大眾銀行（香港）
PUBLIC BANK (HONG KONG)

Public Bank (Hong Kong) Limited

Annual Disclosures

Pillar 3 Templates

For the year ended
31 December 2017
(Consolidated and Unaudited)

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Table OVA: Overview of risk management

The Group is based on the consolidation of Public Bank (Hong Kong) Limited (the "Bank") and Public Finance Limited ("Public Finance"). The Group's risk management is underpinned by the Group's risk appetite and is subject to the respective Boards' oversight through the Risk Management Committees ("RMCs") of the Bank and Public Finance, which are Board Committees overseeing the establishment of company-wide risk management framework, policies and processes. To identify and manage key risks effectively, the Group adopts a risk management framework under which key components of the Group's business model such as business activities conducted to ensure the sustainability of profitability, core supporting operations to support business activities and the delivery of risk based reports, loan product segments and features, debt securities portfolio mix, geographical segments, pricing and loan recovery strategies, and concentration of customer groups are considered in ascertaining its overall risk profile. The Group reviews its risk profile through regular assessments of both qualitative and quantitative risk factors to monitor prevailing risk levels against the applicable risk appetites regularly (at least annually) approved by the Board. The Group shall review and revise its business model, key business strategies and risk tolerance levels as appropriate pursuant to assessment results of risk profile which may vary from time to time.

RMCs are responsible to assist the Board in discharging the Board's roles and responsibilities in managing risk and compliance issues including at least the Group's infrastructures, resources, capital levels and risk controls to manage the risk-taking activities in meeting the risk appetite thresholds and regulatory guidelines. Periodic reports provided by heads of Risk Management Departments ("RMDs") on the state of the Group's risk culture, risk exposures and risk management activities are reviewed by the RMCs regularly. The other key dedicated risk committees (i.e. Assets and Liabilities Management Committees ("ALCOs"), Credit Risk Management Committee ("CRMC"), Credit Committees, Operational Risk Management Committees ("ORMCs")) of the Group are established to ensure that the day-to-day management of the Group's activities are consistent with the risk appetite, frameworks and policies approved by the Board or delegated authorities. The ALCOs are responsible to oversee the development and implementation of policies, processes, procedures and limits for the asset and liability management and ensure key risk issues related to interest rate risk and market risk management, balance sheet structure, capital structure and planning, and liquidity and funding risk management are identified and managed within the risk appetite. The CRMC and Credit Committees are responsible to assist RMC to establish the framework for identifying, measuring, monitoring and controlling credit risk of existing and new products; review credit risk management policies and credit risk tolerable limits (e.g. credit concentration limits of customer groups and industry sectors) as necessary; evaluate and assess the adequacy of strategies to manage the overall credit risk associated with the Group's activities and ensure that the business units implement credit strategy and policies of the Group; monitor exceptional credit approvals within tolerable limits; regularly monitor and assess the asset quality, credit risk portfolio composition and risk-return trade-off of credit products; and oversee loan recovery process. The ORMCs are responsible to ensure the effective implementation of the operational risk management framework; oversee the development of operational risk management policies, guidelines, processes, procedures and limits to ensure operational risk is identified and managed within the Group's risk appetite; and evaluate and assess the adequacy of controls to manage operational risk for all material products, activities, processes and systems taking into consideration the changes in the operating environment. Through the execution of operations and management information system reports of the aforesaid dedicated risk committees and with the coordination of RMDs, RMCs regularly review the Group's risk management framework and ensures that all important risk-related measures are implemented according to established policies with appropriate resources. RMCs also ensure that the Group's risk appetite is reflected in key policies and procedures for the execution by business functions.

The Bank Culture Committee ("BCC") is also established to assist the Board to communicate, cascade and enforce the risk culture within the Group; develop and adopt a holistic and effective framework for fostering a sound culture; formulate a regular process, with the assistance of relevant committees and departments, to review the effectiveness of the overall culture enhancement initiatives pursued by the Group; approve, review and assess the adequacy of any relevant statement which sets out the Group's culture and behavioural standards annually; and ensure the above-mentioned statement is translated into policies and procedures (including training) that are relevant to the day-to-day work of different levels of staff. Dedicated heads of key departments are to assist the BCC to set out in the code of conduct, which is subject to regular review, the culture related behavioural expectation of staff in carrying out their day-to-day responsibilities, build up an effective, continual and regular communication channel to share examples/cases regarding misconduct, improper behaviours and disciplines with the staff and promote an open exchange of view in relation to culture and behavioural standards, design and put in place a clear ownership structure for the core risks and culture reform initiative, ensure that incentive systems (including staff, performance management, remuneration and promotion systems) should not only reward good business performance but also taking into consideration adherence (and non-adherence) to the Group's culture and behavioural standards, produce and analyze a dashboard of indicators for assessing the culture of the Group and to help gauge changes over time, set up and review regularly the conflicts of interest policy to ensure that the policy aligns with culture objectives, and recommend the revisions on the policy, if any, to the BCC.

Senior Management is responsible for implementing the business and risk strategies approved by the Board, and the risk management systems, processes and controls for managing both the financial and nonfinancial risks to which the Group is exposed. Senior Management is also responsible for cultivating the risk culture promoted by the Board, and ensuring that the risk appetite is appropriately translated into risk limits for business lines and legal entities and that those limits are consistent with the Group's overall risk appetite, even under stressed conditions. The culture of risk management is well-integrated throughout the Group and embedded into the respective business practices to enable employees to take into account risks and its impact on the Group in the respective business decision-making. An overview of the magnitude of the risks affecting the Group must be monitored to ensure that the risk-taking activities remain consistent with the approved risk appetite and are periodically reported to the respective risk committees and Senior Management. The key factors to embed risk management into the culture and business operation of the Group are corporate governance; organizational structure with clearly defined roles and responsibilities; effective communication; commitment to compliance with laws, regulations and internal controls; integrity in fiduciary responsibilities; clear policies, procedures and guidelines; and continuous training. The risk management framework of the Group is developed to set out the roles and responsibilities of the respective parties involved in the company-wide risk management; and to establish a risk management process and internal controls that will enable the identification, measurement, continuous monitoring and reporting of all relevant and material risks, including new and emerging risks.

The Group has adopted a "Three Lines of Defence" risk management structure to ensure that roles within the Group are clearly defined in regard to risk management. The first line of defence is provided by the business functions and supporting functions where risks are taken, and they are responsible for day-to-day identification, assessment, management and reporting of key risks (particularly credit risk, operational risk and compliance risk) within their products, activities, processes and systems in the course of conducting business activities; ensuring proper identification, assessment, management and reporting of relevant risk exposures on an ongoing basis and any breaches of risk limits and material risk exposures are promptly reported to the heads of RMDs and the Senior Management; executing risk mitigation strategies and processes, and ensuring that internal controls are consistent with the risk policies and risk appetite approved by the Board or delegated authorities. The second line of defence is Risk Management Function ("RMF") and Compliance Function. The RMF is performed by RMDs and dedicated heads of departments, and is responsible for identifying, measuring, monitoring, controlling and reporting the Group's overall risk exposures at company-wide and group-wide, portfolio and business line levels to Senior Management, RMCs and the Boards, encompassing risks independently from the first-line of defence. Compliance Function is performed by Compliance Department and dedicated officers, and is responsible for coordinating the identification and assessment of compliance risk at the group-wide level, independently monitoring the compliance and ensuring testing of compliance controls are carried out consistently across the Group. Internal Audit Function supports the Audit Committee to carry out its roles and responsibilities. Being the third-line of defence, Internal Audit Function is performed by Internal Audit Department, and is responsible for providing an independent assessment of the adequacy and reliability of the risk management processes and system of internal controls and compliance with approved risk policies and regulatory requirements. The head of Internal Audit Department reports directly to the Audit Committee.

Management information systems support risk management processes to facilitate the timely and reliable reporting of risks and enable the identification, measurement, continuous monitoring and reporting of all relevant and material risks of the Group. The risk management processes shall capture both quantitative and qualitative elements of risks. The key risk areas are documented in risk management related policies and comprise credit risk, credit concentration risk, liquidity risk, interest rate risk, market risk, operational risk, reputation risk, legal risk and strategic risk. The sophistication of the risk management processes takes into consideration the business growth, nature, scale and complexity of its activities and the risk of the operating environment. Information systems are in place to provide information of the size, quality and composition of exposures across risk types, material products and counterparties at all relevant levels.

Key risks are communicated across the Group and material risk management issues and the progress of the implementation of risk measures are reported to the Board/Board Committees and Senior Management in a timely manner so that suitable measures can be initiated at an early stage. Risk monitoring and reporting requirements are established across the Group including the development and the use of key risk indicators to provide early warnings and adverse risk developments. Risk monitoring and reporting is performed at business unit, portfolio level, company-wide and group-wide level. Any deficiencies and limitations in the risk estimate as well as any significant embedded assumptions are communicated/ escalated to the Board/Board Committees and Senior Management. Risk reporting draws on a range of risk analytical tools/ approaches and are subject to independent periodic review by the RMF and Internal Audit Function.

Policies, procedures and processes are in place to evaluate strategic position of the Group when developing appropriate strategies to achieve their strategic goals and objectives. They incorporate at least how environmental influences will affect the Group's business and its use of products or services, technology and delivery channels; analysis of strengths, weaknesses, opportunities and threats of the Group; possible alternative strategies that can be adopted by the Group having regard to corporate goals and objectives; risk tolerance and appetite; flexibility in allowing changes to deal with sudden environmental changes and crisis situations; whether strategies are financially and operationally feasible in capital management and capital related targets. Pursuant to stress-testing program of the Group, the RMF uses techniques such as sensitivity tests and scenario analyses on relevant assets/ portfolios and liabilities including at least loans and advances, debt securities portfolio, bank placements, investment properties and net open positions of financial instruments. The time horizon for regular stress-testing is in the range of 6 months to 3 years in general. Stress-testing exercises of the Group are conducted to identify possible events or stressed scenarios, measure their adverse impact on profitability and capital base or strength and assess the Group's ability to withstand such impact. Stressed scenarios and analyses are either qualitative or quantitative covering at least the downturn in domestic economy such as adverse changes to the unemployment rate, or gross domestic product growth, or composite price index; increase in hit rate of personal bankruptcy petitions and corporate wind-up orders leading to an increase in the Bank's bad debts; the decrease in prices of loan collaterals leading to the increase of provisioning level; and rating migrations of counterparties. Stress-testing results are provided by RMDs to Senior Management and relevant risk committees for their feedback and/or decision making such as changes in strategic planning, changes in risk appetite and business model, shift of strategic focus, changes in business initiatives and decisions, risk-mitigating strategies to be taken, and increase or decrease of internal resources devoted to a business or an operation. Pursuant to the Group's risk appetite, the Group is not engaged in complex derivative financial instrument transactions and has no securitization exposures. The continuing effectiveness of mitigants and hedges, if any, for key risks is also monitored regularly (by dedicated risk committees at least bi-monthly). In developing a mitigation strategy or providing risk response, consideration is given to the impact of the chosen mitigation strategy on other risks to ensure all potential risks are accounted for and to avoid giving rise to new unattended risks.

Supplementary information of risk governance structure and risk management issues can be referred to note 36 of the Annual Report.

Template OV1: Overview of RWA

The table below provides an overview of RWA and the related minimum capital requirements by risk type as at 31 December 2017 and 30 September 2017 respectively. The Group has adopted standardized approach for both credit risk and market risk. Regarding operational risk, the Bank and Public Finance have adopted basic indicator approach and standardized approach respectively. During the fourth quarter of 2017, RWA increased by HK$163.0 million to HK$26.91 billion. The increase of RWA was mainly due to an increase of HK$916.2 million in credit risk weighted amounts related to loans and advances.

		(a)	(b)	(c)
		RWA		Minimum capital requirements[1]
		31 December 2017	30 September 2017	31 December 2017
		HK$'000	HK$'000	HK$'000
1	Credit risk for non-securitization exposures (excluding counterparty credit risk and 250% RWA)	23,168,424	23,025,576	1,853,474
2	Of which STC approach	23,168,424	23,025,576	1,853,474
2a	Of which BSC approach	0	0	0
3	Of which IRB approach	0	0	0
4	Counterparty credit risk	5,299	6,401	424
4a	Of which CVA risk	1,813	2,225	145
5	Of which SA-CCR	0	0	0
5a	Of which CEM	3,486	4,176	279
6	Of which IMM(CCR) approach	0	0	0
7	Equity exposures in banking book under the market-based approach	0	0	0
8	CIS exposures – LTA	0	0	0
9	CIS exposures – MBA	0	0	0
10	CIS exposures – FBA	0	0	0
11	Settlement risk	0	0	0
12	Securitization exposures in banking book[2]	0	0	0
13	Of which IRB(S) approach – ratings-based method	0	0	0
14	Of which IRB(S) approach – supervisory formula method	0	0	0
15	Of which STC(S) approach	0	0	0
16	Market risk	1,215,025	1,201,788	97,202
17	Of which STM approach	1,215,025	1,201,788	97,202
18	Of which IMM approach	0	0	0
19	Operational risk	2,542,913	2,517,450	203,433

[1] Calculated at 8% of RWA as of 31 December 2017

[2] Of note, after entering into force of the revised securitization framework in January 2018, the following replacements in row 13, 14 and 15 should be made: (i) IRB(S) rating based method should be replaced by Securitization Internal Ratings-Based Approach (SEC-IRBA)*; (ii) IRB(S) supervisory formula method should be replaced by Securitization External Ratings-Based Approach (SEC-ERBA)*; and (iii) STC(S) should be replaced by Securitization Standardized Approach (SEC-SA)*. A new row following row 15 (say, row 15a) may be added to cater for Securitization Fall-back Approach (SEC-FBA)* where this is applicable. (* all names and applicable approaches subject to the final amendments to the BCR)

		(a)	(b)	(c)
		RWA		Minimum capital requirements[1]
		31 December 2017	30 September 2017	31 December 2017
		HK$'000	HK$'000	HK$'000
20	Of which BIA approach	1,202,200	1,177,500	96,176
21	Of which STO approach	1,340,713	1,339,950	107,257
21a	Of which ASA approach	0	0	0
22	Of which AMA approach	N/A	N/A	N/A
23	Amounts below the thresholds for deduction (subject to 250% RW)	156,905	160,655	12,552
24	Capital floor adjustment	0	0	0
24a	Deduction to RWA	174,791	161,122	13,983
24b	Of which portion of regulatory reserve for general banking risks and collective provisions which is not included in Tier 2 Capital	157,043	145,289	12,563
24c	Of which portion of cumulative fair value gains arising from the revaluation of land and buildings which is not included in Tier 2 Capital	17,748	15,833	1,420
25	**Total**	**26,913,775**	**26,750,748**	**2,153,102**

N/A: Not applicable in the case of Hong Kong

Template LI1: Differences between accounting and regulatory scopes of consolidation and mapping of financial statement categories with regulatory risk categories

The following table shows the differences between the carrying values as reported in the Group's financial statements under the scope of accounting consolidation and the carrying values under the scope of regulatory consolidation, with a breakdown into regulatory risk categories of every item of the assets and liabilities reported in financial statements based on the scope of accounting consolidation.

	31 December 2017						
	(a)	(b)	(c)	(d)	(e)	(f)	(g)
	Carrying values as reported in published financial statements	Carrying values under scope of regulatory consolidation	Carrying values of items: subject to credit risk framework	subject to counterparty credit risk framework	subject to the securitization framework	subject to market risk framework	not subject to capital requirements or subject to deduction from capital
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Assets							
Cash and short term placements	4,871,536	4,863,308	4,863,308	0	0	0	0
Placements with banks and financial institutions maturing after one month but not more than twelve months	1,514,095	1,514,095	1,514,095	0	0	0	0
Derivative financial instruments	4,317	4,317	4,317	0	0	0	0
Loans and advances and receivables	29,304,483	29,304,483	29,304,483	0	0	0	0
Available-for-sale financial assets	6,804	6,804	6,804	0	0	0	0

	31 December 2017						
	(a)	(b)	(c)	(d)	(e)	(f)	(g)
	Carrying values as reported in published financial statements	Carrying values under scope of regulatory consolidation	Carrying values of items:				
			subject to credit risk framework	subject to counterparty credit risk framework	subject to the securitization framework	subject to market risk framework	not subject to capital requirements or subject to deduction from capital
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Held-to-maturity investments	5,671,749	5,671,749	5,671,749	0	0	0	0
Investments in subsidiaries	0	66,008	66,008	0	0	0	0
Deferred tax assets	24,062	24,050	0	0	0	0	24,050
Tax recoverable	3	0	0	0	0	0	0
Intangible assets	718	0	0	0	0	0	0
Property and equipment	87,414	75,584	75,584	0	0	0	0
Land held under finance leases	100,820	129,480	129,480	0	0	0	0
Investment properties	111,692	111,692	111,692	0	0	0	0
Goodwill	242,342	242,342	0	0	0	0	242,342
Other assets	253,368	205,587	205,587	0	0	0	0
Total assets	**42,193,403**	**42,219,499**	**41,953,107**	**0**	**0**	**0**	**266,392**

	31 December 2017						
	(a)	(b)	(c)	(d)	(e)	(f)	(g)
	Carrying values as reported in published financial statements	Carrying values under scope of regulatory consolidation	Carrying values of items: subject to credit risk framework	subject to counterparty credit risk framework	subject to the securitization framework	subject to market risk framework	not subject to capital requirements or subject to deduction from capital
	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
Liabilities							
Deposits and balances of banks and other financial institutions at amortized cost	1,123,792	1,123,792	0	0	0	0	1,123,792
Derivative financial instruments	1,696	1,696	0	0	0	0	1,696
Customer deposits at amortized cost	34,094,775	34,327,196	0	0	0	0	34,327,196
Certificates of deposit issued at amortized cost	753,293	753,293	0	0	0	0	753,293
Current tax payable	39,568	38,689	0	0	0	0	38,689
Deferred tax liabilities	12,629	13,910	0	0	0	0	13,910
Other liabilities	450,746	378,709	0	0	0	0	378,709
Total liabilities	**36,476,499**	**36,637,285**	**0**	**0**	**0**	**0**	**36,637,285**

Template LI2: Main sources of differences between regulatory exposure amounts and carrying values in financial statements

The following table shows the main sources of differences between the carrying values in financial statements and the exposure amounts used for the calculation of regulatory capital in respect of the assets and liabilities based on the scope of regulatory consolidation.

		31 December 2017				
		(a)	(b)	(c)	(d)	(e)
		Total	Items subject to:			
			credit risk framework	securitization framework	counterparty credit risk framework	market risk framework
		HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
1	**Asset carrying value amount under scope of regulatory consolidation (as per template LI1)**	**41,953,107**	**41,953,107**	**0**	**0**	**0**
2	Liabilities carrying value amount under regulatory scope of consolidation (as per template LI1)	0	0	0	0	0
3	Total net amount under regulatory scope of consolidation	41,953,107	41,953,107	0	0	0
4	Off-balance sheet amounts	4,402,687	67,011	0	0	0
5	Differences due to consideration of provisions		8,891	0	0	0
6	**Exposure amounts considered for regulatory purposes**	**42,029,009**	**42,029,009**	**0**	**0**	**0**

Table LIA: Explanations of differences between accounting and regulatory exposure amounts

The basis of consolidation for regulatory purposes is different from that for accounting purposes. In accordance with the Banking (Capital) Rules, the computation of the consolidated total capital ratio and other regulatory capital ratios of the Group based on the consolidation of the Bank and Public Finance is only for purpose of regulatory reporting to the Hong Kong Monetary Authority ("HKMA"). The subsidiaries not included in the computation of the consolidated total capital ratio, other capital adequacy ratios and corresponding capital base, Tier 1 Capital, other capital related components and risk weighted amounts of the Group are Public Bank (Nominees) Limited, Public Credit Limited, Public Futures Limited, Public Pacific Securities Limited, Public Financial Securities Limited, Public Financial Limited, Public Securities Limited and Public Securities (Nominees) Limited.

The key drivers for the differences between accounting and regulatory exposure amounts differences are as follows:

- The carrying amounts reported in the financial statements are after deduction of collective and individual impairment allowances while the exposure amounts for regulatory purposes are before deducting such impairment allowances (except for exposures under Standardized Approach of credit risk from which individual impairment allowances made against the exposures are deducted);
- Counterparty credit risk exposures for regulatory purposes consist of both the current exposures and the potential exposures derived from applying credit conversion factors (CCFs) to the notional principal of foreign exchange contracts.

The Group measures its investment properties and derivative financial instruments at fair value using the fair value hierarchy described as follows:

Level 1: based on quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2: based on valuation techniques for which the lowest level input that is significant to the fair value measurement is observable, either directly or indirectly

Level 3: based on valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

In order to ensure that the valuation estimates are prudent and reliable, fair value is measured under level 1 of the hierarchy (i.e. quoted market prices) as far as possible. Where fair value is determined using level 2 or level 3 of the hierarchy, model inputs or outputs are validated against secondary sources, when appropriate, and the valuation process is also handled by a control function independent from business lines.

Table CRA: General information about credit risk

The Group's business activities are underpinned by its business model and mainly comprise loan business development, investments in held-to-collect debt securities and inter-bank placements without the involvement of complex credit related derivatives, which are major components of the Group's credit risk profile. The business model is reviewed regularly (at least monthly) taking into account factors such as prevailing business and economic conditions, regulatory requirements, credit risk profile and business/ risk appetite, and capital resources to be devoted to support a business activity. In formulating credit risk related policies and setting credit related limits, both regulatory/ statutory requirements (such as section 83 of the Banking Ordinance ("BO") on connected lending and section 81 of BO on single largest exposure to a customer group) and risk appetite derived from internal business model are taken into consideration. The risk appetite and underlying credit related limits are reviewed taking into account the interactions among external changes in operating/ business conditions, credit profile of customers, and internal changes in business model and strategies. The Group manages its credit risk within a conservative framework and its credit policies, guidelines and risk management processes are regularly reviewed subject to revisions taking into account the aforesaid factors and interactions.

The Group's loan development focuses on secured lending of the Bank and unsecured consumer financing of Public Finance. There were no exposures to PIIGS countries. More than 90% of loan exposures are in Hong Kong. The Group mitigates credit risk by credit protection provided by guarantors and by loan collateral such as customer deposits, properties, listed shares, taxi licences, public light bus licences and vehicles.

RMCs are responsible for setting a credit risk management governance framework, monitoring credit risk independently, and providing recommendations or advice to the Credit Committees and CRMC in managing all credit risk related issues of the Group. Credit Committees of the Group are dedicated to review and amend credit approval criteria and procedures, underwriting standards and credit related limits as appropriate taking into account changes in business strategies, risk appetite, and external environment in which the Group operates. They also monitor the quality of financial assets which are neither past due nor impaired by financial performance indicators (such as the loan-to-value ratio, debts servicing ratio, financial soundness of borrowers and personal guarantees) through meeting discussions and management reports. Loan borrowers subject to legal proceedings, negative comments from other counterparties and rescheduled arrangements are put under watch lists or under the "special mention" grade for management oversight. CRMC is responsible for establishing the framework for identifying, measuring, monitoring and controlling credit risk of the existing and new products. The CRMC reviews credit risk management policies and credit risk tolerable limits, and reports to board-level RMC. CRMC is also dedicated to work out proposals of revised credit limit setting processes/ models and revised credit concentration limits with justifications or derived from the aforesaid processes/ models taking into account stress-testing results arising from limit excesses in particular loan segments. Both Credit Committees and CRMC make recommendations of the above-mentioned revisions of credit related policies, controls and processes after the utilization of internal audit and compliance review results. Exceptions such as material deviations of underwriting standards, breaches of credit related limits and serious financial loses damage to reputation resulting from control lapses will be escalated to RMCs for discussions and further actions as appropriate.

The Group has established policies, procedures, risk profile and management information systems to identify, measure, monitor, control, and report on credit risk. The guidelines for credit risk management have been elaborated in credit risk management policies and loan product manuals of the Group. They incorporate at least delegated lending authorities and limits, credit underwriting criteria, credit monitoring processes, loan classification guidelines, credit recovery procedures and provisioning policies, and are reviewed and updated on an ongoing basis to cater for market changes, statutory requirements and prevailing practices in risk management processes. The Group adopts a "Three Lines of Defence" model for credit risk management. Business units and dedicated departments such as Credit Department and Financial Institutions Department constitute the first line of defence and are responsible for day-to-day identification, assessment, management and reporting of credit risks within their products, activities, processes and systems; ensuring proper reporting of relevant risk exposures on an ongoing basis and any breaches of risk limits and material risk exposures are promptly reported to the heads of RMDs and the Senior Management. Heads of RMDs and Compliance Departments of the Group constitute the second line of defence and are the Risk Controllers. The heads of RMDs report to RMCs and work closely with Credit Committees and CRMC to obtain credit risk related information to perform credit risk assessment on loan portfolio and treasury operations independently taking into account at least emerging risk issues and latest market/ regulatory developments. The heads of Compliance Departments also report to RMCs and are responsible to check against working files and procedures of Credit Departments, and other involved departments whether they comply with key credit risk management related policies which are formulated in accordance with the guidelines or statutory requirements stipulated by regulators and the risk appetite of the Group. Being the third line of defence, Internal Audit Departments report to Audit Committees which are responsible for providing assurance on the effectiveness of the Group's risk management framework including credit risk governance. Internal Audit Departments are responsible for reviewing credit risk related policies, controls and processes (e.g. whistle-blowing mechanism) to determine whether they can fulfil the requirements of the regulators and whether they are adequate to minimize and detect credit control lapses such as fraud cases.

Supplementary information of credit risk management issues are shown under "Credit Risk Management" in note 36 of the Annual Report.

Template CR1: Credit quality of exposures

The table below provides a breakdown of defaulted and non-defaulted loans, debt securities and off-balance sheet exposures as at 31 December 2017. The defaulted loans are individually determined to be impaired after considering the loan overdue more than three months and the qualitative factors such as bankruptcy proceedings, corporate winding-up arrangements and other serious warning signals of repayment ability of counterparties. There were no defaulted debt securities and off-balance sheet exposures as at 31 December 2017.

		31 December 2017			
		(a)	(b)	(c)	(d)
		Gross carrying amounts of			
		Defaulted exposures	Non-defaulted exposures	Allowances / impairments	Net values
		HK$'000	HK$'000	HK$'000	HK$'000
1	Loans	135,035	29,249,423	79,975	29,304,483
2	Debt securities	0	5,695,399	0	5,695,399
3	Off-balance sheet exposures	0	4,402,687	0	4,402,687
4	**Total**	**135,035**	**39,347,509**	**79,975**	**39,402,569**

Template CR2: Changes in defaulted loans and debt securities

The table below provides the movement of defaulted loans. During the year of 2017, defaulted loans decreased by HK$95.6 million to HK$135.0 million mainly due to write-off of impaired loans and loan repayments. There were no defaulted debt securities as at 31 December 2016 and 31 December 2017 respectively.

		(a)
		Amount
		HK$'000
1	**Defaulted loans and debt securities at end of the previous reporting period (31 Dec 2016)**	**230,616**
2	Loans and debt securities that have defaulted since the last reporting period	374,638
3	Returned to non-defaulted status	(87,307)
4	Amounts written off	(327,314)
5	Other changes*	(55,598)
6	**Defaulted loans and debt securities at end of the current reporting period (31 Dec 2017)**	**135,035**

* Other changes were mainly related to loan repayments

Table CRB: Additional disclosure related to credit quality of exposures

In general, loans and other similar credit exposures with a specific expiry date are treated as overdue where principal or interest remains unpaid as at a reporting date. Loans and other credit exposures repayable by regular instalments shall be treated as overdue when an instalment payment remains unpaid as at a reporting date. Loans or other similar credit exposures repayable on demand shall be treated as overdue where a demand for repayment has been served on the borrower but repayment has not been made in accordance with the instruction of the Group, or the credit exposures have remained continuously outside the approved credit limit already advised to the borrower as at a reporting date.

The Group classifies the loans and advances in accordance with the loan classification system required to be adopted for reporting to the HKMA. "Impaired" means "substandard, doubtful or loss in accordance with loan classification system of the HKMA" taking into account both qualitative factors (such as bankruptcy proceedings) and quantitative factors (for example, past due for more than 90 days) regarding credit quality of exposures. There were no loans which were past due for more than 90 days and non-impaired. After the determination of which assets are impaired taking into account the aforesaid factors, individual impairment shall be computed between a credit exposure and a recoverable amount. The recoverable amount takes into account cashflow from various debts collection means (such as realization of eligible collaterals). Collective impairment is computed for loans which are not subject to individual impairment assessment.

In general, a restructured asset is an asset that has been restructured and renegotiated between the Group and the borrower because of a deterioration in the financial position of the borrower or of the inability of the borrower to meet the original repayment schedule and for which the revised repayment terms, either of interest or of repayment period, are non-commercial to the Group. Such rescheduled asset shall be treated as "impaired" in general. A rescheduled asset may be upgraded from "impaired" to "special mention" if (i) the agreed haircut has been fully written off and all the potential losses have been fully provided upon completion of restructuring; (ii) the Group is satisfied that the borrower will be able to service all future principal and interest payments in accordance with the revised repayment terms. Such asset however continues to be classified as "rescheduled" until the borrower has serviced all principal and interest payments in accordance with the revised repayment terms continuously for a reasonable period. The reasonable period of continuing repayments for rescheduled assets with monthly payments is 6 months; whilst the reasonable period for other rescheduled assets is a period of continuing repayment of 12 months.

Rescheduled assets are no longer regarded as "rescheduled" and are at "pass" grade when their revised repayment terms are, or become, commercial to the institution and where there is reasonable assurance that the borrowers will be able to service all future principal and interest payments on the assets in accordance with the revised repayment terms and the borrowers have serviced all principal and interest payments on the assets in accordance with the revised repayment terms continuously for a reasonable period.

Analysis on credit quality of exposures that are "neither past due nor impaired", "past due but not impaired" and "impaired" is provided as follows:

	31 December 2017			
Credit exposures	Loans exposures	Debt securities	Off-balance sheet exposures	Total
	HK$'000	HK$'000	HK$'000	HK$'000
- neither past due nor impaired	28,694,288	5,695,399	4,402,687	38,792,374
- past due but not impaired	555,135	0	0	555,135
- impaired	135,035	0	0	135,035
Total	29,384,458	5,695,399	4,402,687	39,482,544

Of which,

	31 December 2017			
Credit exposures that are neither past due nor impaired	Loans exposures	Debt securities	Off-balance sheet exposures	Total
	HK$'000	HK$'000	HK$'000	HK$'000
- pass	28,612,120	5,695,399	4,402,687	38,710,206
- special mention	82,168	0	0	82,168
Total	28,694,288	5,695,399	4,402,687	38,792,374

Also, the ageing analysis of loans and advances to customers that are past due but not impaired is as follows:

	31 December 2017			
Credit exposures that are past due but not impaired	Loans exposures	Debt securities	Off-balance sheet exposures	Total
	HK$'000	HK$'000	HK$'000	HK$'000
- overdue 3 months or less	555,135	0	0	555,135
- overdue more than 3 months	0	0	0	0
Total	555,135	0	0	555,135

The quantitative disclosures of exposures by geographical areas, industry and residual maturity are shown in note 35 and supplementary financial information "Advances to customers by industry sectors" of the Annual Report. The amounts of impaired exposures and related allowances and write-offs; ageing analysis of accounting past due exposures and breakdown of restructured exposures are shown in note 17 of the Annual Report.

Table CRC: Qualitative disclosures related to credit risk mitigation

In evaluating credit risk associated with an individual customer, a customer group or a counterparty, financial strength and repayment ability are always the first considerations in credit review and approval process. Credit risk is mitigated by obtaining recognized collaterals (including cash deposits, marketable securities, properties, taxi licences and public light bus licences) and eligible guarantees (such as standby letter of credit issued by a bank of sound financial strength). Meanwhile, recognized netting is not adopted by the Group.

The relevant policies and processes relating to the use of credit risk mitigation are established and approved by Credit Committees and are subject to regular reviews to ensure the effectiveness of credit risk management. The Group monitors the value of the collateral regularly with respect to the nature of collateral and market practice. Marketable securities are marked-to-market on a daily basis whilst valuations on properties, taxi licences and public light bus licences are reviewed periodically (i.e. at least monthly).

Template CR3: Overview of recognized credit risk mitigation

The table below provides a breakdown of unsecured and secured exposures (net of impairment allowances), including loans and debt securities as at 31 December 2017. The major collateral for secured loans and advances and receivables were cash deposits, properties, listed shares, taxi licences and public light bus licences. All debt securities were unsecured and assigned with a grading of Grade A3 or above based on the credit rating of Moody's Investors Service ("Moody's").

		31 December 2017				
		(a)	(b1)	(b)	(d)	(f)
		Exposures unsecured: carrying amount	Exposures to be secured	Exposures secured by recognized collateral	Exposures secured by recognized guarantees	Exposures secured by recognized credit derivative contracts
		HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
1	Loans	4,420,025	24,884,458	24,284,912	599,546	0
2	Debt securities	5,695,399	0	0	0	0
3	**Total**	**10,115,424**	**24,884,458**	**24,284,912**	**599,546**	**0**
4	Of which defaulted	32,543	31,405	31,405	0	0

Table CRD: Qualitative disclosures on use of ECAI ratings under STC approach

Credit ratings from Moody's, an external credit agency, are used in the Group for risk-weighting credit risk exposures under the following relevant exposure classes of the Group:

- Sovereign;
- Public sector entity;
- Bank;
- Securities firm; and
- Corporate

Over 90% of bank placements were deposited with banks and financial institutions rated with a grading of Baa2 or above based on the credit rating of Moody's. All issuers of debt securities are either central governments, public sector enterprises or banks with a grading of A3 or above. Over 90% of loan exposures are non-rated. There are no transfers of External Credit Assessment Institutions ("ECAI") issuer ratings to ECAI issue specific ratings onto comparable assets in the banking book.

Template CR4: Credit risk exposures and effects of recognized credit risk mitigation ("CRM") – for STC approach

The table below illustrates the effect of any recognized CRM on the calculation of credit risk capital requirements under STC approach as at 31 December 2017.

		31 December 2017					
		(a)	(b)	(c)	(d)	(e)	(f)
		Exposures pre-CCF and pre-CRM		**Exposures post-CCF and post-CRM**		**RWA and RWA density**	
	Exposure classes	On-balance sheet amount	Off-balance sheet amount	On-balance sheet amount	Off-balance sheet amount	RWA	RWA density
		HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	%
1	Sovereign exposures	2,173,861	0	2,173,861	0	101,946	4.7%
2	PSE exposures	378,390	0	378,390	0	75,678	20.0%
2a	Of which: domestic PSEs	378,390	0	378,390	0	75,678	20.0%
2b	Of which: foreign PSEs	0	0	0	0	0	N/A
3	Multilateral development bank exposures	0	0	0	0	0	N/A
4	Bank exposures	9,862,869	37,546	9,862,869	7,510	3,519,612	35.7%
5	Securities firm exposures	559,072	0	559,072	0	279,536	50.0%
6	Corporate exposures	5,175,996	1,842,088	5,175,996	14,671	5,190,019	100.0%
7	CIS exposures	0	0	0	0	0	N/A
8	Cash items	1,804,115	0	1,804,115	0	280,511	15.5%
9	Exposures in respect of failed delivery on transactions entered into on a basis other than a delivery-versus-payment basis	0	0	0	0	0	N/A

		31 December 2017					
		(a)	(b)	(c)	(d)	(e)	(f)
		Exposures pre-CCF and pre-CRM		**Exposures post-CCF and post-CRM**		**RWA and RWA density**	
	Exposure classes	On-balance sheet amount	Off-balance sheet amount	On-balance sheet amount	Off-balance sheet amount	RWA	RWA density
		HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	%
10	Regulatory retail exposures	9,796,944	1,146,531	9,796,944	27,401	7,364,272	75.0%
11	Residential mortgage loans	9,979,345	65,630	9,979,345	0	4,184,470	41.9%
12	Other exposures which are not past due exposures	2,098,203	0	2,098,203	0	2,098,203	100.0%
13	Past due exposures	57,025	0	57,025	0	74,177	130.1%
14	Significant exposures to commercial entities	0	0	0	0	0	N/A
15	**Total**	**41,885,820**	**3,091,795**	**41,885,820**	**49,582**	**23,168,424**	**55.2%**

Template CR5: Credit risk exposures by asset classes and by risk weights – for STC approach

The table below provides the breakdown of credit risk exposures by asset classes and by risk weights under STC approach as at 31 December 2017.

		31 December 2017										
	HK$'000	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(ha)	(i)	(j)
	Exposure class \ Risk Weight	0%	10%	20%	35%	50%	75%	100%	150%	250%	Others	Total credit risk exposures amount (post CCF and post CRM)
1	Sovereign exposures	1,664,133	0	509,728	0	0	0	0	0	0	0	2,173,861
2	PSE exposures	0	0	378,390	0	0	0	0	0	0	0	378,390
2a	Of which: domestic PSEs	0	0	378,390	0	0	0	0	0	0	0	378,390
2b	Of which: foreign PSEs	0	0	0	0	0	0	0	0	0	0	0
3	Multilateral development bank exposures	0	0	0	0	0	0	0	0	0	0	0
4	Bank exposures	0	0	4,760,850	0	5,084,174	0	25,355	0	0	0	9,870,379
5	Securities firm exposures	0	0	0	0	559,072	0	0	0	0	0	559,072
6	Corporate exposures	648	0	0	0	0	0	5,190,019	0	0	0	5,190,667
7	CIS exposures	0	0	0	0	0	0	0	0	0	0	0
8	Cash items	401,559	0	1,402,556	0	0	0	0	0	0	0	1,804,115

	HK$'000	31 December 2017										
		(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(ha)	(i)	(j)
	Exposure class / Risk Weight	0%	10%	20%	35%	50%	75%	100%	150%	250%	Others	Total credit risk exposures amount (post CCF and post CRM)
9	Exposures in respect of failed delivery on transactions entered into on a basis other than a delivery-versus-payment basis	0	0	0	0	0	0	0	0	0	0	0
10	Regulatory retail exposures	10,837	0	0	0	0	9,796,944	16,564	0	0	0	9,824,345
11	Residential mortgage loans	0	0	0	8,783,564	0	342,232	853,549	0	0	0	9,979,345
12	Other exposures which are not past due exposures	0	0	0	0	0	0	2,098,203	0	0	0	2,098,203
13	Past due exposures	0	0	0	0	0	0	22,722	34,303	0	0	57,025
14	Significant exposures to commercial entities	0	0	0	0	0	0	0	0	0	0	0
15	**Total**	**2,077,177**	**0**	**7,051,524**	**8,783,564**	**5,643,246**	**10,139,176**	**8,206,412**	**34,303**	**0**	**0**	**41,935,402**

Table CCRA: Qualitative disclosures related to counterparty credit risk (including those arising from clearing through CCPs)

The Group's relevant counterparty credit risk exposures are applicable to interbank placements and nostro balances; certificates of deposit; held-to-maturity bonds and debt securities; commercial exposures (i.e. standby letters of credit (SBLC), bank guarantees, letter of credit confirmations, trade finance lines); and over-the-counter derivative financial instruments (i.e. foreign exchange contracts). Counterparty credit risk management policy is in place to set the scope for the management of all on- and off-balance sheet credit risk exposures with sovereigns and financial institutions undertaken by the Bank and ensure counterparty credit risk management is consistently applied across all entities within the Group.

The Group has adopted the Current Exposure Method for regulatory capital calculation of its counterparty credit risk arising from securities financing transactions and derivative contracts booked in the banking book and trading book.

All transactions with counterparties are to be transacted within approved limits which are put in place to manage pre-settlement and settlement risks. Monitoring of counterparty exposures against respective approved limits for each counterparty is to be conducted on a daily basis. In setting the counterparty limits, actual business needs of the Group based on past months' utilisations; the Group's projected future business needs; credit standing of a counterparty and its related entities; and internal capital set aside for counterparty credit risk exposures are considered. Settlement Risk is managed via settlement via payment-versus-payment channels (where possible) and approved counterparty credit risk limits. The Group also monitors the risk exposure due to fluctuations in the market using the current exposure and the potential exposure value of the transactions. Financial Institutions Department is responsible for the aggregation of the approved limits and outstanding of similar counterparties for all the entities within the Group and to report quarterly to the Credit Committees for review.

The Group is not involved in complex derivative financial instruments (e.g. commodities contracts and equity swap contracts) in general and there are no material counterparty credit risk exposures arising from clearing through CCPs. There are also no other material counterparty credit exposures involving general and specific wrong-way risk and related credit risk mitigation via collateral or guarantee. The Group has adopted the Current Exposure Method for regulatory capital calculation of its counterparty credit risk arising from derivative contracts (i.e. foreign exchange contracts).

As at 31 December 2017, the potential value of the additional collateral pertaining to ISDA CSA downgrade thresholds that the Group would need to post with counterparties in the event of a two-notch downgrade was nil. No recognized credit derivative contract was applied as credit risk mitigation, and no valid bilateral netting agreement was made and taken into account in the calculation of regulatory capital.

Template CCR1: Analysis of counterparty default risk exposures (other than those to CCPs) by approaches

The table below provides a breakdown of counterparty default risk exposures (other than those to CCPS), RWAs, and where applicable, main parameters under the approaches used to calculate default risk exposures in respect of derivative contracts as at 31 December 2017.

		31 December 2017					
		(a)	(b)	(c)	(d)	(e)	(f)
		Replacement cost (RC)	PFE	Effective EPE	Alpha (α) used for computing default risk exposure	Default risk exposure after CRM	RWA
		HK$'000	HK$'000	HK$'000	HK$'000	HK$'000	HK$'000
1	SA-CCR (for derivative contracts)	0	0		1.4	0	0
1a	CEM	4,320	13,109		N/A	17,429	3,486
2	IMM (CCR) approach			0	0	0	0
3	Simple Approach (for SFTs)					0	0
4	Comprehensive Approach (for SFTs)					0	0
5	VaR (for SFTs)					0	0
6	**Total**						**3,486**

Template CCR2: CVA capital charge

The table below provides information on CVA capital charge and the CVA calculations based on standardized CVA method as at 31 December 2017.

		31 December 2017	
		(a)	(b)
		EAD post CRM	RWA
		HK$'000	HK$'000
	Netting sets for which CVA capital charge is calculated by the advanced CVA method	0	0
1	(i) VaR (after application of multiplication factor if applicable)		0
2	(ii) Stressed VaR (after application of multiplication factor if applicable)		0
3	Netting sets for which CVA capital charge is calculated by the standardized CVA method	17,429	1,813
4	**Total**	**17,429**	**1,813**

Template CCR3: Counterparty default risk exposures (other than those to CCPs) by asset classes and by risk weights – for STC approach

The Bank's counterparty default risk exposures by asset classes and by risk weights under STC approach as at 31 December 2017 are shown below :

		31 December 2017										
	HK$'000	(a)	(b)	(c)	(ca)	(d)	(e)	(f)	(g)	(ga)	(h)	(i)
	Exposure class / Risk Weight	0%	10%	20%	35%	50%	75%	100%	150%	250%	Others	Total default risk exposure after CRM
1	Sovereign exposures	0	0	0	0	0	0	0	0	0	0	0
2	PSE exposures	0	0	0	0	0	0	0	0	0	0	0
2a	Of which: domestic PSEs	0	0	0	0	0	0	0	0	0	0	0
2b	Of which: foreign PSEs	0	0	0	0	0	0	0	0	0	0	0
3	Multilateral development bank exposures	0	0	0	0	0	0	0	0	0	0	0
4	Bank exposures	0	0	17,429	0	0	0	0	0	0	0	17,429
5	Securities firm exposures	0	0	0	0	0	0	0	0	0	0	0
6	Corporate exposures	0	0	0	0	0	0	0	0	0	0	0
7	CIS exposures	0	0	0	0	0	0	0	0	0	0	0
8	Regulatory retail exposures	0	0	0	0	0	0	0	0	0	0	0
9	Residential mortgage loans	0	0	0	0	0	0	0	0	0	0	0
10	Other exposures which are not past due exposures	0	0	0	0	0	0	0	0	0	0	0
11	Significant exposures to commercial entities	0	0	0	0	0	0	0	0	0	0	0
12	**Total**	**0**	**0**	**17,429**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**17,429**

Table MRA: Qualitative disclosures related to market risk

RMCs is responsible to assist the Board to oversee and monitor market risk exposures and to set out Risk Management Framework for identifying and managing potential risks of the Group. Under such framework, three lines of defence are adopted for market risk management to promote sound risk culture through a clear focus on key market risks associated with the Group's activities and to provide timely and appropriate responses to inappropriate risk-taking behaviour. The first line of defence comprises market risk owners at Treasury Department and business units. They are primarily responsible for the day-to-day market risk management. The second line of defence refers to the RMD. The risk controller of market risk, who is Head of RMD, works closely with ALCOs which are responsible for monitoring and reporting of material market risk issues to the RMCs, conducting regular review of market risk trends and setting out market risk management strategy as appropriate. The third line of defence refers to Internal Audit Departments which are under oversight of Audit Committees.

The Group has formulated risk management policy to identify, measure, monitor, control, and report on market risk exposures. Adequate capital resources are set aside to cover those risk exposures. The risk management policy and control limits regarding market risk governance are approved by the RMC, and are regularly reviewed and updated to align with market changes, statutory requirements, and prevailing practices in market. Risk limits and management action triggers are set with reference to risk appetite of the Bank.

Risk appetite has been defined in accordance with the Group's business strategies and objectives to govern the trading book activities. Currently, our Group is not involved in and does not plan to conduct complex derivative financial contract transactions. Only traditional over-the-counter foreign exchange transactions are conducted at present. Hedging is monitored under market risk management framework.

For measuring and monitoring of market risk exposures, market risk analysis is conducted for all principal currencies with potential loss and impact to capital adequacy. For reporting of market risk, risk reporting for trading book positions is compiled and monitored on a daily basis, and risk reports are prepared for different levels of governances on a regular basis.

Template MR1: Market risk under STM approach

The table below provides information on market risk RWA as at 31 December 2017. The market risk RWA arose from foreign exchange exposures only. Our Group had no gold contract exposures.

		31 December 2017
		(a)
		RWA
		HK$'000
	Outright product exposures	
1	Interest rate exposures (general and specific risk)	0
2	Equity exposures (general and specific risk)	0
3	Foreign exchange (including gold) exposures	1,215,025
4	Commodity exposures	0
	Option exposures	
5	Simplified approach	0
6	Delta-plus approach	0
7	Other approach	0
8	Securitization exposures	0
9	**Total**	**1,215,025**

Key capital ratios disclosures

Capital adequacy ratio

	Item	**31 December 2017** **HK$'000**	**30 September 2017** **HK$'000**
1	CET1 capital	4,857,700	4,742,579
2	AT1 capital	0	0
3	Tier 1 capital (Tier 1 = CET1 + AT1)	4,857,700	4,742,579
4	Tier 2 capital	306,132	302,834
5	Total capital (Total capital = Tier 1 + Tier 2)	5,163,832	5,045,413
6	Total risk weighted assets	26,913,775	26,750,748
Capital ratios (as a percentage of risk weighted assets)			
	CET1 capital ratio	18.05%	17.73%
	Tier 1 capital ratio	18.05%	17.73%
	Total capital ratio	19.19%	18.86%

Leverage ratio

	Item	**31 December 2017** **HK$'000**	**30 September 2017** **HK$'000**
1	Tier 1 capital	4,857,700	4,742,579
2	Total exposures	41,870,577	42,492,031
Leverage ratio (as a percentage of total exposures)			
	Leverage ratio	11.60%	11.16%

Glossary

Abbreviations	Descriptions
AT1	Additional Tier 1
CCF	Credit Conversion Factor
CCP	Central Counterparty
CCR	Counterparty Credit Risk
CEM	Current Exposure Method
CET1	Common Equity Tier 1
CIS	Collective Investment Scheme
CRM	Credit Risk Mitigation
CVA	Credit Valuation Adjustment
EAD	Exposure At Default
EPE	Expected Positive Exposure
IMM	Internal Models Method
IRB	Internal Ratings-Based
IRB(S)	Internal Ratings-Based (Securitization)
PFE	Potential Future Exposure
PSE	Public Sector Entity
RWA	Risk Weighted Asset
SA-CCR	Standardized Approach (Counterparty Credit Risk)
SFT	Securities Financing Transaction
STC	Standardized (Credit Risk)
STM	Standardized (Market Risk)
STO	Standardized (Operational Risk)
VaR	Value-At-Risk