements ensure that the risk management processes are operating effectively.

The Internal Audit Department is responsible for conducting independent review on the effectiveness of the Group's risk management and control environment.

3.1 Credit risk

The Group takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss for the Group by failing to discharge an obligation. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration in the Group's portfolio, could result in losses that are different from those provided for at the reporting date.

The Group has in place effective credit review, monitoring and control systems including an effective loan classification system that identify, monitor, and determine impairment allowance in a timely manner. Management therefore carefully manages the exposure to credit risk.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Limits on the level of credit risk by product, industry sector and by country are reviewed and approved by the Board of Directors from time to time but at least annually.

The exposure to any one counterparty including banks and brokers is further restricted by sub-limits covering on – 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.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations and by changing these lending limits where appropriate. The Group has in place effective monitoring and control systems to identify, monitor and address problem credits in an accurate and timely manner. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees. The Group further mitigates credit risk by entering into netting arrangements with counterparties such as banks with which it undertakes credit activities.

Arising from the adverse economic impact from the Covid-19 pandemic, the Bank has been closely monitoring the situation and carrying out necessary evaluation to assess the level of expected credit loss. Relief measures, including those initiated by the regulators and by the Bank such as Pre-approved Principal Payment Holiday Scheme, Special 100% Loan Guarantee under the SME Financing Guarantee Scheme and Principal Moratorium for Mortgage Loans, have been made available for eligible customers and credit assessment has been performed, and there has been no significant increase in credit risk and expected credit loss. The macro-economic variable forecasts have been reviewed and projected by the Bank's economists on a monthly basis to account for the possible evolvement of resulting economy, both within the period of pandemic and the potential recovery afterward, in Hong Kong and other major countries which the Bank's network covers. In addition, the Bank has also performed a portfolio review to evaluate the credit quality of loan customers by assessing their repayment ability, and management overlay has been quantified and provided for to cater for the credit quality deterioration identified. Additional measures with various early monitoring tools have been applied to identify negatively impacted customers aimed to minimize potential credit loss.

3.1.1 Expected credit loss measurement

The Group adopts a "three-stage" model in accordance with HKFRS 9 for impairment based on changes in credit quality since initial recognition as summarised below:

- A financial instrument that is not credit-impaired at initial recognition is classified as "Stage 1" and has its credit risk continuously monitored by the Group;
- If a significant increase in credit risk ("SICR") since initial recognition is identified, the financial instrument is moved to "Stage 2" though it has not yet deemed to be credit-impaired;
- If the financial instrument is credit-impaired, it will be allocated to "Stage 3";
- Financial instruments in Stage 1 have their expected credit loss ("ECL") measured at an amount equal to the portion of lifetime ECL that result from default events possible within the next 12 months. Instruments at Stages 2 or 3 have their ECL measured on lifetime basis;
- ECL of financial instruments are measured by taking into consideration forward-looking information; and
- Purchased or originated credit-impaired ("POCI") financial assets are those financial assets that are credit-impaired at initial recognition. Their ECL are always measured on lifetime basis (Stage 3).

The Group adopts the approach that utilises the Probability of Default ("PD"), Exposure at Default ("EAD") and Loss Given Default ("LGD") to estimate ECL of financial instruments. Simplified alternatives are applied to portfolios that have difficulties in adopting this approach.

To estimate PD, EAD and LGD, exposures are first segmented according to their product types and customer types so that each group contains exposures with similar risk characteristics and product specifications. The factors used for segmentation are outlined below:

(i) Customers' characteristics
(ii) Product types
(iii) Facilities' utilization
(iv) Loan to collateral ratios

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.1 Expected credit loss measurement (Continued)

The modelling approaches used for different segments vary and with the consideration of the following factors:

(i) Portfolio size
(ii) Historical behavioural data
(iii) Data sufficiency

In assessing the ECL of financial instrument classified as Stage 3, the values of property-related collaterals are adjusted to the expected point of sales to reflect the probability weighted recoveries from the sales of properties. When ECL is not provided against the unsecured exposure, the rationale must be sufficient and clearly documented. For assessing the ECL for credit card advances in Stage 3, ECL shall be estimated by using their EAD and LGD.

Management overlay and judgements

For HKFRS 9 ECL calculation, the Group has implemented and applied management overlay above the modeled ECL. The management overlay methodologies and amounts are subject to regular robust review and governance processes to assess the adequacy and relevancy of such overlay. The management overlay includes items that are inevitably not precisely quantifiable and necessitate involvement of expert judgments, so as to account for model constraints, data limitation, exceptional events, etc. The management overlay methodologies constitute of allowing for reasonably sufficient impairment to the portfolios of the overseas branches and marginal Stage 1 loans, and accounting for other uncertainty factors on data, models, and events that might impact the ECL computation. In addition, arising from various major incidences during the year such as Covid-19 outbreak and US-China trade tensions, based on a portfolio review performed, the Group applied an additional management overlay to cater for potential credit quality deterioration of vulnerable sectors.

The key judgements and assumptions adopted by the Group in addressing the requirements of the standard are discussed below:

3.1.1.1 SICR

The Group considers a financial instrument to have experienced a significant increase in credit risk when one or more of the following criteria have been met:

– The borrower is more than 30 days past due on its contractual payments;
– The financial instrument is downgraded in the internal rating categories and there is an increase in PD more than predetermined thresholds since initial recognition; and
– Significant increase in credit risk since initial recognition with reference to external rating downgrade after initial recognition for treasury portfolio.

The Group applies practical expedient for treasury traded instruments that have low credit risk at the reporting date. The Group does not recognize the instrument's lifetime ECL when it is with low credit risk, overdue not more than 30 days and its issuer acquires satisfactory internal credit assessment on credit quality, irrespective of the change in credit risk from initial recognition.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.1 Expected credit loss measurement (Continued)

3.1.1.2 Definition of default and credit-impaired assets

The Group 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:

Quantitative criteria

The borrower is more than 90 days past due on its contractual payments.

Qualitative criteria

The borrower meets unlikeliness-to-pay criteria, which indicates the borrower is in significant financial difficulty. These could be instances where:

– The financial instrument is restructured due to financial stress;
– The financial instrument is partially written off;
– The borrower is bankrupt;
– The borrower is unlikely to honour its credit obligation; and
– The instrument is tagged with Substandard, Doubtful or Loss in reference to the HKMA Loan Classification.

3.1.1.3 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. ECL is calculated as the discounted product of the PD, EAD and LGD, defined as follows:

– PD represents the likelihood of a borrower defaulting on its financial obligation.
– EAD is based on the amounts the Group expects to be owed at the time of default.
– LGD represents the Group'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.

There have been no significant changes in estimation technique or significant assumptions made during the reporting period.

3.1.1.4 Forward-looking information incorporated in the ECL models

The calculation of ECL incorporates forward-looking information by considering key economic variables identified by the Group that have impact on credit risk and ECL for the Group's portfolios.

These economic variables and their associated impact on the PD, EAD and LGD vary by the type of financial instruments. Expert judgement has also been applied in this process. Forecasts of these economic variables (the "base economic scenario") are provided by the Group's Treasury Research team on a monthly basis as a projection of how the global economy will evolve over the next four years. Beyond these four years, the average portfolio default rate is adopted as the PD of the facilities and the last forecasted LGD is adopted for the remaining lifetime of the instrument.

In addition to the base economic scenario, the Group's Treasury Research team also provides two other plausible scenarios along with the assigned weightings as probability of occurrence under the current economic environment. The scenarios and their corresponding weightings are determined by a combination of model-based analysis and expert judgement, taking into account the range of possible outcomes each chosen scenario is representative of. The probability weighted ECL is determined by applying each scenario on the financial instruments through running the relevant ECL models and multiplying the resulted ECLs by the appropriate scenario weighting.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.1 Expected credit loss measurement (Continued)

3.1.1.4 Forward-looking information incorporated in the ECL models (Continued)

Economic variable assumptions

The most significant period-end economic variable assumptions used for the ECL estimate as at 31 December 2020 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios.

		4Q2020	2021	2022	2023	2024
Hong Kong Gross Domestic Product ("GDP")	Base	-1.9%	0.4% to 4.4%	2.4% to 3.1%	3.1% to 3.5%	2.6% to 2.9%
	Upside	1.0%	1.7% to 5.7%	2.6% to 3.6%	3.5% to 3.9%	2.9% to 3.1%
	Downside	-4.3%	−1.4% to 5.4%	−0.2% to 1.3%	1.6% to 2.7%	1.8% to 2.2%
United States GDP	Base	-1.4%	−3.2% to 5.5%	1.5% to 1.5%	1.5% to 1.5%	1.5% to 1.5%
	Upside	1.0%	2.0% to 7.0%	1.8% to 1.8%	1.8% to 1.8%	1.8% to 1.8%
	Downside	-6.1%	−6.9% to 2.7%	1.0% to 1.6%	1.0% to 1.0%	1.0% to 1.0%
Hong Kong unemployment rate	Base	6.9%	6.6% to 6.9%	6.5% to 6.7%	6.3% to 6.6%	5.8% to 6.1%
	Upside	6.4%	6.2% to 6.4%	5.9% to 6.2%	5.5% to 5.9%	5.0% to 5.3%
	Downside	7.2%	7.2% to 7.4%	7.2% to 7.6%	7.7% to 8.0%	8.0% to 8.0%
United States unemployment rate	Base	7.5%	4.7% to 8.0%	4.8% to 5.1%	5.2% to 5.5%	5.6% to 5.8%
	Upside	7.0%	3.6% to 6.0%	3.7% to 3.8%	3.8% to 3.8%	3.8% to 3.8%
	Downside	9.0%	10.5% to 12.5%	6.5% to 8.5%	7.4% to 8.3%	8.5% to 8.8%
Hong Kong property price index	Base	-1.2%	−1.7% to 6.5%	0.0% to 0.0%	3.0% to 3.0%	3.0% to 3.0%
	Upside	1.8%	2.7% to 8.9%	2.0% to 2.0%	5.0% to 5.0%	4.0% to 4.0%
	Downside	-2.9%	−23.5% to −9.1%	−13.7% to 6.1%	0.0% to 0.0%	0.0% to 0.0%
United States house price index	Base	7.0%	2.7% to 6.6%	2.0% to 2.0%	2.0% to 2.0%	2.0% to 2.0%
	Upside	10.5%	2.2% to 8.5%	2.3% to 2.4%	2.4% to 2.4%	2.4% to 2.4%
	Downside	-0.1%	−14.5% to −5.8%	−5.3% to 1.6%	0.8% to 0.8%	0.8% to 0.8%
United Kingdom house price index	Base	0.4%	−4.5% to 0.3%	−0.4% to 0.8%	0.9% to 1.2%	1.2% to 1.2%
	Upside	4.4%	0.5% to 5.4%	0.8% to 0.8%	1.0% to 1.4%	1.4% to 1.4%
	Downside	-0.7%	−13.3% to −5.0%	−5.9% to 0.0%	0.0% to 0.0%	0.0% to 0.0%
People's Republic of China house price index	Base	4.0%	−0.5% to 5.0%	2.0% to 2.0%	2.0% to 2.0%	2.0% to 2.0%
	Upside	6.1%	3.0% to 7.7%	3.0% to 3.0%	3.0% to 3.0%	3.0% to 3.0%
	Downside	-0.3%	−14.2% to −4.8%	0.0% to 0.0%	0.0% to 0.0%	0.0% to 0.0%
Hong Kong commercial building price index	Base	-1.2%	−1.7% to 6.5%	0.0% to 0.0%	3.0% to 3.0%	3.0% to 3.0%
	Upside	1.8%	2.7% to 8.9%	2.0% to 2.0%	5.0% to 5.0%	4.0% to 4.0%
	Downside	-2.9%	−23.5% to −9.1%	−13.7% to 6.1%	0.0% to 0.0%	0.0% to 0.0%

The weightings assigned to each economic scenario as at 31 December 2020 were as follows:

	Base	Upside	Downside
All portfolios	60%	20%	20%

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.1 Expected credit loss measurement (Continued)

3.1.1.4 Forward-looking information incorporated in the ECL models (Continued)

Economic variable assumptions (Continued)

The most significant period-end economic variable assumptions used for the ECL estimate as at 31 December 2019 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios.

		4Q2019	2020	2021	2022	2023
Hong Kong GDP	Base	1.5%	–0.5% to 2.0%	2.9% to 3.3%	2.9% to 3.3%	3.4% to 3.4%
	Upside	2.2%	0.6% to 2.2%	3.3% to 3.7%	3.3% to 3.7%	3.8% to 3.8%
	Downside	-1.0%	–4.7% to 0.6%	3.0% to 3.5%	3.1% to 3.5%	3.0% to 3.0%
United States GDP	Base	2.1%	0.4% to 1.4%	1.6% to 1.6%	1.5% to 1.5%	1.5% to 1.5%
	Upside	3.0%	2.2% to 2.2%	2.0% to 2.0%	1.8% to 1.8%	1.8% to 1.8%
	Downside	-0.2%	–1.9% to –0.9%	1.1% to 1.1%	1.0% to 1.0%	1.0% to 1.0%
Hong Kong unemployment rate	Base	3.0%	3.3% to 3.7%	3.5% to 3.9%	3.7% to 4.1%	3.9% to 4.3%
	Upside	3.0%	3.0% to 3.5%	3.3% to 3.7%	3.5% to 4.0%	3.8% to 3.9%
	Downside	3.5%	3.7% to 4.3%	4.3% to 4.8%	4.8% to 5.3%	5.3% to 5.7%
United States unemployment rate	Base	3.9%	4.1% to 4.5%	4.5% to 4.8%	4.9% to 5.2%	5.3% to 5.5%
	Upside	3.8%	3.8% to 3.8%	3.9% to 4.0%	4.0% to 4.1%	4.1% to 4.1%
	Downside	4.4%	4.8% to 5.7%	5.8% to 6.1%	6.2% to 6.5%	6.6% to 6.8%
Hong Kong property price index	Base	0.9%	–7.4% to 4.8%	3.0% to 7.4%	0.0% to 0.0%	3.0% to 3.0%
	Upside	10.3%	1.9% to 6.0%	2.0% to 2.0%	2.0% to 2.0%	5.0% to 5.0%
	Downside	-3.6%	–19.3% to –4.3%	–0.3% to 4.1%	0.0% to 0.0%	0.0% to 0.0%
United States house price index	Base	2.0%	–1.3% to 1.2%	1.2% to 3.0%	2.0% to 2.0%	2.0% to 2.0%
	Upside	3.2%	0.2% to 1.8%	1.5% to 3.3%	2.3% to 2.4%	2.4% to 2.4%
	Downside	-2.4%	–8.5% to –4.3%	–5.4% to –2.1%	–3.2% to –0.8%	–0.8% to –0.8%
United Kingdom house price index	Base	3.7%	–0.8% to 3.2%	–3.9% to –1.6%	–0.4% to 0.8%	0.9% to 1.0%
	Upside	5.5%	1.7% to 4.6%	0.2% to 1.2%	0.8% to 0.8%	1.0% to 1.1%
	Downside	-1.5%	–2.3% to 0.9%	–7.8% to –3.7%	–5.9% to 0.0%	0.0% to 0.0%
People's Republic of China house price index	Base	4.0%	–2.6% to 0.5%	1.0% to 2.0%	2.0% to 2.0%	2.0% to 2.0%
	Upside	6.0%	3.0% to 3.0%	3.0% to 3.0%	3.0% to 3.0%	3.0% to 3.0%
	Downside	-5.0%	–5.0% to –2.0%	2.0% to 2.0%	2.0% to 2.0%	2.0% to 2.0%
Hong Kong commercial building price index	Base	0.9%	–7.4% to 4.8%	3.0% to 7.4%	0.0% to 0.0%	3.0% to 3.0%
	Upside	10.3%	1.9% to 6.0%	2.0% to 2.0%	2.0% to 2.0%	5.0% to 5.0%
	Downside	-3.6%	–19.3% to –4.3%	–0.3% to 4.1%	0.0% to 0.0%	0.0% to 0.0%

The weightings assigned to each economic scenario as at 31 December 2019 were as follows:

	Base	Upside	Downside
All portfolios	60%	20%	20%

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.1 Expected credit loss measurement (Continued)

3.1.1.5 Sensitivity analysis

The output of the Group's ECL model takes into consideration forward-looking information and scenarios based on the market analysis prepared by the Group's Treasury Research team. The Group has applied appropriate weightings to the base case, upside and downside scenarios which are sources of sensitivity. Two additional sensitivity scenarios (scenarios 1 and 2 below) have been drawn up. Should the weightings applied by the Group be changed to those of the sensitivity scenarios as follows, the impact to ECL amount would be immaterial.

2020

	Base	Upside	Downside
Weightings applied by the Group	60%	20%	20%
Sensitivity scenario 1	40%	30%	30%
Sensitivity scenario 2	80%	10%	10%

2019

	Base	Upside	Downside
Weightings applied by the Group	60%	20%	20%
Sensitivity scenario 1	40%	30%	30%
Sensitivity scenario 2	80%	10%	10%

Arising from the Covid-19 outbreak, the general market condition has deteriorated and might impact the credit quality of the Group's customers. As such, the Group applied 100% worst case scenario to its portfolio as a particular case of sensitivity analysis, showing a resulting ECL increase of HK$55.4 million, 11% of HK$526 million total impairment allowances provided as at 31 December 2020, which is considered manageable to the Group despite such extreme stress, mainly due to the adequate credit risk mitigation of low loan-to-value ratio on our exposures.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.2 Loss allowance

The loss allowance recognised in the period is impacted by a variety of factors, as described below:

- Transfers between Stage 1, Stage 2 and Stage 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 recognised during the period, as well as releases for financial instruments de-recognised 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;
- Impact on the measurement of ECL due to changes made to models and assumptions;
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis;
- Foreign exchange retranslations for assets denominated in foreign currencies and other movements; and
- Write-offs of allowances related to assets that were written off during the period.

Reconciliation of gross carrying amount and allowances for loans and advances to customers are as follows:

	Stage 1		Stage 2		Stage 3		Originated credit-impaired		Total	
	Gross carrying amount	Credit impairment allowances	Gross carrying amount	Credit impairment allowances	Gross carrying amount	Credit impairment allowances	Gross carrying amount	Credit impairment allowances	Gross carrying amount	Credit impairment allowances
As at 1 January 2019	82,947,044	279,499	3,528,507	51,618	586,149	19,866	26,560	11,731	87,088,260	362,714
Transfer to lifetime ECL	(2,129,587)	(11,410)	2,139,724	25,804	(10,137)	(6)	–	–	–	14,388
Transfer to credit impaired loans and advances	(38,723)	(32)	(22,454)	(979)	61,177	7,737	–	–	–	6,726
Transfer to 12-month ECL	437,354	3,285	(409,621)	(7,892)	(27,733)	(75)	–	–	–	(4,682)
Loans derecognised or repayments	(27,110,595)	(57,757)	(1,406,643)	(6,685)	(97,285)	(1,018)	(10,814)	(126)	(28,625,337)	(65,586)
New loans originated and further lending	39,702,404	103,570	1,178,463	9,552	33,815	2,840	15,374	2,726	40,930,056	118,688
Change in PDs/LGDs/EADs	–	(27,940)	–	(2,926)	–	5,870	–	(472)	–	(25,468)
Write-offs	–	–	–	–	(10,808)	(10,808)	–	–	(10,808)	(10,808)
Foreign exchange and other movements	(97,661)	12,970	(99,513)	4,788	2,153	(262)	(59)	(68)	(195,080)	17,428
As at 31 December 2019	93,710,236	302,185	4,908,463	73,280	537,331	24,144	31,061	13,791	99,187,091	413,400
As at 1 January 2020	93,710,236	302,185	4,908,463	73,280	537,331	24,144	31,061	13,791	99,187,091	413,400
Transfer to lifetime ECL	(6,028,906)	(22,503)	6,028,906	56,082	–	–	–	–	–	33,579
Transfer to credit impaired loans and advances	(66,068)	(64)	(34,531)	(632)	100,599	29,120	–	–	–	28,424
Transfer to 12-month ECL	1,191,994	12,635	(1,178,508)	(23,215)	(13,486)	(140)	–	–	–	(10,720)
Loans derecognised or repayments	(23,254,563)	(62,419)	(1,300,459)	(9,731)	(476,119)	(7)	(14,380)	–	(25,045,521)	(72,157)
New loans originated and further lending	26,375,560	61,371	845,578	7,920	4,856	40	21,800	29	27,247,794	69,360
Change in PDs/LGDs/EADs	–	29,744	–	(8,365)	–	18,774	–	(470)	–	39,683
Write-offs	–	–	–	–	(40,983)	(40,983)	–	–	(40,983)	(40,983)
Foreign exchange and other movements	368,637	5,082	3,819	23,522	17,735	1,379	(78)	(14)	390,113	29,969
As at 31 December 2020	92,296,890	326,031	9,273,268	118,861	129,933	32,327	38,403	13,336	101,738,494	490,555

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.3 Write-off policy

The Group writes off financial assets in whole 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 (i) ceasing enforcement activity and (ii) the shortfall amount after realization of collateral.

The Group seeks to recover amounts that are legally owed in full, but it writes off financial assets in part when the recovery method is realization of collateral and the value of the collateral is such that there is no reasonable expectation of recovering amounts that are legally owed in full.

3.1.4 Risk limit control and mitigation policies

(a) Collateral

The Group employs a range of policies and practices to mitigate credit risk. The most traditional of these methods is the taking of security for funds advanced, which is a common practice. The Group implements guidelines on the acceptability of specific classes of collateral for credit risk mitigation. Guideline is in place to govern the management of collateral acceptable by the Group and the guideline is reviewed periodically.

The Group closely monitors collateral held for financial assets which are considered to be credit-impaired in order to mitigate potential losses.

The principal collateral types for loans and advances are:

– Mortgages over residential properties;
– Charges over business assets such as premises, inventory and accounts receivable; and
– Charges over bank deposits and financial instruments such as debt securities and equities.

In addition to the above, the Group will also seek for guarantee where appropriate. To minimise credit loss, the Group will seek additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances which are partially secured or unsecured.

(b) Derivatives

The Group maintains strict control limits on net open derivatives positions (i.e. the difference between purchase and sale contracts), by both amount and term. At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets where their fair values are positive), which in relation to derivatives is only a small fraction of the contract or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements. Collateral or other security is not usually obtained for credit risk exposures on these instruments, except where the Group requires margin deposits from counterparties.

(c) Credit-related commitments

The Group has issued credit related commitments including guarantees and letters of credit. These instruments carry similar credit risk as loans. The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit – which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties – carry the same credit risk as loans. Documentary and commercial letters of credit – which are written undertakings by the Group on behalf of a customer authorising a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions – are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct loan.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.5 Maximum exposure to credit risk

	Maximum exposure	
	2020	2019
Financial instruments subject to impairment		
Credit risk exposures relating to on-balance sheet assets are as follows:		
Loans and advances	101,247,939	98,773,691
Balances with banks and placements with banks	38,497,536	40,456,429
Investment securities	71,856,356	69,320,531
Other assets	2,306,424	1,619,430
Credit risk exposures relating to off-balance sheet items are as follows:		
– Financial guarantees	2,316,753	2,409,657
– Off-balance sheet commitments and other credit related contingent liabilities	48,884,396	50,605,678
Financial instruments not subject to impairment		
Financial assets at fair value through profit or loss	2,074,595	1,853,440
Derivative financial instruments	842,146	285,089

The following table contains an analysis of the credit risk exposure of financial instruments for which a credit impairment allowance is recognised. The gross carrying amount of financial assets below also represents the Group's maximum exposure to credit risk on these assets, without taking account of any collateral held or other credit enhancements attached.

2020	Loans and advances				
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Originated credit-impaired	Total
Credit grade					
Pass	91,811,702	2,894,601	90	–	94,706,393
Special Mention	485,180	6,378,567	–	931	6,864,678
Substandard	8	100	74,882	24,021	99,011
Doubtful	–	–	52,344	13,089	65,433
Loss	–	–	2,617	362	2,979
Gross carrying amount	92,296,890	9,273,268	129,933	38,403	101,738,494
Credit impairment allowances	(326,031)	(118,861)	(32,327)	(13,336)	(490,555)
Net carrying amount	91,970,859	9,154,407	97,606	25,067	101,247,939

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.5 Maximum exposure to credit risk (Continued)

2019

	Loans and advances				
	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Originated credit-impaired	Total
Credit grade					
Pass	93,121,397	3,160,278	210	1,686	96,283,571
Special Mention	588,810	1,747,997	6	988	2,337,801
Substandard	29	188	102,923	17,350	120,490
Doubtful	–	–	430,655	10,675	441,330
Loss	–	–	3,537	362	3,899
Gross carrying amount	93,710,236	4,908,463	537,331	31,061	99,187,091
Credit impairment allowances	(302,185)	(73,280)	(24,144)	(13,791)	(413,400)
Net carrying amount	93,408,051	4,835,183	513,187	17,270	98,773,691

As at 31 December 2020, 98% (2019: 98%) of the off-balance sheet items are "Pass" and 2% (2019: 2%) are "Special Mention". The amount classified as "Substandard", "Doubtful" or "Loss" is immaterial. Majority of the credit impairment allowances are provided on Stage 1 (2019: Stage 1).

"Pass" represents loans for which borrowers are current in meeting commitments and full repayment of interest and principal is not in doubt.

"Special Mention" represents loans with deficiencies and potential weakness such that if adverse conditions persist, loss of principal or interest for the Bank may occur.

"Sub-standard" represents loans in which borrowers are displaying a definable weakness that is likely to jeopardise repayment. These loans include rescheduled loans and loans where some losses of principal or interest are possible.

"Doubtful" represents loans which the Group expects to sustain a loss of interest and/or principal.

"Loss" represents loans which considered as uncollectible after exhausting all collection efforts such as realisation of collateral, initiation of legal proceedings and need to be fully or partially written off.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.5 Maximum exposure to credit risk (Continued)

The table below presents an analysis of debt securities by rating agency designation for the respective issues as at 31 December, based on Standard & Poor's ratings or their equivalent. In the absence of such issue ratings, the ratings designated for the issuers are reported.

	Investment securities					
	2020			2019		
	Investment securities at fair value through other comprehensive income	Investment securities at amortised cost	Total	Investment securities at fair value through other comprehensive income	Investment securities at amortised cost	Total
Credit grade						
AAA	1,695,278	–	1,695,278	1,497,657	–	1,497,657
AA – to AA+	16,939,790	344,675	17,284,465	14,928,202	2,442,022	17,370,224
A – to A+	39,776,072	–	39,776,072	36,867,032	–	36,867,032
BBB – to BBB+	9,532,774	–	9,532,774	8,630,279	38,922	8,669,201
Unrated	3,567,772	–	3,567,772	4,916,437	–	4,916,437
Gross carrying amount	71,511,686	344,675	71,856,361	66,839,607	2,480,944	69,320,551
Stage 1 credit impairment allowances	12,468	5	12,473	7,959	20	7,979

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.6 Concentration of credit risk of financial assets

International claims

The following table shows the Group's international claims by major country or geographical segment, each representing 10% or more of the Group's total international claims. International claims refer to exposures to counterparties on which the ultimate risk lies, and are derived according to the location of the counterparties after taking into account any recognised risk transfer. In general, transfer of risk from one country to another is recognised if the claims against a counterparty are guaranteed by another party in a different country or if the claims are on an overseas branch of a bank whose head office is located in a different country.

As at 31 December 2020			Non-bank private sector		
	Banks	Official sector	Non-bank financial institutions	Non-financial private sector	Total
Developed countries	18,392,000	5,464,000	1,814,000	1,234,000	26,904,000
Offshore centres	5,720,000	–	3,067,000	29,230,000	38,017,000
– of which Hong Kong	3,882,000	–	2,237,000	25,644,000	31,763,000
Developing Asia-Pacific	40,950,000	117,000	1,104,000	9,916,000	52,087,000
– of which China	29,498,000	117,000	1,104,000	7,934,000	38,653,000

As at 31 December 2019			Non-bank private sector		
	Banks	Official sector	Non-bank financial institutions	Non-financial private sector	Total
Developed countries	21,027,000	315,000	1,987,000	718,000	24,047,000
Offshore centres	5,969,000	63,000	3,967,000	27,560,000	37,559,000
– of which Hong Kong	4,009,000	63,000	1,953,000	22,778,000	28,803,000
Developing Asia-Pacific	45,486,000	194,000	252,000	8,203,000	54,135,000
– of which China	33,672,000	194,000	252,000	6,689,000	40,807,000

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.7 Loans and advances (excluding trade bills and other eligible bills)

(a) Loans and advances by industry sector

The following table shows the breakdown of the Group's loans and advances (excluding trade bills and other eligible bills) by industry sector according to the usage of loans based on the categories and definitions set by the Hong Kong Monetary Authority.

	2020		2019	
	Balance	% covered by collateral	Balance	% covered by collateral
Loans for use in Hong Kong				
Industrial, commercial and financial				
– Property development	3,307,366	61%	4,870,738	53%
– Property investment	6,340,395	93%	6,878,804	93%
– Financial concerns	2,157,314	7%	2,176,346	8%
– Stockbrokers	817,691	74%	460,367	20%
– Wholesale and retail trade	1,696,627	48%	2,199,875	47%
– Manufacturing	1,113,524	63%	1,253,394	71%
– Transport and transport equipment	638,595	59%	415,212	96%
– Recreational activities	2,442,598	18%	526,287	85%
– Information technology – telecommunication	4,884	100%	85,777	70%
– Hotels, boarding houses and catering	2,089,880	91%	1,912,016	90%
– Others	13,422,363	58%	14,030,765	58%
Individuals				
– Loans for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme or their respective successor schemes	73,510	100%	82,168	100%
– Loans for the purchase of other residential properties	4,199,453	100%	4,066,948	100%
– Credit card advances	166,720	0%	195,944	0%
– Others	7,151,373	98%	7,205,968	93%
Trade financing	7,941,981	61%	7,894,868	68%
Loans for use outside Hong Kong	47,743,633	85%	44,558,560	86%
	101,307,907	77%	98,814,037	77%

As at 31 December 2020 and 2019, the Bank did not have exposures to individual industry sector constituting 10% or more of the Group's total amount of loans and advances.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.7 Loans and advances (excluding trade bills and other eligible bills) (Continued)

(b) Loans and advances by geographical area

The information concerning the breakdown of the gross amount of loans and advances to customers (excluding trade bills and other eligible bills) by country or geographical area is derived according to the location of the customers after taking into account any transfer of risk. In general, such transfer of risk takes place if the loans and advances are guaranteed by a party in a country which is different from that of the customers.

As at 31 December 2020

	Balance	Stage 3 balance	Balance overdue for over 3 months	Total Stage 3 credit impairment allowances	Total Stage 1 and Stage 2 credit impairment allowances
Hong Kong	62,915,349	71,610	24,287	15,749	375,327
Mainland China	7,155,458	71,751	47,907	29,914	14,799
United States	26,557,550	22,066	–	–	39,718
Others	4,679,550	2,909	2,804	–	14,767
	101,307,907	168,336	74,998	45,663	444,611
% of total loans and advances to customers		0.17			
Fair value of collateral		392,915			

As at 31 December 2019

	Balance	Stage 3 balance	Balance overdue for over 3 months	Total Stage 3 credit impairment allowances	Total Stage 1 and Stage 2 credit impairment allowances
Hong Kong	62,849,908	496,248	427,878	20,500	311,987
Mainland China	7,383,429	60,507	44,913	17,435	11,155
United States	24,185,044	6,675	6,675	–	38,650
Others	4,395,656	3,348	–	–	13,264
	98,814,037	566,778	479,466	37,935	375,056
% of total loans and advances to customers		0.57			
Fair value of collateral		1,389,110			

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.1 Credit risk (Continued)

3.1.7 Loans and advances (excluding trade bills and other eligible bills) (Continued)

(c) Loans and advances overdue for more than 3 months

	2020		2019	
		% of gross loans and advances to customers		% of gross loans and advances to customers
Balances which have been overdue for:				
– 6 months or less but over 3 months	6,086	0.01	46,975	0.05
– 1 year or less but over 6 months	5,507	–	2,049	–
– over 1 year	63,405	0.06	430,442	0.44
	74,998	0.07	479,466	0.49
Current market value of collateral	160,761		1,184,434	
Covered portion by collateral	61,945		459,602	
Uncovered portion by collateral	13,053		19,864	
Credit impairment allowances	37,520		34,674	

Collateral held against such loans and advances mainly include mortgages over properties.

(d) Rescheduled loans and advances (net of amounts included in loans and advances overdue for more than 3 months)

	2020		2019	
		% of gross loans and advances to customers		% of gross loans and advances to customers
Rescheduled loans and advances	30,760	0.03	17,768	0.02

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk

Market risk is the risk that interest rates, foreign exchange rates, equity or commodity prices will move relative to positions taken, resulting in profits or losses. In the ordinary course of business, the Group enters into various types of financial instruments, mainly foreign exchange and equity contracts, that comprise transactions initiated for the Group's own account and customer needs. The Group's positions are managed by the Treasury Division under the limits and guidelines laid down in the foreign exchange risk management policy and the policy on allocating transactions of financial instruments to the trading, non-trading or investment book, approved by the Executive Committee. The Risk Management Division is responsible for monitoring the transactions to ensure the activities are within the relevant limits and guidelines.

3.2.1 Market risk measurement techniques

The measuring procedures and limit structure used for market risk management have been approved by the Executive Committee. Limits on notional, stop loss and sensitivity are set for trading positions which are marked-to-market daily.

Stress tests provide an indication of the potential size of losses that could arise in extreme conditions. The stress testing is tailored to the business and typically uses scenario analysis. The results of the stress tests are reviewed by management, the Asset and Liability Committee, the Risk Committee and the Board of Directors.

3.2.2 Market risk sensitivity summary

The Group uses different types of derivatives to manage foreign exchange and interest rate sensitivity primarily by hedging its underlying positions. The derivatives used by the Group including foreign exchange rate and interest rate contracts which are typically made over-the-counter and are managed within limits approved by the Executive Committee.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.3 Foreign exchange risk

Foreign exchange risk is the risk that the holding of foreign currencies will affect the Group's position as a result of a change in foreign currency exchange rates. The Group takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Group's foreign exchange risk arises primarily from currency exposures originated by the Group's commercial banking businesses. The foreign exchange risk is managed by the Treasury Division and monitored by the Risk Management Division and the Asset and Liability Committee within position limits set in the foreign exchange risk management policy. Changes to the position limits are approved by the Executive Committee and reviewed by the Risk Committee on a regular basis. The table below summarises the Group's exposure to foreign currency exchange rate risk as at 31 December. Included in the table are the Group's financial instruments at carrying amounts, categorised by currency.

Concentrations of currency risk: on- and off-balance sheet financial instruments

As at 31 December 2020	HKD	USD	RMB	Other	Total
Assets					
Cash and balances with banks	7,744,948	13,482,017	5,136,465	3,631,824	29,995,254
Placements with banks	1,279,702	6,661,186	1,013,336	279,873	9,234,097
Loans and advances to customers	51,529,682	36,366,214	6,676,062	6,675,981	101,247,939
Financial assets at fair value through profit or loss	92,811	2,105,940	–	–	2,198,751
Derivative financial instruments	842,146	–	–	–	842,146
Investment securities at fair value through other comprehensive income	28,418,575	34,563,579	10,325,699	2,381,190	75,689,043
Investment securities at amortised cost	–	344,670	–	–	344,670
Other assets	1,597,797	631,796	130,373	90,034	2,450,000
Total	91,505,661	94,155,402	23,281,935	13,058,902	222,001,900
Liabilities					
Deposits and balances from banks	1,370,008	2,680,300	2,032,805	1,757,221	7,840,334
Deposits from customers	90,155,471	63,694,103	15,602,339	8,345,026	177,796,939
Derivative financial instruments	924,669	–	–	–	924,669
Subordinated debts	–	4,241,480	–	–	4,241,480
Other liabilities	1,824,682	527,716	822,778	31,093	3,206,269
Total	94,274,830	71,143,599	18,457,922	10,133,340	194,009,691
Net on-balance sheet position	(2,769,169)	23,011,803	4,824,013	2,925,562	27,992,209
Credit commitments	31,204,672	17,687,076	1,917,747	406,455	51,215,950

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.3 Foreign exchange risk (Continued)

As at 31 December 2019	HKD	USD	RMB	Other	Total
Assets					
Cash and balances with banks	5,372,535	18,571,074	5,941,493	4,243,512	34,128,614
Placements with banks	3,949,894	2,191,401	814,665	134,596	7,090,556
Loans and advances to customers	55,201,124	31,461,424	6,060,172	6,050,971	98,773,691
Financial assets at fair value through profit or loss	27,585	1,853,440	–	–	1,881,025
Derivative financial instruments	55,859	74,020	60,006	95,204	285,089
Investment securities at fair value through other comprehensive income	34,944,515	24,219,873	10,056,078	2,338,080	71,558,546
Investment securities at amortised cost	2,045,006	435,918	–	–	2,480,924
Other assets	1,181,785	469,719	120,397	42,366	1,814,267
Total	102,778,303	79,276,869	23,052,811	12,904,729	218,012,712
Liabilities					
Deposits and balances from banks	955,759	5,685,808	3,392,585	1,643,458	11,677,610
Deposits from customers	86,958,501	63,309,583	14,034,177	8,136,255	172,438,516
Derivative financial instruments	17	133,020	70,470	89,092	292,599
Subordinated debts	–	4,257,647	–	–	4,257,647
Other liabilities	1,917,813	704,704	147,552	43,814	2,813,883
Total	89,832,090	74,090,762	17,644,784	9,912,619	191,480,255
Net on-balance sheet position	12,946,213	5,186,107	5,408,027	2,992,110	26,532,457
Credit commitments	31,000,027	19,953,814	1,538,350	535,247	53,027,438

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.4 Interest rate risk in the banking book ("IRRBB")

General information about IRRBB

The primary forms of IRRBB faced by the Group can be divided into three broad categories:

– Gap risk is the risk arising from changes in the interest rates on instruments of different maturities. The extent of gap risk depends on whether changes to the term structure of interest rates occur consistently across the yield curve (parallel risk) or differentially by period (non-parallel risk). Parallel risk is fundamental to banking business and this risk is taken on the balance sheet as part of the strategy to improve earnings. It can, however, affect the income and economic value of the Group as interest rates fluctuate. Non-parallel risk materialises when unanticipated changes in the shape of the yield curve have adverse effects on the Group's income or economic value.

– Basis risk arises from imperfect correlation between changes in the rates earned and paid on different instruments with otherwise similar repricing characteristics. As a result of these differences, the cash flows and earnings spread between assets, liabilities and off-balance sheet instruments of similar maturities or repricing frequencies will change.

– Option risk arises from interest rate option derivatives or from option elements embedded in the Group's assets, liabilities and/or off-balance sheet instruments, where the customers can alter the level and timing of their cash flows. Option risk can be further characterised into automatic option risk and behavioural option risk. Automatic option risk arises from standalone instruments, such as exchange-traded and over-the-counter option contracts, or options explicitly embedded within an otherwise standard financial instrument, where the option will almost certainly be exercised if it is in the holder's financial interest to do so. Behavioural option risk arises from the flexibility embedded implicitly or within the terms of financial contracts, such that changes in interest rates may affect the behaviour of the customer.

Apart from the three sources of risks listed above, which are directly linked to IRRBB, credit spread risk in the banking book ("CSRBB") is a related risk that is monitored and assessed within interest rate risk management framework. CSRBB refers to any kind of asset/liability spread risk of credit-risky instruments that is not explained by IRRBB or by the expected credit risk or jump to default risk.

Governance of IRRBB risk management

The Group's IRRBB risk management framework follows a hierarchy structure:

The Executive Committee and Risk Committee are delegated by the Board to be responsible for ensuring that an appropriate interest rate risk management structure, which identifies the lines of authorities and responsibilities for different levels of management is established, maintaining continued awareness of the Group's performance and overall interest rate risk, and ensuring the interest rate risk is adequately managed and controlled within the established risk management framework.

The Asset and Liability Committee is responsible for monitoring and management of the overall interest rate risk of the Group, reviewing the report on interest rate risk position and reporting regularly on interest rate risk management to the Executive Committee and Risk Committee.

The Treasury Division is responsible for the day-to-day management of interest rate risk for the Group including branches of the Bank outside Hong Kong under the guidelines and limits approved by the Executive Committee.

The Risk Management Division is responsible for monitoring the day-to-day management of the interest rate risk for the Group including branches of the Bank outside Hong Kong, reporting identified irregularities and taking appropriate remedial actions. It is also responsible for conducting regular stress test on interest rate risk and reviewing the IRRBB behavioural assumption on a periodic basis.

The Internal Audit Department is responsible for conducting periodic review on the adequacy and effectiveness of the Group's internal control and risk management process for interest rate risk.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.4 Interest rate risk in the banking book ("IRRBB") (Continued)

IRRBB risk measure

The IRRBB is assessed daily with risk indicators, such as the repricing gap and the sensitivity of the net interest income ("NII") and economic value of equity ("EVE") under interest rate shock and stress scenarios.

Six interest rate shock scenarios prescribed by the Hong Kong Monetary Authority ("HKMA") under the completion instruction for the "Return of Interest Rate Risk in the Banking Book" are applied to the Group's banking book. They include parallel shifts up and down of the interest rate curves, and non-parallel shifts such as a steepening or flattening of the interest rate curves, as well as shifting the short rate up and down relative to the long rate. The sensitivity of the EVE is specified as the maximum decrease of the banking book economic value under the six interest rate shock scenarios. Likewise, the sensitivity of the NII is specified as the maximum reduction in NII under the parallel shifts up and down scenarios, compared to the base scenario, over a period of 12 months. Additional scenarios are also applied for Internal Capital Adequacy Assessment Process purposes, which make reference to historical scenarios such as the Asian Financial Crisis in 1997 and the Global Financial Crisis in 2008, to estimate the IRRBB capital charge under those stressed scenarios.

IRRBB related hedging decisions are made by the Asset and Liability Committee and executed in the market by the Treasury Division. The Group has not designated any derivatives in any hedge relationship for the application of hedge accounting.

Key modelling and parametric assumptions

For EVE change/impact, commercial margins and other spread components have been included in the cash flow profiling, while the discount curves used are risk-free yield curves without spread components.

For Non-maturity deposits ("NMDs"), these are segmented into several sub-portfolios according to entity (such as head office and overseas branches), customer type and transaction type (such as retail and non-retail accounts, and transactional and non-transactional accounts), currency, and product type (such as current and savings accounts). It is assumed that customer behaviours within the same sub-portfolio are homogeneous. For each sub-portfolio, the average repricing maturity is determined after:

– Stable NMDs over a 10-year historical horizon are identified;

– The Core Deposit Ratio is estimated based on historical interest rate changes; and

– Slotting rates for NMDs repricing, which are subject to average repricing maturity caps in accordance with the customer types, are constructed.

The average and longest repricing maturity of the NMDs of major currencies as at 31 December 2020 were 0.78 years and 8.33 years (2019: 1.68 years and 8.33 years) respectively.

For fixed rate loan prepayment, a statistical behavioural model is developed using the historical data for retail fixed rate loans, which are segmented into sub-portfolios by product type and branches and further by homogeneous groups with similar prepayment behaviour categorized by currency, customer type, tenor, etc. This allows the conditional prepayment rates ("CPR") to be estimated. The parameters are then applied in cash flow slotting for reporting.

For early withdrawal of time deposits, a statistical behavioural model is developed using the historical data for retail term deposits to estimate early withdrawal rates. The term deposit portfolio is segmented into sub-portfolios by currency and tenor group with homogeneous early redemption behaviour for modelling.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.2 Market risk (Continued)

3.2.4 Interest rate risk in the banking book ("IRRBB") (Continued)

Quantitative disclosure

The IRRBB introduces six interest rate shock scenarios (namely interest yield curve parallel up, parallel down, steepener, flattener, short rate up and short rate down) for assessing the impact in economic value of equity ("EVE") and net interest income ("NII") in respect of the interest rate exposures arising from banking book positions.

The table below shows the negative impact in economic value of equity ("ΔEVE") and changes in net interest income ("ΔNII") over next 12 months under the six prescribed interest rate shock scenarios for banking books provided by the HKMA per Supervisory Policy Manual IR-1 comprising major currencies based on the financial positions as at 31 December 2020 and 31 December 2019. As at 31 December 2020, the maximum losses among the six scenarios on EVE and NII would have been HK$1,179 million and HK$94 million (2019: HK$299 million and HK$282 million) respectively. The year-on-year increase in maximum potential losses arising from the delta EVE under the regulatory prescribed stress scenario of parallel upward shifts in the respective interest rate curves mainly stems from the increase in holding fixed rate debt securities maturing within 3 years.

(All major currencies) in HK dollar thousands		(a)	(b)	(c)	(d)
		ΔEVE*		ΔNII**	
	Period	31 December 2020	31 December 2019	31 December 2020	31 December 2019
1	Parallel up	1,179,000	299,000	(92,000)	(279,000)
2	Parallel down	–	100,000	94,000	282,000
3	Steepener	57,000	25,000		
4	Flattener	145,000	84,000		
5	Short rate up	616,000	246,000		
6	Short rate down	3,000	70,000		
7	Maximum loss	1,179,000	299,000	94,000	282,000
	Period	31 December 2020		31 December 2019	
8	Tier 1 capital	30,087,958		27,572,305	

* Positive value indicates negative impact in EVE

** Negative value indicates increase in NII, positive value indicates decrease in NII

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfil commitments to lend. The Group's liquidity is managed by the Treasury Division and monitored by the Asset and Liability Committee in accordance with the guidelines and procedures laid down in the liquidity risk management policy approved by the Board of Directors. Liquidity risk is managed with regard to a variety of factors, including the liquidity maintenance ratio, core funding ratio, loan to deposit ratio, size of the liquidity cushion, maturity mismatch profile, the diversity and stability of the deposit base, and the ability to borrow in the interbank market to ensure that both the funding liquidity and market liquidity are properly handled. An adequate stock of high quality liquid assets is maintained at all times in order to enable the Group to meet deposit withdrawals, to repay interbank borrowings, and to make new loans and investments as and when required in a timely and cost effective manner under both normal business conditions and emergency situations.

3.3.1 Liquidity risk management process

The Group's liquidity management process, as carried out within the Group and monitored by management, includes:

– Day-to-day funding, managed by monitoring future cash flows to ensure that requirements can be met. This includes replenishment of funds as they mature or are borrowed by customers. The Group maintains an active presence within the global money markets to enable this to happen;
– Maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
– Monitoring liquidity maintenance and core funding ratios against internal and regulatory requirements; and
– Managing the concentration and profile of debt maturities.

Monitoring and reporting take the form of cash flow measurement and projections for the next day, week and month respectively, as these are key periods for liquidity management. The starting point for those projections is an analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets (Note 3.3.4).

Management also monitors unmatched medium-term assets, the level and type of undrawn lending commitments, the usage of overdraft facilities and the impact of contingent liabilities such as standby letters of credit and guarantees.

The Group conducts stress testing regularly to analyse liquidity risk. The Group's stress tests are conducted with hypothetical as well as historical assumptions. Both funding and market liquidity risks are addressed. Three stress scenarios including an institution-specific crisis, a general market crisis and a combined crisis are adopted with minimum survival period defined according to the Supervisory Policy Manual: LM-2 "Sound Systems and Controls for Liquidity Risk Management" of the Hong Kong Monetary Authority ("HKMA").

With reference to the stress-testing results, the Group identifies potential vulnerability within the Group, and formulates a Contingency Funding Plan, which itself is a component of the Group's Business Continuity Plan, to describe the Group's strategy for dealing with any liquidity problem and the procedures for making up cash flow deficits in emergency situations.

An annual drill test is conducted and the Contingency Funding Plan is subject to regular review in order to cope with changes in the business environment. Significant changes to the Contingency Funding Plan are approved by the Board of Directors.

The Group also performs reverse stress-testing in accordance with the HKMA's Supervisory Policy Manual: IC-5 "Stress-testing". It is a process of working backwards from a critical stress event and involves a mix of qualitative and quantitative analyses. The Group uses the stress-testing and reverse stress-testing results to strengthen its resilience to liquidity stress. These are supplemented with early-warning triggers for the formulation of management actions and contingency funding plan to mitigate any potential stress and vulnerability which the Group might face.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.2 Maturity analysis

The table below analyses the Group's assets and liabilities into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date.

As at 31 December 2020	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
Assets								
Cash and balances with banks	11,558,058	18,437,196	–	–	–	–	–	29,995,254
Placements with banks	–	–	4,561,410	4,672,687	–	–	–	9,234,097
Loans and advances to customers	5,257,392	6,469,279	9,334,628	28,433,906	34,579,492	17,039,591	133,651	101,247,939
Financial assets at fair value through profit or loss	–	14,336	–	38,740	168,479	1,853,040	124,156	2,198,751
Derivative financial instruments	–	55,703	145,140	570,418	70,885	–	–	842,146
Investment securities at fair value through other comprehensive income	–	8,205,014	6,542,749	22,764,819	29,091,129	4,905,101	4,180,231	75,689,043
Investment securities at amortised cost	–	38,760	62,324	243,586	–	–	–	344,670
Properties for sale	–	–	–	–	591,418	–	–	591,418
Investments in associates and joint venture	–	–	–	–	–	–	443,480	443,480
Properties and equipment	–	10,102	19,628	80,803	154,158	69,756	2,322,709	2,657,156
Investment properties	–	–	–	–	–	–	1,010,526	1,010,526
Deferred income tax assets	–	–	–	–	–	–	27,668	27,668
Other assets	389,854	1,294,776	83,188	269,300	345,918	62,776	4,188	2,450,000
Total assets	17,205,304	34,525,166	20,749,067	57,074,259	65,001,479	23,930,264	8,246,609	226,732,148
Liabilities								
Deposits and balances from banks	1,321,983	3,594,486	2,392,853	531,012	–	–	–	7,840,334
Deposits from customers	70,545,414	34,429,328	48,208,921	24,426,259	187,017	–	–	177,796,939
Derivative financial instruments	–	85,120	168,007	600,657	70,885	–	–	924,669
Subordinated debts	–	–	–	–	–	4,241,480	–	4,241,480
Other liabilities	516,898	1,705,154	368,077	372,273	173,027	70,329	511	3,206,269
Current income tax liabilities	–	97,820	19,967	–	–	–	–	117,787
Deferred income tax liabilities	–	–	–	–	–	–	109,871	109,871
Total liabilities	72,384,295	39,911,908	51,157,825	25,930,201	430,929	4,311,809	110,382	194,237,349
Net liquidity gap	(55,178,991)	(5,386,742)	(30,408,758)	31,144,058	64,570,550	19,618,455	8,136,227	32,494,799
Of which lease liabilities included in: Other liabilities	–	9,803	19,808	84,371	170,069	70,329	–	354,380

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.2 Maturity analysis (Continued)

As at 31 December 2019	Repayable on demand	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Indefinite	Total
Assets								
Cash and balances with banks	8,634,242	25,494,372	–	–	–	–	–	34,128,614
Placements with banks	–	–	3,138,599	3,951,957	–	–	–	7,090,556
Loans and advances to customers	5,493,495	5,566,299	10,536,189	22,349,213	36,015,386	18,201,327	611,782	98,773,691
Financial assets at fair value through profit or loss	–	2,277	–	7,898	18,179	1,825,087	27,584	1,881,025
Derivative financial instruments	–	48,398	53,318	127,613	55,760	–	–	285,089
Investment securities at fair value through other comprehensive income	–	4,259,517	10,597,303	22,351,737	25,707,988	3,920,188	4,721,813	71,558,546
Investment securities at amortised cost	–	31,104	1,009,042	1,417,323	23,455	–	–	2,480,924
Properties for sale	–	–	–	–	449,462	–	–	449,462
Investments in associates and joint venture	–	–	–	–	–	–	417,663	417,663
Properties and equipment	–	10,318	19,363	76,806	175,116	78,583	2,339,828	2,700,014
Investment properties	–	–	–	–	–	–	1,017,148	1,017,148
Deferred income tax assets	–	–	–	–	–	–	28,115	28,115
Other assets	197,993	789,679	118,179	279,506	348,809	75,787	4,314	1,814,267
Total assets	14,325,730	36,201,964	25,471,993	50,562,053	62,794,155	24,100,972	9,168,247	222,625,114
Liabilities								
Deposits and balances from banks	1,260,751	6,018,335	3,585,042	813,482	–	–	–	11,677,610
Deposits from customers	60,399,842	39,696,628	43,196,509	28,885,935	259,602	–	–	172,438,516
Derivative financial instruments	–	49,274	52,804	134,761	55,760	–	–	292,599
Subordinated debts	–	–	–	–	–	4,257,647	–	4,257,647
Other liabilities	311,291	1,135,109	374,909	685,440	226,262	80,262	610	2,813,883
Current income tax liabilities	–	407,914	93,780	–	–	–	–	501,694
Deferred income tax liabilities	–	–	–	–	–	–	18,901	18,901
Total liabilities	61,971,884	47,307,260	47,303,044	30,519,618	541,624	4,337,909	19,511	192,000,850
Net liquidity gap	(47,646,154)	(11,105,296)	(21,831,051)	20,042,435	62,252,531	19,763,063	9,148,736	30,624,264
Of which lease liabilities included in:								
Other liabilities	–	9,914	18,793	74,979	192,575	80,262	–	376,523

3.3.3 Funding approach

Sources of liquidity are regularly reviewed by management to maintain a wide diversification of sources based on currency, geography, provider, product and term.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.4 Non-derivative financial liabilities and assets held for managing liquidity risk

The table below presents the cash flows payable by the Group under non-derivative financial liabilities and assets held for managing liquidity risk by remaining contractual maturities at the reporting date. The amounts disclosed in the table are the contractual undiscounted cash flow, whereas the Group manages the liquidity risk based on a different basis, they do not result in a significantly different analysis.

As at 31 December 2020	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities						
Deposits and balances from banks	4,923,822	2,399,466	532,969	–	–	7,856,257
Deposits from customers	105,075,619	48,364,228	24,690,681	204,673	–	178,335,201
Subordinated debts	58,142	–	130,818	755,840	4,793,824	5,738,624
Other liabilities	2,127,831	186,083	314,205	177,384	70,855	2,876,358
Total	112,185,414	50,949,777	25,668,673	1,137,897	4,864,679	194,806,440
Assets held for managing liquidity risk	50,332,521	21,164,945	58,427,429	69,602,048	33,512,689	233,039,632

As at 31 December 2019	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities						
Deposits and balances from banks	7,285,244	3,624,031	828,468	–	–	11,737,743
Deposits from customers	100,329,884	43,554,088	29,486,720	280,571	–	173,651,263
Subordinated debts	58,383	–	131,361	758,974	5,002,025	5,950,743
Other liabilities	1,207,537	84,889	538,862	234,355	81,022	2,146,665
Total	108,881,048	47,263,008	30,985,411	1,273,900	5,083,047	193,486,414
Assets held for managing liquidity risk	49,880,457	26,070,406	52,845,904	68,312,827	35,727,468	232,837,062

Assets available to meet all of the liabilities and to cover outstanding loan commitments include cash and balances with banks, placements with banks, loans and advances to customers, investment securities at fair value through other comprehensive income, investment securities at amortised cost, and financial assets at fair value through profit or loss. In addition, debt securities can be pledged to secure funding, if necessary. The Group would also be able to meet unexpected net cash outflows by selling securities and accessing additional funding sources such as the asset-backed markets.

The Group's policy defines the size and composition of the liquidity cushion, which includes but is not limited to high quality government securities such as Exchange Fund papers and United States Treasury securities.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.3 Liquidity risk (Continued)

3.3.5 Derivative liabilities

The table below analyses the Group's derivative financial liabilities that will be settled on a net basis, together with all derivative financial instruments that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. Contractual maturities are assessed to be essential for an understanding of the timing of the cashflows on all derivatives. Some of the Group's derivatives are subject to collateral requirements. Cash flows for those derivatives could occur earlier than the contractual maturity. The amounts disclosed in the table are the contractual undiscounted cash flows.

As at 31 December 2020	Up to 1 month	1-3 months	3-12 months	1-5 years	Total
Derivatives held for trading settled on a net basis:					
Exchange rate contracts					
– Inflow/(Outflow)	–	–	–	–	–
Derivatives held for trading settled on a gross basis:					
Exchange rate contracts					
– Outflow	(23,016,331)	(10,958,673)	(32,065,178)	(108,494)	(66,148,676)
– Inflow	22,987,545	10,936,541	32,035,467	108,494	66,068,047
Interest rate contracts					
– Outflow	–	(1,195)	(3,293)	(2,160)	(6,648)
– Inflow	–	1,195	3,293	2,160	6,648

As at 31 December 2019	Up to 1 month	1-3 months	3-12 months	1-5 years	Total
Derivatives held for trading settled on a net basis:					
Exchange rate contracts					
– Inflow/(Outflow)	–	–	–	–	–
Derivatives held for trading settled on a gross basis:					
Exchange rate contracts					
– Outflow	(26,554,972)	(12,634,691)	(46,991,915)	(19,049,856)	(105,231,434)
– Inflow	26,556,235	12,635,957	46,991,404	19,049,856	105,233,452
Interest rate contracts					
– Outflow	–	–	–	–	–
– Inflow	–	–	–	–	–

3.3.6 Off-balance sheet items

The contractual maturity profile of off-balance sheet items including contingent liabilities and commitments is included in Note 36.

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Fair value of financial assets and liabilities

(a) Financial instruments not measured at fair value

(i) Balances with banks and placements with banks

Balances with banks and placements with banks include inter-bank placements and are stated net of impairment allowances. The maturities of these financial assets are within one year. The carrying amount at the reporting date approximates their fair value.

(ii) Loans and advances to customers

Loans and advances to customers are stated net of impairment allowances. An insignificant portion of loans and advances to customers bears interest at fixed rate. The carrying amount at the reporting date approximates their fair value.

(iii) Investment securities at amortised cost

The fair value for investment securities at amortised cost is based on market prices or broker/dealer price quotations. Where this information is not available, fair value is estimated using quoted market prices for securities with similar credit, maturity and yield characteristics. For the carrying value of investment securities at amortised cost, please refer to Note 22. The fair value of investment securities at amortised cost is classified under Level 1 (2020: HK$344,486,000; 2019: HK$2,479,459,000) in the fair value hierarchy. Please refer to Note 3.4(b) for the definition of fair value hierarchy.

(iv) Deposits and balances from banks and deposits from customers

Substantially all the deposits and balances from banks and deposits from customers will mature within 1 year from the reporting date. Hence, the carrying amount at the reporting date approximates their fair value.

(v) Subordinated debts

The fair value of subordinated debts of HK$4,496,447,000 (2019: HK$4,430,988,000) is classified under Level 2 in the fair value hierarchy.

(b) Fair value hierarchy

Valuation governance

The Group has in place fair valuation policy to ensure adequate governance and control processes for the designation and valuation of financial instruments to be measured at fair value for financial reporting, risk management and regulatory capital purposes. The valuation process is conducted by control units independent of risk taking units.

The Group is to recognise transfers into and transfers out of fair value hierarchy levels as of that date of the event or change in circumstances that caused the transfer.

HKFRS 13 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Group's market assumptions. These two types of inputs have created the following fair value hierarchy:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities, funds and debt securities on exchanges, exchange-traded derivative contracts and paper gold.

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the assets or liabilities, either directly (that is, as prices) or indirectly (that is, derived from prices). This level includes instruments such as over-the-counter derivative contracts, unlisted equity securities and unlisted debt securities. Observable parameters that are used as input include market data such as yield curves and exchange rate implied volatilities.

Level 3 – Inputs for the assets or liabilities that are not based on observable market data (unobservable inputs). This level includes unlisted equity securities and unlisted debt securities with significant unobservable components.

This hierarchy requires the use of observable market data when available. The Group considers relevant and observable market prices in its valuations where possible.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Fair value of financial assets and liabilities (Continued)

(b) Fair value hierarchy (Continued)

Recurring fair value measurement

As at 31 December 2020	Level 1	Level 2	Level 3	Total
Financial assets at fair value through profit or loss				
Debt securities	144,854	1,929,741	–	2,074,595
Equity securities	101,696	–	8,722	110,418
Funds	13,735	–	–	13,735
Others	3	–	–	3
Derivative financial instruments				
Exchange rate contracts	–	841,615	–	841,615
Interest rate contracts	–	531	–	531
Investment securities at fair value through other comprehensive income				
Debt securities	40,641,517	30,867,295	2,874	71,511,686
Equity securities	4,112,883	–	64,474	4,177,357
Total Assets	45,014,688	33,639,182	76,070	78,729,940
Derivative financial instruments				
Exchange rate contracts	–	923,745	–	923,745
Interest rate contracts	–	531	–	531
Equity contracts	393	–	–	393
Total Liabilities	393	924,276	–	924,669

As at 31 December 2019	Level 1	Level 2	Level 3	Total
Financial assets at fair value through profit or loss				
Debt securities	–	1,853,440	–	1,853,440
Equity securities	20,391	–	7,194	27,585
Funds	–	–	–	–
Others	–	–	–	–
Derivative financial instruments				
Exchange rate contracts	–	285,089	–	285,089
Interest rate contracts	–	–	–	–
Investment securities at fair value through other comprehensive income				
Debt securities	33,689,617	33,147,116	2,874	66,839,607
Equity securities	4,657,821	–	61,118	4,718,939
Total Assets	38,367,829	35,285,645	71,186	73,724,660
Derivative financial instruments				
Exchange rate contracts	–	292,599	–	292,599
Interest rate contracts	–	–	–	–
Equity contracts	–	–	–	–
Total Liabilities	–	292,599	–	292,599

There were no significant transfers of financial assets or liabilities between level 1 and level 2 fair value hierarchy classifications.

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.4 Fair value of financial assets and liabilities (Continued)

(b) Fair value hierarchy (Continued)

Level 2 fair values of unlisted debt securities are determined based on quotes from brokers. The most significant input is discount rate of the instruments.

Level 2 fair value of foreign exchange rate contracts and interest rate contracts are determined using the appropriate foreign exchange rates, interest rate yield curves and where applicable, the implied option volatility at the reporting date, with the expected cash-flow discounted back to present value.

Level 3 fair values of unlisted equity securities and debentures are determined based on valuation techniques using significant unobservable inputs, which includes the market comparison approach and the dividend discount approach. The fair value is affected by the price to book ratio of appropriate comparables or dividend growth rate.

If the significant unobservable inputs would be shifted by +/– 5%, the impact on other comprehensive income would be increased by HK$995,000 (2019: HK$3,584,000) or decreased by HK$794,000 (2019: HK$3,289,000) and profit or loss would be increased/decreased by HK$436,000 (2019: HK$360,000) respectively.

The following table presents the changes in level 3 instruments for the years ended 31 December 2019 and 2020 respectively.

	Financial assets at fair value through profit or loss		Investment securities at fair value through other comprehensive income		
	Equity securities	Total	Equity securities	Debt securities	Total
As at 1 January 2019	6,017	6,017	60,415	2,874	63,289
Total gains					
– Profit	1,177	1,177	–	–	–
– Other comprehensive income	–	–	926	–	926
Exchange adjustments	–	–	(223)	–	(223)
As at 31 December 2019	7,194	7,194	61,118	2,874	63,992
As at 1 January 2020	**7,194**	**7,194**	**61,118**	**2,874**	**63,992**
Total gains					
– Profit	**1,528**	**1,528**	**–**	**–**	**–**
– Other comprehensive income	**–**	**–**	**695**	**–**	**695**
Exchange adjustments	**–**	**–**	**2,661**	**–**	**2,661**
As at 31 December 2020	**8,722**	**8,722**	**64,474**	**2,874**	**67,348**

(All amounts in HK dollar thousands unless otherwise stated)

3 FINANCIAL RISK MANAGEMENT (CONTINUED)

3.5 Capital management

The Group's policy is to maintain a strong capital base to support the development of the Group's business and to ensure compliance with the statutory capital adequacy ratio requirement, a requirement used to assess the capital adequacy of banks. Capital is allocated to the various activities of the Group depending on the risk taken by each business division. Where the subsidiaries or branches are directly regulated by other regulators, they are required to maintain capital according to the rules of those regulators.

The Group's objectives when managing capital, which is a broader concept than the "equity" on the face of statement of financial position, are:

- To comply with the capital requirements under the Banking (Capital) Rules ("BCR") of the Banking Ordinance;
- To safeguard the Group's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders;
- To support the Group's stability and growth;
- To allocate capital in an efficient and risk based approach to optimise risk adjusted return to the shareholders; and
- To maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored daily by the Group's management, employing techniques based on the BCR. The required information is filed with the Hong Kong Monetary Authority ("HKMA") periodically.

The HKMA requires each bank or banking group to maintain a ratio of total regulatory capital to the risk-weighted asset (the capital adequacy ratio) at or above the statutory minimum ratio. Subsidiaries of the Group are also subject to statutory capital requirements from other regulatory authorities, such as the Securities and Futures Commission.

The regulatory capital requirements are strictly observed when managing economic capital. The regulatory capital of the Group comprises the following:

- Common Equity Tier 1 ("CET1") capital and Tier 1 capital: share capital, general reserve, investment revaluation reserve and retained earnings; and
- Tier 2 capital: subordinated debts, Stage 1 and Stage 2 credit impairment allowances and regulatory reserve.

	2020	2019
CET1 capital ratio	16.9%	16.2%
Tier 1 capital ratio	16.9%	16.2%
Total capital ratio	20.1%	19.5%

3.6 Operational risk management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It is inherent in all material products, activities, processes and systems. The Compliance and Operational Risk Management Committee oversees the Group's operational risk to ensure the operations are in accordance with the controls and procedures laid down in the operational risk management policy approved by the Risk Committee. The Operational Risk Management Department is responsible for the central operational risk management function. Policies and procedures have been established to control exposures and to identify operational risk factors. Insurance policies are taken to mitigate unforeseeable operational risk. A Business Continuity Plan is established to ensure the Group's ability to operate on an ongoing basis and limit losses in the event of severe business disruption, particularly where the Group's physical, telecommunication, or information technology infrastructures have been damaged or made inaccessible.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Group's financial statements and its financial results are influenced by accounting policies, assumptions, estimates, and management judgements which necessarily have to be made in the course of preparation of the consolidated financial statements.

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events.

Accounting policies and management's judgements for certain items are especially critical for the Group's results and financial situation due to their materiality in amount.

Measurement of the expected credit loss ("ECL") allowance

The measurement of the ECL allowance for financial assets measured at amortised 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 behaviour (e.g. the likelihood of customers defaulting and the resulting losses). Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in Note 3.1.1, which also sets out key sensitivities of the ECL to changes in these elements.

A number of significant judgements are 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;
- Establishing groups of similar financial assets for the purposes of measuring ECL; and
- Assessing data limitation and model uncertainty, and determining post model adjustments.

Determining the lease term of a right-of-use asset

In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option, or not to 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).

The assessment is reviewed if a significant event or a significant change in circumstances occurs which affects this assessment and that is within the control of the lessee. During the current financial period, no revisions were made to the lease terms to reflect the effect of exercising extension and termination options.

5 SEGMENT REPORTING

(a) By operating segment

Operating segments, and the amounts of each segment item reported in the consolidated financial statements, are identified from the financial information provided regularly to the Group's most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

For the purpose of assessing performance of business activity by class, the allocation of revenue, besides the direct revenue generated by the business, also includes the benefits of funding resources derived from the other businesses by way of internal fund transfer pricing mechanisms. Cost allocation is based on the direct cost incurred by the class of business and internal allocation of management overheads. Asset allocation is based on the assets directly attributable to the class of business and internal allocation of assets.

The Group is engaged predominantly in banking and related financial activities. It comprises retail and corporate banking, trade finance, treasury and other classes of business.

Retail and corporate banking – incorporating banking services to individual and corporate customers such as current accounts, savings accounts, time deposits, safe deposit box, credit and debit cards, loans and other credit facilities.

Trade finance – incorporating import and export bills services, invoice financing and invoice discounting.

Treasury – conducting treasury operations for trading and investment purposes such as foreign exchange, money market and capital market activities and providing treasury products such as yield enhancement and hedging products to retail and corporate customers.

The "Others" business mainly comprises remittance, share dealing, provision of trustee, wealth management and insurance services.

(All amounts in HK dollar thousands unless otherwise stated)

5 SEGMENT REPORTING (CONTINUED)

(a) By operating segment (Continued)

2020

	Retail and corporate banking	Trade finance	Treasury	Others	Total
Net interest income	2,703,009	56,631	728,178	63,841	3,551,659
Non-interest income	308,714	84,251	338,607	786,724	1,518,296
Operating income	3,011,723	140,882	1,066,785	850,565	5,069,955
Operating expenses	(876,132)	(86,798)	(107,936)	(550,273)	(1,621,139)
Operating profit before credit impairment losses	2,135,591	54,084	958,849	300,292	3,448,816
Credit impairment losses	(121,186)	1,241	(5,242)	(253)	(125,440)
Operating profit after credit impairment losses	2,014,405	55,325	953,607	300,039	3,323,376
Share of net profits of associates and joint venture	–	–	–	45,609	45,609
Profit before income tax (after taking into account internal fund transfers and cost allocation)	2,014,405	55,325	953,607	345,648	3,368,985
Income tax expense	453,367	7,135	164,367	2,069	626,938
Depreciation expenses	90,683	9,940	9,957	135,122	245,702
Total assets	101,947,517	3,415,378	114,868,008	6,501,245	226,732,148
Total liabilities	178,700,531	62,743	13,566,895	1,907,180	194,237,349

2019

	Retail and corporate banking	Trade finance	Treasury	Others	Total
Net interest income	2,903,070	82,024	798,390	193,809	3,977,293
Non-interest income	378,809	105,240	285,911	685,673	1,455,633
Operating income	3,281,879	187,264	1,084,301	879,482	5,432,926
Operating expenses	(871,681)	(85,222)	(119,197)	(573,153)	(1,649,253)
Operating profit before credit impairment losses	2,410,198	102,042	965,104	306,329	3,783,673
Credit impairment losses	(62,859)	1,450	1,167	(262)	(60,504)
Operating profit after credit impairment losses	2,347,339	103,492	966,271	306,067	3,723,169
Share of net profits of associates and joint venture	–	–	–	36,519	36,519
Profit before income tax (after taking into account internal fund transfers and cost allocation)	2,347,339	103,492	966,271	342,586	3,759,688
Income tax expense	553,060	13,379	157,507	13,759	737,705
Depreciation expenses	89,616	9,778	6,850	125,063	231,307
Total assets	99,737,363	3,618,689	113,258,316	6,010,746	222,625,114
Total liabilities	173,887,503	86,828	16,471,637	1,554,882	192,000,850

(All amounts in HK dollar thousands unless otherwise stated)

5 SEGMENT REPORTING (CONTINUED)

(b) By geographical area

The following tables provide information by geographical area, which was determined with reference to the location of the principal operations of the branches and subsidiaries of the Group.

2020	Total assets	Total liabilities	Contingent liabilities and commitments	Total operating income	Profit before income tax	Capital expenditure
Hong Kong and Mainland China	191,902,931	181,056,433	44,027,519	3,948,293	2,418,235	183,880
United States	29,344,970	10,593,085	6,721,216	1,038,638	899,514	2,934
United Kingdom	5,484,247	2,587,831	467,215	83,024	51,236	274
Total	226,732,148	194,237,349	51,215,950	5,069,955	3,368,985	187,088

2019	Total assets	Total liabilities	Contingent liabilities and commitments	Total operating income	Profit before income tax	Capital expenditure
Hong Kong and Mainland China	190,562,725	175,150,782	43,887,734	4,340,807	2,840,940	206,708
United States	27,056,085	13,895,206	8,992,640	1,005,527	859,306	33,744
United Kingdom	5,006,304	2,954,862	147,064	86,592	59,442	1,185
Total	222,625,114	192,000,850	53,027,438	5,432,926	3,759,688	241,637

6 NET INTEREST INCOME

Interest income	2020	2019
Cash and balances with banks	410,197	760,743
Investment securities at amortised cost	16,572	44,250
Investment securities at fair value through other comprehensive income	1,497,748	1,784,182
Loans and advances to customers	3,748,904	4,141,403
Others	6,260	15,523
Interest income on financial assets that are not measured at fair value through profit or loss	5,679,681	6,746,101

Interest expense	2020	2019
Deposits and balances from banks	148,655	291,508
Deposits from customers	1,778,146	2,267,754
Subordinated debts	190,413	189,413
Lease liabilities	8,702	11,759
Others	2,106	8,374
Interest expense on financial liabilities that are not measured at fair value through profit or loss	2,128,022	2,768,808

(All amounts in HK dollar thousands unless otherwise stated)

7 NET FEE AND COMMISSION INCOME

Fee and commission income	2020	2019
Bills	69,258	87,511
Nominees, custodian and securities brokerage	278,895	174,058
Investment products	132,452	125,833
Remittance	60,653	63,387
Credit cards	38,271	49,363
Retail banking	48,856	47,439
Insurance	39,009	51,798
Loans and advances and facility fees	208,981	267,918
Trust and other commissions	3,454	3,529
Total fee and commission income	879,829	870,836
Less: fee and commission expense	(56,923)	(55,159)
Net fee and commission income	822,906	815,677
Of which:		
Net fee and commission income, other than amounts included in determining the effective interest rate, arising from financial assets or financial liabilities that are not measured at fair value through profit or loss		
– fee and commission income	316,510	404,792
– fee and commission expense	11,263	11,281
Net fee and commission income on trust and other fiduciary activities		
– fee and commission income	22,801	24,310

(All amounts in HK dollar thousands unless otherwise stated)

8 NET TRADING INCOME

	2020	2019
Foreign exchange	158,091	168,599
Interest rate instruments	20,606	46,546
Equities	19,875	3,741
Other trading income	8,379	6,340
	206,951	225,226

"Foreign exchange" trading income includes gains and losses from spot, forward and option contracts, swaps and translated foreign currency assets and liabilities, which are not designated as qualifying hedging relationship. "Interest rate instruments" trading income includes the results of trading in government securities, corporate debt securities, money market instruments and interest rate swaps. "Equities" trading income includes the results of trading in equity securities and derivatives.

9 OTHER OPERATING INCOME

	2020	2019
Gross rental income from investment properties	71,794	87,723
Net (losses)/gains from disposal of equipment	(176)	50
Others	76,677	77,164
	148,295	164,937

Direct operating expenses arising from investment properties of HK$869,000 (2019: HK$131,000) are included in premises management expenses (Note 11).

10 NET EARNED INSURANCE PREMIUM AND NET INSURANCE CLAIMS INCURRED AND MOVEMENT IN POLICYHOLDERS' LIABILITIES

	2020	2019
Insurance premium revenue	54,962	62,031
Insurance premium ceded to reinsurers	(11,370)	(11,643)
	43,592	50,388

The related net insurance claims incurred and movement in policyholders' liabilities of HK$32,058,000 (2019: HK$38,152,000) were shown after being netted off with the insurance claims and loss adjustment expenses recovered from reinsurers of HK$3,524,000 (2019: HK$5,023,000).

(All amounts in HK dollar thousands unless otherwise stated)

11 OPERATING EXPENSES

	2020	2019
Auditor's remuneration		
Audit services (Note a)	9,879	9,927
Non-audit and other services (Note b)	4,146	5,476
Premises management expenses	44,499	43,636
Depreciation expenses		
Properties and equipment	113,554	97,453
Right-of-use assets	123,254	124,960
Investment properties	8,894	8,894
Employee benefit expenses		
Wages and salaries and other costs (Note c)	930,789	949,536
Pension costs – defined contribution schemes	70,807	67,027
Expenses relating to short-term and low-value leases	2,441	2,628
Information technology and communications	72,061	76,087
Legal and consultancy	32,335	15,482
Printing, stationery and postage	23,313	23,380
Promotion and advertising	41,524	47,269
Others	143,643	177,498
	1,621,139	1,649,253

Note a: The above auditor's remuneration for audit services represents the fee for the audit of the Group's financial information for the interim and annual period to comply with the statutory and regulatory requirements in Hong Kong and Taiwan.

Note b: The above fee for non-audit and other services includes the fee for the review under Hong Kong Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" for the first and third quarter results of the Group in accordance with the regulatory requirements of the ultimate holding company in Taiwan.

Note c: Employee benefit expenses include directors' emoluments (Note 13(a)). In 2020, the Bank applied for a subsidy from the Employment Support Scheme granted by the Hong Kong Government. An amount of HK$44,771,000 was approved and received in October 2020 and applied to salaries expenses for the period from September 2020 to November 2020.

(All amounts in HK dollar thousands unless otherwise stated)

12 CREDIT IMPAIRMENT LOSSES

	2020	2019
Loans and advances to customers	111,238	61,776
Balances with banks and placements with banks	6,080	(90)
Investment securities	4,494	(1,083)
Other assets	930	556
Loan commitments and financial guarantee contracts	2,698	(655)
	125,440	60,504

13 BENEFITS AND INTERESTS OF DIRECTORS

(a) Directors' emoluments

The emoluments of the Directors of the Bank disclosed pursuant to section 383 of the Hong Kong Companies Ordinance (Cap.622) and the Companies (Disclosure of Information about Benefits of Directors) Regulation (Cap. 622G) are set out below:

	2020	2019
Fees	8,250	7,725
Basic salaries, allowances and bonus	26,732	28,776
Contributions to retirement benefits schemes	1,307	1,297
	36,289	37,798

(b) Directors' material interests in transactions, arrangements or contracts

In 2019, The Bank had entered into a contract with Hanison Contractors Limited ("Hanison") as the main contractor for a sum of HK$452,880,000 relating to the redevelopment of West Point Branch where Mr. Johnson M. D. CHA is a common director of the Bank and Hanison Construction Holdings Ltd., the holding company of Hanison.

(All amounts in HK dollar thousands unless otherwise stated)

14 INCOME TAX EXPENSE

Hong Kong profits tax has been provided at the rate of 16.5% (2019: 16.5%) on the estimated assessable profits for the year. Taxation on overseas profits has been calculated on the estimated assessable profits for the year at the rates of taxation prevailing in the countries in which the Group operates.

The amount of taxation charged to the statement of profit or loss represents:

	2020	2019
Current income tax:		
– Hong Kong profits tax	349,678	422,813
– Overseas taxation	282,822	315,004
– (Over)/under provisions in respect of prior years	(4,458)	3,299
Total current income tax	628,042	741,116
Deferred income tax:		
– Hong Kong deferred tax	(1,937)	2,303
– Overseas deferred tax	833	(5,714)
Total deferred income tax	(1,104)	(3,411)
Income tax expense	626,938	737,705

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the tax rates of the countries in which the Group operates as follows:

	2020	2019
Profit before tax	3,368,985	3,759,688
Tax calculated at domestic tax rates applicable to profits in the respective countries	688,686	760,458
Tax effects of:		
Income not subject to tax	(72,160)	(49,261)
Expenses not deductible for tax purposes	14,870	23,209
(Over)/under provisions in respect of prior years	(4,458)	3,299
Income tax expense	626,938	737,705

15 DIVIDEND

The dividends paid in 2020 and 2019 were HK$940,000,000 (HK$47 per share) for both years. A dividend in respect of the year ended 31 December 2020 of HK$15.65 per share, amounting to a total dividend of HK$313,000,000, is to be proposed at the Annual General Meeting on 21 April 2021. These financial statements do not reflect this dividend payable.

	2020	2019
Proposed final dividend of HK$15.65 (2019: HK$47) per ordinary share	313,000	940,000

(All amounts in HK dollar thousands unless otherwise stated)

16 CASH AND BALANCES WITH BANKS

	2020	2019
Cash in hand	731,815	762,741
Balances with central banks and the Hong Kong Monetary Authority	4,223,675	2,779,502
Balances with banks	25,040,710	30,586,874
	29,996,200	34,129,117
Less: Stage 1 credit impairment allowances	(946)	(503)
	29,995,254	34,128,614
Gross amount of cash and balances with banks	29,996,200	34,129,117
Less: Amount with an original maturity beyond 3 months	(3,594,966)	(733,761)
Amount included in cash and cash equivalents	26,401,234	33,395,356

Included in the above amounts, HK$299,931,000 (2019: HK$247,051,000) were deposited in central banks or designated banks as at 31 December 2020, to comply with the statutory requirements of respective jurisdiction in which the Group is operating the business.

17 PLACEMENTS WITH BANKS

	2020	2019
Placements with banks maturing between 1 and 12 months	9,239,840	7,090,662
Less: credit impairment allowances		
– Stage 1	(298)	(106)
– Stage 3	(5,445)	–
	9,234,097	7,090,556
Gross amount of placements with banks	9,239,840	7,090,662
Less: Amount with an original maturity beyond 3 months	(8,141,437)	(5,810,916)
Amount included in cash and cash equivalents	1,098,403	1,279,746

Included in the above amounts, HK$319,886,000 (2019: HK$365,289,000) were deposited with designated banks in the People's Republic of China as at 31 December 2020, to comply with the local statutory requirement.

As at 31 December 2020, a placement with bank of HK$5,445,000 was classified as Stage 3 and credit impairment allowance has been fully provided for.

(All amounts in HK dollar thousands unless otherwise stated)

18 LOANS AND ADVANCES TO CUSTOMERS

	2020	2019
Gross loans and advances to customers	101,738,494	99,187,091
Less: credit impairment allowances		
– Stage 1	(326,031)	(302,185)
– Stage 2	(118,861)	(73,280)
– Stage 3	(45,663)	(37,935)
	101,247,939	98,773,691
Gross trade bills and other eligible bills, included within gross loans and advances to customers	430,587	373,054
Less: credit impairment allowances on trade bills		
– Stage 1	(234)	(227)
– Stage 2	(47)	(182)
	430,306	372,645

The Group accepted listed securities at fair value of HK$3,347,508,000 (2019: HK$3,968,969,000) as collateral for shares financing facilities. These securities are permitted to be sold or re-pledged in the event of default by the borrowers.

19 FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2020	2019
Debt securities		
Listed in Hong Kong	23,361	–
Listed outside Hong Kong	121,493	–
Unlisted	1,929,741	1,853,440
Total debt securities	2,074,595	1,853,440
Equity securities		
Listed in Hong Kong	70,354	20,391
Listed outside Hong Kong	31,342	–
Unlisted	8,722	7,194
Total equity securities	110,418	27,585
Funds		
Listed in Hong Kong	13,735	–
Total funds	13,735	–
Others	3	–
Total	2,198,751	1,881,025
Type of issuer:		
Sovereigns	80,230	20,557
Public sector entities	17,682	–
Banks	18,560	–
Corporates	2,082,279	1,860,468
	2,198,751	1,881,025

As at 31 December 2020, financial assets at fair value through profit or loss amounting to HK$1,891,002,000 (2019: HK$1,853,440,000) have been pledged to a shareholder of the Bank for its provision of the credit facilities of HK$1,550,440,000 (2019: HK$1,556,870,000) to the Bank's branches in the United States.

(All amounts in HK dollar thousands unless otherwise stated)

20 DERIVATIVE FINANCIAL INSTRUMENTS

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on 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 Group'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 contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable, and thus 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 below.

As at 31 December 2020

	Contract amount	Fair values	
		Assets	Liabilities
Derivatives held for trading			
Exchange rate contracts	138,532,505	841,615	(923,745)
Interest rate contracts	140,000	531	(531)
Equity contracts	13,217	–	(393)
Total recognised derivative assets/(liabilities)		842,146	(924,669)

As at 31 December 2019

	Contract amount	Fair values	
		Assets	Liabilities
Derivatives held for trading			
Exchange rate contracts	105,233,452	285,089	(292,599)
Interest rate contracts	–	–	–
Equity contracts	–	–	–
Total recognised derivative assets/(liabilities)		285,089	(292,599)

	Credit risk weighted amount	
	2020	2019
Exchange rate contracts	1,562,726	1,217,716
Interest rate contracts	1,056	–
Equity contracts	793	–
	1,564,575	1,217,716

The contract amounts of these instruments indicate the volume of transactions outstanding as at the reporting date, they do not represent the amounts at risk.

The credit risk weighted amounts as at 31 December 2020 and 2019 are the amounts that have been calculated in accordance with the Banking (Capital) Rules.

The above credit risk weighted amounts and fair values have not taken into account the effect of bilateral netting arrangements and accordingly the amounts disclosed are shown on a gross basis.

(All amounts in HK dollar thousands unless otherwise stated)

20 DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

The Group uses the following derivative strategies:

– Trading purposes (customer needs)
The Group offers its customers derivatives in connection with their risk management actions to transfer, modify or reduce their interest rate, foreign exchange and other market/credit risks or for their own trading purposes. As part of this process, the Group considers the customers' suitability for the risk involved, and the business purpose for the transaction. The Group also manages its derivative-risk positions through offsetting trade activities, controls focused on price verification, and daily reporting of positions to senior managers.

– Trading purposes (own account)
The Group trades derivatives for its own account. These derivatives entered into in order to take proprietary positions. Trading limits and price verification controls are key aspects of this activity.

21 INVESTMENT SECURITIES AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	2020	2019
Debt securities		
Listed in Hong Kong	16,029,366	13,840,219
Listed outside Hong Kong	19,517,159	11,948,600
Unlisted	35,965,161	41,050,788
Total debt securities	71,511,686	66,839,607
Equity securities		
Listed outside Hong Kong	4,112,883	4,657,821
Unlisted	64,474	61,118
Total equity securities	4,177,357	4,718,939
Total	75,689,043	71,558,546
Type of issuer:		
Sovereigns	9,195,653	8,051,350
Public sector entities	3,198,389	45,469
Banks	34,634,305	39,495,147
Corporates	28,660,696	23,966,580
	75,689,043	71,558,546
– Stage 1 credit impairment allowances on debt securities	12,468	7,959

Note: As at 31 December 2020, equity securities designated at fair value through other comprehensive income amounting to HK$4,177,357,000 (2019: HK$4,718,939,000) were for long term investment purpose, of which HK$3,983,598,000 (2019: HK$4,504,341,000) were the fair value of the Bank's investment in Bank of Shanghai, China. In addition, listed and unlisted Exchange Fund Bills and Notes at fair value through other comprehensive income of HK$3,999,737,000 (2019: HK$2,045,006,000 at amortised cost as reported in Note 22) were pledged to the Hong Kong Monetary Authority to facilitate settlement operations. There were no related liabilities at the year end.

(All amounts in HK dollar thousands unless otherwise stated)

22 INVESTMENT SECURITIES AT AMORTISED COST

	2020	2019
Debt securities		
Listed in Hong Kong	–	38,922
Listed outside Hong Kong	344,675	397,016
Unlisted	–	2,045,006
	344,675	2,480,944
Less: Stage 1 credit impairment allowances	(5)	(20)
	344,670	2,480,924
Type of issuer:		
Sovereigns	344,670	2,442,018
Banks	–	38,906
	344,670	2,480,924

As at 31 December 2020, certain of the Bank's branches in the United States have pledged investment securities at amortised cost amounting to HK$344,675,000 (2019: HK$397,016,000) to the State of California and with the Office of the Comptroller of the Currency in compliance with local regulatory requirements.

As at 31 December 2019, listed and unlisted Exchange Fund Bills and Notes at amortised cost of HK$2,045,006,000 were pledged to the Hong Kong Monetary Authority to facilitate settlement operations. There were no related liabilities at the year end.

23 PROPERTIES FOR SALE

	2020	2019
Property development		
Leasehold land held for development for sale	381,188	382,598
Building development cost	210,230	66,864
	591,418	449,462

The Group has undertaken a project to redevelop the properties located in West Point. As at 31 December 2020, the net book amount of land and building incurred for this project were HK$736,297,000 (2019: HK$561,609,000), of which HK$591,418,000 (2019: HK$449,462,000) were classified as properties held for sale while the remaining HK$144,879,000 (2019: HK$112,147,000) as bank premises under development (Note 26) in accordance with the redevelopment plan.

(All amounts in HK dollar thousands unless otherwise stated)

24 SUBSIDIARIES

The following is a list of the subsidiaries as at 31 December 2020:

Name	Place of incorporation	Principal activities and place of operation	Particulars of issued share capital	Percentage of ordinary share capital held	2020 Total assets	2020 Total equity	2019 Total assets	2019 Total equity
Shanghai Commercial Bank (Nominees) Limited	Hong Kong	Nominee services Hong Kong	100 ordinary shares	100%[1]	10	10	10	10
Shanghai Commercial Bank Trustee Limited	Hong Kong	Trustee services Hong Kong	1,000 ordinary shares	60%[2]	15,865	15,643	15,798	15,476
Shacom Futures Limited	Hong Kong	Advising and dealing in futures contracts Hong Kong	600,000 ordinary shares	100%[1]	105,785	56,750	97,224	54,557
Shacom Investment Limited	Hong Kong	Investment in Exchange Fund Bills and Notes Hong Kong	10,000 ordinary shares	100%[1]	3,015,962	11,186	2,788,841	2,102
Shacom Property Holdings (BVI) Limited	British Virgin Islands	Property holding United Kingdom	2 ordinary shares of US$1 each	100%[1]	26,340	3,645	24,431	2,516
Shacom Property (NY), Inc.	United States of America	Property holding United States of America	10 ordinary shares of US$1 each	100%[1]	5,533	5,533	5,595	5,595
Shacom Property (CA), Inc.	United States of America	Property holding United States of America	10 ordinary shares of US$1 each	100%[1]	2,677	2,677	2,711	2,711
Shacom Assets Investments Limited	Hong Kong	Investment in notes and bonds Hong Kong	10,000 ordinary shares	100%[1]	1,081,921	(29)	1,081,974	37
Infinite Financial Solutions Limited	Hong Kong	I.T. application services provider Hong Kong	500,000 ordinary shares	100%[1]	29,608	21,987	27,008	20,001
Shacom Insurance Brokers Limited	Hong Kong	Insurance broker Hong Kong	1,000,000 ordinary shares	100%[1]	2,755	1,882	7,716	1,507
Shacom Securities Limited	Hong Kong	Securities brokerage services Hong Kong	1,000,000 ordinary shares	100%[1]	420,520	165,686	286,731	163,250
Hai Kwang Property Management Company Limited	Hong Kong	Property management Hong Kong	2 ordinary shares	100%[1]	835	589	845	527

(All amounts in HK dollar thousands unless otherwise stated)

24 SUBSIDIARIES (CONTINUED)

Name	Place of incorporation	Principal activities and place of operation	Particulars of issued share capital	Percentage of ordinary share capital held	2020 Total assets	2020 Total equity	2019 Total assets	2019 Total equity
Paofoong Insurance Company (Hong Kong) Limited	Hong Kong	Insurance Hong Kong	500,000 ordinary shares	60%[2]	328,707	213,276	312,876	200,478
Right Honour Investments Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of US$1 each	100%[1]	6	(163)	5	(145)
Glory Step Westpoint Investments Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of US$1 each	100%	360,593	(21,462)	191,187	(6,754)
Silver Wisdom Westpoint Investments Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of US$1 each	100%	1,041,801	(24,857)	294,791	(19,487)
KCC 23F Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of HK$1 each	100%[1]	310,013	118,441	344,314	152,951
KCC 25F Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of HK$1 each	100%[1]	310,998	119,356	345,253	153,856
KCC 26F Limited	British Virgin Islands	Property holding Hong Kong	1 ordinary share of HK$1 each	100%[1]	311,960	120,463	347,258	155,970

1 Ordinary share capital is held directly by the Bank.

2 60% of ordinary share capital is held directly by the Bank and 40% of ordinary share capital is held by non-controlling interests in equity.

(All amounts in HK dollar thousands unless otherwise stated)

25 INVESTMENTS IN ASSOCIATES AND JOINT VENTURE

Movement in investments in associates and joint venture

	2020			2019		
	Investment in associates	Investment in joint venture	Total	Investment in associates	Investment in joint venture	Total
As at 1 January	378,779	38,884	417,663	349,557	38,890	388,447
Share of profits, net of tax	45,737	(128)	45,609	36,490	29	36,519
Dividends paid	(26,100)	(35)	(26,135)	(25,500)	(35)	(25,535)
Other equity movement	6,343	–	6,343	18,232	–	18,232
As at 31 December	404,759	38,721	443,480	378,779	38,884	417,663

The Group's interests in its associates and joint venture for the years ended 2020 and 2019, which are unlisted, are as follows:

Name of entity	Principle activities	Place of incorporation and operation	Proportion of voting power	% of ownership interest	Nature of relationship
Bank Consortium Holding Limited	Investment holding and provision of trustee, administration and custodian services for retirement schemes	Hong Kong	14.29% of "A" shares	13.33%	Associate
BC Reinsurance Limited	Underwriting of general reinsurance business	Hong Kong	21%	21%	Associate
Hong Kong Life Insurance Limited	Underwriting of life insurance business	Hong Kong	16.67%	16.67%	Associate
Joint Electronic Teller Services Limited	Provision of ATM network services	Hong Kong	20% of "A" shares	2.67%	Joint venture

(All amounts in HK dollar thousands unless otherwise stated)

25 INVESTMENTS IN ASSOCIATES AND JOINT VENTURE (CONTINUED)

Summarised financial information for associates and joint venture which are accounted for using the equity method is set out below:

2020

Name	Assets	Liabilities	Revenue	Profit/(loss)	Other comprehensive income	Total comprehensive income	Dividends received
Bank Consortium Holding Limited	1,049,484	97,517	813,925	250,263	–	250,263	24,000
BC Reinsurance Limited	918,920	392,931	158,911	51,935	824	52,759	2,100
Hong Kong Life Insurance Limited	19,457,368	18,309,139	2,770,151	8,776	37,018	45,794	–
Joint Electronic Teller Services Limited	430,271	47,668	111,977	(103)	–	(103)	35
	21,856,043	18,847,255	3,854,964	310,871	37,842	348,713	26,135

2019

Name	Assets	Liabilities	Revenue	Profit	Other comprehensive income	Total comprehensive income	Dividends received
Bank Consortium Holding Limited	1,018,151	140,946	761,667	220,975	(97)	220,878	23,400
BC Reinsurance Limited	885,474	402,243	149,512	32,621	640	33,261	2,100
Hong Kong Life Insurance Limited	18,645,989	17,543,555	1,601,644	1,059	108,665	109,724	–
Joint Electronic Teller Services Limited	456,702	83,543	134,516	1,010	–	1,010	35
	21,006,316	18,170,287	2,647,339	255,665	109,208	364,873	25,535

Note: The balances with the associates and joint venture arise from normal business transactions and are included in Note 39.

(All amounts in HK dollar thousands unless otherwise stated)

26 PROPERTIES AND EQUIPMENT

				Property under development			
	Leasehold land	Bank premises	Furniture, fittings and equipment	Leasehold land	Development cost	Right-of-use assets	Total
As at 1 January 2019							
Cost	1,391,652	1,042,896	837,144	96,278	8,437	–	3,376,407
Accumulated depreciation	(160,772)	(282,572)	(599,616)	(738)	–	–	(1,043,698)
Net book amount	1,230,880	760,324	237,528	95,540	8,437	–	2,332,709
Year ended 31 December 2019							
Opening net book amount	1,230,880	760,324	237,528	95,540	8,437	–	2,332,709
Change in accounting policy	–	–	–	–	–	349,689	349,689
Additions	–	32,755	63,620	–	8,279	136,833	241,487
Disposals/write-off/expiry							
Cost	–	–	(12,624)	–	–	(31,823)	(44,447)
Accumulated depreciation	–	–	12,517	–	–	31,707	44,224
Depreciation charge	(17,432)	(24,923)	(54,989)	(109)	–	(124,960)	(222,413)
Exchange adjustments	–	74	(49)	–	–	(1,260)	(1,235)
Closing net book amount	1,213,448	768,230	246,003	95,431	16,716	360,186	2,700,014
As at 31 December 2019							
Cost	1,391,652	1,075,785	888,175	96,278	16,716	691,488	4,160,094
Accumulated depreciation	(178,204)	(307,555)	(642,172)	(847)	–	(331,302)	(1,460,080)
Net book amount	1,213,448	768,230	246,003	95,431	16,716	360,186	2,700,014
Year ended December 2020							
Opening net book amount	1,213,448	768,230	246,003	95,431	16,716	360,186	2,700,014
Additions	–	3,338	60,247	–	23,826	97,405	184,816
Transfers							
Cost	(130)	–	–	1,545	7,480	–	8,895
Accumulated depreciation	3	–	–	(9)	–	–	(6)
Disposals/write-off/expiry							
Cost	–	–	(20,517)	–	–	(98,334)	(118,851)
Accumulated depreciation	–	–	20,170	–	–	98,109	118,279
Depreciation charge	(17,432)	(24,905)	(71,107)	(110)	–	(123,254)	(236,808)
Exchange adjustments	–	321	161	–	–	335	817
Closing net book amount	1,195,889	746,984	234,957	96,857	48,022	334,447	2,657,156
As at 31 December 2020							
Cost	1,391,522	1,079,650	929,474	97,823	48,022	692,639	4,239,130
Accumulated depreciation	(195,633)	(332,666)	(694,517)	(966)	–	(358,192)	(1,581,974)
Net book amount	1,195,889	746,984	234,957	96,857	48,022	334,447	2,657,156

The Group has undertaken a project to redevelop the properties located in West Point. As at 31 December 2020, the net book amount of land and building incurred for this project were HK$736,297,000 (2019: HK$561,609,000), of which HK$591,418,000 (2019: HK$449,462,000) were classified as properties held for sale (Note 23) while the remaining HK$144,879,000 (2019: HK$112,147,000) as bank premises under development in accordance with the redevelopment plan.

As at 31 December 2020, interests in freehold land outside Hong Kong amounted to HK$34,552,000 (2019: HK$34,131,000) are included as bank premises above.

(All amounts in HK dollar thousands unless otherwise stated)

27 INVESTMENT PROPERTIES

	Leasehold land	Buildings	Total
As at 1 January 2019			
Cost	725,305	332,204	1,057,509
Accumulated depreciation	(9,539)	(22,078)	(31,617)
Net book amount	715,766	310,126	1,025,892
Year ended December 2019			
Opening net book amount	715,766	310,126	1,025,892
Additions	–	150	150
Depreciation charge	(866)	(8,028)	(8,894)
Closing net book amount	714,900	302,248	1,017,148
As at 31 December 2019			
Cost	725,305	332,354	1,057,659
Accumulated depreciation	(10,405)	(30,106)	(40,511)
Net book amount	714,900	302,248	1,017,148
Year ended December 2020			
Opening net book amount	**714,900**	**302,248**	**1,017,148**
Additions	**–**	**2,272**	**2,272**
Depreciation charge	**(865)**	**(8,029)**	**(8,894)**
Closing net book amount	**714,035**	**296,491**	**1,010,526**
As at 31 December 2020			
Cost	**725,305**	**334,626**	**1,059,931**
Accumulated depreciation	**(11,270)**	**(38,135)**	**(49,405)**
Net book amount	**714,035**	**296,491**	**1,010,526**

(a) Fair value measurement of investment properties

As at 31 December 2020, the Group's investment properties were valued at HK$2,967,000,000 (2019: HK$3,361,000,000) by an independent firm of chartered surveyors, Cushman & Wakefield Limited, who has among their staff Fellows of the Hong Kong Institute of Surveyors with recent experience in the location and category of properties being valued. The valuations were performed on an open market value basis.

The basis of the valuation of property was market value which is consistent with the definition of fair value under HKFRS 13 "Fair value measurement" and takes into account the highest and best use of the property from the perspective of market participants.

The major key input used in valuing the investment properties was the unit sale rate taking into account of time, location, and individual factors such as size and levels of buildings, which ranged from HK$27,000 (2019: HK$34,000) to HK$84,000 (2019: HK$107,000) per square foot. A decrease in unit sale rate would result in the decrease in fair value measurement of the investment properties by the same percentage and vice versa.

Investment properties are classified as Level 3 under the fair value hierarchy as defined in HKFRS 13 "Fair value measurement" as at 31 December 2020 and 2019.

(All amounts in HK dollar thousands unless otherwise stated)

27 INVESTMENT PROPERTIES (CONTINUED)

(b) Information about Level 3 fair value measurement

	Valuation technique(s)	Unobservable input(s)	Range 2020	Range 2019
Investment properties	Income capitalisation approach	Market yields	2.5% to 2.75%	2.5% to 2.75%
		Market rental	HK$62 to HK$192 per square foot	HK$76 to HK$243 per square foot

For investment properties of which the fair value is determined using the income capitalisation approach, the assessment is conducted on the basis of capitalisation of net income with due allowance for outgoings and reversionary income potential. The fair value measurement is positively correlated to the market rental and inversely correlated to the market yields.

(c) Operating lease commitments as a lessor

Where a group company is the lessor, the future minimum lease receivables under non-cancellable leases are as follows:

	2020	2019
Not later than 1 year	63,072	92,066
1 to 2 years	32,434	62,859
2 to 3 years	4,280	13,904
	99,786	168,829

The Group leases its investment properties under operating lease arrangements, with leases typically for a period from 3 to 5 years. The terms of the leases generally require the tenants to pay security deposits and provide for rent adjustments according to the prevailing market conditions at the expiration of the lease.

28 OTHER ASSETS

	2020	2019
Accounts receivable and prepayments	1,537,782	882,889
Interest receivable	707,122	800,738
Others	206,649	131,263
	2,451,553	1,814,890
Less: credit impairment allowances		
– Stage 1	(1,532)	(623)
– Stage 3	(21)	–
	2,450,000	1,814,267

29 DEPOSITS FROM CUSTOMERS

	2020	2019
Demand deposits and current accounts	18,003,831	15,060,867
Savings deposits	51,696,337	44,224,648
Time, call and notice deposits	107,709,161	112,763,783
Deposits from Hong Kong Government Exchange Fund	387,610	389,218
	177,796,939	172,438,516

(All amounts in HK dollar thousands unless otherwise stated)

30 SUBORDINATED DEBTS

	2020	2019
US$250 million fixed rate subordinated notes issued due 2027 at amortised cost (Note a)	1,927,368	1,935,108
US$300 million fixed rate subordinated notes issued due 2029 at amortised cost (Note b)	2,314,112	2,322,539
	4,241,480	4,257,647

Note a: This represents US$250,000,000 Basel III compliant 10-year subordinated fixed rate notes qualifying as Tier 2 capital of the Bank in accordance with the Banking (Capital) Rules ("BCR"), which are listed on the Hong Kong Stock Exchange. The notes will mature on 29 November 2027 with an optional redemption date falling on 29 November 2022. Interest at 3.75% p.a. is payable semi-annually from the issue date to the optional redemption date. Thereafter, if the notes are not redeemed, the interest rate will be reset and the notes will bear interest at the prevailing 5-year U.S. Treasury Rate plus 170.5 basis points. The Bank may, subject to receiving the prior approval of the Hong Kong Monetary Authority ("HKMA"), redeem the notes at the option of the Bank in whole but not in part, at par either on the optional redemption date or for tax or regulatory reasons at any time prior to maturity of the notes.

Note b: This represents US$300,000,000 Basel III compliant 10-year subordinated fixed rate notes qualifying as Tier 2 capital of the Bank in accordance with the BCR, which are listed on the Hong Kong Stock Exchange. The notes will mature on 17 January 2029 with an optional redemption date falling on 17 January 2024. Interest at 5.00% p.a. is payable semi-annually from the issue date to the optional redemption date. Thereafter, if the notes are not redeemed, the interest rate will be reset and the notes will bear interest at the prevailing 5-year U.S. Treasury Rate plus 250 basis points. The Bank may, subject to receiving the prior approval of the HKMA, redeem the notes at the option of the Bank in whole but not in part, at par either on the optional redemption date or for tax or regulatory reasons at any time prior to maturity of the notes.

31 OTHER LIABILITIES

	2020	2019
Accounts payable and accruals	1,283,202	672,886
Deferred income	126,208	187,183
Interest payable	340,501	684,983
Lease liabilities	354,380	376,523
Liabilities for insurance contracts (Note)	109,689	107,363
Margin deposits	278,607	307,296
Stage 1 and Stage 2 credit impairment allowances for undrawn commitments and financial guarantees	14,801	12,103
Others	698,881	465,546
	3,206,269	2,813,883

Note: Amounts recoverable from reinsurance of liabilities under insurance contracts issued amounting to HK$10,400,000 (2019: HK$6,859,000) are included in "Others" in Note 28.

(All amounts in HK dollar thousands unless otherwise stated)

32 DEFERRED INCOME TAX

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. The offset amounts are as follows:

Deferred income tax assets

	Credit impairment allowances	Accelerated tax depreciation	Fair value (gains)/losses on investment securities at fair value through other comprehensive income	Others	Total
As at 1 January 2019	66,033	(38,686)	23,085	23,258	73,690
Credited/(charged) to the statement of profit or loss	5,670	(10,328)	–	8,075	3,417
Exchange adjustments	(336)	(77)	–	(106)	(519)
Charged to equity	–	–	(67,341)	–	(67,341)
Reclassified (to)/from deferred income tax liabilities	(56,422)	45,150	44,253	(14,113)	18,868
As at 31 December 2019	14,945	(3,941)	(3)	17,114	28,115
Credited/(charged) to the statement of profit or loss	10,976	(6,814)	–	(4,946)	(784)
Exchange adjustments	913	(510)	–	(69)	334
Reclassified from deferred income tax liabilities	2	1	–	–	3
As at 31 December 2020	26,836	(11,264)	(3)	12,099	27,668

Deferred income tax liabilities

	Credit impairment allowances	Accelerated tax depreciation	Fair value gains on investment securities at fair value through other comprehensive income	Others	Total
As at 1 January 2019	–	(27)	–	–	(27)
Charged to the statement of profit or loss	–	(6)	–	–	(6)
Reclassified from/(to) deferred income tax assets	56,422	(45,150)	(44,253)	14,113	(18,868)
As at 31 December 2019	56,422	(45,183)	(44,253)	14,113	(18,901)
Credited/(charged) to the statement of profit or loss	10,881	(6,013)	–	(2,980)	1,888
Charged to equity	–	–	(92,855)	–	(92,855)
Reclassified to deferred income tax assets	(2)	(1)	–	–	(3)
As at 31 December 2020	67,301	(51,197)	(137,108)	11,133	(109,871)

33 SHARE CAPITAL

	2020	2019
Issued and fully paid: 20,000,000 shares	2,000,000	2,000,000

(All amounts in HK dollar thousands unless otherwise stated)

34 RESERVES ATTRIBUTABLE TO EQUITY HOLDERS

	Regulatory reserve	Investment revaluation reserve	General and other reserves	Total
As at 1 January 2019	736,735	2,563,779	7,203,109	10,503,623
Investment securities at fair value through other comprehensive income	–	682,298	–	682,298
Currency translation difference arising from overseas operations	(1,441)	–	(23,795)	(25,236)
Share of reserves of associates and joint venture	–	18,098	134	18,232
Transfer from retained earnings	200,000	–	–	200,000
As at 31 December 2019	935,294	3,264,175	7,179,448	11,378,917
As at 1 January 2020	**935,294**	**3,264,175**	**7,179,448**	**11,378,917**
Investment securities at fair value through other comprehensive income	**–**	**(55,419)**	**–**	**(55,419)**
Currency translation difference arising from overseas operations	**4,977**	**–**	**91,246**	**96,223**
Share of reserves of associates and joint venture	**–**	**6,170**	**173**	**6,343**
As at 31 December 2020	**940,271**	**3,214,926**	**7,270,867**	**11,426,064**

Nature and purpose of reserves:

(a) Regulatory reserve

The regulatory reserve is maintained to satisfy the provisions of the Hong Kong Banking Ordinance and local regulatory requirements of overseas branches for prudent supervision purpose. Any movements in the regulatory reserve for Hong Kong operations are made in consultation with the Hong Kong Monetary Authority.

As at 31 December 2020, the regulatory reserves for Hong Kong and overseas branches operations were HK$812,455,000 (2019: HK$812,455,000) and HK$127,816,000 (2019: HK$122,839,000) respectively.

(b) Investment revaluation reserve

Investment revaluation reserve represents the cumulative net change in the fair value of investment securities at fair value through other comprehensive income until these investments are derecognised or impaired as stated in the accounting policy for financial assets (Note 2.6).

(c) General and other reserves

General and other reserves comprise previous years' transfers from retained earnings and translation reserve arising from translation of foreign operations during consolidation and share of changes in equity of associates and joint venture.

(All amounts in HK dollar thousands unless otherwise stated)

35 OTHER CASH FLOW INFORMATION

Reconciliation of liabilities arising from financing activities

	Subordinated debts	
	2020	2019
Balance as at 1 January	4,257,647	1,945,079
Cash inflow from issue of subordinated debts net of cost	–	2,338,326
Non-cash changes:		
– Foreign exchange movement	(17,944)	(29,232)
– Amortisation of discount and issuance cost	1,777	3,474
Balance as at 31 December	4,241,480	4,257,647

36 CONTINGENT LIABILITIES AND COMMITMENTS

(a) Credit commitments

The contract and credit risk weighted amounts of the Group's off-balance sheet financial instruments that commit it to extend credit to customers are as follows:

Contract amounts	2020	2019
Direct credit substitutes	2,319,494	2,411,445
Trade-related contingencies	2,238,682	2,243,403
Other commitments with an original maturity of:		
– under 1 year	1,857,689	1,215,399
– 1 year and over	8,421,031	10,168,005
– unconditionally cancellable	36,379,054	36,989,186
	51,215,950	53,027,438

The contractual maturity profile of credit commitments is analysed as follows:

	2020	2019
No later than 1 year	46,021,692	44,850,273
Later than 1 year and no later than 5 years	3,283,126	6,609,355
Later than 5 years	1,911,132	1,567,810
	51,215,950	53,027,438

	2020	2019
Credit risk weighted amounts	6,222,945	7,361,624

(All amounts in HK dollar thousands unless otherwise stated)

36 CONTINGENT LIABILITIES AND COMMITMENTS (CONTINUED)

(b) Capital commitments

Capital expenditure for the acquisition of properties and equipment outstanding as at the reporting date but not yet incurred is as follows:

	2020	2019
Contracted but not provided for	488,368	562,769

(c) Other contingent liabilities

The Group is involved in legal actions which are in relation to its normal business operations. No material provision was made for those actions against the Group because the management believes that the Group has adequate grounds to defend against the claimants or the amounts involved in those actions are not expected to be material.

37 OFFSETTING FINANCIAL INSTRUMENTS

The following tables present details of financial instruments subject to offsetting, enforceable master netting arrangements and similar agreements.

As at 31 December 2020

	Gross amounts of recognised financial assets	Gross amounts of recognised 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 set off in the statement of financial position		Net amounts
				Financial instruments	Cash collateral received	
Assets						
Derivative financial instruments	518,783	–	518,783	(426,019)	(74,809)	17,955
Other assets	911,567	(700,793)	210,774	–	–	210,774
Total	1,430,350	(700,793)	729,557	(426,019)	(74,809)	228,729

	Gross amounts of recognised financial liabilities	Gross amounts of recognised 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 set off in the statement of financial position		Net amounts
				Financial instruments	Cash collateral pledged	
Liabilities						
Derivative financial instruments	771,893	–	771,893	(426,019)	(263,652)	82,222
Other liabilities	742,441	(700,793)	41,648	–	–	41,648
Total	1,514,334	(700,793)	813,541	(426,019)	(263,652)	123,870

(All amounts in HK dollar thousands unless otherwise stated)

37 OFFSETTING FINANCIAL INSTRUMENTS (CONTINUED)

As at 31 December 2019

	Gross amounts of recognised financial assets	Gross amounts of recognised 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 set off in the statement of financial position: Financial instruments	Related amounts not set off in the statement of financial position: Cash collateral received	Net amounts
Assets						
Derivative financial instruments	168,803	–	168,803	(137,896)	(16,269)	14,638
Other assets	472,378	(349,792)	122,586	–	–	122,586
Total	641,181	(349,792)	291,389	(137,896)	(16,269)	137,224

	Gross amounts of recognised financial liabilities	Gross amounts of recognised 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 set off in the statement of financial position: Financial instruments	Related amounts not set off in the statement of financial position: Cash collateral pledged	Net amounts
Liabilities						
Derivative financial instruments	209,196	–	209,196	(137,896)	(71,300)	–
Other liabilities	350,241	(349,792)	449	–	–	449
Total	559,437	(349,792)	209,645	(137,896)	(71,300)	449

Derivative financial instruments disclosed above are recorded on a gross basis in the statement of financial position. Since master netting agreements have been entered into for these derivative financial instruments, the net settlement amounts if an event of default or other precedent events occurred are disclosed under "Net amounts" to comply with the accounting requirements.

(All amounts in HK dollar thousands unless otherwise stated)

37 OFFSETTING FINANCIAL INSTRUMENTS (CONTINUED)

The tables below reconcile the amounts of derivative financial instruments, net amounts of other assets and other liabilities presented in the statement of financial position.

	2020	2019
Assets		
Net amounts of derivative financial instruments after offsetting as stated above	518,783	168,803
Derivative financial instruments not in scope of offsetting disclosures	323,363	116,286
Total derivative financial instruments	842,146	285,089
Net amounts of other assets after offsetting as stated above	210,774	122,586
Other assets not in scope of offsetting disclosures	2,239,226	1,691,681
Total other assets	2,450,000	1,814,267
Liabilities		
Net amounts of derivative financial instruments after offsetting as stated above	771,893	209,196
Derivative financial instruments not in scope of offsetting disclosures	152,776	83,403
Total derivative financial instruments	924,669	292,599
Net amounts of other liabilities after offsetting as stated above	41,648	449
Other liabilities not in scope of offsetting disclosures	3,164,621	2,813,434
Total other liabilities	3,206,269	2,813,883

38 INFORMATION ABOUT LOANS, QUASI-LOANS AND OTHER DEALINGS IN FAVOUR OF DIRECTORS, CONTROLLED BODIES CORPORATE AND CONNECTED ENTITIES

Balances below are disclosed pursuant to Section 383 of the Hong Kong Companies Ordinance (Cap. 622) and Companies (Disclosure of Information about Benefits of Directors) Regulation (Cap. 622G).

	Balance outstanding as at 31 December		Maximum balance during the year	
	2020	2019	2020	2019
Aggregate amount outstanding in respect of principal and interest	62,904	587,972	68,253	912,345

(All amounts in HK dollar thousands unless otherwise stated)

39 RELATED PARTY TRANSACTIONS

A number of banking transactions were entered into with related parties by the Group in the normal course of business and at arm's length basis. The outstanding balances of the related party transactions at the reporting date, and related expense and income for the year are as follows:

2020	Ultimate holding company and fellow subsidiaries	Associates and joint venture	Key management personnel (Note a)	Other related parties (Note b)	Total
Aggregate amounts outstanding at the year end					
– Loans and advances	–	–	297,828	–	297,828
– Cash and balances with banks	10,003	–	–	134,825	144,828
– Deposits and balances from banks and customers	457,155	385,642	1,353,581	1,944,110	4,140,488
– Investment securities at fair value through other comprehensive income	129,285	–	–	79,351	208,636
– Stage 1 and Stage 2 credit impairment allowances	–	2	515	18	535
– Contingent liabilities and other commitments	–	2,000	237,608	–	239,608
Interest income received from related parties	136	–	9,437	1,781	11,354
Interest expenses paid to related parties	4,499	5,071	11,875	31,720	53,165
Net fee and commission (expense)/income (to)/ from related parties	(2,983)	51,792	–	(1,090)	47,719
Net other operating income/(expense) from/(to) related parties	33	(2,768)	(300)	(6,477)	(9,512)

(All amounts in HK dollar thousands unless otherwise stated)

39 RELATED PARTY TRANSACTIONS (CONTINUED)

2019

	Ultimate holding company and fellow subsidiaries	Associates and joint venture	Key management personnel (Note a)	Other related parties (Note b)	Total
Aggregate amounts outstanding at the year end					
– Loans and advances	–	–	580,528	–	580,528
– Cash and balances with banks	4,676	–	–	82,831	87,507
– Deposits and balances from banks and customers	473,908	578,367	2,058,623	3,480,544	6,591,442
– Investment securities at fair value through other comprehensive income	153,480	–	–	–	153,480
– Stage 1 and Stage 2 credit impairment allowances	–	1	914	–	915
– Contingent liabilities and other commitments	–	2,000	1,319,224	–	1,321,224
Interest income received from related parties	18	–	7,015	11,916	18,949
Interest expenses paid to related parties	5,969	7,819	17,312	88,699	119,799
Net fee and commission (expense)/income (to)/ from related parties	(10,088)	63,792	–	(874)	52,830
Net other operating expense to related parties	(16)	(2,313)	(300)	(3,691)	(6,320)

Note a: Include key management personnel and Directors of the Bank and the ultimate holding company, their close family members and entities that are controlled or jointly controlled, directly or indirectly, by key management personnel or Directors.

Note b: Include other shareholders of the Group.

Key management personnel compensation

The compensation for Directors and key management personnel of the Bank is as follows:

	2020	2019
Salaries and other short-term employee benefits	109,792	99,680

(All amounts in HK dollar thousands unless otherwise stated)

40 STATEMENT OF FINANCIAL POSITION AND RESERVE MOVEMENT OF THE BANK

(a) Statement of Financial Position of the Bank

	As at 31 December	
	2020	2019
ASSETS		
Cash and balances with banks	29,993,830	34,127,171
Placements with banks	9,234,097	7,090,556
Loans and advances to customers	101,247,939	98,773,691
Financial assets at fair value through profit or loss	2,174,451	1,860,634
Derivative financial instruments	842,146	285,089
Investment securities at fair value through other comprehensive income	75,689,043	71,543,427
Investment securities at amortised cost	344,670	435,918
Investments in associates and joint venture	188,000	188,000
Investments in and loans to subsidiaries	1,786,584	3,047,476
Properties and equipment	1,917,237	1,996,114
Investment properties	1,040,100	1,047,150
Deferred income tax assets	27,662	28,152
Other assets	2,322,525	1,747,092
TOTAL ASSETS	226,808,284	222,170,470
LIABILITIES		
Deposits and balances from banks	7,840,334	11,677,610
Deposits from customers	177,796,939	172,438,516
Derivative financial instruments	924,669	292,599
Subordinated debts	4,241,480	4,257,647
Other liabilities	3,007,766	2,715,812
Current income tax liabilities	117,504	501,011
Deferred income tax liabilities	104,966	17,086
TOTAL LIABILITIES	194,033,658	191,900,281
EQUITY		
CAPITAL AND RESERVES ATTRIBUTABLE TO EQUITY HOLDERS		
Share capital	2,000,000	2,000,000
Retained earnings	19,370,754	16,907,082
Reserves	11,403,872	11,363,107
	32,774,626	30,270,189
TOTAL EQUITY AND LIABILITIES	226,808,284	222,170,470

Approved and authorised for issue by the Board of Directors on 16 March 2021.

Stephen Ching Yen LEE
Chairman

Hung-ching YUNG
Director

Gordon Che Keung KWONG
Director

David Sek-chi KWOK
Managing Director & Chief Executive

(All amounts in HK dollar thousands unless otherwise stated)

40 STATEMENT OF FINANCIAL POSITION AND RESERVE MOVEMENT OF THE BANK (CONTINUED)

(b) Reserve movement of the Bank

	Regulatory reserve	Investment revaluation reserve	General reserve	Total
As at 1 January 2019	736,735	2,567,398	7,201,964	10,506,097
Investment securities at fair value through other comprehensive income	–	682,266	–	682,266
Currency translation difference arising from overseas operations	(1,441)	–	(23,815)	(25,256)
Transfer from retained earnings	200,000	–	–	200,000
As at 31 December 2019	935,294	3,249,664	7,178,149	11,363,107
As at 1 January 2020	**935,294**	**3,249,664**	**7,178,149**	**11,363,107**
Investment securities at fair value through other comprehensive income	**–**	**(55,400)**	**–**	**(55,400)**
Currency translation difference arising from overseas operations	**4,977**	**–**	**91,188**	**96,165**
As at 31 December 2020	**940,271**	**3,194,264**	**7,269,337**	**11,403,872**

41 COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the current year's presentation.

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