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ANNUAL
REPORT
2016

Corporate Information

Board of Directors

Non-Executive Chairman

Tan Sri Dato' Sri Dr. Teh Hong Piow (Chairman),
also Founder and Chairman of Public Bank Berhad

Executive Directors

Tan Yoke Kong
Chong Yam Kiang

Non-Executive Directors

Tan Sri Dato' Sri Tay Ah Lek
Quah Poh Keat
Dato' Chang Kat Kiam

Independent Non-Executive Directors

Lai Wan (Co-Chairman)
Lee Chin Guan
Tang Wing Chew

Company Secretary

Chan Sau Kuen

Registered Office and Head Office

2/F, Public Bank Centre
120 Des Voeux Road Central
Central, Hong Kong
Telephone : (852) 2541 9222
Facsimile : (852) 2541 0009
Website : www.publicbank.com.hk

Auditor

Ernst & Young
Certified Public Accountants

Legal Advisers

Charles Yeung Clement Lam Liu & Yip
Deacons
Siao, Wen and Leung
Stephenson Harwood

Principal Bankers

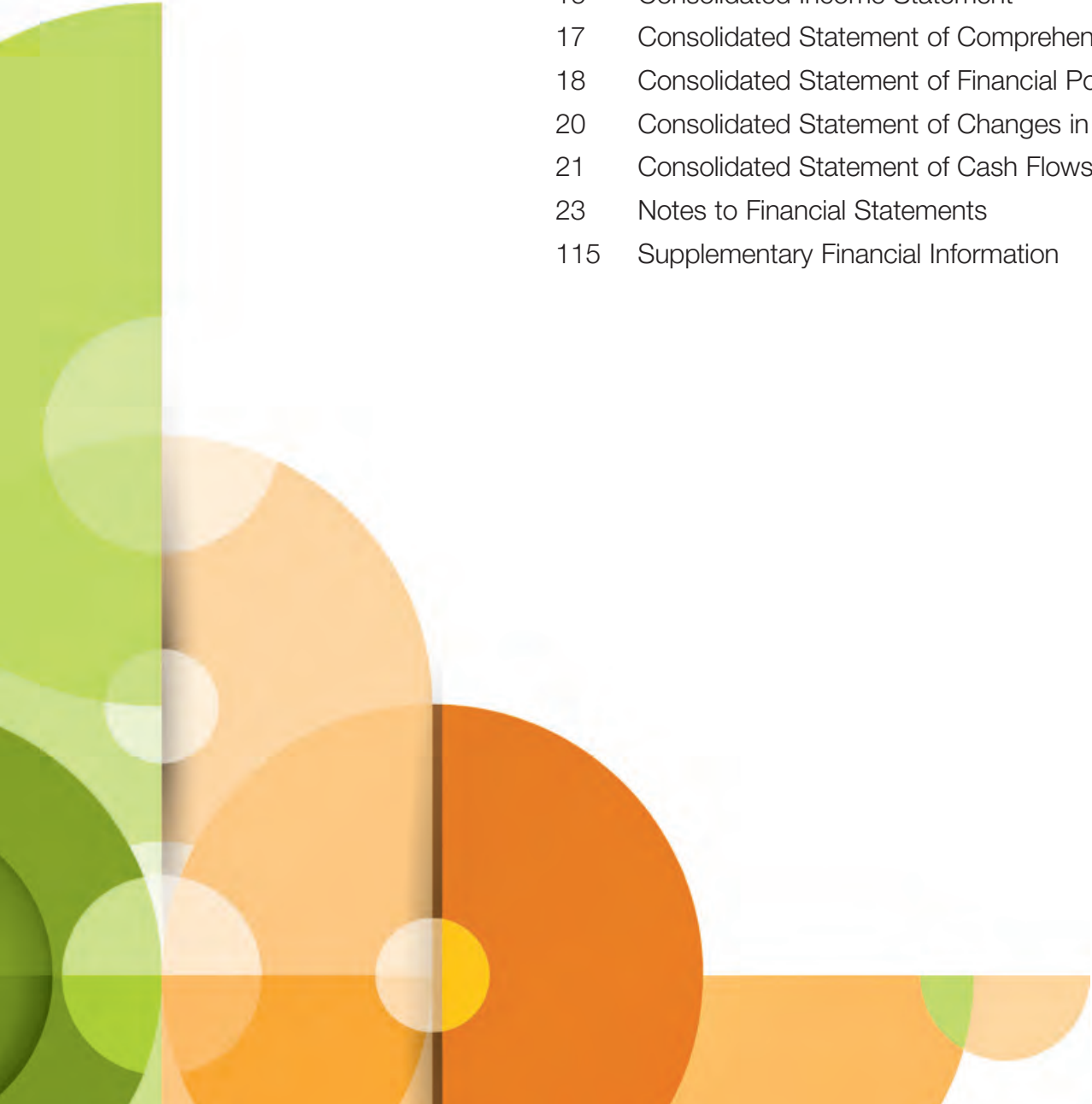
CIMB Bank Berhad
JPMorgan Chase Bank, N.A. Hong Kong Branch
Oversea-Chinese Banking Corporation Limited
Public Bank Berhad
Public Bank (L) Ltd
Standard Chartered Bank (Hong Kong) Limited
The Bank of East Asia, Limited
The Hongkong and Shanghai Banking Corporation
Limited



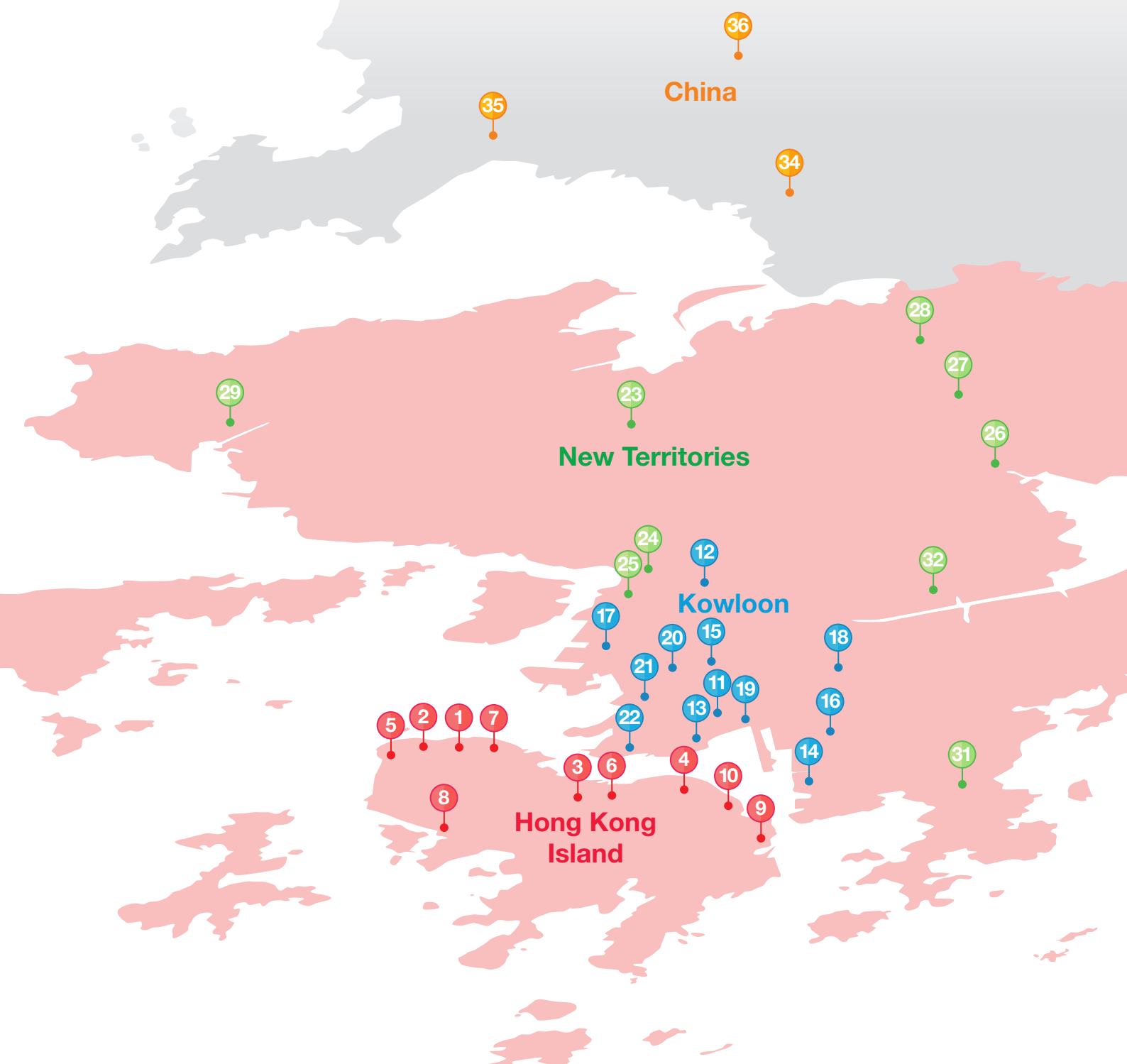
Public Bank (Hong Kong) Limited Annual Report 2016

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Public Bank (Hong Kong) Limited Branch Network



HEAD OFFICE AND BRANCHES

Head Office

2/F, Public Bank Centre, 120 Des Voeux Road Central

Tel : 2541 9222 Telex : 73085 CBHK HKHH

P.O. Box : G.P.O. Box 824

Fax : 2541 0009

Website : www.publicbank.com.hk

HONG KONG ISLAND

- | | | |
|--|---|--|
| <p>1 Main Branch
G/F, Public Bank Centre
120 Des Voeux Road Central
Tel: 2541 9222 Fax: 2545 2866
Manager: Fong Fung Mei Marisa</p> <p>2 Western Branch
Shop 2-3, G/F, Kam Kwan Building
163-173 Des Voeux Road West
Tel: 2858 2220 Fax: 2858 2638
Manager: Lau Ching Sang, Paul</p> <p>3 Wanchai Commercial Centre
Unit A, 9/F, China Overseas Building
139 Hennessy Road
Tel: 2841 4171 Fax: 2834 1012
Manager: Pun Man Por</p> | <p>4 North Point Branch
Shop 2, G/F, Two Chinachem Exchange Square
338 King's Road
Tel: 2568 5141 Fax: 2567 0655
Manager: Louie Sze Ho, Eugene</p> <p>5 Shek Tong Tsui Branch
Shop B1, G/F, Hong Kong Plaza
188 Connaught Road West
Tel: 2546 2055 Fax: 2559 7962
Manager: Ting Lai May, May</p> <p>6 Causeway Bay Branch
G/F and M/F,
447 Hennessy Road
Tel: 2572 2363 Fax: 2572 3033
Manager: Chui King Yan, Connie</p> <p>7 Central Branch
Unit A, G/F, Wing On House
71 Des Voeux Road Central
Tel: 2147 2140 Fax: 2147 2244
Manager: Wong Hon Choi</p> | <p>8 Aberdeen Branch
Shop C, G/F, Kong Kai Building
184 Aberdeen Main Road
Tel: 2871 0928 Fax: 2871 0383
Manager: Wong Chun Hoi, Wilson</p> <p>9 Shau Kei Wan Branch
Shop 2, G/F, Hong Tai Building
326-332 Shaukeiwan Road
Tel: 2884 3993 Fax: 2885 9283
Manager: Leung Yuen Fan, Maggie</p> <p>10 Quarry Bay Branch
Shop 8, G/F, Oceanic Mansion
1010-1026 King's Road
Tel: 2856 3880 Fax: 2856 0833
Manager: Leung Siu Ying, Fanny</p> |
|--|---|--|

KOWLOON

- | | | |
|--|--|--|
| <p>11 Yaumatei Branch
G/F, Ek Nam Building
486 Nathan Road
Tel: 2381 1678 Fax: 2395 6398
Manager: Chan Wai Cheong</p> <p>12 Kowloon City Branch
G/F, 15 Nga Tsin Wai Road
Tel: 2382 0147 Fax: 2718 4281
Manager: Wong Lik Kin, Lopyy</p> <p>13 Hung Hom Branch
G/F, Hunghom Commercial Centre
37 Ma Tau Wai Road
Tel: 2363 9213 Fax: 2363 3195
Manager: Choi Kam Yee, Catalina</p> <p>14 Kwun Tong Branch
Unit 2310, Tower 1, Millennium City 1
388 Kwun Tong Road
Tel: 2389 9119 Fax: 2389 9969
Manager: Lee Wai Kwan, Luceta</p> | <p>15 Mongkok Branch
G/F, JCG Building
16 Mongkok Road
Tel: 2391 8393 Fax: 2391 6909
Manager: Chan Shiu Man, Ricky</p> <p>16 San Po Kong Branch
Shop B, G/F, Perfect Industrial Building
31 Tai Yau Street
Tel: 2326 8318 Fax: 2326 9180
Manager: Kee Ka Wai</p> <p>17 Cheung Sha Wan Branch
Unit C2, G/F, 746 Cheung Sha Wan Road
Tel: 2786 9858 Fax: 2786 9506
Manager: Lai Siu Yee, Flora</p> <p>18 Wong Tai Sin Branch
Shop 641-642, 6/F,
Tsz Wan Shan Shopping Centre
Tel: 2328 7332 Fax: 2328 7991
Manager: Kwong Hon Wun, Peter</p> | <p>19 To Kwa Wan Branch
Shop D, G/F, In House,
No. 307 To Kwa Wan Road
Tel: 2362 0238 Fax: 2362 3999
Manager: Kan Pak Ling, Lucia</p> <p>20 Prince Edward Branch
G/F, 751 Nathan Road
Tel: 2397 3830 Fax: 2397 1006
Manager: Ngan Pui Shan, Sandy</p> <p>21 Tai Kok Tsui Branch
Shop 2B, G/F, Tai Chuen Building
88-102 Ivy Street
Tel: 2392 1538 Fax: 2392 1101
Manager: So Tak Fai, Peter</p> <p>22 Tsim Sha Tsui Branch
G/F, (Front Portion), 43 Mody Road
Tel: 2721 1218 Fax: 2721 1028
Manager: Yam Oi Yin, Pauline</p> |
|--|--|--|

NEW TERRITORIES

- | | | |
|---|---|--|
| <p>23 Yuen Long Branch
Shop 5, G/F, Fu Ho Building
3-7 Kau Yuk Road
Tel: 2479 4265 Fax: 2473 3934
Manager: Lam Wong Kan, Kent</p> <p>24 Tsuen Wan Branch
G/F, Victory Court,
185-187 Castle Peak Road
Tel: 2490 4191 Fax: 2490 4811
Manager: Chui Pui Ching, Anny</p> <p>25 Kwai Chung Branch
Shop 88B of Trendy Place
3/F, Kwai Chung Plaza, 7-11 Kwai Foo Road
Tel: 2480 0002 Fax: 2401 2367
Manager: Tang Wing Yi, Athena</p> | <p>26 Tai Po Branch
Eastmost Shop on G/F,
Nos. 37/39 Po Yick Street
Tel: 2657 2861 Fax: 2657 7389
Manager: Yan Yi Kam, Patrick</p> <p>27 Fanling Branch
G/F, 11 Wo Lung Street
Luen Wo Market
Tel: 2669 1559 Fax: 2669 8780
Manager: Wong Kai Ip, Jimmy</p> <p>28 Sheung Shui Branch
G/F, 137 San Shing Avenue
Tel: 2639 0307 Fax: 3124 0091
Manager: Chong Mei Kuen, Joe</p> <p>29 Tuen Mun Branch
Shop E, G/F, Kam Lai Building
Nos. 1-7 Kai Man Path
Tel: 2440 1298 Fax: 2440 1398
Manager: Chan Sau Ping, Rebecca</p> | <p>30 Sai Kung Branch
G/F, 16 Yi Chun Street
Tel: 2792 8588 Fax: 2791 0077</p> <p>31 Tseung Kwan O Branch
G105-106, G/F, Metro City Plaza I
Tel: 2701 7688 Fax: 2701 7628
Manager: Lau Chi Kai, Thomas</p> <p>32 Shatin Branch
Shop 4-6B,
Lucky Plaza Commercial Centre
Tel: 2601 6308 Fax: 2601 3686
Manager: Tsang Wai Chor</p> |
|---|---|--|

CHINA

- | | | |
|---|---|---|
| <p>33 Shenzhen Branch
Shop No. 1, G/F, Carrianna Friendship Square
Renminnan Road, Shenzhen
People's Republic of China
Tel : (86-755) 2518 2822
Fax : (86-755) 2518 2327
Manager : Cheung Po Tung, David</p> <p>34 Futian Sub-branch
1-3 Jinrun Mansion, No. 6019 Shennan Road
Futian District, Shenzhen
People's Republic of China
Tel : (86-755) 8280 0026
Fax : (86-755) 8280 0016
Manager : Ye Jun Liang, Leo</p> | <p>35 Shekou Sub-branch
Shop No.155-156, Coastal Building (East Block)
Hai De San Dao, Nanshan District, Shenzhen
People's Republic of China
Tel : (86-755) 8627 1388
Fax : (86-755) 8627 0699
Manager : Ying Wei Jun, Yoyo</p> <p>36 Longhua Sub-branch
No.110, Block 1, Laimeng Spring Garden
(Land No.: A818-0449), Minzhi Office, Longhua
New District, Shenzhen, People's Republic of China
Tel : (86-755) 2377 7601
Fax : (86-755) 2377 6919
Manager : Tu Yuan, Roy</p> | <p>Shenyang Representative Office
Unit 1801, 18/F, Sunwah Hi-tech Building
No. 262 Shifu Road, Shenhe District, Shenyang
Liaoning Province, People's Republic of China
Tel : (86-24) 2279 1368
Fax : (86-24) 2279 1369
Representative : Li Yu Jie</p> <p>Shanghai Representative Office
Room G, 8/F, Majesty Building
138 Pu Dong Avenue, Shanghai
People's Republic of China
Tel : (86-21) 5887 8851
Fax : (86-21) 5887 9951
Representative : Chen Li Hang</p> |
|---|---|---|

Chairman's Statement



I have the pleasure to report the financial results of the Group for the financial year ended 31 December 2016.

Tan Sri Dato' Sri Dr. Teh Hong Piow
Chairman

FINANCIAL HIGHLIGHTS

Public Bank (Hong Kong) Limited (the "Bank") and its subsidiaries (the "Group") recorded a profit after tax of HK\$396.9 million for the year ended 31 December 2016, representing an increase of HK\$2.3 million or 0.6% when compared to the previous year. Total loans and advances (including trade bills) of the Group decreased by HK\$0.48 billion or 1.6% to HK\$28.85 billion as at 31 December 2016 from HK\$29.33 billion as at 31 December 2015. Customer deposits of the Group increased by HK\$0.71 billion or 2.2% to HK\$33.88 billion as at 31 December 2016 from HK\$33.17 billion as at 31 December 2015.

The Board of Directors (the "Board") had declared an interim dividend of HK\$6.639 (2015: HK\$6.324) per share in June 2016. The Board recommended the payment of a final dividend of HK\$6.602 (2015: HK\$6.669) per share, making a total dividend of HK\$13.241 (2015: HK\$12.993) per share for 2016. The total dividend declared and recommended for the year 2016 amounted to HK\$196.2 million.

For the year under review, the Group's interest income decreased by HK\$12.3 million or 0.8% to HK\$1.63 billion due to lower yield on consumer financing loan portfolio of Public Finance Limited ("Public Finance"), a subsidiary of the Bank, whilst interest expense decreased by HK\$28.5 million or 8.8% to HK\$296.3 million due to lower cost of funding. Consequently, the Group's net interest income increased by HK\$16.2 million or 1.2% to HK\$1.33 billion from HK\$1.32 billion in the previous year. Impairment allowances for loans and advances decreased by HK\$8.3 million or 3.2% to HK\$248.4 million when compared to the previous year. Total operating income of the Group decreased by HK\$2.7 million or 0.2% to HK\$1.53 billion for the year 2016 from decrease in stockbroking fee income. Total operating expenses (before changes in fair value of investment properties) of the Group increased by HK\$0.2 million to HK\$803.2 million, mainly due to increase in branch premises related costs. Gain from the changes in fair value of investment properties decreased by HK\$0.1 million to HK\$1.8 million as compared to the previous year.

Chairman's Statement

LOANS AND CUSTOMER DEPOSITS

During the year under review, the Bank recorded a decrease in total loans and advances (including trade bills) of HK\$593.2 million or 2.5% to HK\$23.49 billion as at 31 December 2016 due to repayments of foreign currency loans of some customers based in Mainland China driven by the deprecation of Renminbi ("RMB"). Public Finance recorded an increase in total loans and advances of HK\$117.2 million or 2.2% to HK\$5.36 billion as at 31 December 2016.

During the year under review, the Bank recorded an increase in customer deposits (excluding intra-group's deposits) of HK\$562.8 million or 2.0% to HK\$29.15 billion as at 31 December 2016. Public Finance recorded an increase in customer deposits of HK\$177.7 million or 3.7% to HK\$4.98 billion as at 31 December 2016.

The Group will continue to focus on expanding its retail and commercial banking and consumer loans businesses through the extensive branch network of the Group, offering competitive products whilst providing premium customer service. The Group will continue to adopt prudent and flexible business strategies and adjust to market and environmental changes accordingly in the expansion of its customer base and business.

The Group will also continue to improve its operating cost efficiency, and streamline the support services of the combined branch network of the Group.

BRANCH NETWORK

The Bank, which has a branch network of 32 branches in Hong Kong and 4 branches in Shenzhen in the People's Republic of China ("PRC"), continued to focus on providing a broad range of commercial and retail banking services to its targeted market segments in 2016. Public Finance, which has a branch network of 42 branches in Hong Kong, continued to focus on its core business in personal lendings. The Group has a combined network of 78 branches as at the end of 2016. The Group also undertakes securities trading business through two stockbroking subsidiaries.

ACKNOWLEDGEMENT

On behalf of the Board, I wish to take this opportunity to express our appreciation to the management and staff of the Group for their commitment, dedication and perseverance, and sincere gratitude to our customers for their invaluable patronage. I would also like to express our appreciation and gratitude to the Hong Kong Monetary Authority ("HKMA"), the Securities and Futures Commission ("SFC") and other relevant authorities for their invaluable advice, guidance and support.

Tan Sri Dato' Sri Dr. Teh Hong Piow
Chairman

Our Corporate Family

Corporate Events & Recreational Activities



1



2



3



4



5



6



7

1. Business Forum 2016 of the Bank held on 17 April 2016.
2. Branch Managers and Heads of Departments gave the thumbs-up at the Business Forum 2016 of the Bank.
3. Staff singing the Public Bank's Corporate Song at the start of the Business Forum 2016.
4. Mr. Tan Yoke Kong, Chief Executive, delivering his opening address at the Group's Annual Dinner 2016 held on 28 May 2016.
5. Senior management proposing a toast on stage at the Group's Annual Dinner 2016.
6. Staff performing an amazing Tron Dance in total darkness at the Group's Annual Dinner 2016.
7. The Opening vibrant flag dance performance led by Mr. Ng Chee Khuen, Director of Winton Financial Limited, at the Group's Annual Dinner 2016.



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16

8. Ceremony attended by senior management and Longhua Sub-branch staff at the grand opening of Longhua Sub-branch.
9. A group photo of senior management and branch staff at the opening of the new Sub-branch in Longhua, Shenzhen in August 2016.
10. One-day trip to Repulse Bay and Lei Yue Mun organised by the Public Bank Group, Hong Kong Sports and Recreation Club attended by staff and family members on 21 February 2016.
11. One-day Team Building Workshop conducted in October 2016 for encouraging better communication, collaboration and team work among staff.
12. Staff taking part in activities and games at the Team Building Workshop 2016.
13. Public Bank Group, Hong Kong Sports and Recreation Club organised interesting cake baking lessons in November 2016.
14. Participants in one of the cake baking lessons showing off their great-tasting cheese cakes.
15. A group photo of participants for the Christmas Bowling Competition 2016.
16. Winners of the Christmas Bowling Competition 2016 taking photo together to share their joy.

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香港銀行公會成員 銀行牌照持牌人 銀行牌照持牌人 銀行牌照持牌人

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大眾財務有限公司 PUBLIC FINANCE LIMITED

香港銀行公會成員 銀行牌照持牌人 銀行牌照持牌人 銀行牌照持牌人



Report of the Directors

The Directors present their report and the audited financial statements of the Group for the year ended 31 December 2016.

PRINCIPAL ACTIVITIES

The principal activities of the Group have not changed during the year and consisted of the provision of a comprehensive range of banking, financial and related services.

Details of the principal activities of the Bank's subsidiaries are set out in note 1 to the financial statements.

RESULTS AND DIVIDENDS

The Group's profit for the year ended 31 December 2016 and the Group's financial position as at that date are set out in the financial statements on pages 16 to 114.

Interim dividend of HK\$6.639 (2015: HK\$6.324) per ordinary share was declared and paid during the year. The Directors recommend the payment of a final dividend of HK\$6.602 (2015: HK\$6.669) per ordinary share for the year.

PROPERTY AND EQUIPMENT, LAND HELD UNDER FINANCE LEASES AND INVESTMENT PROPERTIES

Details of movements in the property and equipment, land held under finance leases and investment properties of the Group during the year are set out in notes 23, 24 and 25 to the financial statements, respectively.

SHARE CAPITAL

There was no movement in the Bank's issued share capital during the year.

RESERVES

Details of movements in the reserves of the Group and of the Bank during the year are set out in notes 30 and 37(c) to the financial statements, respectively, and the consolidated statement of changes in equity.

DIRECTORS

The Directors of the Bank during the year and up to the date of this report were as follows:

Non-Executive Directors:

Tan Sri Dato' Sri Dr. Teh Hong Piow, Chairman
Tan Sri Dato' Sri Tay Ah Lek
Quah Poh Keat
Dato' Chang Kat Kiam

Independent Non-Executive Directors:

Lai Wan, Co-Chairman
Lee Chin Guan
Tang Wing Chew

Executive Directors:

Tan Yoke Kong
Chong Yam Kiang

In accordance with Articles 109 and 110 of the Articles of Association of the Bank, Mr. Lee Chin Guan, Mr. Quah Poh Keat and Mr. Chong Yam Kiang shall retire by rotation and, being eligible, will offer themselves for re-election at the forthcoming annual general meeting ("AGM").

Report of the Directors

DIRECTORS (Continued)

The Directors of the subsidiaries of the Bank during the year and up to the date of this report were as follows:

Tan Yoke Kong
Chong Yam Kiang
Lee Huat Oon
Chiu Chik Shang
Chan Sau Kuen
Chau Man Ching, Gladys
Ma Hin Lap

DIRECTORS' RIGHTS TO ACQUIRE SHARES AND DEBENTURES

At no time during the year or at the end of the year has been/was the Bank or any of its holding companies, subsidiaries or fellow subsidiaries a party to any arrangement to enable the Bank's Directors to acquire benefits by means of the acquisition of shares in, or debentures of, the Bank or any other body corporate.

EQUITY-LINKED AGREEMENTS

No equity-linked agreements that will or may result in the Bank issuing shares or that require the Bank to enter into any agreements that will or may result in the Bank issuing shares were entered into by the Bank during the year or subsisted at the end of the year.

DIRECTORS' INTERESTS IN TRANSACTIONS, ARRANGEMENTS OR CONTRACTS

Except as detailed in note 33 to the financial statements, there has been no transaction, arrangement or contract of significance to which the Bank or any of its holding companies, subsidiaries or fellow subsidiaries was a party and in which a Director of the Bank or an entity connected with the Director is or was materially interested, either directly or indirectly, subsisting during or at the end of the year.

PERMITTED INDEMNITY PROVISION

Pursuant to Article 156 of the Bank's Articles of Association and subject to the provisions of the statutes, every Director, secretary or officer of the Bank shall be indemnified out of the funds of the Bank against all liability incurred by him as such Directors, secretary or officer of the Bank in or about the execution or holding of his office or otherwise in relation thereto. The Bank has maintained Directors and officers liability insurance during the year.

COMPLIANCE WITH SUPERVISORY POLICY MANUAL

The Bank has complied with the guidelines in the Supervisory Policy Manual ("SPM") issued by the HKMA as follows:

- (i) Module CA-D-1 "Guideline on the Application of the Banking (Disclosure) Rules";
- (ii) Module CG-1 "Corporate Governance of Locally Incorporated Authorised Institutions"; and
- (iii) Module CG-5 "Guideline on a Sound Remuneration System".

The Bank has also complied with the capital requirements related to capital base and capital adequacy ratio stipulated by the HKMA.

Report of the Directors

DONATIONS

During the year, the Group made charitable donations totaling HK\$12,000 (2015:Nil).

AUDITOR

Ernst & Young retires and a resolution for its re-appointment as auditor of the Bank will be proposed at the forthcoming AGM.

ON BEHALF OF THE BOARD

Lai Wan

Director

Tan Yoke Kong

Director

19 January 2017

Independent Auditor's Report



To the members of Public Bank (Hong Kong) Limited
(Incorporated in Hong Kong with limited liability)

OPINION

We have audited the consolidated financial statements of Public Bank (Hong Kong) Limited (the "Bank") and its subsidiaries (the "Group") set out on pages 16 to 114, which comprise the consolidated statement of financial position as at 31 December 2016, and the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

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 2016, 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 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. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

OTHER INFORMATION INCLUDED IN THE ANNUAL REPORT

The directors of the Bank are responsible for the other information. The other information comprises 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.

Independent Auditor's Report

RESPONSIBILITIES OF THE DIRECTORS 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 of the Bank 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 of the Bank either intend to liquidate the Bank or to cease operations or have no realistic alternative but to do so.

The directors of the Bank are assisted by the Audit Committee in discharging their responsibilities 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. Our report is made 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 HKSA's 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.

As part of an audit in accordance with HKSA's, we exercise professional judgement and maintain professional skepticism 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.

Independent Auditor's Report

AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- 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.

Ernst & Young
Certified Public Accountants
22/F CITIC Tower
1 Tim Mei Avenue
Central, Hong Kong

19 January 2017

Consolidated Income Statement

For the year ended 31 December 2016

	Notes	2016 HK\$'000	2015 HK\$'000
Interest income	8	1,629,632	1,641,953
Interest expense	8	(296,323)	(324,846)
NET INTEREST INCOME		1,333,309	1,317,107
Other operating income	9	197,052	215,917
OPERATING INCOME		1,530,361	1,533,024
Operating expenses	10	(803,241)	(803,063)
Changes in fair value of investment properties		1,762	1,874
OPERATING PROFIT BEFORE IMPAIRMENT ALLOWANCES		728,882	731,835
Impairment allowances for loans and advances and receivables	11	(248,418)	(256,725)
OPERATING PROFIT AFTER IMPAIRMENT ALLOWANCES		480,464	475,110
Share of (loss)/profit of a joint venture	20	(286)	199
PROFIT BEFORE TAX		480,178	475,309
Tax	13	(83,318)	(80,783)
PROFIT FOR THE YEAR		396,860	394,526
ATTRIBUTABLE TO:			
Owners of the Bank		396,860	394,526

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2016

	2016 HK\$'000	2015 HK\$'000
PROFIT FOR THE YEAR	396,860	394,526
OTHER COMPREHENSIVE INCOME FOR THE YEAR		
Other comprehensive income to be reclassified to profit or loss in subsequent periods:		
Exchange loss on translating foreign operations, net of tax	(52,182)	(25,971)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	344,678	368,555
ATTRIBUTABLE TO:		
Owners of the Bank	344,678	368,555

Consolidated Statement of Financial Position

31 December 2016

	Notes	2016 HK\$'000	2015 HK\$'000
ASSETS			
Cash and short term placements	15	4,255,829	3,927,210
Placements with banks and financial institutions maturing after one month but not more than twelve months	16	2,222,825	1,018,133
Derivative financial instruments		412	3,864
Loans and advances and receivables	17	28,807,836	29,290,179
Available-for-sale financial assets	18	6,804	6,804
Held-to-maturity investments	19	5,693,861	5,342,872
Interest in a joint venture	20	1,606	1,892
Deferred tax assets	28	28,247	25,771
Tax recoverable		10,055	–
Intangible assets	22	718	718
Property and equipment	23	88,741	67,346
Land held under finance leases	24	104,464	101,178
Investment properties	25	106,087	63,137
Goodwill	26	242,342	242,342
Other assets	21	128,995	143,317
TOTAL ASSETS		41,698,822	40,234,763

Consolidated Statement of Financial Position

31 December 2016

	Notes	2016 HK\$'000	2015 HK\$'000
EQUITY AND LIABILITIES			
LIABILITIES			
Deposits and balances of banks and other financial institutions at amortised cost		929,392	984,093
Derivative financial instruments		23,157	588
Customer deposits at amortised cost	27	33,879,348	33,165,823
Certificates of deposit issued at amortised cost		1,072,778	499,977
Current tax payable		14,060	22,654
Deferred tax liabilities	28	11,738	7,420
Other liabilities	21	402,172	335,538
TOTAL LIABILITIES		36,332,645	35,016,093
EQUITY ATTRIBUTABLE TO OWNERS OF THE BANK			
Share capital	29	2,854,045	2,854,045
Reserves	30	2,512,132	2,364,625
TOTAL EQUITY		5,366,177	5,218,670
TOTAL EQUITY AND LIABILITIES		41,698,822	40,234,763

Lai Wan
Director

Tan Yoke Kong
Director

Chong Yam Kiang
Director

Consolidated Statement of Changes in Equity

For the year ended 31 December 2016

	Note	2016 HK\$'000	2015 HK\$'000
TOTAL EQUITY			
Balance at the beginning of the year		5,218,670	5,033,804
Profit for the year		396,860	394,526
Other comprehensive income in translation reserve		(52,182)	(25,971)
Total comprehensive income for the year		344,678	368,555
Dividends paid in respect of previous year	14(a)	(98,808)	(89,992)
Dividends paid in respect of current year	14(a)	(98,363)	(93,697)
Balance at the end of the year		5,366,177	5,218,670

Consolidated Statement of Cash Flows

For the year ended 31 December 2016

	Notes	2016 HK\$'000	2015 HK\$'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		480,178	475,309
Adjustments for:			
Dividend income from listed investments	9	(78)	(67)
Dividend income from unlisted investments	9	(700)	(800)
Depreciation of property and equipment and land held under finance leases	10	22,388	20,653
Increase in fair value of investment properties	25	(1,762)	(1,874)
Share of loss/(profit) of a joint venture	20	286	(199)
Increase in impairment allowances for loans and advances and receivables		9,358	11,985
Net losses on disposal of property and equipment		55	29
Exchange differences		(52,891)	(25,356)
Profits tax paid		(100,125)	(73,980)
Operating profit before changes in operating assets and liabilities		356,709	405,700
Increase in operating assets:			
Increase in placements with banks and financial institutions		(337,344)	(50,133)
Decrease/(increase) in derivative financial instruments		3,452	(1,694)
Decrease/(increase) in loans and advances and receivables		473,694	(869,269)
Increase in held-to-maturity investments		(445,257)	(766,760)
Decrease in other assets		14,322	20,859
		(291,133)	(1,666,997)
Increase in operating liabilities:			
(Decrease)/increase in deposits and balances of banks and other financial institutions at amortised cost		(54,701)	469,028
Increase in customer deposits at amortised cost		713,525	1,510,337
Increase/(decrease) in certificates of deposit issued at amortised cost		572,801	(863,517)
Increase/(decrease) in derivative financial instruments		22,569	(5,406)
Increase/(decrease) in other liabilities		66,634	(38,021)
		1,320,828	1,072,421
Net cash inflow/(outflow) from operating activities		1,386,404	(188,876)

Consolidated Statement of Cash Flows

For the year ended 31 December 2016

	Notes	2016 HK\$'000	2015 HK\$'000
CASH FLOWS FROM INVESTING ACTIVITIES			
Exchange differences		(9)	(64)
Purchases of property and equipment	23	(39,572)	(17,137)
Purchase of an investment property	25	(48,731)	–
Sales proceeds from disposal of property and equipment		–	25
Dividends received from listed investments		78	67
Dividends received from unlisted investments		700	800
Net cash outflow from investing activities		(87,534)	(16,309)
CASH FLOWS FROM FINANCING ACTIVITIES			
Dividends paid on shares		(197,171)	(183,689)
Net cash outflow from financing activities		(197,171)	(183,689)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		1,101,699	(388,874)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		4,226,308	4,615,182
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR		5,328,007	4,226,308
ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS			
Cash and short term placements repayable on demand	35	1,377,805	1,027,164
Money at call and short notice with an original maturity within three months	35	2,878,024	2,900,046
Placements with banks and financial institutions with an original maturity within three months		1,072,178	204,830
Held-to-maturity investments with an original maturity within three months		–	94,268
		5,328,007	4,226,308

Notes to Financial Statements

1. CORPORATE AND GROUP INFORMATION

The Bank is a limited liability company and its registered office is located at 2/F, Public Bank Centre, 120 Des Voeux Road Central, Central, Hong Kong. During the year, the Group's principal activities were the provision of a comprehensive range of commercial and retail banking, financial and related services.

The Bank is a wholly-owned subsidiary of Public Financial Holdings Limited ("PFHL"). In the opinion of the Directors, the ultimate holding company of the Bank is Public Bank Berhad, which is incorporated in Malaysia.

Particulars of the Bank's subsidiaries, which are incorporated and operate in Hong Kong, are as follows:

Name	Issued ordinary share capital HK\$	Percentage of equity attributable to the Bank		Principal activities
		Direct %	Indirect %	
Public Financial Securities Limited	48,000,000	100	–	Securities brokerage
Public Bank (Nominees) Limited	100,000	100	–	Provision of nominee services
Public Credit Limited	5,000,000	100	–	Dormant
Public Futures Limited	2	100	–	Dormant
Public Pacific Securities Limited	12,000,000	100	–	Dormant
Public Finance Limited	671,038,000	100	–	Deposit-taking and financing
Public Financial Limited	10,100,000	–	100	Investment holding
Public Securities Limited	10,000,000	–	100	Securities brokerage
Public Securities (Nominees) Limited	10,000	–	100	Provision of nominee services

2. BASIS OF PREPARATION

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs") (a collective term which includes all applicable individual HKFRSs, Hong Kong Accounting Standards ("HKASs") and Interpretations ("Int")) issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong and the provision of the Hong Kong Companies Ordinance. They have also complied with the disclosure requirements of the Guideline on the Application of the Banking (Disclosure) Rules under the SPM issued by the HKMA.

Notes to Financial Statements

2. BASIS OF PREPARATION (Continued)

These financial statements have been prepared under the historical cost convention, as modified for the revaluation of investment properties, available-for-sale financial assets, financial assets and financial liabilities (including derivative financial instruments) at fair value through profit or loss.

3. BASIS OF CONSOLIDATION

The consolidated financial statements include the financial statements of the Bank and its subsidiaries for the year ended 31 December 2016.

A subsidiary is an entity (including a structured entity), directly or indirectly, controlled by the Bank. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee (i.e. existing rights that give the Group the current ability to direct the relevant activities of the investee).

When the Bank has, directly or indirectly, less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- (i) the contractual arrangement with the other vote holders of the investee;
- (ii) rights arising from other contractual arrangements; and
- (iii) the Group's voting rights and potential voting rights.

The financial statements of the subsidiaries are prepared for the same reporting period as the Bank, using consistent accounting policies. The results of subsidiaries are consolidated from the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases.

Profit or loss and each component of other comprehensive income ("OCI") are attributed to the owners of the parent of the Group. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

The Group reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control described above. A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction.

If the Group loses control over a subsidiary, it derecognises (i) the assets (including goodwill) and liabilities of the subsidiary, (ii) the carrying amount of any non-controlling interest and (iii) the cumulative translation differences recorded in equity; and recognises (i) the fair value of the consideration received, (ii) the fair value of any investment retained and (iii) any resulting surplus or deficit in profit or loss. The Group's share of components previously recognised in OCI is reclassified to profit or loss or retained profits, as appropriate, on the same basis as would be required if the Group had directly disposed of the related assets or liabilities.

Notes to Financial Statements

3. BASIS OF CONSOLIDATION (Continued)

The subsidiaries consolidated for accounting purposes are as follows:

Name	31 December 2016		31 December 2015		Principal activities
	Total assets HK\$	Total equity HK\$	Total assets HK\$	Total equity HK\$	
Public Financial Securities Limited	64,874,353	48,000,027	79,359,669	47,894,134	Securities brokerage
Public Bank (Nominees) Limited	100,000	100,000	100,000	100,000	Provision of nominee services
Public Credit Limited	2,471,985	2,471,985	2,471,985	2,471,985	Dormant
Public Futures Limited	1	1	1	1	Dormant
Public Pacific Securities Limited	4,611,278	4,611,278	4,625,458	4,625,458	Dormant
Public Finance Limited*	6,454,564,792	1,421,026,386	6,310,743,549	1,444,553,306	Deposit-taking and financing
Public Financial Limited	10,101,371	10,101,371	10,101,371	10,101,371	Investment holding
Public Securities Limited	178,378,171	151,306,345	168,435,297	148,796,008	Securities brokerage
Public Securities (Nominees) Limited	1,133,919	1,130,183	1,108,963	1,093,561	Provision of nominee services

* The financial entity specified by the HKMA to form the basis of consolidation for regulatory reporting purpose in respect of common equity tier 1 ("CET1") capital ratio, tier 1 capital ratio, total capital ratio, capital conservation buffer ("CCB") ratio, countercyclical capital buffer ("CCyB") ratio, leverage ratio and liquidity maintenance ratio.

4. BASIS OF CAPITAL DISCLOSURES

The Group has complied with the capital requirements during the reporting period related to capital base and the capital adequacy ratio as stipulated by the HKMA, and has also complied with the Guideline on the Application of the Banking (Disclosure) Rules issued by the HKMA.

Should the Group have not complied with the externally imposed capital requirements of the HKMA, capital management plans should be submitted to the HKMA for restoration of capital to the minimum required level as soon as possible.

The computation of the consolidated total capital ratio of the Group is based on the ratio of the aggregate of risk-weighted exposures to the aggregate of capital bases of the Bank and Public Finance for regulatory reporting purposes.

There are no major restrictions or impediments on the transfer of capital or funds among the members of the Bank's consolidation group except that liquidity, capital and other performance indicators of Public Financial Securities Limited and Public Securities Limited should satisfy the minimum requirements of the Securities and Futures (Financial Resources) Rules issued by the SFC.

A portion of retained profits, based on a percentage of gross loans and advances, is set aside as a non-distributable regulatory reserve as part of CET1 capital and is included in the capital base pursuant to the HKMA capital requirements.

Notes to Financial Statements

4. BASIS OF CAPITAL DISCLOSURES (Continued)

The Group has adopted the provisions of the Banking (Amendment) Ordinance 2012 relating to the Basel III capital standards and the amended Banking (Capital) Rules (the “Capital Rules”). The Capital Rules outline the general requirements on regulatory capital ratios, the components of eligible regulatory capital as well as the levels of those ratios at which banking institutions are required to operate. The Capital Rules have been developed based on internationally-agreed standards on capital adequacy promulgated by the Basel Committee on Banking Supervision. Under the Capital Rules, the minimum capital ratio requirements are progressively increased during the period from 1 January 2013 to 1 January 2019, and include a phased introduction of a new CCB ratio of 2.5%. Furthermore, the leverage ratio that forms part of Basel III implementation is under parallel run until January 2017 and relevant information has been submitted by the Bank and Public Finance for regulatory monitoring since 2014. Additional capital requirements, including a new CCyB ratio ranging from 0% to 2.5%, have been implemented since 1 January 2016. The CCyB ratio requirement for 2016 and 2017 is 0.625% and 1.25%, respectively.

5. ACCOUNTING POLICIES

Changes in accounting policies and disclosures

The HKICPA has issued a number of new and revised HKFRSs, which are generally effective for accounting periods beginning on or after 1 January 2016. The Group has adopted the following new and revised HKFRSs for the first time for the current year’s financial statements.

- | | |
|---|--|
| • Amendments to HKFRS 10 and HKAS 28 (2011) | <i>Sale or Contribution of Assets between an Investor and its Associate or Joint Venture</i> |
| • Amendments to HKFRS 10, HKFRS 12 and HKAS 28 (2011) | <i>Investment Entities: Applying the Consolidation Exception</i> |
| • Amendments to HKFRS 11 | <i>Accounting for Acquisitions of Interests in Joint Operations</i> |
| • HKFRS 14 | <i>Regulatory Deferral Accounts</i> |
| • Amendments to HKAS 1 | <i>Disclosure Initiative</i> |
| • Amendments to HKAS 16 and HKAS 38 | <i>Clarification of Acceptable Methods of Depreciation and Amortisation</i> |
| • Amendments to HKAS 16 and HKAS 41 | <i>Agriculture: Bearer Plants</i> |
| • Amendments to HKAS 27 (2011) | <i>Equity Method in Separate Financial Statements</i> |
| • Annual Improvements to 2012-2014 Cycle | <i>Amendments to a number of HKFRSs</i> |

Except for the amendments to HKFRS 10 and HKAS 28 (2011), amendments to HKFRS 10, HKFRS 12 and HKAS 28 (2011), amendments to HKFRS 11, HKFRS 14, amendments to HKAS 16 and HKAS 41, amendments to HKAS 27 (2011), and amendments included in the Annual Improvements 2012-2014 Cycle, which are not relevant to the preparation of the Group’s financial statements, the nature and the impact of the amendments are described below.

Amendments to HKAS 1 include narrow-focus improvements in respect of the presentation and disclosure in financial statements. The amendments clarify:

- (i) the materiality requirements in HKAS 1;
- (ii) that specific line items in the income statement and the statement of financial position may be disaggregated;
- (iii) that entities have flexibility as to the order in which they present the notes to financial statements; and
- (iv) that the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued) Changes in accounting policies and disclosures (Continued)

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the income statement. The amendments have had no significant impact on the Group's financial statements.

Amendments to HKAS 16 and HKAS 38 clarify the principle in HKAS 16 and HKAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through the use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets. The amendments are applied prospectively. The amendments have had no impact on the financial position or performance of the Group as the Group has not used a revenue-based method for the calculation of depreciation of its assets.

Issued but not yet effective HKFRSs

The Group has not applied the following new and revised HKFRSs, that have been issued but are not yet effective, in these financial statements.

• Amendments to HKFRS 2	<i>Classification and Measurement of Share-based Payment Transactions²</i>
• Amendments to HKFRS 4	<i>Applying HKFRS 9 Financial Instruments with HKFRS 4 Insurance Contracts²</i>
• HKFRS 9	<i>Financial Instruments²</i>
• HKFRS 15	<i>Revenue from Contracts with Customers²</i>
• Amendments to HKFRS 15	<i>Clarifications to HKFRS 15 Revenue from Contracts with Customers²</i>
• HKFRS 16	<i>Leases³</i>
• Amendments to HKAS 7	<i>Disclosure Initiative¹</i>
• Amendments to HKAS 12	<i>Recognition of Deferred Tax Assets for Unrealised Losses¹</i>

¹ Effective for annual periods beginning on or after 1 January 2017

² Effective for annual periods beginning on or after 1 January 2018

³ Effective for annual periods beginning on or after 1 January 2019

Further information about those HKFRSs that are expected to be applicable to the Group is as follows:

The HKICPA issued amendments to HKFRS 2 in August 2016 that address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding a certain amount in order to meet the employee's tax obligation associated with the share-based payment; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash-settled to equity-settled. The amendments clarify that the approach used to account for vesting conditions when measuring equity-settled share-based payments also applies to cash-settled share-based payments. The amendments introduce an exception so that a share-based payment transaction with net share settlement features for withholding a certain amount in order to meet the employee's tax obligation is classified in its entirety as an equity-settled share-based payment transaction when certain conditions are met. Furthermore, the amendments clarify that if the terms and conditions of a cash-settled share-based payment transaction are modified, with the result that it becomes an equity-settled share-based payment transaction, the transaction is accounted for as an equity-settled transaction from the date of the modification. The Group expects to adopt the amendments from 1 January 2018. The amendments are not expected to have any significant impact on the Group's financial statements.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued) Issued but not yet effective HKFRSs (Continued)

In September 2014, the HKICPA issued the final version of HKFRS 9, bringing together all phases of the financial instruments project to replace HKAS 39 and all previous versions of HKFRS 9. The standard introduces new requirements for classification and measurement, impairment and hedge accounting. The Group expects to adopt HKFRS 9 from 1 January 2018. The Group is currently assessing the impact of the standard upon adoption and expects that the adoption of HKFRS 9 will have an impact on the classification and measurement of the Group's financial assets.

HKFRS 15 establishes a new five-step model to account for revenue arising from contracts with customers. Under HKFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in HKFRS 15 provide a more structured approach for measuring and recognising revenue. The standard also introduces extensive qualitative and quantitative disclosure requirements, including disaggregation of total revenue, information about performance obligations, changes in contract asset and liability account balances between periods and key judgements and estimates. The standard will supersede all current revenue recognition requirements under HKFRSs. In June 2016, the HKICPA issued amendments to HKFRS 15 to address the implement issues on identifying performance obligations, application guidance on principal versus agent and licences of intellectual property, and transition. The amendments are also intended to help ensure a more consistent application when entities adopt HKFRS 15 and decrease the cost and complexity of applying the standard. The Group expects to adopt HKFRS 15 on 1 January 2018 and is currently assessing the impact of HKFRS 15 upon adoption.

HKFRS 16 replaces HKAS 17 *Leases*, HK(IFRIC)-Int 4 *Determining whether an Arrangement contains a Lease*, HK(SIC)-Int 15 *Operating Leases – Incentives* and HK(SIC)-Int 27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to recognise assets and liabilities for most leases. The standard includes two recognition exemptions for lessees – leases of low-value assets and short-term leases. At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e. the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e. the right-of-use asset). The right-of-use asset is subsequently measured at cost less accumulated depreciation and any impairment losses unless the right-of-use asset meets the definition of investment property in HKAS 40. The lease liability is subsequently increased to reflect the interest on the lease liability and reduced for the lease payments. Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset. Lessees will also be required to remeasure the lease liability upon the occurrence of certain events, such as change in the lease term and change in future lease payments resulting from a change in an index or rate used to determine those payments.

Lessees will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset. Lessor accounting under HKFRS 16 is substantially unchanged from the accounting under HKAS 17. Lessors will continue to classify all leases using the same classification principle as in HKAS 17 and distinguish between operating leases and finance leases. The Group expects to adopt HKFRS 16 on 1 January 2019 and is currently assessing the impact of HKFRS 16 upon adoption.

Amendments to HKAS 7 require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. The amendments will result in additional disclosure to be provided in the financial statements. The Group expects to adopt the amendments from 1 January 2017.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued) Issued but not yet effective HKFRSs (Continued)

Amendments to HKAS 12 were issued with the purpose of addressing the recognition of deferred tax assets for unrealised losses related to debt instruments measured at fair value, although they also have a broader application for other situations. The amendments clarify that an entity, when assessing whether taxable profits will be available against which it can utilise a deductible temporary difference, needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount. The Group expects to adopt the amendments from 1 January 2017.

Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below:

(1) Foreign currency translation

These financial statements are presented in Hong Kong dollars ("HKD"), which is the Bank's functional currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

(a) Transactions and balances

Transactions in foreign currencies are initially recorded in the functional currency rates prevailing at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency rates of exchange ruling at the end of the reporting period. Differences arising on settlement or translation of monetary items are recognised in "Other operating income" or "Other operating expenses" in the consolidated income statement with the exception of differences on foreign currency borrowings that provide an effective hedge against a net investment in a foreign entity which is taken directly to equity until the disposal of the net investment, at which time they are recognised in the consolidated income statement. Tax charges and credits attributable to exchange differences on those borrowings are also recorded in OCI.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was measured. The gain or loss arising on translation of a non-monetary item measured at fair value is treated in line with the recognition of the gain or loss on change in fair value of the item (i.e. translation difference on the item whose fair value gain or loss is recognised in OCI or profit or loss is also recognised in OCI or profit or loss, respectively).

Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operation and translated at the closing rate.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued)

Summary of significant accounting policies (Continued)

(1) Foreign currency translation (Continued)

(b) *Group companies*

As at the reporting date, the assets and liabilities of subsidiaries and overseas branches and offices are translated into the Group's presentation currency at the rates of exchange ruling at the end of the reporting period, and their income statements are translated at the weighted average exchange rates for the year. Exchange differences arising on translation are taken directly to a separate component of equity. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the consolidated income statement as part of gain or loss on disposal.

(2) Financial instruments – initial recognition and subsequent measurement

(a) *Date of recognition*

Purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset. Derivatives are recognised on the trade date basis.

(b) *Initial recognition of financial instruments*

The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments are acquired and their characteristics. All financial instruments are measured initially at their fair value plus, in the case of financial assets and financial liabilities not at fair value through profit or loss, any directly attributable incremental costs of acquisition or issue.

(c) *Derivative financial instruments*

Derivatives include interest rate swaps and futures, cross currency swaps, forward foreign exchange contracts and options on interest rates, foreign currencies and equities. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives held for trading are included in "Net gain or loss on derivative financial instruments".

Derivatives embedded in other financial instruments, such as the conversion option in an acquired convertible bond, are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host contract are carried at fair value in the trading portfolio with changes in fair value recognised in the consolidated income statement.

(d) *Financial assets at fair value through profit or loss*

Financial assets classified in this category are held for trading or are designated by management on initial recognition when the following criteria are met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis;
- the assets and liabilities are part of a group of financial assets, financial liabilities or both which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued)

Summary of significant accounting policies (Continued)

(2) Financial instruments – initial recognition and subsequent measurement (Continued)

(d) *Financial assets at fair value through profit or loss (Continued)*

- the financial instrument contains an embedded derivative, unless the embedded derivative does significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

Financial assets and financial liabilities at fair value through profit or loss are recorded in the consolidated statement of financial position at fair value. Changes in fair value are recorded in “Net gain or loss on financial assets designated at fair value through profit or loss”. Interest earned or incurred is accrued in interest income or expense, respectively, according to the terms of the contract, while dividend income is recorded in “Other operating income” when the right to the payment has been established.

(e) *Held-to-maturity investments*

Held-to-maturity investments measured at amortised cost are those which carry fixed or determinable payments and have fixed maturity and which the Group has the intention and ability to hold to maturity. After initial measurement, held-to-maturity investments are subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in “Interest income” in the consolidated income statement. The losses arising from impairment of such investments are recognised in the consolidated income statement as “Impairment allowances for held-to-maturity investments”.

(f) *Cash and short term placements, placements with banks and financial institutions, and loans and advances and receivables*

Cash and short term placements, placements with banks and financial institutions, and loans and advances and receivables are categorised as loans and advances. They are carried at amortised cost and are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short term resale. After initial measurement, amounts due from banks and loans and advances and receivables are subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. The amortisation is included in “Interest income” in the consolidated income statement. The losses arising from impairment are recognised in the consolidated income statement in “Impairment allowances for loans and advances and receivables”.

(g) *Available-for-sale financial assets*

Available-for-sale financial assets are those which are designated as such or do not qualify to be classified as at fair value through profit or loss, held-to-maturity investments or loans and advances. They include equity instruments, investments in mutual funds and money markets and other debt instruments.

After initial measurement, available-for-sale financial assets are subsequently measured at fair value. Unrealised gains and losses are recognised directly in equity in the “Available-for-sale financial asset revaluation reserve”.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued)

Summary of significant accounting policies (Continued)

(2) Financial instruments – initial recognition and subsequent measurement (Continued)

(g) *Available-for-sale financial assets (Continued)*

When the security is disposed of, the cumulative gain or loss previously recognised in equity is recognised in the consolidated income statement in “Other operating income” or “Other operating expenses”. Where the Group holds more than one investment in the same security, they are deemed to be disposed of on a first-in, first-out basis. Interest earned whilst holding available-for-sale financial assets is reported as interest income using the effective interest rate method. Dividends earned whilst holding available-for-sale financial assets are recognised in the consolidated income statement as “Other operating income” when the right of the payment has been established. The losses arising from impairment of such investments are recognised in the consolidated income statement in “Impairment allowances for available-for-sale financial assets” and removed from the “Available-for-sale financial asset revaluation reserve”.

(h) *Certificates of deposit*

Issued financial instruments or their components, which are not designated at fair value through profit or loss, are classified as liabilities under “Certificates of deposit issued at amortised cost” where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares. The components of compound financial instruments, that contain both liability and equity elements, are accounted for separately, with the equity component being assigned the residual amount after deducting from the instrument as a whole the amount separately determined as the fair value of the liability component on the date of issue.

After initial measurement, debt issued and other borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate.

(i) *Loans and borrowings*

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost, using the effective interest rate method unless the effect of discounting would be immaterial, in which case they are stated at cost. Gains and losses are recognised in the consolidated income statement when the liabilities are derecognised as well as through the amortisation process using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate. The effective interest rate amortisation is included in finance costs in the consolidated income statement.

(3) Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the financial statements in “Other liabilities” at fair value less transaction costs that are directly attributable to the acquisition or issue of the financial guarantee contract, except when such contract is recognised at fair value through profit or loss. Subsequent to initial recognition, the Group measures the financial guarantee contract at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued) Summary of significant accounting policies (Continued)

(3) Financial guarantees (Continued)

Any increase in the liability relating to financial guarantees is taken to the consolidated income statement. The premium received is recognised in the consolidated income statement in “Net fees and commission income” under “Other operating income” on a straight-line basis over the life of the guarantee.

(4) Derecognition of financial assets and financial liabilities

(a) *Financial assets*

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognised (i.e. removed from the Group’s consolidated statement of financial position) when:

- the rights to receive cash flows from the asset have expired; or
- the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a “pass-through” arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a “pass-through” arrangement, it evaluates if and to what extent it has retained the risk and rewards of ownership of the asset. When it has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the Group continues to recognise the transferred asset to the extent of the Group’s continuing involvement. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

(b) *Financial liabilities*

A financial liability is derecognised when the obligation under the liability is discharged or cancelled, or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the consolidated income statement.

(c) *Offsetting of financial instruments*

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position if there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued)

Summary of significant accounting policies (Continued)

(5) Fair value measurement

The Group measures its investment properties and derivative financial instruments at fair value at the end of each reporting period. Fair value is the price that will be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either in the principal market for the asset or liability, or in the absence of a principal market, in the most advantageous market for the asset or liability. The principal or the most advantageous market must be accessible by the Group. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that will use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- 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

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by reassessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

(6) Impairment of financial assets

The Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. An impairment exists if one or more events that occurred after the initial recognition of the asset has/have an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that a borrower or a group of borrowers is/are experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and observable data indicating that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with default.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued) Summary of significant accounting policies (Continued)

(6) Impairment of financial assets (Continued)

(a) *Placements with banks and financial institutions, and loans and advances and receivables*

For amounts due from banks and loans and advances to customers carried at amortised cost, the Group first assesses whether impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and the Group collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

The amount of any impairment loss identified is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the loss is recognised in the consolidated income statement. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral had been realised or had been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. Any subsequent reversal of an impairment is recognised in the consolidated income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date. If a future write-off is later recovered, the recovery is credited to "Impairment losses and allowances" in the consolidated income statement.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Group's internal credit risk-based system that considers credit risk characteristics such as asset type, industry, collateral type, economic factors and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued)

Summary of significant accounting policies (Continued)

(6) Impairment of financial assets (Continued)

(b) *Held-to-maturity investments*

For held-to-maturity investments, the Group assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the amount of the loss is recognised in the consolidated income statement.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, any amounts formerly charged are credited to "Impairment allowances for held-to-maturity investments", to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

(c) *Available-for-sale financial assets*

For available-for-sale financial assets, the Group assesses at the end of each reporting period whether there is objective evidence that an investment or a group of investments is impaired.

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the consolidated income statement, is removed from OCI and recognised in the consolidated income statement.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of an investment below its cost. "Significant" is evaluated against the original cost of the investment and "prolonged" against the period in which the fair value has been below its original cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the consolidated income statement – is removed from OCI and recognised in the consolidated income statement. Impairment losses on equity instruments classified as available-for-sale are not reversed through the consolidated income statement. Increases in their fair value after impairment are recognised directly in OCI.

The determination of what is "significant" or "prolonged" requires judgement. In making this judgement, the Group evaluates, among other factors, the duration or extent to which the fair value of an investment is less than its cost.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortised cost and the current fair value, less any impairment loss on that investment previously recognised in the consolidated income statement. Future interest income continues to be accrued based on the reduced carrying amount of the asset and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of finance income. Impairment losses on debt instruments are reversed through the consolidated income statement if the increase in fair value of the instruments can be objectively related to an event occurring after the impairment loss was recognised in the consolidated income statement.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued) Summary of significant accounting policies (Continued)

(7) Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at the inception date: whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

(a) *Group as a lessee*

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item other than legal titles, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments and classified as "Property and equipment" but represented on a separate line with the corresponding liability to the lessor included in "Other liabilities". Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income in "Interest expense" in the consolidated income statement.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term.

Operating lease payments are not recognised in the consolidated statement of financial position. Any rentals payable are accounted for on a straight-line basis over the lease term and are included in "Operating expenses".

Land held under finance leases are stated at cost less accumulated depreciation and any impairment, and are depreciated over the remaining lease terms on a straight-line basis to the consolidated income statement.

Medium term leases are leases with remaining lease period of more than 10 years but not more than 50 years. Long term leases are leases with remaining lease period of more than 50 years.

(b) *Group as a lessor*

Leases where the Group retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. The Group leases out all of its investment properties as operating leases, thus generating rental income. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and are recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

The amounts due from the lessees under finance leases are recorded in the consolidated statement of financial position as loans and advances to customers. The amount comprises the gross investment in the finance leases less gross earnings allocated to future accounting periods. The total gross earnings under finance leases are allocated to the accounting periods over the duration of the underlying agreements so as to produce an approximately constant periodic rate of return on the net cash investment for each accounting period.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued)

Summary of significant accounting policies (Continued)

(8) Recognition of revenue and expenditure

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

(a) *Interest income and expense*

For all financial instruments measured at amortised cost and interest-bearing financial instruments classified as available-for-sale financial assets, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts over the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in the carrying amount is recorded as interest income or expense.

Once the value of a financial asset or a group of similar financial assets had been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

(b) *Fee and commission income*

The Group earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

- (i) *Fee income earned from services that are provided over a certain period of time*
Fees earned from the provision of services over a period of time are accrued over that period. These fees include commission income and asset management, custody and other management and advisory fees. Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the effective interest rate on the loan.
- (ii) *Fee income from providing transaction services*
Fees arising from negotiating or participating in the negotiation of a transaction for a third party, such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses, are recognised on completion of the underlying transaction.

(c) *Dividend income*

Dividend income is recognised when the Group's right to receive the payment is established.

(d) *Net trading income*

Net trading income arising from trading activities includes all gains and losses from changes in fair value for financial assets and financial liabilities held for trading. Gains and losses on foreign exchange trading and other transactions are also reported as "Net trading income" except for those gains and losses on translation of foreign currencies recognised in the translation reserve.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued) Summary of significant accounting policies (Continued)

(8) Recognition of revenue and expenditure (Continued)

(e) *Rental income*

Rental income arising on investment properties is accounted for on a straight-line basis over the lease terms on ongoing leases and is recorded in the consolidated income statement as “Other operating income”.

(9) Cash and cash equivalents

For the purpose of consolidated statement of cash flows, cash and cash equivalents consist of cash on hand, amounts due from banks on demand or with original maturity within three months and held-to-maturity investments with original maturity within three months.

(10) Business combinations and goodwill

Business combinations are accounted for using the acquisition method. The consideration transferred is measured at the acquisition date fair value which is the sum of the acquisition date fair values of assets transferred by the Group, liabilities assumed by the Group to the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree that are present ownership interests and entitle their holders to a proportionate share of net assets in the event of liquidation at fair value or at the proportionate share of the acquiree’s identifiable net assets. All other components of non-controlling interests are measured at fair value. Acquisition-related costs are expensed as incurred.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts of the acquiree.

If the business combination is achieved in stages, the previously held equity interest is re-measured at its acquisition date fair value and any resulting gain or loss is recognised in profit or loss.

Any contingent consideration to be transferred by the acquirer is recognised at fair value at the acquisition date. Contingent consideration classified as an asset or a liability is measured at fair value with changes in fair value recognised in profit or loss. Contingent consideration that is classified as equity is not remeasured and subsequent settlement is accounted for within equity.

Goodwill is initially measured at cost, being the excess of the aggregate of the consideration transferred, the amount recognised for non-controlling interests and any fair value of the Group’s previously held equity interests in the acquiree over the identifiable net assets acquired and liabilities assumed. If the sum of this consideration and other items is lower than the fair value of the net assets of the subsidiary acquired, the difference is, after reassessment, recognised in the consolidated income statement as a gain on bargain purchase.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. The Group performs its annual impairment test of goodwill as at 31 December. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group’s cash-generating units (the “CGU(s)”, or group of CGUs, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued)

Summary of significant accounting policies (Continued)

(10) Business combinations and goodwill (Continued)

Impairment is determined by assessing the recoverable amount of the CGU (or group of CGUs) to which the goodwill relates. Where the recoverable amount of the CGU (or group of CGUs) is less than the carrying amount, an impairment loss is recognised. An impairment loss recognised for goodwill is not reversed in a subsequent period.

Where goodwill has been allocated to a CGU (or group of CGUs) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on the disposal. Goodwill disposed of in these circumstances is measured based on the relative values of the operation disposed of and the portion of the CGU retained.

(11) Joint ventures

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

The Group's investments in joint ventures are stated in the consolidated statement of financial position at the Group's share of net assets under the equity method of accounting, less any impairment loss.

The Group's share of the post-acquisition results and OCI of joint ventures is included in the consolidated income statement and consolidated statement of comprehensive income, respectively. In addition, when there has been a change recognised directly in the equity of the joint venture, the Group recognises its share of any change, when applicable, in the consolidated statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and its joint ventures are eliminated to the extent of the Group's investments in the joint ventures, except where unrealised losses provide evidence of an impairment of the asset transferred.

(12) Related parties

A party is considered to be related to the Group if:

- (a) the party is a person or a close member of that person's family and that person
 - (i) has control or joint control over the Group;
 - (ii) has significant influence over the Group; or
 - (iii) is a member of the key management personnel of the Group or of a parent of the Group;

or

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued) Summary of significant accounting policies (Continued)

(12) Related parties (Continued)

- (b) the party is an entity where any of the following conditions applies:
- (i) the entity and the Group are members of the same group;
 - (ii) one entity is an associate or joint venture of the other entity (or of a parent, subsidiary or fellow subsidiary of the other entity);
 - (iii) the entity and the Group are joint ventures of the same third party;
 - (iv) one entity is a joint venture of a third entity and the other entity is an associate of the third entity;
 - (v) the entity is a post-employment benefit plan for the benefit of employees of either the Group or an entity related to the Group;
 - (vi) the entity is controlled or jointly controlled by a person identified in (a);
 - (vii) a person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity); and
 - (viii) the entity, or any member of a group of which it is a part, provides key management personal services to the Group or to the parent of the Group.

(13) Property and equipment, and depreciation

The property and equipment is stated at cost, except for certain buildings transferred from investment properties which are stated at deemed cost at the date of transfer, less accumulated depreciation and impairment. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after items of property and equipment have been put into operation, such as repairs and maintenance, is normally charged to the consolidated income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property and equipment, and where the cost of the item can be measured reliably, the expenditure is capitalised as an additional cost of that asset or as a replacement.

Depreciation is calculated on a straight-line basis to write off the cost of each item of property and equipment to its residual value over its estimated useful life. The estimated useful lives are as follows:

- | | |
|---|--|
| • Buildings | Over the shorter of the remaining lease terms and 50 years |
| • Leasehold improvements: | |
| Own leasehold buildings | 3 to 5 years |
| Others | Over the shorter of the remaining lease terms and 7 years |
| • Furniture, fixtures, equipment and motor vehicles | 3 to 10 years |
| • Land held under finance leases | Over the lease term |

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued)

Summary of significant accounting policies (Continued)

(13) Property and equipment, and depreciation (Continued)

Where parts of an item of property and equipment have different useful lives, the cost of that item is allocated on a reasonable basis among the parts and each part is depreciated separately.

Residual values, useful lives and the depreciation method are reviewed, and adjusted if appropriate, at the end of each reporting period.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on disposal or retirement recognised in the consolidated income statement in the year the asset is derecognised is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Land held under finance leases is stated at cost less accumulated depreciation and any impairment, and is depreciated over the remaining lease terms on a straight-line basis to the consolidated income statement.

Medium term leases are leases with remaining lease periods of more than 10 years to 50 years. Long term leases are leases with remaining lease periods of more than 50 years.

(14) Investment properties

Investment properties are interests in land and buildings held to earn rental income and/or for capital appreciation, rather than for use in the production or supply of goods or services or for administrative purposes; or for sale in the ordinary course of business. Such properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are stated at fair value, which reflects market conditions at the end of the reporting period. Gains or losses arising from changes in the fair values of investment properties are included in the consolidated income statement in the year in which they arise.

Any gains or losses on the retirement or disposal of an investment property are recognised in the consolidated income statement in the year of retirement or disposal.

For a transfer from investment properties to owner-occupied properties or inventories, the deemed cost of a property for subsequent accounting is its fair value at the date of change in use. If a property occupied by the Group as an owner-occupied property becomes an investment property, the Group accounts for such property in accordance with the policy stated under "Property and equipment, and depreciation" up to the date of change in use, and any difference at that date between the carrying amount and the fair value of the property is accounted for as a revaluation in accordance with the policy stated under "Property and equipment, and depreciation" above. For a transfer from inventories to investment properties, any difference between the fair value of the property at that date and its previous carrying amount is recognised in the consolidated income statement.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued) Summary of significant accounting policies (Continued)

(15) Intangible assets (other than goodwill)

Intangible assets, representing eligibility rights to trade on or through Hong Kong Exchanges and Clearing Limited, are stated at cost less impairment. The useful lives are assessed to be indefinite and they are reviewed annually to determine whether the indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is accounted for on a prospective basis. The carrying amount of intangible assets is subject to an annual impairment test, and impairment, if any, is charged to the consolidated income statement.

(16) Impairment of non-financial assets

The Group assesses at each reporting date or more frequently if events or changes in circumstances indicate that the carrying value may be impaired, whether there is an indication that a non-financial asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group will make an estimate of the asset's recoverable amount. Where the carrying amount of an asset (or CGU) exceeds its recoverable amount, the asset (or CGU) the Group considered impaired is written down to its recoverable amount.

For assets excluding goodwill and deferred tax assets, an assessment is made at each reporting date as to determine whether there is an indication that previously recognised impairment losses may no longer exist or may have decreased. If such an indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount but not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation) had no impairment been recognised for the asset in prior years. A reversal of such an impairment loss is credited to the consolidated income statement in the period it arises.

(17) Repossessed assets and valuation of collateral

Collateral assets for loans and advances and receivables are repossessed by the Group when the borrowers are unable to service their repayments, and would be realised in satisfaction of outstanding debts. Advances with repossessed collateral assets will continue to be accounted for as customer advances, except for those where the Group has taken the legal title and control of the repossessed collateral assets, in which cases the repossessed assets are shown under other accounts at the predetermined value with a corresponding reduction in the related advances. Individual impairment allowance is made on the shortfall between the expected net realisable value of the repossessed assets and the outstanding advances.

Repossessed assets are recognised at the lower of the carrying amount of the related loans and advances and receivables and fair value less costs to sell.

(18) Provisions

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the end of the reporting period of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in "Operating expenses" in the consolidated income statement.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued) Summary of significant accounting policies (Continued)

(19) Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the consolidated income statement, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities.

Deferred tax is provided, using the liability method, on all temporary differences at the end of the reporting period between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- when the deferred tax liability arises from the initial recognition of an asset or a liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries and joint ventures, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, the carryforward of unused tax credit and any unused tax losses. Deferred tax assets are recognised, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax credit and unused tax losses can be utilised, except:

- when the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or a liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries and joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at the end of each reporting period and are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be recovered.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued) Summary of significant accounting policies (Continued)

(19) Income tax (Continued)

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the end of the reporting period.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

(20) Employee benefits

(a) Retirement benefit schemes

The Group participates in two defined contribution retirement benefit schemes for those employees who are eligible to participate. The assets of the schemes are held separately from those of the Group in independently administered funds.

Contribution for Mandatory Provident Fund (MPF) Scheme is made based on a percentage of the participating employees' relevant monthly income from the Group while contribution for Occupational Retirement Schemes Ordinance (ORSO) Scheme is made based on the participating employees' basic salary, and the contributions are charged to the consolidated income statement as they become payable in accordance with the rules of the respective schemes. When an employee leaves the Group prior to his/her interest in the Group's employer non-mandatory contributions vesting with the employee, the ongoing contributions payable by the Group may be reduced by the relevant amount of forfeited contributions. The Group's mandatory contributions vest fully with the employee.

(b) Share option scheme

PFHL operated a share option scheme for the purpose of providing incentives and rewards to eligible participants who contributed to the success of the PFHL Group's operations. Employees (including Directors) of the Group received remuneration in the form of share-based payments whereby employees rendered services as consideration for equity-settled transactions.

For share options granted under the share option scheme, the fair value of the employee's services rendered in exchange for the grant of the options is recognised as an expense and credited to an employee share-based compensation reserve under equity. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted at the grant date. At the end of each reporting period, the PFHL Group revises its estimates of the number of options that is expected to become exercisable. It recognises the impact of the revision of the original estimates, if any, in the consolidated income statement, and a corresponding adjustment to the employee share-based compensation reserve over the remaining vesting period.

Notes to Financial Statements

5. ACCOUNTING POLICIES (Continued)

Summary of significant accounting policies (Continued)

(20) Employee benefits (Continued)

(b) *Share option scheme (Continued)*

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified if the original terms of the award are met. In addition, an expense is recognised for any modification, which increases the total fair value of the share-based payments, or is otherwise beneficial to the employee as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and is designated as a replacement award on the date that is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

(c) *Employee leave entitlements*

The cost of accumulating compensated absences is recognised as an expense and measured based on the additional amount that the Group expects to pay as a result of the unused entitlement that has accumulated as at the end of the reporting period.

(21) Dividends

Final dividends proposed by the Directors will remain in retained profits within reserves in the consolidated statement of financial position, until they have been approved by the shareholders in a general meeting. Final dividends are recognised as a liability when they are approved by the shareholders in the general meeting.

Interim dividends and special dividends are simultaneously proposed and declared by the Directors. Consequently, interim dividends and special dividends are recognised directly as a liability when they are proposed and declared.

6. SIGNIFICANT ACCOUNTING ESTIMATES

Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below.

Impairment allowances on loans and advances and receivables, and held-to-maturity investments

The Group reviews its portfolios of loans and advances and receivables, and held-to-maturity investments to assess impairment on a regular basis. In determining whether an impairment loss should be recorded in the consolidated income statement, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the discounted estimated future cash flows from a portfolio of loans and advances and receivables, and held-to-maturity investments before the decrease can be identified with an individual loan or a held-to-maturity investment in those portfolios. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group.

Notes to Financial Statements

6. SIGNIFICANT ACCOUNTING ESTIMATES (Continued)

Impairment allowances on loans and advances and receivables, and held-to-maturity investments (Continued)

For loans and advances and receivables for which no individual impairment is observed, management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the loan portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value-in-use of the CGUs to which the goodwill is allocated. Estimating the value-in-use requires the Group to make an estimate of the expected future cash flows from the CGU and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill as at 31 December 2016 and 2015 was HK\$242,342,000. Further details are set out in note 26 to the financial statements.

7. SEGMENT INFORMATION

Operating segment information

In accordance with the Group's internal financial reporting, the Group has identified operating segments based on similar economic characteristics, products and services and delivery methods. The operating segments are identified by senior management who is designated as the "Chief Operating Decision Maker" to make decisions about resources allocation to the segments and assess their performance. A summary of the operating segments is as follows:

- retail and commercial banking businesses segment mainly comprises the provision of deposit account services, the extension of mortgages and consumer lending, hire purchase and leasing, provision of financing to purchasers of licensed public vehicles such as taxis and public light buses, provision of services and financing activities for customers in trading, manufacturing and various business sectors, foreign exchange activities, centralised cash management for deposit taking and lending, interest rate risk management and the overall funding management of the Group;
- wealth management services, stockbroking and securities management segment comprises management of investments in debt securities and equities, securities dealing and receipt of commission income and the provision of authorised wealth management products and services; and
- other businesses segment comprise mainly the letting of investment properties.

Notes to Financial Statements

7. SEGMENT INFORMATION (Continued) Operating segment information (Continued)

The following table discloses the revenue and profit information for operating segments for the years ended 31 December 2016 and 2015.

	Retail and commercial banking businesses		Wealth management services, stockbroking and securities management		Other businesses		Total	
	2016	2015	2016	2015	2016	2015	2016	2015
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Segment revenue								
External:								
Net interest income/(expenses)	1,333,338	1,317,102	(29)	5	-	-	1,333,309	1,317,107
Other operating income:								
Fees and commission income	146,576	144,763	29,476	47,702	-	-	176,052	192,465
Others	11,441	14,682	(10)	(75)	9,569	8,845	21,000	23,452
Operating income	1,491,355	1,476,547	29,437	47,632	9,569	8,845	1,530,361	1,533,024
Operating profit after impairment allowance	463,210	447,920	7,713	18,447	9,541	8,743	480,464	475,110
Share of (loss)/profit of a joint venture							(286)	199
Profit before tax							480,178	475,309
Tax							(83,318)	(80,783)
Profit for the year							396,860	394,526
Other segment information								
Depreciation of property and equipment and land held under finance leases	(22,388)	(20,653)	-	-	-	-	(22,388)	(20,653)
Change in fair value of investment properties	-	-	-	-	1,762	1,874	1,762	1,874
Impairment allowances for loans and advances and receivables	(248,418)	(256,725)	-	-	-	-	(248,418)	(256,725)
Net losses on disposal of property and equipment	(55)	(29)	-	-	-	-	(55)	(29)

Notes to Financial Statements

7. SEGMENT INFORMATION (Continued) Operating segment information (Continued)

The following table discloses certain asset and liability information regarding operating segments as at 31 December 2016 and 2015.

	Retail and commercial banking businesses		Wealth management services, stockbroking and securities management		Other businesses		Total	
	2016	2015	2016	2015	2016	2015	2016	2015
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Segment assets other than intangible assets and goodwill	40,982,149	39,576,851	327,618	324,052	106,087	63,137	41,415,854	39,964,040
Intangible assets	-	-	718	718	-	-	718	718
Goodwill	242,342	242,342	-	-	-	-	242,342	242,342
Segment assets	41,224,491	39,819,193	328,336	324,770	106,087	63,137	41,658,914	40,207,100
Unallocated assets:								
Interest in a joint venture							1,606	1,892
Deferred tax assets and tax recoverable							38,302	25,771
Total assets							41,698,822	40,234,763
Segment liabilities	36,182,983	34,864,080	120,472	118,515	3,392	3,424	36,306,847	34,986,019
Unallocated liabilities:								
Deferred tax liabilities and tax payable							25,798	30,074
Total liabilities							36,332,645	35,016,093
Other segment information								
Additions to non-current assets – capital expenditure	88,303	17,137	-	-	-	-	88,303	17,137

Notes to Financial Statements

7. SEGMENT INFORMATION (Continued)

Geographical information

Geographical information is analysed by the Group based on the locations of the principal operations of the branches and subsidiaries which are responsible for reporting the results or booking the assets.

The following table discloses the segment revenue information for geographical segments for the years ended 31 December 2016 and 2015.

	2016 HK\$'000	2015 HK\$'000
Segment revenue from external customers:		
Hong Kong	1,442,210	1,455,008
Mainland China	88,151	78,016
	1,530,361	1,533,024

Segment revenue is allocated to the reportable segments with reference to interest and fees and commission income generated by these segments.

The following table discloses the non-current assets information for geographical segments as at 31 December 2016 and 2015.

	2016 HK\$'000	2015 HK\$'000
Non-current assets:		
Hong Kong	525,890	458,688
Mainland China	18,068	17,925
	543,958	476,613

Non-current assets consist of investment properties, property and equipment, land held under finance leases, interest in a joint venture, goodwill and intangible assets.

Operating income or revenue from major customers

Operating income or revenue from transactions with each external customer, including a group of entities which are known to be under common control with that customer, amounts to less than 10% (2015: less than 10%) of the Group's total operating income or revenue.

Notes to Financial Statements

8. INTEREST INCOME AND EXPENSE

	2016 HK\$'000	2015 HK\$'000
Interest income from:		
Loans and advances and receivables	1,503,244	1,508,070
Short term placements and placements with banks	66,679	67,495
Held-to-maturity investments	59,709	66,388
	1,629,632	1,641,953
Interest expense on:		
Deposits from banks and financial institutions	14,058	3,669
Deposits from customers	282,124	321,027
Bank loans	141	150
	296,323	324,846

Interest income and interest expense for the year ended 31 December 2016, calculated using the effective interest method for financial assets and financial liabilities which are not designated at fair value through profit or loss, amounted to HK\$1,629,632,000 and HK\$296,323,000 (2015: HK\$1,641,953,000 and HK\$324,846,000) respectively. Interest income on the impaired loans and advances for the year ended 31 December 2016 amounted to HK\$6,643,000 (2015: HK\$4,152,000).

Notes to Financial Statements

9. OTHER OPERATING INCOME

	2016 HK\$'000	2015 HK\$'000
Fees and commission income:		
Retail and commercial banking	147,997	146,308
Wealth management services, stockbroking and securities management	29,476	47,702
	177,473	194,010
Less: Fees and commission expenses	(1,421)	(1,545)
Net fees and commission income	176,052	192,465
Gross rental income	9,639	8,885
Less: Direct operating expenses	(70)	(40)
Net rental income	9,569	8,845
Gains less losses arising from dealing in foreign currencies	31,664	7,935
Net (losses)/gains on derivative financial instruments	(22,745)	3,276
	8,919	11,211
Net losses on disposal of property and equipment	(55)	(29)
Dividend income from listed investments	78	67
Dividend income from unlisted investments	700	800
Others	1,789	2,558
	197,052	215,917

Direct operating expenses included repair and maintenance expenses arising from investment properties.

There were no net gains or losses arising from available-for-sale financial assets, held-to-maturity investments, loans and advances and receivables, financial liabilities measured at amortised cost and financial assets and financial liabilities designated at fair value through profit or loss for the years ended 31 December 2016 and 2015.

All fees and commission income and expenses are related to financial assets or financial liabilities which are not designated at fair value through profit or loss. No fees and commission income and expenses are related to trust and other fiduciary activities.

Notes to Financial Statements

10. OPERATING EXPENSES

	Notes	2016 HK\$'000	2015 HK\$'000
Staff costs:			
Salaries and other staff costs		450,485	453,980
Pension contributions		20,520	21,153
Less: Forfeited contributions		(44)	(38)
Net contribution to retirement benefit schemes		20,476	21,115
		470,961	475,095
Other operating expenses:			
Operating lease rentals on leasehold buildings		63,541	61,944
Depreciation of property and equipment and land held under finance leases	23, 24	22,388	20,653
Auditor's remuneration		3,542	3,511
Administrative and general expenses		69,924	65,138
Others		172,885	176,722
Operating expenses before changes in fair value of investment properties		803,241	803,063

As at 31 December 2016 and 2015, the Group had no material forfeited contributions available to reduce its contributions to the pension schemes in future years. The credits for the years ended 31 December 2016 and 2015 arose in respect of staff who left the schemes during the years.

Notes to Financial Statements

11. IMPAIRMENT ALLOWANCES

	2016 HK\$'000	2015 HK\$'000
Net charge for/(write-back of) impairment losses and allowances:		
– loans and advances	248,551	255,111
– trade bills, accrued interest and receivables	(133)	1,614
	248,418	256,725
Net charge for/(write-back of) impairment losses and allowances:		
– individually assessed	251,788	259,907
– collectively assessed	(3,370)	(3,182)
	248,418	256,725
Of which:		
– new impairment losses and allowances (including any amount directly written off during the year)	401,077	414,687
– releases and recoveries	(152,659)	(157,962)
Net charge to the consolidated income statement	248,418	256,725

There were no impairment allowances for financial assets other than loans and advances and receivables for the years ended 31 December 2016 and 2015.

12. DIRECTORS' REMUNERATION

Directors' remuneration, disclosed pursuant to section 383(1)(a), (b), (c) and (f) of the Hong Kong Companies Ordinance and Part 2 of the Companies (Disclosure of Information about Benefits of Directors) Regulation, is as follows:

	2016 HK\$'000	2015 HK\$'000
Fees	848	898
Other emoluments:		
Salaries, bonuses, allowances and benefits in kind	5,669	5,196
Retirement benefits contribution	352	327
	6,869	6,421

Notes to Financial Statements

13. TAX

	Note	2016 HK\$'000	2015 HK\$'000
Current tax charge:			
Hong Kong		67,620	69,177
Overseas		13,856	11,082
Deferred tax charge, net	28	1,842	524
		83,318	80,783

Hong Kong profits tax has been provided at the rate of 16.5% (2015: 16.5%) on the estimated assessable profits arising in Hong Kong during the year. Taxes on profits assessable overseas have been calculated at the rates of tax prevailing in the jurisdictions in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

A reconciliation of the tax expense applicable to profit before tax using the statutory tax rates for the jurisdictions in which the Bank, its subsidiaries and a joint venture are domiciled to the tax expense at the effective tax rates, and a reconciliation of the applicable rates (i.e. statutory tax rates) to the effective tax rates, are as follows:

	Hong Kong		2016 Mainland China		Total	
	HK\$'000	%	HK\$'000	%	HK\$'000	%
Profit before tax	430,008		50,170		480,178	
Tax at the applicable tax rate	70,952	16.5	12,542	25.0	83,494	17.4
Estimated tax losses not recognised	2	–	–	–	2	–
Estimated tax effect of net income that are not taxable	(177)	–	(1)	–	(178)	–
Tax charge at the Group's effective rate	70,777	16.5	12,541	25.0	83,318	17.4

Notes to Financial Statements

13. TAX (Continued)

	Hong Kong HK\$'000	%	2015 Mainland China HK\$'000	%	Total HK\$'000	%
Profit before tax	428,212		47,097		475,309	
Tax at the applicable tax rate	70,655	16.5	11,774	25.0	82,429	17.3
Estimated tax losses from previous periods utilised	(189)	–	–	–	(189)	–
Estimated tax effect of net income that are not taxable	(1,078)	(0.3)	(379)	(0.8)	(1,457)	(0.3)
Tax charge at the Group's effective rate	69,388	16.2	11,395	24.2	80,783	17.0

14. DIVIDENDS

(a) Dividends approved and paid during the year

	2016 HK\$ per ordinary share	2015 HK\$ per ordinary share	2016 HK\$'000	2015 HK\$'000
Interim dividend	6.639	6.324	98,363	93,697
Final dividend in respect of previous year	6.669	6.074	98,808	89,992
	13.308	12.398	197,171	183,689

Final dividend of 2015 was paid in 2016 with the consent of shareholders at the 2016 AGM.

Notes to Financial Statements

14. DIVIDENDS (Continued)
(b) Dividends attributable to the year

	2016 HK\$ per ordinary share	2015 HK\$ per ordinary share	2016 HK\$'000	2015 HK\$'000
Interim dividend	6.639	6.324	98,363	93,697
Proposed final dividend	6.602	6.669	97,815	98,808
	13.241	12.993	196,178	192,505

The proposed final dividend was recommended after respective year end and had not been recognised as a liability at respective year end dates. The proposed final dividend of 2016 is subject to the approval of shareholders at the 2017 AGM.

15. CASH AND SHORT TERM PLACEMENTS

	2016 HK\$'000	2015 HK\$'000
Cash on hand	168,220	158,304
Placements with banks and financial institutions	1,209,585	868,860
Money at call and short notice	2,878,024	2,900,046
	4,255,829	3,927,210

Over 90% (2015: over 90%) of the placements were deposited with banks and financial institutions rated with a grading of Baa2 or above based on the credit rating of an external credit agency, Moody's.

There were no overdue or rescheduled placements with banks and financial institutions and no impairment allowances for such placements accordingly.

16. PLACEMENTS WITH BANKS AND FINANCIAL INSTITUTIONS MATURING AFTER ONE MONTH BUT NOT MORE THAN TWELVE MONTHS

	2016 HK\$'000	2015 HK\$'000
Placements with banks and financial institutions	2,222,825	1,018,133

Over 90% (2015: over 90%) of the placements were deposited with banks and financial institutions rated with a grading of Baa2 or above based on the credit rating of an external credit agency, Moody's.

There were no overdue or rescheduled placements with banks and financial institutions and no impairment allowances for such placements accordingly.

Notes to Financial Statements

17. LOANS AND ADVANCES AND RECEIVABLES

	2016 HK\$'000	2015 HK\$'000
Loans and advances to customers	28,800,181	29,264,683
Trade bills	53,012	64,552
Loans and advances, and trade bills	28,853,193	29,329,235
Accrued interest	79,343	77,277
Other receivables	28,932,536 1,217	29,406,512 935
Gross loans and advances and receivables	28,933,753	29,407,447
Less: Impairment allowances for loans and advances and receivables		
– individually assessed	(113,607)	(101,543)
– collectively assessed	(12,310)	(15,725)
	(125,917)	(117,268)
Loans and advances and receivables	28,807,836	29,290,179

Over 90% (2015: over 90%) of the loans and advances and receivables were unrated exposures. Over 90% (2015: over 90%) of the collateral for the secured loans and advances and receivables were customer deposits, properties, listed shares, taxi licences, public light bus licences and vehicles.

Loans and advances and receivables are summarised as follows:

	2016 HK\$'000	2015 HK\$'000
Neither past due nor impaired loans and advances and receivables	28,165,049	28,852,447
Past due but not impaired loans and advances and receivables	538,088	384,841
Individually impaired loans and advances	226,271	167,393
Individually impaired receivables	4,345	2,766
Gross loans and advances and receivables	28,933,753	29,407,447

About 67% (2015: 66%) of “Neither past due nor impaired loans and advances and receivables” were property mortgage loans and hire purchase loans secured by properties, taxi licences, public light bus licences and vehicles.

Notes to Financial Statements

17. LOANS AND ADVANCES AND RECEIVABLES (Continued)**(a) (i) Ageing analysis of overdue and impaired loans and advances**

	2016		2015	
	Gross amount HK\$'000	Percentage of total loans and advances %	Gross amount HK\$'000	Percentage of total loans and advances %
Loans and advances overdue for:				
Six months or less but over three months	82,566	0.29	83,420	0.28
One year or less but over six months	38,384	0.13	14,168	0.05
Over one year	8,903	0.03	11,050	0.04
Loans and advances overdue for more than three months	129,853	0.45	108,638	0.37
Rescheduled loans and advances overdue for three months or less	56,432	0.20	35,162	0.12
Impaired loans and advances overdue for three months or less	39,986	0.14	23,593	0.08
Total overdue and impaired loans and advances	226,271	0.79	167,393	0.57

Notes to Financial Statements

17. LOANS AND ADVANCES AND RECEIVABLES (Continued)

(a) (ii) Ageing analysis of overdue and impaired trade bills, accrued interest and other receivables

	2016 HK\$'000	2015 HK\$'000
Trade bills, accrued interest and other receivables overdue for:		
Six months or less but over three months	287	251
One year or less but over six months	1,605	384
Over one year	1,960	1,972
Trade bills, accrued interest and other receivables overdue for more than three months	3,852	2,607
Impaired trade bills, accrued interest and other receivables overdue for three months or less	493	159
Total overdue and impaired trade bills, accrued interest and other receivables	4,345	2,766

Impaired loans and advances and receivables are individually determined to be impaired after considering the overdue ageing analysis and other qualitative factors such as bankruptcy proceedings and individual voluntary arrangements.

Notes to Financial Statements

17. LOANS AND ADVANCES AND RECEIVABLES (Continued)**(b) Geographical analysis of overdue and impaired loans and advances and receivables, and individual impairment allowances****(i) Analysis of overdue loans and advances and receivables**

	Hong Kong HK\$'000	2016 Mainland China HK\$'000	Total HK\$'000
Loans and advances and receivables overdue for more than three months	109,118	24,587	133,705
Individual impairment allowances	53,764	22,429	76,193
Current market value and fair value of collateral			96,114
	Hong Kong HK\$'000	2015 Mainland China HK\$'000	Total HK\$'000
Loans and advances and receivables overdue for more than three months	98,497	12,748	111,245
Individual impairment allowances	69,128	11,457	80,585
Current market value and fair value of collateral			41,782

Notes to Financial Statements

17. LOANS AND ADVANCES AND RECEIVABLES (Continued)

(b) Geographical analysis of overdue and impaired loans and advances and receivables, and individual impairment allowances (Continued)

(ii) Analysis of impaired loans and advances and receivables

	Hong Kong HK\$'000	2016 Mainland China HK\$'000	Total HK\$'000
Impaired loans and advances and receivables	206,029	24,587	230,616
Individual impairment allowances	91,178	22,429	113,607
Current market value and fair value of collateral			164,908
	Hong Kong HK\$'000	2015 Mainland China HK\$'000	Total HK\$'000
Impaired loans and advances and receivables	157,303	12,856	170,159
Individual impairment allowances	89,978	11,565	101,543
Current market value and fair value of collateral			100,854

Over 90% (2015: over 90%) of the Group's gross loans and advances and receivables were derived from operations carried out in Hong Kong. Accordingly, no geographical segment information of gross loans and advances and receivables is presented herein.

(c) The value of collateral held in respect of the overdue loans and advances and the split between the portion of the overdue loans and advances covered by credit protection (covered portion) and the remaining portion (uncovered portion) are as follows:

	2016 HK\$'000	2015 HK\$'000
Current market value and fair value of collateral held against the covered portion of overdue loans and advances	96,114	41,782
Covered portion of overdue loans and advances	51,124	22,053
Uncovered portion of overdue loans and advances	78,729	86,585

Notes to Financial Statements

17. LOANS AND ADVANCES AND RECEIVABLES (Continued)

- (c) The value of collateral held in respect of the overdue loans and advances and the split between the portion of the overdue loans and advances covered by credit protection (covered portion) and the remaining portion (uncovered portion) are as follows: (Continued)

The assets taken as collateral should satisfy the following criteria:

- The market value of the asset is readily determinable or can be reasonably established and verified.
- The asset is marketable and there exists a readily available secondary market for disposal of the asset.
- The Group's right to repossess the asset is legally enforceable without impediment.
- The Group is able to secure control over the asset if necessary.

The main types of guarantors for credit risk mitigation are as follows:

- Central governments with a grading of Aa3 or above
- Unrated public sector enterprises
- Banks with a grading of Baa2 or above
- Unrated corporations
- Individual shareholders and directors of corporate customers

(d) Repossessed assets

As at 31 December 2016, the total value of repossessed assets of the Group amounted to HK\$7,210,000 (2015: Nil).

(e) Past due but not impaired loans and advances and receivables

	2016		2015	
	Gross amount HK\$'000	Percentage of total loans and advances %	Gross amount HK\$'000	Percentage of total loans and advances %
Loans and advances overdue for three months or less	521,497	1.81	383,544	1.31
Trade bills, accrued interest and other receivables overdue for three months or less	16,591		1,297	

Notes to Financial Statements

17. LOANS AND ADVANCES AND RECEIVABLES (Continued)

(f) Movements in impairment losses and allowances on loans and advances and receivables

	Individual impairment allowances HK\$'000	2016 Collective impairment allowances HK\$'000	Total HK\$'000
As at 1 January 2016	101,543	15,725	117,268
Amounts written off	(377,182)	–	(377,182)
Impairment losses and allowances charged to the consolidated income statement	400,941	136	401,077
Impairment losses and allowances released to the consolidated income statement	(149,153)	(3,506)	(152,659)
Net charge/(release) of impairment losses and allowances	251,788	(3,370)	248,418
Loans and advances and receivables recovered	138,122	–	138,122
Exchange difference	(664)	(45)	(709)
As at 31 December 2016	113,607	12,310	125,917
Deducted from:			
Loans and advances	111,492	12,025	123,517
Trade bills, accrued interest and other receivables	2,115	285	2,400
	113,607	12,310	125,917

Notes to Financial Statements

17. LOANS AND ADVANCES AND RECEIVABLES (Continued)

(f) Movements in impairment losses and allowances on loans and advances and receivables (Continued)

	Individual impairment allowances HK\$'000	2015 Collective impairment allowances HK\$'000	Total HK\$'000
As at 1 January 2015	85,745	18,923	104,668
Amounts written off	(391,515)	–	(391,515)
Impairment losses and allowances charged to the consolidated income statement	414,376	311	414,687
Impairment losses and allowances released to the consolidated income statement	(154,469)	(3,493)	(157,962)
Net charge/(release) of impairment losses and allowances	259,907	(3,182)	256,725
Loans and advances and receivables recovered	148,005	–	148,005
Exchange difference	(599)	(16)	(615)
As at 31 December 2015	101,543	15,725	117,268
Deducted from:			
Loans and advances	99,236	15,499	114,735
Trade bills, accrued interest and other receivables	2,307	226	2,533
	101,543	15,725	117,268

Notes to Financial Statements

17. LOANS AND ADVANCES AND RECEIVABLES (Continued)

(g) Finance lease receivables

Included in loans and advances and receivables were receivables in respect of assets leased under finance leases as set out below:

	2016	
	Minimum lease payments HK\$'000	Present value of minimum lease payments HK\$'000
Amounts receivable under finance leases:		
Within one year	363,858	270,485
In the second to fifth years, inclusive	1,063,750	758,967
Over five years	3,717,836	3,088,024
	5,145,444	4,117,476
Less: Unearned finance income	(1,027,968)	
Present value of minimum lease payments receivable	4,117,476	
	2015	
	Minimum lease payments HK\$'000	Present value of minimum lease payments HK\$'000
Amounts receivable under finance leases:		
Within one year	354,284	268,568
In the second to fifth years, inclusive	1,022,499	749,935
Over five years	3,425,481	2,862,167
	4,802,264	3,880,670
Less: Unearned finance income	(921,594)	
Present value of minimum lease payments receivable	3,880,670	

The Group has entered into finance lease arrangements with customers in respect of motor vehicles and equipment. The terms of the finance leases entered into range from 1 to 25 years.

Notes to Financial Statements

18. AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2016 HK\$'000	2015 HK\$'000
Unlisted equity investments in corporate entity, at fair value: At the beginning and at the end of the year	6,804	6,804

The unlisted investments issued by corporate entity are measured at fair value based on the present value of cash flows over a period of 10 years.

19. HELD-TO-MATURITY INVESTMENTS

	2016 HK\$'000	2015 HK\$'000
Certificates of deposit held	2,530,788	2,816,789
Treasury bills and government bonds (including Exchange Fund Bills)	1,682,974	1,767,836
Other debt securities	1,480,099	758,247
	5,693,861	5,342,872
Listed or unlisted:		
– Listed in Hong Kong	1,617,360	1,557,815
– Listed outside Hong Kong	81,784	58,025
– Unlisted	3,994,717	3,727,032
	5,693,861	5,342,872
Analysed by type of issuers:		
– Central government	1,682,974	1,767,836
– Banks and other financial institutions	4,010,887	3,575,036
	5,693,861	5,342,872

There were no impairment allowances made against held-to-maturity investments as at 31 December 2016 and 2015. There were no movements in impairment allowances for the years ended 31 December 2016 and 2015.

There were neither impaired nor overdue held-to-maturity investments as at 31 December 2016 and 2015.

All exposures attributed to the held-to-maturity investments were rated with a grading of A3 or above based on the credit rating of an external credit agency, Moody's, as at 31 December 2016 and 2015.

Notes to Financial Statements

20. INTEREST IN A JOINT VENTURE

	2016 HK\$'000	2015 HK\$'000
Unlisted shares, at cost	–	–
Share of net assets other than goodwill	1,606	1,892
	1,606	1,892

Particulars of the Group's joint venture are as follows:

Name	Business structure	Place of incorporation and operations	Percentage of ownership, interest and profit sharing %	Voting power	Principal activity
Net Alliance Co. Limited	Corporate	Hong Kong	17.6	2 out of 8*	Provision of electronic banking support services

* Representing the number of votes on the board of directors attributable to the Group.

The following table illustrates the summarised financial information of the Group's interest in the joint venture which is accounted for using the equity method:

	2016 HK\$'000	2015 HK\$'000
Share of the joint venture's assets and liabilities:		
Assets	1,903	2,073
Liabilities	(297)	(181)
Net assets	1,606	1,892
Share of the joint venture's profit and loss:		
Total income	2,305	2,257
Total expenses	(2,591)	(2,058)
(Loss)/profit after tax	(286)	199

The joint venture had no contingent liabilities or capital commitments as at 31 December 2016 and 2015.

Notes to Financial Statements

21. OTHER ASSETS AND OTHER LIABILITIES

Other assets

	2016 HK\$'000	2015 HK\$'000
Interest receivables from financial institutions	22,434	16,638
Other debtors, deposits and prepayments	102,923	104,755
Net amount of accounts receivable from Hong Kong Securities Clearing Company Limited ("HKSCC")	3,638	21,924
	128,995	143,317

There were no other overdue or rescheduled assets, and no impairment allowances for such other assets accordingly.

Other liabilities

	2016 HK\$'000	2015 HK\$'000
Interest payable	73,282	92,262
Creditors, accruals and other payables	304,563	243,276
Net amount of accounts payable to HKSCC	24,327	–
	402,172	335,538

Notes to Financial Statements

21. OTHER ASSETS AND OTHER LIABILITIES (Continued)

Public Financial Securities Limited and Public Securities Limited maintain accounts with HKSCC through which they conduct securities trading transactions and settlement on a net basis.

In presenting the amounts due from and to HKSCC, the individual subsidiaries concerned have offset the gross amount of the accounts receivable from and the gross amount of the accounts payable to HKSCC. The amounts offset and the net balances are shown as follows:

	Gross amount HK\$'000	Amount offset HK\$'000	Net amount HK\$'000
Other assets			
2016			
Amount of accounts receivable from HKSCC	18,478	(14,840)	3,638
2015			
Amount of accounts receivable from HKSCC	65,890	(43,966)	21,924
Other liabilities			
2016			
Amount of accounts payable to HKSCC	(39,167)	14,840	(24,327)
2015			
Amount of accounts payable to HKSCC	(43,966)	43,966	–

22. INTANGIBLE ASSETS

	2016 HK\$'000	2015 HK\$'000
Cost:		
At the beginning and at the end of the year	1,923	1,923
Accumulated impairment:		
At the beginning and at the end of the year	1,205	1,205
Net carrying amount:		
At the beginning and at the end of the year	718	718

Intangible assets represent trading rights held by the Group. The trading rights are retained for stock trading and stockbroking activities, and have indefinite useful lives as the trading rights have no expiry date. They comprise five units (2015: five units) of Stock Exchange Trading Right and one unit (2015: one unit) of Futures Exchange Trading Right in Hong Kong Exchanges and Clearing Limited.

Notes to Financial Statements

23. PROPERTY AND EQUIPMENT

	Buildings HK\$'000	Leasehold improvements, furniture, fixtures, equipment and motor vehicles HK\$'000	Total HK\$'000
Cost:			
As at 1 January 2016	17,745	223,663	241,408
Transfer from investment properties	698	–	698
Additions	–	39,572	39,572
Disposals/write-off	–	(3,684)	(3,684)
As at 31 December 2016	18,443	259,551	277,994
Accumulated depreciation:			
As at 1 January 2016	6,475	167,587	174,062
Provided during the year	408	18,421	18,829
Disposals/write-off	–	(3,629)	(3,629)
Exchange difference	(9)	–	(9)
As at 31 December 2016	6,874	182,379	189,253
Net carrying amount:			
As at 31 December 2016	11,569	77,172	88,741

Notes to Financial Statements

23. PROPERTY AND EQUIPMENT (Continued)

	Buildings HK\$'000	Leasehold improvements, furniture, fixtures, equipment and motor vehicles HK\$'000	Total HK\$'000
Cost:			
As at 1 January 2015	17,745	209,725	227,470
Additions	–	17,137	17,137
Disposals/write-off	–	(3,199)	(3,199)
As at 31 December 2015	17,745	223,663	241,408
Accumulated depreciation:			
As at 1 January 2015	6,086	153,975	160,061
Provided during the year	453	16,757	17,210
Disposals/write-off	–	(3,145)	(3,145)
Exchange difference	(64)	–	(64)
As at 31 December 2015	6,475	167,587	174,062
Net carrying amount:			
As at 31 December 2015	11,270	56,076	67,346

There were no impairment allowances made against the above items of property and equipment as at 31 December 2016 and 2015. There were no movements in impairment allowances for the years ended 31 December 2016 and 2015.

Notes to Financial Statements

24. LAND HELD UNDER FINANCE LEASES

	HK\$'000
Cost:	
As at 1 January 2015, 31 December 2015 and 1 January 2016	143,621
Transfer from investment properties	6,845
As at 31 December 2016	150,466
Accumulated depreciation and impairment:	
As at 1 January 2015	39,000
Depreciation provided during the year	3,443
As at 31 December 2015 and 1 January 2016	42,443
Depreciation provided during the year	3,559
As at 31 December 2016	46,002
Net carrying amount:	
As at 31 December 2016	104,464
As at 31 December 2015	101,178

The Group's land held under finance leases at net carrying amount is held under the following lease terms:

	2016 HK\$'000	2015 HK\$'000
Leaseholds:		
Held in Hong Kong		
– On long term leases	7,130	7,138
– On medium term leases	83,454	79,605
Held outside Hong Kong		
– On medium term leases	13,880	14,435
	104,464	101,178

Land leases are stated at the recoverable amount subject to an impairment test pursuant to HKAS 36, which is based on the higher of fair value less costs to sell and value-in-use.

Notes to Financial Statements

25. INVESTMENT PROPERTIES

	2016 HK\$'000	2015 HK\$'000
Carrying amount as at 1 January	63,137	61,263
Additions	48,731	–
Transfer to property and equipment	(698)	–
Transfer to land held under finance leases	(6,845)	–
Change in fair value recognised in the consolidated income statement	1,762	1,874
Carrying amount as at 31 December	106,087	63,137

The Group's investment properties are situated in Hong Kong and are held under medium term leases in Hong Kong.

All investment properties were classified under Level 3 in the fair value hierarchy. During the year, there were no transfers of fair value measurements between Level 1 and Level 2 and no transfer into or out of Level 3 (2015: Nil). The Group has assessed that the highest and best use of its properties did not differ from their existing use.

As at 31 December 2016, investment properties were revalued according to the revaluation reports issued by C S Surveyors Limited, a firm of independent professionally qualified valuers. Finance and Control Department has discussions with the valuer on the valuation methodology and valuation results twice a year when the valuation is performed for interim and annual financial reporting.

The fair value of investment properties located in Hong Kong is determined using market comparison approach by reference to recent sales price of comparable properties on a price per square metre basis. Below is a summary of the significant inputs to the valuation of investment properties:

	2016 Range HK\$	Weighted average HK\$	2015 Range HK\$	Weighted average HK\$
Price per square metre	74,000 to 482,000	352,000	72,000 to 474,000	221,000

A significant increase/decrease in the price per square metre would result in a significant increase/decrease in the fair value of the investment properties.

The investment properties held by the Group are let under operating leases from which the Group earns rental income. Details of future annual rental receivables under operating leases are included in note 32(a) to the financial statements.

Notes to Financial Statements

26. GOODWILL

	2016 HK\$'000	2015 HK\$'000
Cost and net carrying amount:		
At the beginning and at the end of the year	242,342	242,342

Impairment test of goodwill

There is a CGU, namely Public Finance, which represents an operating entity within the business segment "Retail and commercial banking businesses" identified by the Group. The recoverable amount of the CGU at each subsequent reporting date is determined based on the value-in-use using the present value of cash flows. The cash flow projections are based on financial budgets approved by management covering a 10-year period and assumed growth rates are used to extrapolate the cash flows in the following 40 years. The financial budgets are prepared based on a 10-year business plan which is appropriate after considering the sustainability of business growth, stability of core business developments, long term economic cycle and achievement of business targets extrapolated from a track record of financial results. All cash flows are discounted at discount rates of 3% and 6% under baseline and stress scenarios, respectively. Management's financial model assumes an average growth rate of 5% to 6% per annum from the eleventh to fiftieth year taking into account long term gross domestic product growth and other relevant economic factors. The discount rates used are based on the rates which reflect specific risks relating to the CGU.

No impairment loss has been recognised in respect of goodwill for the years ended 31 December 2016 and 2015 as its value-in-use exceeds the carrying amount.

27. CUSTOMER DEPOSITS AT AMORTISED COST

	2016 HK\$'000	2015 HK\$'000
Demand deposits and current accounts	3,586,745	3,125,943
Savings deposits	5,507,254	5,143,268
Time, call and notice deposits	24,785,349	24,896,612
	33,879,348	33,165,823

Notes to Financial Statements

28. DEFERRED TAX

The movements in deferred tax assets and liabilities during the year are as follows:

Deferred tax assets:

	Impairment allowances for loans and advances and receivables HK\$'000	Others HK\$'000	Total HK\$'000
As at 1 January 2015	25,517	382	25,899
Deferred tax charged to the consolidated income statement	(78)	(50)	(128)
As at 31 December 2015 and 1 January 2016	25,439	332	25,771
Deferred tax credited to the consolidated income statement	2,387	89	2,476
As at 31 December 2016	27,826	421	28,247

Deferred tax liabilities:

	Depreciation allowance in excess of related depreciation HK\$'000
As at 1 January 2015	7,024
Deferred tax charged to the consolidated income statement	396
As at 31 December 2015 and 1 January 2016	7,420
Deferred tax charged to the consolidated income statement	4,318
As at 31 December 2016	11,738

Notes to Financial Statements

29. SHARE CAPITAL

	2016 HK\$'000	2015 HK\$'000
Issued and fully paid: 14,816,000 (2015: 14,816,000) ordinary shares	2,854,045	2,854,045

30. RESERVES

	Group reconstruction reserve HK\$'000	Capital reserve HK\$'000	Regulatory reserve HK\$'000	Retained profits HK\$'000	Translation reserve HK\$'000	Total HK\$'000
As at 1 January 2015	3,065	17,660	438,935	1,651,946	68,153	2,179,759
Profit for the year	-	-	-	394,526	-	394,526
Other comprehensive income	-	-	-	-	(25,971)	(25,971)
Transfer from retained profits	-	-	16,507	(16,507)	-	-
Dividends paid in respect of previous year	-	-	-	(89,992)	-	(89,992)
Dividends paid in respect of current year	-	-	-	(93,697)	-	(93,697)
As at 31 December 2015 and 1 January 2016	3,065	17,660	455,442	1,846,276	42,182	2,364,625
Profit for the year	-	-	-	396,860	-	396,860
Other comprehensive income	-	-	-	-	(52,182)	(52,182)
Transfer to retained profits	-	-	(16,704)	16,704	-	-
Dividends paid in respect of previous year	-	-	-	(98,808)	-	(98,808)
Dividends paid in respect of current year	-	-	-	(98,363)	-	(98,363)
As at 31 December 2016	3,065	17,660	438,738	2,062,669	(10,000)	2,512,132

Note:

The regulatory reserve is maintained to satisfy the provisions of the Hong Kong Banking Ordinance for prudential supervision purpose. It is held as a buffer of capital to absorb potential financial losses in excess of the accounting standards' requirements pursuant to the HKMA's guidelines.

(a) Contingent liabilities, commitments and derivatives

	Contractual amount HK\$'000	Credit equivalent amount HK\$'000	2016 Credit risk-weighted amount HK\$'000	Positive fair value- assets HK\$'000	Negative fair value- liabilities HK\$'000
Direct credit substitutes	723,281	723,281	197,661	-	-
Transaction-related contingencies	15,235	7,618	2,569	-	-
Trade-related contingencies	101,475	20,294	5,687	-	-
Forward forward deposits placed	-	-	-	-	-
Forward asset purchases	-	-	-	-	-
	839,991	751,193	205,917	-	-
Derivatives held for trading:					
Foreign exchange rate contracts	1,214,516	12,557	2,529	412	23,157
Other commitments with an original maturity of:					
Not more than one year	-	-	-	-	-
More than one year	-	-	-	-	-
Other commitments which are unconditionally cancellable or which provide for automatic cancellation due to deterioration of creditworthiness of the counterparties	3,789,134	-	-	-	-
	5,843,641	763,750	208,446	412	23,157

	2016 Contractual amount HK\$'000
Capital commitments contracted for, but not provided in the consolidated statement of financial position	11,643

Notes to Financial Statements

31. OFF-BALANCE SHEET EXPOSURE (Continued)
(a) Contingent liabilities, commitments and derivatives (Continued)

	Contractual amount HK\$'000	Credit equivalent amount HK\$'000	2015 Credit risk-weighted amount HK\$'000	Positive fair value- assets HK\$'000	Negative fair value- liabilities HK\$'000
Direct credit substitutes	171,846	171,846	89,632	–	–
Transaction-related contingencies	14,363	7,181	1,649	–	–
Trade-related contingencies	45,298	9,060	6,660	–	–
Forward forward deposits placed	–	–	–	–	–
Forward asset purchases	1,513	1,513	303	–	–
	233,020	189,600	98,244	–	–
Derivatives held for trading:					
Foreign exchange rate contracts	2,344,121	27,040	4,894	3,864	588
Other commitments with an original maturity of:					
Not more than one year	–	–	–	–	–
More than one year	17,333	8,667	8,667	–	–
Other commitments which are unconditionally cancellable or which provide for automatic cancellation due to deterioration of creditworthiness of the counterparties	3,876,373	–	–	–	–
	6,470,847	225,307	111,805	3,864	588

	2015 Contractual amount HK\$'000
Capital commitments contracted for, but not provided in the consolidated statement of financial position	17,031

The Group had not entered into any bilateral netting arrangements and accordingly the above amounts are shown on a gross basis. The credit risk-weighted amounts are calculated in accordance with the Capital Rules and guidelines issued by the HKMA. The amounts calculated are dependent upon the status of the counterparty and the maturity characteristics. The risk weights used range from 0% to 100% for contingent liabilities, commitments and derivatives.

As at 31 December 2016 and 2015, the Group had no material outstanding contingent liabilities and commitments save as disclosed above.

Notes to Financial Statements

31. OFF-BALANCE SHEET EXPOSURE (Continued)

(b) Derivative financial instruments

The Group uses the following derivative financial instruments:

Currency forwards represent commitments to purchase foreign and domestic currencies, including undelivered spot transactions. Foreign currency and interest rate futures are contractual obligations to receive or pay a net amount based on changes in currency rates or interest rates, or to buy or sell a foreign currency or a financial instrument on a future date at a specified price, established in an organised financial market. The credit risk is negligible, as changes in the futures contract value are settled daily with the exchange. Forward rate agreements are individually negotiated interest rate futures that call for a cash settlement at a future date for the difference between a contracted rate of interest and the current market rate, based on a notional principal amount.

Interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an exchange of interest rates (for example, fixed rate or floating rate). No exchange of principal takes place. The Group's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligations. This risk is monitored on an ongoing basis with reference to the current fair value, a proportion of the notional amount of the contracts and the liquidity of the market. To control the level of credit risk taken, the Group assesses counterparties using the same techniques as used for its lending activities.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised in the consolidated 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 risk. The derivative financial 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 the instruments are favourable or unfavourable, and thus the aggregate fair values of derivative financial assets and liabilities, can fluctuate significantly from time to time.

Notes to Financial Statements

32. OPERATING LEASE ARRANGEMENTS

(a) As lessor

The Group leases its investment properties in note 25 under operating lease arrangements, and the terms of the leases range from 1 to 5 years.

As at 31 December 2016 and 2015, the Group had total future minimum lease rental receivables under non-cancellable operating leases falling due as follows:

	2016 HK\$'000	2015 HK\$'000
Within one year	2,791	2,875
In the second to fifth years, inclusive	949	1,891
	3,740	4,766

(b) As lessee

The Group has entered into non-cancellable operating lease arrangements with landlords, and the terms of the leases range from 1 to 10 years.

As at 31 December 2016 and 2015, the Group had total future minimum lease rental payables under non-cancellable operating leases falling due as follows:

	2016 HK\$'000	2015 HK\$'000
Within one year	66,905	91,783
In the second to fifth years, inclusive	45,468	49,486
Over five years	872	382
	113,245	141,651

Notes to Financial Statements

33. RELATED PARTY TRANSACTIONS

During the year, the Group had the following major transactions with related parties in the normal course of business. In addition to those disclosed elsewhere in the financial statements, the details of related party transactions, related expenses and income for the year and outstanding balances as at the year end are as follows:

	Notes	2016 HK\$'000	2015 HK\$'000
Related party transactions included in the consolidated income statement:			
Management fees and bank service charges from a fellow subsidiary	(a)	902	928
Management fees to the immediate holding company	(a)	1,740	1,740
Rent paid to the immediate holding company	(c)	43,005	42,923
Building management fee to the immediate holding company	(c)	92	109
Interest received from the immediate holding company	(l)	521	558
Interest received from key management personnel	(e)	–	–
Interest paid to the ultimate holding company	(f)	5	2
Interest paid to the immediate holding company	(f)	–	–
Interest paid to fellow subsidiaries	(f)	26	1,855
Interest paid to key management personnel	(f)	12	19
Commission and service fee paid to a fellow subsidiary	(g)	38	107
Commission income from key management personnel	(j)	–	23
Commitment fee paid to the ultimate holding company	(k)	2,396	2,355
Key management personnel compensation:			
– Short-term employee benefits	(h)	5,877	5,657
– Post employment benefits	(h)	304	287

	Notes	2016 HK\$'000	2015 HK\$'000
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Related party transactions included in the consolidated statement of financial position:

Cash and short term funds with the ultimate holding company	(d)	1,869	150
Rental deposit from a fellow subsidiary	(b)	60	60
Rental deposits and rent prepaid to the immediate holding company	(c)	32,183	32,283
Loans to key management personnel	(e)	201	115
Deposits from the ultimate holding company	(f)	15,304	414,696
Deposits from the immediate holding company	(f)	135,843	116,140
Deposits from fellow subsidiaries	(f)	23,968	21,298
Deposits from key management personnel	(f)	1,537	1,746
Bank loans to the immediate holding company	(l)	35,000	35,000
Interest payable to the ultimate holding company	(f)	–	2
Interest payable to a fellow subsidiary	(f)	2	2
Interest payable to key management personnel	(f)	2	1
Amounts due from a fellow subsidiary included in other assets	(i)	771	876

Notes to Financial Statements

33. RELATED PARTY TRANSACTIONS (Continued)

Notes:

- (a) Management fees arose in respect of administrative services provided to a fellow subsidiary by the Group. They were charged based on costs incurred during the year. Bank service charges arose in respect of banking services provided to the fellow subsidiary by the Group during the year.

Management fees arose in respect of administrative services provided by the immediate holding company to the Group. They were charged based on costs incurred during the year.

- (b) Rental deposit was derived from a property leased to a fellow subsidiary as its office.
- (c) Rent paid, rent prepaid, rental deposits and building management fee were related to properties rented from the immediate holding company as the Bank's offices during the year.
- (d) The Group placed deposits with the ultimate holding company. Interests were received/receivable from the ultimate holding company. The balances of the said deposits and interest receivable were included in cash and short term placements and other assets, respectively, in the consolidated statement of financial position.
- (e) These balances represented credit card receivables due from Directors of the Bank.
- (f) The ultimate holding company, the immediate holding company, fellow subsidiaries and key management personnel placed deposits with the Bank at the prevailing market rates. Interest expense/payables were paid by the Bank for the year in respect of these placements. The balances were included in customer deposits in the consolidated statement of financial position. In 2015, interest was also paid to a fellow subsidiary for a loan granted to a subsidiary of the Group.
- (g) The expenses represented commission and service fee paid to a fellow subsidiary for the referrals of taxi financing loans.
- (h) Further details of the Directors' remuneration are included in note 12 to the financial statements.
- (i) These balances include other receivables from a fellow subsidiary.
- (j) Commission income was received from key management personnel of the Group for securities dealings through the Group companies.
- (k) During the year, commitment fee was paid to the ultimate holding company in order to obtain standby facilities from the ultimate holding company to the Bank and Public Finance.
- (l) During the year, a facility line was granted to the immediate holding company in the normal course of business by the Bank and interest was received/receivable from the immediate holding company.

Notes to Financial Statements

34. FAIR VALUE OF FINANCIAL INSTRUMENTS

(a) Financial assets and financial liabilities not carried at fair value

The following describes the methodologies and assumptions used to determine fair values of financial instruments which are not carried at fair value in the financial statements.

Liquid or/and very short term and variable rate financial instruments

Liquid or/and very short term and variable rate financial instruments include loans and advances and receivables, held-to-maturity investments, customer deposits, certificates of deposit issued and unsecured bank loans. As these financial instruments are liquid or having a short term maturity or at variable rate, the carrying amounts are reasonable approximations of their fair values. In the case of loans and unquoted debt securities, their fair values do not reflect changes in their credit quality as the impact of credit risk is recognised separately by deducting the amount of the impairment allowances.

Fixed rate financial instruments

Fixed rate financial instruments include placements with banks and financial institutions, loans and advances and receivables, held-to-maturity investments, deposits from banks and other financial institutions, customer deposits and certificates of deposit issued. The fair values of these fixed rate financial instruments carried at amortised cost are based on prevailing money-market interest rates or current interest rates offered for similar financial instruments appropriate for the remaining term to maturity. The carrying amounts of such financial instruments are not materially different from their fair values.

(b) Financial assets and financial liabilities carried at fair value

The following table shows an analysis of financial instruments carried at fair value by level of the fair value hierarchy:

	2016			
	Level 1 HK\$'000	Level 2 HK\$'000	Level 3 HK\$'000	Total HK\$'000
Financial assets:				
Derivative financial instruments	–	412	–	412
Available-for-sale financial assets	–	–	6,804	6,804
	–	412	6,804	7,216
Financial liabilities:				
Derivative financial instruments	–	23,157	–	23,157

Notes to Financial Statements

34. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

(b) Financial assets and financial liabilities carried at fair value (Continued)

	Level 1	2015 Level 2	Level 3	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Financial assets:				
Derivative financial instruments	–	3,864	–	3,864
Available-for-sale financial assets	–	–	6,804	6,804
	–	3,864	6,804	10,668
Financial liabilities:				
Derivative financial instruments	–	588	–	588

Level 2 financial instruments comprise forward foreign exchange contracts and currency swaps. These instruments have been measured at fair value based on the forward foreign exchange rates that are quoted in an active market. As at 31 December 2016, the effects of discounting were considered insignificant for the Level 2 financial instruments.

Level 3 financial instruments are measured at fair value based on the present value cash flows over a period of 10 years.

For financial instruments measured at fair value on a recurring basis, the Group determines whether transfer has occurred between levels in the hierarchy by reassessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period. Finance and Control Department performs the valuation of financial instruments required for financial reporting purposes, including Level 3 fair values, at the end of each reporting period. The impact due to changes in fair value of the Level 3 financial instruments is insignificant to the Group.

For the years ended 31 December 2016 and 2015, there were no transfers amongst Level 1, Level 2 and Level 3 in the fair value hierarchy.

For the years ended 31 December 2016 and 2015, there were no issues and settlements related to the Level 3 financial instruments.

There was no gain or loss and no OCI reported in the consolidated income statement and consolidated statement of comprehensive income respectively related to the Level 3 financial instruments for the years ended 31 December 2016 and 2015.

For fair value measurement at Level 3, changing one or more of the inputs to the reasonably possible alternative assumptions would not change the fair value significantly.

Notes to Financial Statements

35. MATURITY ANALYSIS OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The table below shows an analysis of financial assets and financial liabilities analysed by principal according to the period that they are expected to be recovered or settled. The Group's contractual undiscounted repayment obligations are shown in the sub-section "Liquidity risk management" in note 36 to the financial statements.

	2016							
	Repayable on demand HK\$'000	Up to 1 month HK\$'000	Over 1 month but not more than 3 months HK\$'000	Over 3 months but not more than 12 months HK\$'000	Over 1 year but not more than 5 years HK\$'000	Over 5 years HK\$'000	Repayable within an indefinite period HK\$'000	Total HK\$'000
Financial assets:								
Cash and short term placements	1,377,805	2,878,024	-	-	-	-	-	4,255,829
Placements with banks and financial institutions maturing after one month but not more than twelve months	-	-	1,750,984	471,841	-	-	-	2,222,825
Loans and advances and receivables (gross)	691,761	2,018,871	1,419,931	2,840,117	6,286,764	15,445,693	230,616	28,933,753
Available-for-sale financial assets	-	-	-	-	-	-	6,804	6,804
Held-to-maturity investments	-	155,009	1,244,144	3,094,868	1,199,840	-	-	5,693,861
Other assets	293	31,631	15,413	31,197	-	-	50,461	128,995
Foreign exchange contracts (gross)	-	824,229	208,616	181,671	-	-	-	1,214,516
Total financial assets	2,069,859	5,907,764	4,639,088	6,619,694	7,486,604	15,445,693	287,881	42,456,583
Financial liabilities:								
Deposits and balances of banks and other financial institutions at amortised cost	58,788	597,212	151,152	122,240	-	-	-	929,392
Customer deposits at amortised cost	9,115,498	6,713,868	11,244,633	6,170,097	635,252	-	-	33,879,348
Certificates of deposit issued at amortised cost	-	529,990	542,788	-	-	-	-	1,072,778
Other liabilities	361	56,506	19,709	27,109	10,788	-	287,699	402,172
Foreign exchange contracts (gross)	-	841,281	212,083	183,897	-	-	-	1,237,261
Total financial liabilities	9,174,647	8,738,857	12,170,365	6,503,343	646,040	-	287,699	37,520,951
Net liquidity gap	(7,104,788)	(2,831,093)	(7,531,277)	116,351	6,840,564	15,445,693	182	4,935,632

Notes to Financial Statements

35. MATURITY ANALYSIS OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (Continued)

	2015							
	Repayable on demand HK\$'000	Up to 1 month HK\$'000	Over 1 month but not more than 3 months HK\$'000	Over 3 months but not more than 12 months HK\$'000	Over 1 year but not more than 5 years HK\$'000	Over 5 years HK\$'000	Repayable within an indefinite period HK\$'000	Total HK\$'000
Financial assets:								
Cash and short term placements	1,027,164	2,900,046	–	–	–	–	–	3,927,210
Placements with banks and financial institutions maturing after one month but not more than twelve months	–	–	444,339	573,794	–	–	–	1,018,133
Loans and advances and receivables (gross)	965,259	1,704,689	1,793,036	3,093,102	6,356,996	15,324,206	170,159	29,407,447
Available-for-sale financial assets	–	–	–	–	–	–	6,804	6,804
Held-to-maturity investments	–	204,276	792,086	3,313,255	1,033,255	–	–	5,342,872
Other assets	72	55,780	6,457	33,707	–	–	47,301	143,317
Foreign exchange contracts (gross)	–	1,521,753	512,407	309,961	–	–	–	2,344,121
Total financial assets	1,992,495	6,386,544	3,548,325	7,323,819	7,390,251	15,324,206	224,264	42,189,904
Financial liabilities:								
Deposits and balances of banks and other financial institutions at amortised cost	49,824	674,269	200,000	60,000	–	–	–	984,093
Customer deposits at amortised cost	8,285,703	8,947,867	10,517,342	5,396,063	18,848	–	–	33,165,823
Certificates of deposit issued at amortised cost	–	–	499,977	–	–	–	–	499,977
Other liabilities	92	81,482	22,279	50,389	2,381	–	178,915	335,538
Foreign exchange contracts (gross)	–	1,519,405	511,681	309,759	–	–	–	2,340,845
Total financial liabilities	8,335,619	11,223,023	11,751,279	5,816,211	21,229	–	178,915	37,326,276
Net liquidity gap	(6,343,124)	(4,836,479)	(8,202,954)	1,507,608	7,369,022	15,324,206	45,349	4,863,628

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial liabilities, other than derivatives, comprise customer deposits and certificates of deposit issued. The main purpose of these financial liabilities is to raise finance for the Group's operations. The Group has various financial assets such as cash and short term placements, held-to-maturity investments, loans and advances and receivables, and available-for-sale financial assets, which arise directly from its operations.

The Group also enters into derivative transactions, including principally forward currency contracts held for trading. The purpose is to manage or mitigate currency risk arising from the Group's operations.

The main risks arising from the Group's financial instruments are interest rate risk, market risk, credit risk, liquidity risk and operational risk.

The Group's business activities comprise retail and commercial banking services. These activities expose the Group to a variety of risks, mainly interest rate risk, market risk, credit risk, liquidity risk and operational risk. The respective Boards of the Bank and Public Finance review and approve policies for managing each of these risks and they are summarised below.

Risk management structure

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 enterprise-wide risk management policies and processes. The RMCs are assisted by the specific risk oversight committees including the Assets and Liabilities Management Committee ("ALCO"), Operational Risk Management Committee ("ORMC"), Credit Committee, Credit Risk Management Committee ("CRMC"), and Anti-Money Laundering and Counter-terrorist Financing (AML) and Compliance Committee or equivalent committees with similar functions of the Bank and Public Finance.

The Group has established systems, policies and procedures for the control and monitoring of interest rate risk, market risk, credit risk, liquidity risk and operational risk, which are approved and endorsed by the respective Boards of the Bank and Public Finance and reviewed regularly by their management, and other designated committees or working groups. Material risks are identified and assessed by designated committees and/or working groups before the launch of new products or business activities, and are monitored, documented and controlled against applicable risk limits after the introduction of new products or services or implementation of new business activities. Internal auditors of the Bank and Public Finance also perform regular audits to ensure compliance with the policies and procedures.

Interest rate risk management

Interest rate risk is the risk that the Group's position may be adversely affected by a change of market interest rates. The Group's interest rate risk arises primarily from the timing difference in the maturity and the repricing of the Group's interest-bearing assets, liabilities and off-balance sheet commitments. The primary objective of interest rate risk management is to limit the potential adverse effects of interest rate movements in net interest income by closely monitoring the net repricing gap of the Group's assets and liabilities. Interest rate risk is daily managed by the Group's Treasury Department and monitored and measured by the respective ALCOs of the Bank and Public Finance against limits approved by the respective Boards.

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Interest rate risk management (Continued)

Interest rate risk exposures in the banking book:

The relevant interest rate risk arises from repricing risk and basis risk.

Repricing risk is one of the sources of interest rate risk which arises from timing differences in interest rate changes and cash flows that occur in the repricing and maturity of fixed and floating rate assets, liabilities and off-balance sheet financial instruments. Should the interest rate increase/decrease by 200 basis points and the positive net interest gap be HK\$3,153 million (2015: HK\$2,610 million) up to 12 months in 2016, profit before tax in 2016 would increase/decrease by HK\$73 million or 1.37% of equity (2015: HK\$77 million or 1.48% of equity). Profit before tax would increase/decrease by HK\$80 million or 1.49% of equity (2015: HK\$59 million or 1.14% of equity) for the next 12 months after the reporting date.

Based on the positive net interest gap of HK\$5,489 million (2015: HK\$5,447 million) up to five years, the economic value would increase by HK\$71 million (2015: HK\$100 million).

Basis risk is one of the sources of interest rate risk which arises from the difference in the changes of interest rates earned and paid on different financial instruments with similar repricing characteristics. The Group adopts two stress-testing scenarios for the sensitivity analysis:

- (i) Interest rates on managed-rate assets would decrease by 200 basis points whilst interest rates on other interest-bearing assets and interest-bearing liabilities would keep unchanged. Based on this scenario assumption, profit before tax would decrease by HK\$340 million or 6.34% of equity (2015: HK\$315 million or 6.04% of equity) for the year ended 31 December 2016. Profit before tax would decrease by HK\$347 million or 6.46% of equity (2015: HK\$336 million or 6.45% of equity) for the next 12 months after the reporting date.
- (ii) Interest rates on interest-bearing assets and liabilities, except for interest rates on fixed rate assets and managed-rate assets, would increase by 200 basis points. Based on this scenario assumption, profit before tax would decrease by HK\$428 million or 7.97% of equity (2015: HK\$397 million or 7.61% of equity) for the year ended 31 December 2016. Profit before tax would decrease by HK\$434 million or 8.09% of equity (2015: HK\$418 million or 8.02% of equity) for the next 12 months after the reporting date.

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Interest rate risk management (Continued)

The carrying amounts, or notional amounts if applicable, of financial instruments exposed to interest rate risk based on the earlier of maturity dates and contractual repricing as at 31 December 2016 and 2015 are detailed as follows:

	1 year or less HK\$'000	Over 1 year but not more than 2 years HK\$'000	Over 2 years but not more than 3 years HK\$'000	Over 3 years but not more than 4 years HK\$'000	Over 4 years but not more than 5 years HK\$'000	Over 5 years HK\$'000	Non- interest- bearing HK\$'000	Total HK\$'000
Assets:								
Fixed rate financial assets								
Cash and short term placements	2,878,024	-	-	-	-	-	1,377,805	4,255,829
Placements with banks and financial institutions maturing after one month but not more than twelve months	2,222,825	-	-	-	-	-	-	2,222,825
Loans and advances and receivables	2,439,155	990,850	520,997	212,769	47,296	2,856	149,380	4,363,303
Derivative financial instruments	-	-	-	-	-	-	412	412
Available-for-sale financial assets	-	-	-	-	-	-	6,804	6,804
Held-to-maturity investments	4,494,020	600,050	532,644	-	-	-	-	5,626,714
	12,034,024	1,590,900	1,053,641	212,769	47,296	2,856	1,534,401	16,475,887
Floating rate financial assets								
Loans and advances and receivables	24,570,450	-	-	-	-	-	-	24,570,450
Held-to-maturity investments	-	-	67,147	-	-	-	-	67,147
	24,570,450	-	67,147	-	-	-	-	24,637,597
Less:								
Liabilities:								
Fixed rate financial liabilities								
Deposits and balances of banks and other financial institutions at amortised cost	870,604	-	-	-	-	-	58,788	929,392
Customer deposits at amortised cost	24,041,072	300,490	334,531	-	231	-	-	24,676,324
Derivative financial instruments	-	-	-	-	-	-	23,157	23,157
	24,911,676	300,490	334,531	-	231	-	81,945	25,628,873
Floating rate financial liabilities								
Customer deposits at amortised cost	7,467,216	-	-	-	-	-	1,735,808	9,203,024
Certificates of deposit issued at amortised cost	1,072,778	-	-	-	-	-	-	1,072,778
	8,539,994	-	-	-	-	-	1,735,808	10,275,802
Total interest sensitivity gap	3,152,804	1,290,410	786,257	212,769	47,065	2,856	(283,352)	5,208,809

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Interest rate risk management (Continued)

	2015							
	1 year or less HK\$'000	Over 1 year but not more than 2 years HK\$'000	Over 2 years but not more than 3 years HK\$'000	Over 3 years but not more than 4 years HK\$'000	Over 4 years but not more than 5 years HK\$'000	Over 5 years HK\$'000	Non- interest- bearing HK\$'000	Total HK\$'000
Assets:								
Fixed rate financial assets								
Cash and short term placements	2,900,046	–	–	–	–	–	1,027,164	3,927,210
Placements with banks and financial institutions maturing after one month but not more than twelve months	1,018,133	–	–	–	–	–	–	1,018,133
Loans and advances and receivables	2,441,971	1,001,838	542,922	224,244	53,252	3,664	124,340	4,392,231
Derivative financial instruments	–	–	–	–	–	–	3,864	3,864
Available-for-sale financial assets	–	–	–	–	–	–	6,804	6,804
Held-to-maturity investments	4,309,617	547,821	404,896	80,538	–	–	–	5,342,872
	10,669,767	1,549,659	947,818	304,782	53,252	3,664	1,162,172	14,691,114
Floating rate financial assets								
Loans and advances and receivables	25,015,216	–	–	–	–	–	–	25,015,216
Held-to-maturity investments	–	–	–	–	–	–	–	–
	25,015,216	–	–	–	–	–	–	25,015,216
Less:								
Liabilities:								
Fixed rate financial liabilities								
Deposits and balances of banks and other financial institutions at amortised cost	934,269	–	–	–	–	–	49,824	984,093
Customer deposits at amortised cost	24,804,435	15,661	3,187	–	–	–	–	24,823,283
Derivative financial instruments	–	–	–	–	–	–	588	588
	25,738,704	15,661	3,187	–	–	–	50,412	25,807,964
Floating rate financial liabilities								
Customer deposits at amortised cost	6,836,385	–	–	–	–	–	1,506,155	8,342,540
Certificates of deposit issued at amortised cost	499,977	–	–	–	–	–	–	499,977
	7,336,362	–	–	–	–	–	1,506,155	8,842,517
Total interest sensitivity gap	2,609,917	1,533,998	944,631	304,782	53,252	3,664	(394,395)	5,055,849

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Interest rate risk management (Continued)

The table below summarises the effective average interest rates as at 31 December for monetary financial instruments:

	2016 Rate %	2015 Rate %
Assets		
Cash and short term placements	2.11	1.19
Placements with banks and financial institutions	2.57	1.55
Loans and advances and receivables (including trade bills)	5.23	5.13
Held-to-maturity investments	1.26	1.02
Liabilities		
Deposits and balances of banks and other financial institutions at amortised cost	1.30	0.62
Customer deposits at amortised cost	0.95	0.91
Certificates of deposit issued at amortised cost	1.31	1.18

Market risk management

(a) Currency risk

Currency 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's foreign exchange risk positions arise from foreign exchange dealing, commercial banking operations and structural foreign currency exposures. All foreign exchange positions are managed by the Group's Treasury Department within limits approved by the Board.

The Group's assets and liabilities are mainly denominated in HKD, USD and RMB. The Group has limited foreign currency risk as the Group's net foreign currency positions are small, except for net structural position of RMB denominated operating capital.

As at 31 December 2016, if RMB had strengthened or weakened by 100 basis points against HKD with all other variables held constant, the Group's equity would have increased or decreased by HK\$12 million (2015: HK\$6 million) mainly as a result of foreign exchange impact arising from net structural position of RMB denominated operating capital.

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Market risk management (Continued)

(a) Currency risk (Continued)

Foreign currency exposures with a net position which constitutes not less than 10% of the total net position in all foreign currencies of the Bank are as follows:

	Spot assets HK\$'million	Spot liabilities HK\$'million	Forward purchases HK\$'million	Forward sales HK\$'million	Net long/ (short) position HK\$'million	Structural assets HK\$'million
As at 31 December 2016						
USD	5,437	4,420	109	1,123	3	–
RMB	2,120	2,087	2	1	34	1,112
Others	885	1,845	959	2	(3)	–
	8,442	8,352	1,070	1,126	34	1,112
	Spot assets HK\$'million	Spot liabilities HK\$'million	Forward purchases HK\$'million	Forward sales HK\$'million	Net long/ (short) position HK\$'million	Structural assets HK\$'million
As at 31 December 2015						
USD	5,508	4,120	477	1,863	2	–
RMB	1,339	1,319	1	2	19	590
AUD	858	943	236	153	(2)	–
Others	807	952	162	18	(1)	–
	8,512	7,334	876	2,036	18	590

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Market risk management (Continued)

(b) Price risk

Price risk is the risk to the Group's earnings and capital due to changes in the prices of securities, including debt securities and equities.

The Group monitors price risk principally by limits established for transactions and open positions. These limits are reviewed and approved by the Board and are monitored on a daily basis.

The Group did not actively trade in financial instruments and in the opinion of the Directors, the price risk related to trading activities to which the Group was exposed was not material. Accordingly, no quantitative market risk disclosures for price risk have been made.

Credit risk management

Credit risk is the risk that a customer or counterparty in a transaction may default. It arises from the lending, trade finance, treasury and other activities undertaken by the Group.

The Group has a credit risk management process to measure, monitor and control credit risk. Its Credit Policy Manual defines the credit extension and measurement criteria, the credit review, approval and monitoring processes, and the loan classification and provisioning systems. It has a hierarchy of credit authority which approves credit in compliance with the Group's credit policy. Credit risk exposures are measured and monitored against credit limits and other control limits (such as connected exposures, large exposures and risk concentration limits approved by respective Boards or dedicated committees). Segregation of duties in key credit functions is in place to ensure separate credit control and monitoring. Management and recovery of problem credits are handled by an independent work-out team.

The Group manages its credit risk within a conservative framework. Its credit policy is regularly revised, taking into account factors such as prevailing business and economic conditions, regulatory requirements and its capital resources. Its policy on connected lending exposure defines and states connected parties, statutory and applicable connected lending limits, types of connected transactions, the taking of collateral, the capital adequacy treatment, and detailed procedures and controls for monitoring connected lending exposures. In general, interest rates and other terms and conditions applying to connected lending should not be more favourable than those loans offered to non-connected borrowers under similar circumstances. The terms and conditions should be determined on normal commercial terms at arm's length and in the ordinary course of business of the Group.

Credit and compliance audits are periodically conducted by Internal Audit Department to evaluate the effectiveness of the credit review, approval and monitoring processes and to ensure that the established credit policies and procedures are complied with.

Compliance Department conducts compliance test at selected business units on identified high risk areas for adherence to regulatory and operational requirements and credit policies.

Credit Committees of the Bank and Public Finance 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.

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Credit risk management (Continued)

Credit Committees of the Bank and Public Finance also monitor the quality of past due or impaired financial assets by internal grading comprising “substandard”, “doubtful” and “loss” accounts through the same meeting discussions and management reports. Impaired financial assets include those subject to personal bankruptcy petitions, corporate winding-up and rescheduled arrangements.

CRMC of the Bank is responsible for establishing the framework for identifying, measuring, monitoring and controlling the credit risk of existing and new products. The Committee reviews credit risk management policies and credit risk tolerance limits, and reports to the RMC.

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.

The “Neither past due nor impaired loans and advances and receivables” are shown in note 17 to the financial statements.

Loans and advances and receivables that were neither past due nor impaired were related to a large number of diversified customers for whom there was no recent history of default.

Maximum credit exposures for off-balance sheet items without taking into account the fair value of collateral are as follows:

	2016 HK\$'000	2015 HK\$'000
Credit related contingent liabilities	839,991	231,507
Loan commitments and other credit related commitments	3,789,134	3,893,706

Liquidity risk management

Liquidity risk is the risk that the Group cannot meet its current obligations. Major sources of liquidity risk of the Group are the early or unexpected withdrawals of deposits in cash outflow and the delay in cash inflow from loan repayments. To manage liquidity risk, the Group has established a liquidity risk management framework which incorporates liquidity risk related policies and procedures, risk related metrics and tools, risk related assumptions, and the manner of reporting significant matters. The major objectives of liquidity risk management framework are to identify, measure and control liquidity risk exposures with proper implementation of funding strategies and reporting of significant risk related matters to management. Liquidity risk related policies are reviewed by senior management and dedicated committees, and significant changes in such policies are approved by the Boards of the Bank and Public Finance or committees delegated by the respective Boards. The respective Boards are responsible for exercising management oversight over the liquidity risk management framework of the Group.

ALCOs of the Bank and Public Finance monitor the liquidity position as part of the ongoing management of assets and liabilities, and set up trigger limits to monitor liquidity risk. They also closely monitor the liquidity of the subsidiaries on a periodic basis to ensure that the liquidity structure of the subsidiaries' assets, liabilities and commitments can meet their funding needs, and that internal liquidity trigger limits are complied with.

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Liquidity risk management (Continued)

Treasury Department of the Bank and a dedicated department of Public Finance are responsible for carrying out the strategies and policies approved by the dedicated committees and the respective Boards, and developing operational procedures and controls to ensure the compliance with the aforesaid policies and to minimise operational disruptions in case of a liquidity crisis.

Risk Management Departments of the Bank and Public Finance are responsible for day-to-day monitoring of liquidity maintenance ratios, loans to deposits ratios, concentration risk related ratios and other liquidity risk related ratios coupled with the use of cash flow projections, maturity ladder, stress-testing methodologies and other applicable risk assessment tools and metrics to detect early warning signals and identify vulnerabilities to potential liquidity risk on forward-looking basis with the objective of ensuring different types of liquidity risks of the Group are appropriately identified, measured, assessed and reported. They also carry out analysis based on risk-based management reports, summarise the data from those reports and present the key information to the respective ALCOs on a regular (at least monthly) basis. In case of significant issues, such as serious limit excesses or breaches or early warning signals of potential severe impact on the Bank or Public Finance are identified from the aforesaid management reports or market information obtained from Treasury Department and business units, a designated ALCO member will convene a meeting (involving senior management members) to discuss risk related matters and propose actions to ALCO whenever necessary. A high level summary of liquidity risk performance of the Bank or Public Finance will be presented by the respective ALCOs to their RMCs and the Boards.

The examples of liquidity risk related metrics of the Bank and Public Finance include internal trigger point of liquidity maintenance ratio which is higher than the statutory liquidity maintenance ratio; cash flow mismatches under normal and different stress scenarios; concentration related limits of deposits and other funding sources, and maturity profile of major assets and liabilities (including on-balance sheet and off-balance sheet items).

The funding strategies of the Group are to (i) diversify funding sources for containing liquidity risk exposures; (ii) minimise disruptions due to operational issues such as transfer of liquidity across group entities; (iii) ensure contingency funding is available to the Group; and (iv) maintain sufficient liquidity cushion to meet critical liquidity needs such as loan commitments and deposits' withdrawals in stressed situations. For illustration, concentration limits of funding sources such as intra-group funding limits are set to reduce reliance on single source of funding.

Contingency funding plan is formulated to address liquidity needs under different stages including the mechanism for the detection of early warning signals of potential crisis at early stage and obtaining of emergency funding in bank-run scenario at later stage. Designated roles and responsibilities of Crisis Management Team, departments and business units and their emergency contact information are documented clearly in the contingency funding plan policy as part of business continuity planning, and contingency funding measures are in place to set priorities of funding arrangements with counterparties, to set procedures for intraday liquidity risk management and intra-group funding support, to manage media relationship and to communicate with internal and external parties during a liquidity crisis. The stress-testing results are updated and reported to senior management regularly and the results such as survival period for positive cashflow mismatches are used in contingency funding planning. Standby facilities and liquid assets are maintained to provide liquidity to meet unexpected and material cash outflows in stressed situations.

The Group maintains sufficient liquidity cushion comprising mainly bills, notes or bonds issued by eligible central governments in total amount not less than HK\$1.5 billion to address critical and emergent liquidity needs on intraday basis and over other different time horizons. The Group is not subject to particular collateral arrangements or requirements in contracts if there is a credit rating downgrade of entities within the Group.

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Liquidity risk management (Continued)

Apart from cash flow projections under normal scenario to manage liquidity under different time horizons, different stress scenarios such as institution-specific stress scenario, general market stress scenario and the combination of such scenarios with assumptions are set and reviewed by dedicated committees and approved by the respective Boards. For instance, under institution-specific stress scenario, loan repayments from some customers are assumed to be delayed. The projected cash inflow would be reduced by the amount of rollover of banking facilities by some corporate customers or reduced by the amount of retail loan delinquencies. Regarding cash outflow projection, part of undrawn banking facilities are not to be utilised by borrowers or honoured by the Group. Core deposits ratio would decrease as there would be early withdrawals of some fixed deposits before contractual maturity dates or there would be fewer renewals of fixed deposits on the contractual maturity dates. In general market stress scenario, some undrawn banking facilities are not to be honored upon drawdown as some bank counterparties will not have sufficient liquidity to honor their obligations in market. The Group may pledge or liquidate its liquid assets such as debt securities (including but not limited to treasury bills or notes or bonds issued by eligible central governments) to secure funding to address potential liquidity crisis. Liquidity stress-tests are conducted regularly (at least monthly) and the results are utilised for part of contingency funding plan or for providing insights to management about the latest liquidity position of the Group.

Liquidity maintenance ratio

The Group was required to comply with the liquidity maintenance ratio requirement pursuant to section 97H of the Hong Kong Banking Ordinance and the Banking (Liquidity) Rules.

	2016	2015
Consolidated average liquidity maintenance ratio	47.9%	44.4%

The Group calculates the average liquidity maintenance ratio of each calendar month by reference to positions of specified days approved by the HKMA pursuant to Rule 48(2) of the Banking (Liquidity) Rules.

The average liquidity maintenance ratio is computed on a consolidated basis using the arithmetic mean of each calendar month's average liquidity maintenance ratio as reported in the return relating to the liquidity position submitted to the HKMA.

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Liquidity risk management (Continued)

Maturity analysis of financial liabilities, based on the contractual undiscounted cash flows, is as follows:

	Repayable on demand HK\$'000	Up to 1 month HK\$'000	2016			Over 5 years HK\$'000	Repayable within an indefinite period HK\$'000	Total HK\$'000
			Over 1 month but not more than 3 months HK\$'000	Over 3 months but not more than 12 months HK\$'000	Over 1 year but not more than 5 years HK\$'000			
Forward assets purchase	-	-	-	-	-	-	-	-
Foreign currency contracts (gross)	-	841,281	212,083	183,897	-	-	-	1,237,261
Credit related contingent liabilities	95,539	6,327	15,354	104,950	617,723	98	-	839,991
Loan commitments and other credit related commitments	2,966,990	792,747	24,622	4,775	-	-	-	3,789,134
Customer deposits at amortised cost	9,115,855	6,729,798	11,280,877	6,237,443	642,639	-	-	34,006,612
Deposits and balances of banks and other financial institutions at amortised cost	58,788	599,365	153,659	123,455	-	-	-	935,267
Certificates of deposit issued at amortised cost	-	536,924	551,607	-	-	-	-	1,088,531
Other liabilities	-	41,192	-	-	-	-	287,698	328,890
	12,237,172	9,547,634	12,238,202	6,654,520	1,260,362	98	287,698	42,225,686

	Repayable on demand HK\$'000	Up to 1 month HK\$'000	2015			Over 5 years HK\$'000	Repayable within an indefinite period HK\$'000	Total HK\$'000
			Over 1 month but not more than 3 months HK\$'000	Over 3 months but not more than 12 months HK\$'000	Over 1 year but not more than 5 years HK\$'000			
Forward assets purchase	-	1,513	-	-	-	-	-	1,513
Foreign currency contracts (gross)	-	1,519,405	511,681	309,759	-	-	-	2,340,845
Credit related contingent liabilities	41,014	36,958	16,353	106,706	30,378	98	-	231,507
Loan commitments and other credit related commitments	3,125,525	666,526	49,688	34,634	17,333	-	-	3,893,706
Customer deposits at amortised cost	8,285,795	8,967,918	10,555,739	5,473,750	19,916	-	-	33,303,118
Deposits and balances of banks and other financial institutions at amortised cost	49,824	674,762	200,600	60,205	-	-	-	985,391
Certificates of deposit issued at amortised cost	-	-	506,075	-	-	-	-	506,075
Other liabilities	-	64,361	-	-	-	-	178,915	243,276
	11,502,158	11,931,443	11,840,136	5,985,054	67,627	98	178,915	41,505,431

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Operational risk management

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, human and system errors or from external events.

The Group has an operational risk management function in place to identify, measure, monitor and control operational risk. Its Operational Risk Management Policy Manual defines the responsibilities of various committees, business units and supporting departments, and highlights key operational risk factors and categories with loss event types to facilitate the measurement and assessment of operational risks and their potential impact. Operational risk exposures are monitored by appropriate key risk indicators for tracking and escalation to management for providing early warning signals of increased operational risk or a breakdown in operational risk management. Regular operational risk management reports are received and consolidated from various parties and reported to the ORMC for the monitoring and control of operational risk.

Capital management

Capital of the Group for regulatory and risk management purposes includes share capital, reserves, retained profits, regulatory reserve and subordinated debts, if any. Finance and Control Department is responsible for monitoring the amount of the capital base and capital adequacy ratios against trigger limits and for risk exposures and ensuring compliance with relevant statutory limits, taking into account business growth, dividend payout and other relevant factors.

The Group's policy is to maintain a strong capital base to support the development of the Group's businesses and to meet the statutory capital adequacy ratio and other regulatory capital requirements. Capital is allocated to various business activities of the Group depending on the risks taken by each business division and in accordance with the requirements of relevant regulatory bodies, taking into account current and future activities within a time frame of 3 years.

Capital adequacy ratios

The consolidated capital adequacy ratios of the Group are computed in accordance with the provisions of the Banking (Amendment) Ordinance 2012 relating to Basel III capital standards and the amended Capital Rules. The Group has adopted the standardised approach for the calculation of credit risk-weighted exposures and market risk-weighted exposures. The Group has adopted the basic indicator approach and the standardised approach for the calculation of operational risk-weighted exposures of the Bank and Public Finance, respectively.

	2016	2015
Consolidated CET1 Capital Ratio	16.6%	16.8%
Consolidated Tier 1 Capital Ratio	16.6%	16.8%
Consolidated Total Capital Ratio	17.7%	18.0%

The above capital ratios are higher than the minimum capital ratios required by the HKMA.

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Capital management (Continued)

Capital disclosures

The components of capital base include the following items:

	2016 HK\$'000	2015 HK\$'000
CET1 capital instruments	2,854,045	2,854,045
Retained earnings	1,953,733	1,740,072
Disclosed reserves	432,398	501,284
CET1 capital before deduction	5,240,176	5,095,401
Deduct:		
Cumulative fair value gains arising from the revaluation of land and buildings (covering both own-use and investment properties)	(26,665)	(26,214)
Regulatory reserve for general banking risk	(438,738)	(455,442)
Goodwill	(242,342)	(242,342)
Deferred tax assets in excess of deferred tax liabilities	(15,210)	(17,077)
CET1 capital after deduction	4,517,221	4,354,326
Additional Tier 1 capital	–	–
Tier 1 capital after deductions	4,517,221	4,354,326
Reserve attributable to fair value gains	11,999	11,796
Regulatory reserve for general banking risk	284,915	272,259
Collective provisions	12,310	15,725
	297,225	287,984
Tier 2 capital	309,224	299,780
Capital base	4,826,445	4,654,106

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Capital management (Continued)

Capital conservation buffer (CCB)

The Group is subject to the 2.5% CCB ratio which has been phased-in from 2016. The applicable CCB ratio effective from 1 January 2016 and 1 January 2017 is 0.625% and 1.25%, respectively. The Group has reserved a capital buffer for the implementation of CCB ratio for which the applicable CCB ratio will become fully effective on 1 January 2019.

Countercyclical capital buffer (CCyB)

The CCyB ratio is an additional layer of CET1 Capital which takes effect as an extension of the Basel III capital conservation buffer.

The Group has reserved a capital buffer for the implementation of CCyB ratio, inclusive of CCyB ratio of 0.625%, to the private sector credit exposures in Hong Kong that has been applied since 1 January 2016.

The following table illustrates the geographical breakdown of risk-weighted amounts ("RWA") in relation to private sector credit exposures:

Jurisdiction (J)	Applicable JCCyB ratio in effect %	Total RWA used in computation of CCyB ratio HK\$'000	CCyB ratio %	CCyB amount HK\$'000
As at 31 December 2016				
1. Hong Kong	0.625	18,188,716		
2. Mainland China	0.000	1,882,585		
Total		20,071,301	0.566	113,679

Comparative figures are not required as this is the first year of disclosure.

Leverage ratio

The leverage ratio is introduced into the Basel III framework as a non-risk-based backstop limit to supplement risk-based capital requirements. It aims to constraining the build-up of excess leverage in the banking sector, and introducing additional safeguards against model risk and measurement errors. The ratio is a volume-based measure calculated as Basel III Tier 1 capital divided by total on-balance sheet and off-balance sheet exposures with reference to the Completion Instruction of the Quarterly Template on Leverage Ratio.

	2016 HK\$'000	2015 HK\$'000
Consolidated Tier 1 Capital	4,517,221	4,354,326
Consolidated Exposure Measure for Leverage Ratio	42,213,511	40,204,730
Consolidated Leverage Ratio	10.7%	10.8%

The disclosure on leverage ratio is effective since 31 March 2015 and the relevant disclosures can be viewed in the "Regulatory Disclosures" section on the Bank's website: www.publicbank.com.hk on or before 30 April 2017.

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Capital management (Continued)

Risk exposures

Class of exposures	2016					
	Rated# HK\$'000	Exposures* Unrated HK\$'000	Total HK\$'000	Risk-weighted amounts		
				Rated HK\$'000	Unrated HK\$'000	Total HK\$'000
On-balance sheet:						
Sovereign	2,346,214	–	2,346,214	–	–	–
Public sector entity	–	101,227	101,227	–	20,245	20,245
Bank	9,575,776	120,794	9,696,570	3,463,819	39,214	3,503,033
Securities firm	–	379,657	379,657	–	189,829	189,829
Corporate	–	6,305,066	6,305,066	–	6,305,066	6,305,066
Cash items	–	585,542	585,542	–	50,700	50,700
Regulatory retail	–	9,300,164	9,300,164	–	6,975,123	6,975,123
Residential mortgage loan	–	10,770,352	10,770,352	–	4,380,168	4,380,168
Other non-past due	–	1,951,363	1,951,363	–	2,047,756	2,047,756
Past due	–	77,978	77,978	–	97,611	97,611
Exposures subject to 1250% risk-weight	–	–	–	–	–	–
Off-balance sheet:						
Over-the-counter (“OTC”) derivative transactions						
– foreign exchange contracts	–	1,214,516	1,214,516	–	2,530	2,530
Other off-balance sheet items	–	4,629,125	4,629,125	–	205,916	205,916
	11,921,990	35,435,784	47,357,774	3,463,819	20,314,158	23,777,977

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)**Capital management (Continued)****Risk exposures (Continued)**

Class of exposures	Rated [#] HK\$'000	Exposures* Unrated HK\$'000	2015			
			Total HK\$'000	Risk-weighted amounts		
				Rated HK\$'000	Unrated HK\$'000	Total HK\$'000
On-balance sheet:						
Sovereign	2,083,451	–	2,083,451	–	–	–
Public sector entity	–	103,754	103,754	–	20,751	20,751
Bank	8,038,208	62,684	8,100,892	3,122,041	30,546	3,152,587
Securities firm	–	608,407	608,407	–	304,204	304,204
Corporate	–	5,910,934	5,910,934	–	5,910,934	5,910,934
Cash items	–	1,133,528	1,133,528	–	172,031	172,031
Regulatory retail	–	8,868,729	8,868,729	–	6,651,547	6,651,547
Residential mortgage loan	–	11,220,995	11,220,995	–	4,537,543	4,537,543
Other non-past due	–	1,974,704	1,974,704	–	2,070,947	2,070,947
Past due	–	45,903	45,903	–	64,523	64,523
Exposures subject to 1250% risk-weight	–	3,347	3,347	–	41,838	41,838
Off-balance sheet:						
OTC derivative transactions						
– foreign exchange contracts	–	2,344,121	2,344,121	–	4,894	4,894
Other off-balance sheet items	–	4,126,727	4,126,727	–	106,911	106,911
	10,121,659	36,403,833	46,525,492	3,122,041	19,916,669	23,038,710

The Group did not enter into OTC derivative transactions other than foreign exchange contracts with counterparties during 2016 and 2015. The Group assigns internal capital and credit limits based on the methodology stipulated in the Capital Rules. Counterparties of those OTC derivative transactions are banks and the Group does not place collaterals to such counterparties. The credit exposures attributed to such transactions were considered insignificant.

* Principal amount or credit equivalent amount, net of individual impairment allowances before or after credit risk mitigation.

[#] Exposures are rated by the Bank's External Credit Assessment Institutions ("ECAI"), Moody's with ECAI issue specific ratings or with ECAI inferred ratings. Risk weights are determined based on ECAI ratings pursuant to the Capital Rules.

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Capital management (Continued)

Risk exposures (Continued)

	2016 Risk-weighted exposures HK\$'000	Capital requirements/ charge HK\$'000
Credit risk	23,777,977	1,902,238
Credit risk – credit valuation adjustment	1,575	126
Market risk – foreign exchange exposures	1,145,950	91,676
Operational risk	2,441,600	195,328
Deductions	(168,489)	
	27,198,613	
	2015 Risk-weighted exposures HK\$'000	Capital requirements/ charge HK\$'000
Credit risk	23,038,710	1,843,097
Credit risk – credit valuation adjustment	675	54
Market risk – foreign exchange exposures	609,288	48,743
Operational risk	2,409,300	192,744
Deductions	(197,601)	
	25,860,372	

For the years ended 31 December 2016 and 2015, the Group has adopted the standardised approach for calculation of credit risk-weighted exposures and market risk-weighted exposures. The Group has adopted the basic indicator approach and the standardised approach for the calculation of operational risk-weighted exposures of the Bank and Public Finance respectively.

As at 31 December 2016 and 2015, the Group had no securitisation exposures.

Notes to Financial Statements

36. RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Capital management (Continued)

Principal subsidiaries and basis of consolidation

The basis of consolidation for financial accounting purposes is in accordance with HKFRSs, as described in note 3 to the financial statements.

The basis of consolidation for regulatory purposes is different from that for accounting purposes. Subsidiaries included in the consolidation for regulatory purposes are specified in a notice from the HKMA in accordance with section 3C(1) of the Capital Rules.

The subsidiaries not included in the computation of the consolidated capital adequacy ratios of the Group are Public Bank (Nominees) Limited, Public Investments Limited (dissolved on 16 December 2015), Public Realty Limited (dissolved on 16 December 2015), 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.

Details of the Bank's subsidiaries are set out in note 1 to the financial statements.

Capital instruments

To comply with the Banking (Disclosure) Rules, the Group will present all the information relating to the disclosure of regulatory capital instruments and the reconciliation to the Group's published financial statements under "Regulatory Disclosures" section on the Bank's website: www.publicbank.com.hk on or before 30 April 2017.

The disclosure will include the following information:

- a description of the main features and full terms and conditions of the Group's capital instruments;
- a detailed breakdown of the Group's CET1 capital, Additional Tier 1 capital, Tier 2 capital and regulatory deductions, using the standard disclosure template as specified by the HKMA; and
- a full reconciliation between the Group's accounting and regulatory balance sheets, using the standard disclosure template as specified by the HKMA.

The following is a summary of the Group's CET1 capital instruments:

	Note	2016 HK\$'000	2015 HK\$'000
CET1 capital instruments issued by the Bank			
Ordinary shares:			
14,816,000 issued and fully paid ordinary shares	29	2,854,045	2,854,045

Notes to Financial Statements

37. STATEMENT OF FINANCIAL POSITION OF THE BANK

Information about the statement of financial position of the Bank at the end of the reporting year is as follows:

	Note	2016 HK\$'000	2015 HK\$'000
ASSETS			
Cash and short term placements		4,024,287	3,707,318
Placements with banks and financial institutions maturing after one month but not more than twelve months		2,222,825	1,018,133
Derivative financial instruments		412	3,864
Loans and advances and receivables	37(a)	23,490,424	24,079,647
Available-for-sale financial assets		6,804	6,804
Held-to-maturity investments		5,673,892	5,322,874
Investments in subsidiaries		1,755,896	1,755,896
Interest in a joint venture		1,500	1,500
Deferred tax assets		13,732	12,728
Tax recoverable		10,055	–
Property and equipment		74,397	53,911
Land held under finance leases		92,019	94,742
Investment properties		82,676	32,480
Other assets		113,185	130,998
TOTAL ASSETS		37,562,104	36,220,895

Notes to Financial Statements

37. STATEMENT OF FINANCIAL POSITION OF THE BANK (Continued)

	Notes	2016 HK\$'000	2015 HK\$'000
EQUITY AND LIABILITIES			
LIABILITIES			
Deposits and balances of banks and other financial institutions at amortised cost		1,688,983	1,720,324
Derivative financial instruments		23,157	588
Customer deposits at amortised cost	37(b)	29,195,510	28,632,191
Certificates of deposit issued at amortised cost		1,072,778	499,977
Current tax payable		7,681	5,769
Deferred tax liabilities		9,027	5,272
Other liabilities		270,624	230,571
TOTAL LIABILITIES		32,267,760	31,094,692
EQUITY ATTRIBUTABLE TO OWNERS OF THE BANK			
Share capital		2,854,045	2,854,045
Reserves	37(c)	2,440,299	2,272,158
TOTAL EQUITY		5,294,344	5,126,203
TOTAL EQUITY AND LIABILITIES		37,562,104	36,220,895

Lai Wan
Director

Tan Yoke Kong
Director

Chong Yam Kiang
Director

Notes to Financial Statements

37. STATEMENT OF FINANCIAL POSITION OF THE BANK (Continued)

(a) Loans and advances and receivables

Information about the loans and advances and receivables of the Bank at the end of the reporting year is as follows:

	2016 HK\$'000	2015 HK\$'000
Loans and advances to customers	23,436,820	24,018,481
Trade bills	53,012	64,552
Loans and advances, and trade bills	23,489,832	24,083,033
Accrued interest	32,906	30,970
Other receivables	23,522,738 1,217	24,114,003 935
Gross loans and advances and receivables	23,523,955	24,114,938
Less: Impairment allowances for loans and advances and receivables		
– individually assessed	(29,131)	(28,741)
– collectively assessed	(4,400)	(6,550)
	(33,531)	(35,291)
Loans and advances and receivables	23,490,424	24,079,647

Over 90% (2015: over 90%) of the loans and advances and receivables were unrated exposures. Over 90% (2015: over 90%) of the collateral for the secured loans and advances and receivables were customer deposits, properties, listed shares, taxi licences, public light bus licences and vehicles.

Loans and advances and receivables are summarised as follows:

	2016 HK\$'000	2015 HK\$'000
Neither past due nor impaired loans and advances and receivables	23,167,009	23,895,714
Past due but not impaired loans and advances and receivables	250,072	150,606
Individually impaired loans and advances	102,529	65,852
Individually impaired receivables	4,345	2,766
Gross loans and advances and receivables	23,523,955	24,114,938

About 74% (2015: 73%) of “Neither past due nor impaired loans and advances and receivables” were property mortgage loans and hire purchase loans secured by properties, taxi licences, public light bus licences and vehicles.

Notes to Financial Statements

37. STATEMENT OF FINANCIAL POSITION OF THE BANK (Continued)**(a) Loans and advances and receivables (Continued)****(i) a) Ageing analysis of overdue and impaired loans and advances**

	2016		2015	
	Gross amount HK\$'000	Percentage of total loans and advances %	Gross amount HK\$'000	Percentage of total loans and advances %
Loans and advances overdue for:				
Six months or less but over three months	17,077	0.07	12,354	0.05
One year or less but over six months	36,583	0.16	12,990	0.05
Over one year	8,903	0.04	11,050	0.05
Loans and advances overdue for more than three months	62,563	0.27	36,394	0.15
Rescheduled loans and advances overdue for three months or less	1,546	0.01	7,098	0.03
Impaired loans and advances overdue for three months or less	38,420	0.16	22,360	0.09
Total overdue and impaired loans and advances	102,529	0.44	65,852	0.27

b) Ageing analysis of overdue and impaired trade bills, accrued interest and other receivables

	2016 HK\$'000	2015 HK\$'000
Trade bills, accrued interest and other receivables overdue for:		
Six months or less but over three months	287	251
One year or less but over six months	1,605	384
Over one year	1,960	1,972
Trade bills, accrued interest and other receivables overdue for more than three months	3,852	2,607
Impaired trade bills, accrued interest and other receivables overdue for three months or less	493	159
Total overdue and impaired trade bills, accrued interest and other receivables	4,345	2,766

Impaired loans and advances and receivables are individually determined to be impaired after considering the overdue ageing analysis and other qualitative factors such as bankruptcy proceedings and individual voluntary arrangements.

Notes to Financial Statements

37. STATEMENT OF FINANCIAL POSITION OF THE BANK (Continued)

(a) Loans and advances and receivables (Continued)

(ii) Geographical analysis of overdue and impaired loans and advances and receivables, and individual impairment allowances

a) Analysis of overdue loans and advances and receivables

	Hong Kong HK\$'000	2016 Mainland China HK\$'000	Total HK\$'000
Loans and advances and receivables overdue for more than three months	41,828	24,587	66,415
Individual impairment allowances	2,853	22,429	25,282
Current market value and fair value of collateral			96,114
	Hong Kong HK\$'000	2015 Mainland China HK\$'000	Total HK\$'000
Loans and advances and receivables overdue for more than three months	26,253	12,748	39,001
Individual impairment allowances	14,397	11,457	25,854
Current market value and fair value of collateral			41,782

Notes to Financial Statements

37. STATEMENT OF FINANCIAL POSITION OF THE BANK (Continued)

(a) Loans and advances and receivables (Continued)

(ii) Geographical analysis of overdue and impaired loans and advances and receivables, and individual impairment allowances (Continued)

b) Analysis of impaired loans and advances and receivables

	Hong Kong HK\$'000	2016 Mainland China HK\$'000	Total HK\$'000
Impaired loans and advances and receivables	82,287	24,587	106,874
Individual impairment allowances	6,702	22,429	29,131
Current market value and fair value of collateral			164,908

	Hong Kong HK\$'000	2015 Mainland China HK\$'000	Total HK\$'000
Impaired loans and advances and receivables	55,762	12,856	68,618
Individual impairment allowances	17,176	11,565	28,741
Current market value and fair value of collateral			100,854

Over 90% (2015: over 90%) of the Bank's gross loans and advances and receivables are derived from operations carried out in Hong Kong. Accordingly, no geographical segment information of gross loans and advances and receivables is presented herein.

Notes to Financial Statements

37. STATEMENT OF FINANCIAL POSITION OF THE BANK (Continued)

(a) Loans and advances and receivables (Continued)

- (iii) The value of collateral held in respect of the overdue loans and advances and the split between the portion of the overdue loans and advances covered by credit protection (covered portion) and the remaining portion (uncovered portion) are as follows:

	2016 HK\$'000	2015 HK\$'000
Current market value and fair value of collateral held against the covered portion of overdue loans and advances	96,114	41,782
Covered portion of overdue loans and advances	51,124	22,053
Uncovered portion of overdue loans and advances	11,439	14,341

The assets taken as collateral should satisfy the following criteria:

- The market value of the asset is readily determinable or can be reasonably established and verified.
- The asset is marketable and there exists a readily available secondary market for disposal of the asset.
- The Bank's right to repossess the asset is legally enforceable without impediment.
- The Bank is able to secure control over the asset if necessary.

The main types of guarantors for credit risk mitigation are as follows:

- Central governments with a grading of Aa3 or above
- Unrated public sector enterprises
- Banks with a grading of Baa2 or above
- Unrated corporations
- Individual shareholders and directors of corporate customers

(iv) Repossessed assets

As at 31 December 2016, the total value of repossessed assets of the Bank amounted to HK\$7,210,000 (2015: Nil).

Notes to Financial Statements

37. STATEMENT OF FINANCIAL POSITION OF THE BANK (Continued)**(a) Loans and advances and receivables (Continued)****(v) Past due but not impaired loans and advances and receivables**

	2016		2015	
	Gross amount HK\$'000	Percentage of total loans and advances %	Gross amount HK\$'000	Percentage of total loans and advances %
Loans and advances overdue for three months or less	233,769	1.00	149,471	0.62
Trade bills, accrued interest and other receivables overdue for three months or less	16,303		1,135	

(b) Customer deposits at amortised cost

The information of the composition of customer deposits of the Bank is as follows:

	2016 HK\$'000	2015 HK\$'000
Demand deposits and current accounts	3,800,544	3,338,362
Savings deposits	5,507,254	5,143,268
Time, call and notice deposits	19,887,712	20,150,561
	29,195,510	28,632,191

Notes to Financial Statements

37. STATEMENT OF FINANCIAL POSITION OF THE BANK (Continued)

(c) Reserves

Information on the movement of the reserves of the Bank during the reporting year is as follows:

	Other reserves				Total HK\$'000
	Capital reserve HK\$'000	Regulatory reserve HK\$'000	Retained profits HK\$'000	Translation reserve HK\$'000	
As at 1 January 2015	3,660	342,303	1,682,925	68,153	2,097,041
Profit for the year	–	–	384,777	–	384,777
Other comprehensive income	–	–	–	(25,971)	(25,971)
Transfer from retained profits	–	12,392	(12,392)	–	–
Dividends paid in respect of previous year	–	–	(89,992)	–	(89,992)
Dividends paid in respect of current year	–	–	(93,697)	–	(93,697)
As at 31 December 2015 and 1 January 2016	3,660	354,695	1,871,621	42,182	2,272,158
Profit for the year	–	–	417,494	–	417,494
Other comprehensive income	–	–	–	(52,182)	(52,182)
Transfer to retained profits	–	(20,841)	20,841	–	–
Dividends paid in respect of previous year	–	–	(98,808)	–	(98,808)
Dividends paid in respect of current year	–	–	(98,363)	–	(98,363)
As at 31 December 2016	3,660	333,854	2,112,785	(10,000)	2,440,299

Note:

The regulatory reserve is maintained to satisfy the provisions of the Hong Kong Banking Ordinance for prudential supervision purpose. It was held as a buffer of capital to absorb potential financial losses in excess of the accounting standards' requirements pursuant to HKMA's guidelines.

38. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the Board on 19 January 2017.

Supplementary Financial Information (Unaudited)

(A) ADVANCES TO CUSTOMERS BY INDUSTRY SECTORS

Gross and impaired loans and advances to customers, impairment allowances, impaired loans and advances written off and collateral are analysed by industry sectors pursuant to the HKMA's guidelines as follows:

Group	31 December 2016								
	Gross loans and advances HK\$'000	Collective impairment allowances HK\$'000	Individual impairment allowances HK\$'000	New impairment allowances charged to income statement HK\$'000	Amount of impaired loans and advances written off HK\$'000	Collateral HK\$'000	Percentage of gross advances covered by collateral %	Impaired loans and advances HK\$'000	Loans and advances overdue for more than three months HK\$'000
Loans and advances for use in Hong Kong									
Manufacturing	573,938	100	127	760	760	560,824	97.7	1,298	127
Building and construction, property development and investment									
Property development	153,517	23	-	1	-	152,698	99.5	-	-
Property investment	5,847,863	860	594	401	-	5,847,267	100.0	17,382	7,655
Civil engineering works	136,135	37	-	-	133	46,389	34.1	-	-
Electricity and gas	-	-	-	-	-	-	-	-	-
Recreational activities	23,004	3	-	-	-	22,894	99.5	-	-
Information technology	3,757	1	-	-	-	3,757	100.0	-	-
Wholesale and retail trade	241,175	88	97	161	623	212,986	88.3	9,717	9,717
Transport and transport equipment	4,084,932	567	1,166	1,192	2,489	4,065,880	99.5	1,166	395
Hotels, boarding houses and catering	160,760	24	-	-	-	152,832	95.1	-	-
Financial concerns	790,989	116	-	39	-	750,989	94.9	-	-
Stockbrokers									
Margin lending	378,922	55	-	-	-	289,018	76.3	-	-
Others	61	-	-	-	-	-	-	-	-
Non-stockbroking companies and individuals for the purchase of shares									
Margin lending	41,713	6	-	-	-	33,730	80.9	-	-
Others	82,014	12	-	-	-	80,215	97.8	-	-
Professional and private individuals									
Loans for the purchase of flats covered by the guarantees issued by the Housing Authority under the Home Ownership Scheme, Private Sector Participation Scheme and Tenant Purchase Scheme	65,124	10	-	-	-	65,124	100.0	-	-
Loans for the purchase of other residential properties	8,713,755	1,235	2,407	2,411	-	8,711,348	100.0	48,816	22,264
Loans for credit card advances	12,051	2	35	104	90	-	-	143	49
Loans for other business purposes	24,184	4	-	-	-	24,184	100.0	-	-
Loans for other private purposes	3,915,156	7,571	85,499	381,105	370,554	207,231	5.3	125,057	66,955
Trade finance	1,091,662	160	-	-	-	1,048,861	96.1	-	-
Other loans and advances	85,812	13	-	-	-	84,118	98.0	-	-
Sub-total	26,426,524	10,887	89,925	386,174	374,649	22,360,345	84.6	203,579	107,162
Loans and advances for use outside Hong Kong	2,373,657	1,138	21,567	14,752	2,505	2,261,269	95.3	22,692	22,691
Total loans and advances (excluding trade bills and other receivables)	28,800,181	12,025	111,492	400,926	377,154	24,621,614	85.5	226,271	129,853

Supplementary Financial Information (Unaudited)

(A) ADVANCES TO CUSTOMERS BY INDUSTRY SECTORS (Continued)

Bank	31 December 2016								
	Gross loans and advances HK\$'000	Collective impairment allowances HK\$'000	Individual impairment allowances HK\$'000	New impairment allowances charged to income statement HK\$'000	Amount of impaired loans and advances written off HK\$'000	Collateral HK\$'000	Percentage of gross advances covered by collateral %	Impaired loans and advances HK\$'000	Loans and advances overdue for more than three months HK\$'000
Loans and advances for use in Hong Kong									
Manufacturing	567,201	83	127	-	-	560,824	98.9	1,298	127
Building and construction, property development and investment									
Property development	153,069	22	-	-	-	152,698	99.8	-	-
Property investment	5,835,227	854	594	399	-	5,834,631	100.0	17,382	7,655
Civil engineering works	127,202	19	-	-	133	46,289	36.4	-	-
Electricity and gas	-	-	-	-	-	-	-	-	-
Recreational activities	22,894	3	-	-	-	22,894	100.0	-	-
Information technology	3,757	1	-	-	-	3,757	100.0	-	-
Wholesale and retail trade	211,783	31	51	51	559	211,237	99.7	9,655	9,655
Transport and transport equipment	3,388,659	496	1,166	1,187	2,489	3,369,967	99.4	1,166	395
Hotels, boarding houses and catering	160,760	24	-	-	-	152,832	95.1	-	-
Financial concerns	790,989	116	-	39	-	750,989	94.9	-	-
Stockbrokers									
Margin lending	378,922	55	-	-	-	289,018	76.3	-	-
Others	61	-	-	-	-	-	-	-	-
Non-stockbroking companies and individuals for the purchase of shares									
Margin lending	41,713	6	-	-	-	33,730	80.9	-	-
Others	82,014	12	-	-	-	80,215	97.8	-	-
Professional and private individuals									
Loans for the purchase of flats covered by the guarantees issued by the Housing Authority under the Home Ownership Scheme, Private Sector Participation Scheme and Tenant Purchase Scheme	65,124	10	-	-	-	65,124	100.0	-	-
Loans for the purchase of other residential properties	7,824,028	1,145	2,407	2,407	-	7,821,621	100.0	48,816	22,264
Loans for credit card advances	12,051	2	35	104	90	-	-	143	49
Loans for other business purposes	24,184	4	-	-	-	24,184	100.0	-	-
Loans for other private purposes	225,544	33	2,159	1,928	2,371	162,345	72.0	2,222	572
Trade finance	1,091,662	160	-	-	-	1,048,861	96.1	-	-
Other loans and advances	85,812	13	-	-	-	84,118	98.0	-	-
Sub-total	21,092,656	3,089	6,539	6,115	5,642	20,715,334	98.2	80,682	40,717
Loans and advances for use outside Hong Kong	2,344,164	1,026	20,477	12,077	549	2,261,069	96.5	21,847	21,846
Total loans and advances (excluding trade bills and other receivables)	23,436,820	4,115	27,016	18,192	6,191	22,976,403	98.0	102,529	62,563

Supplementary Financial Information (Unaudited)

(A) ADVANCES TO CUSTOMERS BY INDUSTRY SECTORS (Continued)

Group	31 December 2015								
	Gross loans and advances HK\$'000	Collective impairment allowances HK\$'000	Individual impairment allowances HK\$'000	New impairment allowances charged to income statement HK\$'000	Amount of impaired loans and advances written off HK\$'000	Collateral HK\$'000	Percentage of gross advances covered by collateral %	Impaired loans and advances HK\$'000	Loans and advances overdue for more than three months HK\$'000
Loans and advances for use in Hong Kong									
Manufacturing	693,231	196	265	596	362	664,341	95.8	265	265
Building and construction, property development and investment									
Property development	298,601	68	–	–	–	298,552	100.0	–	–
Property investment	6,189,315	1,421	9,260	9,262	–	5,992,628	96.8	24,405	9,260
Civil engineering works	132,921	48	580	587	–	43,105	32.4	580	580
Electricity and gas	582	–	–	–	–	582	100.0	–	–
Recreational activities	25,776	6	–	1	–	25,766	100.0	–	–
Information technology	4,535	1	–	–	–	4,535	100.0	–	–
Wholesale and retail trade	200,119	98	859	1,480	1,012	177,739	88.8	859	859
Transport and transport equipment	3,852,832	802	2,547	2,605	–	3,818,607	99.1	2,604	2,547
Hotels, boarding houses and catering	136,149	31	–	–	–	124,426	91.4	–	–
Financial concerns	335,918	77	–	–	–	201,530	60.0	–	–
Stockbrokers									
Margin lending	607,316	139	–	–	–	434,925	71.6	–	–
Others	–	–	–	–	–	–	–	–	–
Non-stockbroking companies and individuals for the purchase of shares									
Margin lending	131,660	30	–	–	–	101,369	77.0	–	–
Others	84,309	19	–	–	–	82,508	97.9	407	–
Professional and private individuals									
Loans for the purchase of flats covered by the guarantees issued by the Housing Authority under the Home Ownership Scheme, Private Sector Participation Scheme and Tenant Purchase Scheme	80,909	19	–	–	–	80,909	100.0	–	–
Loans for the purchase of other residential properties	8,944,032	1,943	–	79	–	8,944,032	100.0	14,588	8,488
Loans for credit card advances	12,034	3	23	134	112	–	–	23	9
Loans for other business purposes	24,748	6	–	–	–	24,748	100.0	–	–
Loans for other private purposes	4,002,251	8,949	75,622	389,914	387,828	267,771	6.7	104,782	72,770
Trade finance	889,528	204	–	94	183	824,825	92.7	7,480	2,564
Other loans and advances	89,108	20	–	–	–	83,908	94.2	–	–
Sub-total	26,735,874	14,080	89,156	404,752	389,497	22,196,806	83.0	155,993	97,342
Loans and advances for use outside Hong Kong	2,528,809	1,419	10,080	8,207	1,889	2,377,050	94.0	11,400	11,296
Total loans and advances (excluding trade bills and other receivables)	29,264,683	15,499	99,236	412,959	391,386	24,573,856	84.0	167,393	108,638

Supplementary Financial Information (Unaudited)

(A) ADVANCES TO CUSTOMERS BY INDUSTRY SECTORS (Continued)

Bank	31 December 2015								
	Gross loans and advances HK\$'000	Collective impairment allowances HK\$'000	Individual impairment allowances HK\$'000	New impairment allowances charged to income statement HK\$'000	Amount of impaired loans and advances written off HK\$'000	Collateral HK\$'000	Percentage of gross advances covered by collateral %	Impaired loans and advances HK\$'000	Loans and advances overdue for more than three months HK\$'000
Loans and advances for use in Hong Kong									
Manufacturing	683,270	157	265	570	362	663,875	97.2	265	265
Building and construction, property development and investment									
Property development	298,601	68	–	–	–	298,552	100.0	–	–
Property investment	6,177,843	1,417	9,260	9,260	–	5,981,156	96.8	24,405	9,260
Civil engineering works	123,910	28	580	580	–	43,105	34.8	580	580
Electricity and gas	582	–	–	–	–	582	100.0	–	–
Recreational activities	25,766	6	–	1	–	25,766	100.0	–	–
Information technology	4,535	1	–	–	–	4,535	100.0	–	–
Wholesale and retail trade	177,396	41	859	943	493	175,277	98.8	859	859
Transport and transport equipment	3,207,486	736	2,547	2,545	–	3,173,908	99.0	2,604	2,547
Hotels, boarding houses and catering	136,149	31	–	–	–	124,426	91.4	–	–
Financial concerns	335,918	77	–	–	–	201,530	60.0	–	–
Stockbrokers									
Margin lending	607,316	139	–	–	–	434,925	71.6	–	–
Others	–	–	–	–	–	–	–	–	–
Non-stockbroking companies and individuals for the purchase of shares									
Margin lending	131,660	30	–	–	–	101,369	77.0	–	–
Others	84,309	19	–	–	–	82,508	97.9	407	–
Professional and private individuals									
Loans for the purchase of flats covered by the guarantees issued by the Housing Authority under the Home Ownership Scheme, Private Sector Participation Scheme and Tenant Purchase Scheme	80,909	19	–	–	–	80,909	100.0	–	–
Loans for the purchase of other residential properties	8,094,481	1,857	–	–	–	8,094,481	100.0	14,588	8,488
Loans for credit card advances	12,034	3	23	134	112	–	–	23	9
Loans for other business purposes	24,748	6	–	–	–	24,748	100.0	–	–
Loans for other private purposes	319,574	73	3,276	4,335	3,990	222,924	69.8	3,857	1,142
Trade finance	889,528	204	–	94	183	824,825	92.7	7,480	2,564
Other loans and advances	89,108	20	–	–	–	83,908	94.2	–	–
Sub-total	21,505,123	4,932	16,810	18,462	5,140	20,643,309	96.0	55,068	25,714
Loans and advances for use outside Hong Kong	2,513,358	1,392	9,624	7,452	1,592	2,376,500	94.6	10,784	10,680
Total loans and advances (excluding trade bills and other receivables)	24,018,481	6,324	26,434	25,914	6,732	23,019,809	95.8	65,852	36,394

The advances to customers are classified by industry sectors based on the industry in which the granted loans are used. In those cases where loans cannot be classified with reasonable certainty, they are classified according to the known principal activities of the borrowers or by reference to the assets financed according to the loan documentation.

Supplementary Financial Information (Unaudited)

(B) INTERNATIONAL CLAIMS

The information of international claims discloses exposures to foreign counterparties on which the ultimate risk lies, and is derived according to the location of the counterparties taking into account any recognised risk transfer. In general, recognised risk transfer 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.

The following tables illustrate the international claims on individual countries or areas taking into account the recognised risk transfer, amounting to 10% or more of the aggregate international claims.

	Banks HK\$'million	Official sector HK\$'million	Non-bank financial institutions HK\$'million	Non- financial private sector HK\$'million	Total HK\$'million
As at 31 December 2016					
1. Developed countries*	3,084	8	–	429	3,521
2. Offshore centres, of which	191	3	34	3,009	3,237
– Hong Kong	140	3	34	2,731	2,908
3. Developing Asia-Pacific, of which	3,453	108	19	1,422	5,002
– China	1,520	108	19	1,367	3,014

	Banks HK\$'million	Official sector HK\$'million	Non-bank financial institutions HK\$'million	Non- financial private sector HK\$'million	Total HK\$'million
As at 31 December 2015					
1. Developed countries*	2,410	495	–	217	3,122
2. Offshore centres, of which	377	2	35	2,240	2,654
– Hong Kong	226	2	35	1,858	2,121
3. Developing Asia-Pacific, of which	3,693	622	39	1,180	5,534
– China	2,187	622	39	1,116	3,964

* There were no exposures to the five "PIIGs" countries namely Portugal, Italy, Ireland, Greece and Spain.

Supplementary Financial Information (Unaudited)

(C) MAINLAND ACTIVITIES

The following table illustrates the disclosure required to be made in respect of the Bank's Mainland China exposures to non-bank counterparties:

Types of counterparties	On-balance sheet exposure HK\$'million	Off-balance sheet exposure HK\$'million	Total HK\$'million
As at 31 December 2016			
Central government, central government-owned entities and their subsidiaries and joint ventures ("JVs")	321	–	321
PRC nationals residing in Mainland China or other entities incorporated in Mainland China and their subsidiaries and JVs	723	662	1,385
PRC nationals residing outside Mainland China or entities incorporated outside Mainland China where the credit is granted for use in Mainland China	2	–	2
Total	1,046	662	1,708
Total assets after provision	37,575		
On-balance sheet exposures as percentage of total assets	2.78%		
Types of counterparties	On-balance sheet exposure HK\$'million	Off-balance sheet exposure HK\$'million	Total HK\$'million
As at 31 December 2015			
Central government, central government-owned entities and their subsidiaries and JVs	320	–	320
PRC nationals residing in Mainland China or other entities incorporated in Mainland China and their subsidiaries and JVs	1,320	138	1,458
PRC nationals residing outside Mainland China or entities incorporated outside Mainland China where the credit is granted for use in Mainland China	2	–	2
Total	1,642	138	1,780
Total assets after provision	36,231		
On-balance sheet exposures as percentage of total assets	4.53%		

Note:

The analysis of non-bank Mainland China exposures is disclosed with reference to the Banking (Disclosure) Rules and Completion Instruction for the HKMA Return of Mainland Activities.

Supplementary Financial Information (Unaudited)

(D) DISCLOSURE OF THE REMUNERATION SYSTEM Remuneration Committee

The Bank has established its Remuneration Committee with written terms of reference with effect from 1 January 2011 in compliance with the requirements of the SPM Module CG-5 on “Guideline on a Sound Remuneration System” (the “Remuneration Guideline”) issued by the HKMA. As at 31 December 2016, there were five members in the Remuneration Committee and three of them were Independent Non-Executive Directors. The Remuneration Committee was chaired by Mr. Lai Wan, the Independent Non-Executive Co-Chairman of the Bank. The other members were Tan Sri Dato’ Sri Tay Ah Lek, Mr. Quah Poh Keat, Mr. Lee Chin Guan and Mr. Tang Wing Chew.

The Remuneration Committee meets at least once a year to review and make recommendations to the Board of the Bank on the overall remuneration policy (the “Remuneration Policy”), specific remuneration packages and compensation arrangement relating to the termination of their office or appointment of Directors, Chief Executive, senior management and key personnel, and for the formulation and implementation of the Remuneration Policy applicable to all employees of the Bank and its subsidiaries other than Public Finance and its subsidiaries.

A meeting was held in 2016. The attendance of each member in 2016 is set out below:

Name of members	Number of meetings attended in 2016	Attendance rate
Mr. Lai Wan, Chairman of the Committee	1/1	100%
Tan Sri Dato’ Sri Tay Ah Lek	1/1	100%
Mr. Quah Poh Keat	1/1	100%
Mr. Lee Chin Guan	1/1	100%
Mr. Tang Wing Chew	1/1	100%

During the year, Directors’ fees, movement of senior officials, 2016 annual salary review, allocation of discretionary bonus, independent review of remuneration practices and annual review of the Remuneration Policy and system in compliance with the Remuneration Guideline of the HKMA were reviewed and noted.

Remuneration of the Directors, Chief Executive, senior management and key personnel is determined by reference to factors including the level of workload, responsibilities and commitments, performance and remuneration packages. No individual Director or any of his associates is involved in deciding his own remuneration.

Supplementary Financial Information (Unaudited)

(D) DISCLOSURE OF THE REMUNERATION SYSTEM (Continued)

Remuneration of Directors

The scales of Directors' fees of the Bank for the years 2016 and 2015 are set out as follows:

Board of Directors	2016 Range HK\$	2015 Range HK\$
Chairman/Co-Chairman	50,000 to 102,500	50,000 to 102,500
Other Directors	25,000 to 92,500	25,000 to 92,500

No remuneration was paid to members of the Remuneration Committee for the years 2016 and 2015 except the aforesaid Directors' fees.

Design and structure of the remuneration processes

The Board of the Bank oversees the formulation, maintenance and implementation of the Remuneration Policy.

The Remuneration Committee of the Bank reviews and recommends the remuneration packages of key senior management personnel of the Group (excluding Public Finance and its subsidiaries which had established their own Remuneration Committee and adopted their own Remuneration Policy) in accordance with the authorities and responsibilities as stipulated in its terms of reference to the Board of the Bank for approval.

Remuneration review is submitted to the Board of the Bank by the Remuneration Committee for approval each year.

The Remuneration Committee of the Bank also works closely with the Human Resources Committee, Audit Committee, Risk Management Committee and other dedicated committees and departments to (i) review if there are any material non-compliance issues in relation to internal policy and statutory requirements and make adjustments to payments of remuneration whenever necessary, and (ii) decide upon the appraisal system which fairly measures the performance of each key personnel, and make changes to the system when necessary to meet the changing needs of the Bank.

Regular compliance monitoring is imposed to review the management and operation of the remuneration system.

Human Resources Department continues to take initiatives on all human resources matters while Human Resources Committee continues to function in accordance with its terms of reference.

Discussions and recommendations related to employees at managerial level made in the meetings of Human Resources Committee are submitted to the Group Human Resources Committee of Public Bank Berhad, the ultimate holding company of the Bank, and where appropriate, to the Remuneration Committee of the Bank for endorsement while discussions and decisions related to non-managerial employees made in the meetings are normally noted in the Board Executive Committee of the Bank.

Supplementary Financial Information (Unaudited)

(D) DISCLOSURE OF THE REMUNERATION SYSTEM (Continued) The Remuneration Policy of the Bank Group

The Bank adopted the Remuneration Policy in compliance with the Remuneration Guideline in December 2010. The Remuneration Policy covers the Bank (including branches and representative offices of the Bank located outside Hong Kong) and its subsidiaries which are subject to the HKMA's consolidated supervision except Public Finance, Public Financial Limited and Public Securities Limited (the "Bank Group"), which have their own remuneration policy. The Remuneration Policy was initiated by the Human Resources Committee and approved by the Board. The Human Resources Committee also reviews and keeps abreast of the legal and regulatory requirements from time to time, and liaises with risk control units including risk management, financial management and compliance functions to strike a balance among sufficient staff motivation, sound remuneration packages and prudent risk management. Any findings and recommendations to be incorporated into the Remuneration Policy will be put forth to the Remuneration Committee for consideration. Having discussed and agreed upon at the Remuneration Committee, the revisions to the Remuneration Policy will be recommended to the Board for approval.

The Bank's Remuneration Policy encourages employee behavior that supports the Bank's risk tolerance, risk management framework and long-term financial soundness. The policy is established and implemented in line with the objectives, business strategies and long-term goals of the Bank and formulated in a way that will not encourage excessive risks taking by employees but allows the Bank to attract and retain employees with relevant skills, knowledge and expertise to discharge their specific functions. The Bank has considered the risks, including market risk, credit risk, liquidity risk and operational risk, when implementing the remuneration measures, which are closely monitored by various management committees and working groups. The Bank considers and reviews the audit reports and various kinds of performance reports to take account of these risks in the remuneration process. Audit reports cover information on asset quality, credit risk management and operational risk management whilst performance reports state various kinds of business performance indicators such as delinquent rate, net impairment ratio, customer deposit, business growth, etc., which are useful for identification of current and future risks. The employees' performances in controlling these current and future risks are linked with their remuneration rewards. The Board will take the overall performance of the Bank Group, risk management, market trends, and other non-financial measures when deciding the performance bonus pool. This will be adjusted as and when the Bank considers appropriate. There is no change of remuneration measures over the past year.

Basically, the remuneration package consists of fixed and variable remuneration which are offered in cash. Fixed remuneration refers to basic salary, the year end double pay, and other fixed income while variable remuneration refers to discretionary bonus, sales commission and other variable income. The remuneration packages are determined by taking into consideration the evaluation of the job's responsibilities and contribution, the market pay levels for benchmark positions, and employee's performance. The level of remuneration and the proportion of variable remuneration to fixed remuneration of senior management and key personnel are linked to their level of responsibility undertaken and contribution to business performance and enhancements of efficiency and effectiveness of operations.

When the amount of variable remuneration payout exceeds a predetermined percentage or amount of the annual fixed remuneration of the employee, a deferment period of 3 years will be imposed in order to align the incentive awards to be granted to an individual employee with the long-term value creation and the time horizons of risk. The deferred remuneration will be vested gradually over the 3-year deferment period and no faster than on a pro-rata basis. To conform to the spirit of the Remuneration Guideline and not to undermine the risk management advantage by applying deferment of variable remuneration, if there is any deferred remuneration, hedging exposures in respect of the unvested portion of deferred remuneration by any trading, investment or other financial activities will be restricted.

Supplementary Financial Information (Unaudited)

(D) **DISCLOSURE OF THE REMUNERATION SYSTEM (Continued)** **The Remuneration Policy of the Bank Group (Continued)**

Subject to the decision of the Remuneration Committee in accordance with the internal guidelines, the deferred remuneration will be forfeited and/or clawed back when it is later established that the data on which the performance measurement for a particular year was based is subsequently proven to have been manifestly misstated; or it is later established that the employee concerned has committed fraud or other malfeasance, or violated any legislation, code or internal control policies of the Bank Group; or there has been a significant downward restatement of the financial performance of the Bank Group; or the employment of the employee is terminated.

The award of variable remuneration to the senior management, key personnel and risk taking employees is subject to the aforesaid deferral mechanism which will be reviewed by the Remuneration Committee at least annually and subject to change when necessary.

The remuneration of the employees within the risk control function, including those performing risk management, accounts, audit, compliance and credit management functions, etc., is determined by the performance of individual employees and is independent of the business they oversee. The performance factors of the appraisees in carrying out their core job responsibilities under their respective job functions are assessed in the performance appraisals. Appropriate remuneration will be recommended based on the results of the appraisals annually.

The Bank uses a comprehensive performance measurement framework that incorporates both financial and non-financial performance in determining the size and allocation of variable remuneration. The financial metrics link the variable remuneration to the profits, revenue and other performance measures of the Bank as a whole, and the contribution of business units or departments and an individual employee to the Bank as well. The applicable and material risks associated with the activities of employees, the cost and quantity of capital required to support the risks taken, and the cost and quantity of liquidity risk in the conduct of business are also taken into consideration. The non-financial metrics capture the performance on qualitative aspects such as the compliance with risk management policies, adherence to legal, regulatory and ethical standards; customer satisfaction; and effectiveness and efficiency of supporting operations. Given the importance in both financial achievements and non-financial factors, poor performance will result in reduction of or elimination to the variable remuneration. Adverse performance in non-financial factors will override outstanding financial achievement, and thus, the employee's performance can be assessed comprehensively.

Annual review of remuneration system and policy

An annual review of the remuneration system and the Remuneration Policy of the Bank Group was conducted by the Remuneration Committee at the end of 2016. The review concludes that the remuneration system and the Remuneration Policy are consistent with the principles set out in the Remuneration Guideline.

Supplementary Financial Information (Unaudited)

(D) DISCLOSURE OF THE REMUNERATION SYSTEM (Continued)

Remuneration of senior management and key personnel

The aggregate quantitative information on remuneration for the Bank's senior management (including the two Executive Directors who also hold the positions of Chief Executive and Alternative Chief Executive respectively) and key personnel is set out below.

- (i) The amount of remuneration for the financial years 2016 and 2015, split into fixed and variable remuneration, is set out below:

Remuneration for senior management*:

	2016 (6 beneficiaries)		2015 (6 beneficiaries)	
	Non-deferred HK\$	Deferred HK\$	Non-deferred HK\$	Deferred HK\$
Fixed remuneration				
Cash	9,843,733	–	9,348,980	–
Variable remuneration				
Cash	3,365,569	–	3,129,010	–

* Senior management comprises Chief Executive, two Alternate Chief Executives, Senior Deputy General Manager, Financial Controller and Head of Treasury

Remuneration for key personnel#:

	2016 (11 beneficiaries)		2015 (12 beneficiaries)	
	Non-deferred HK\$	Deferred HK\$	Non-deferred HK\$	Deferred HK\$
Fixed remuneration				
Cash	9,304,697	–	9,413,561	–
Variable remuneration				
Cash	2,097,261	–	1,925,260	–

Key personnel comprises (1) individual employees whose duties or activities in the course of employment involve the assumption of material risks or the taking on material exposures on behalf of the Bank Group; (2) the key personnel within risk control functions; and (3) other personnel who plays a pivotal role within the Bank

- (ii) No variable remuneration in shares or share-linked instruments was granted during the financial years 2016 and 2015.
- (iii) There was no deferred remuneration awarded, paid out and reduced through performance adjustments and there was no outstanding deferred remuneration during the financial years 2016 and 2015.
- (iv) No senior management or key personnel had been awarded new sign-on or severance payments or paid guaranteed bonuses during the financial years 2016 and 2015.

Supplementary Financial Information (Unaudited)

(E) CORPORATE GOVERNANCE

The Bank is committed to high standards of corporate governance and complies with the guidelines issued by the HKMA in the SPM Module CG-1 on “Corporate Governance of Locally Incorporated Authorised Institutions”. To accomplish this, the Bank exercises corporate governance through the following Committees:

1. Board Executive Committee

Board Executive Committee consists of Executive and Non-Executive Directors and is responsible for the management of the businesses of the Bank in all aspects and the implementation of strategic business plans and policies approved and formulated by the Board. The minutes of Board Executive Committee meetings are tabled to the Board for noting. The present members comprise Tan Sri Dato’ Sri Dr. Teh Hong Piow (Chairman of Board Executive Committee), Tan Sri Dato’ Sri Tay Ah Lek, Mr. Quah Poh Keat, Dato’ Chang Kat Kiam, Mr. Tan Yoke Kong and Mr. Chong Yam Kiang.

2. Risk Management Committee

RMC is responsible for overseeing the overall management of all risks covering market risk management, liquidity risk management, credit risk management and operational risk management. It reviews and approves risk management policies and risk tolerance limits and assesses the adequacy of risk management policies and framework in identifying, measuring, monitoring and controlling risk and the extent to which these are operating effectively. It also conducts review of the compliance functions to ensure adequate resources and independence of Compliance Department. The minutes of RMC meetings are tabled to the Board for noting and further action, where appropriate. The present members comprise Mr. Lai Wan (Chairman of RMC), Tan Sri Dato’ Sri Tay Ah Lek, Mr. Lee Chin Guan, Mr. Tang Wing Chew, Mr. Quah Poh Keat and Dato’ Chang Kat Kiam.

3. Audit Committee

Audit Committee reviews internal control issues identified by Internal Audit Department, external auditor, regulatory authorities and management, and evaluates the adequacy and effectiveness of the Group’s risk management and internal control systems. It also conducts review of the internal audit functions with particular emphasis on the scope of audits, quality of internal audits and independence of Internal Audit Department. The minutes of Audit Committee meetings are tabled to the Board for noting and further action, where appropriate. The Chief Executive and Head of Internal Audit normally attend the meetings. The members of Audit Committee shall be appointed by the Board from amongst the Non-Executive Directors of the Bank and shall consist of not less than three members. The present members comprise Mr. Tang Wing Chew (Chairman of Audit Committee), Tan Sri Dato’ Sri Tay Ah Lek, Mr. Lee Chin Guan, Mr. Lai Wan and Mr. Quah Poh Keat.

4. Remuneration Committee

Remuneration Committee is responsible for reviewing and recommending to the Board the overall Remuneration Policy and remuneration packages of Directors, Chief Executive, senior management and key personnel, and the Remuneration Policy applicable to all employees of the Bank Group. The members of Remuneration Committee comprise Non-Executive Directors appointed by the Board, and the majority of them shall be Independent Non-Executive Directors, and shall consist of not less than three members. The present members comprise Mr. Lai Wan (Chairman of Remuneration Committee), Tan Sri Dato’ Sri Tay Ah Lek, Mr. Lee Chin Guan, Mr. Tang Wing Chew and Mr. Quah Poh Keat.

Supplementary Financial Information (Unaudited)

(E) CORPORATE GOVERNANCE (Continued)

5. Management Committee

Management Committee is established by the Board to ensure the effectiveness of the daily operations and that the operations are in accordance with the corporate objectives, strategies and the annual budget as well as the policies and business directions that have been approved. The members of the Committee comprise the Chief Executive, Alternate Chief Executive, Senior Deputy General Manager, Deputy General Manager, Head of Treasury, Head of Branch Banking, Head of Credit and Financial Controller.

6. Credit Committee

Credit Committee is responsible for making decisions on applications for all types of credit facilities within its limits set out in the Credit Policy and in particular, monitoring the lending portfolio for managing the overall credit risk of the Bank. The members of the Committee comprise the Chief Executive, Alternate Chief Executive, Senior Deputy General Manager, Head of Branch Banking, Head of Credit, Head of Credit Analysis and Credit Manager.

7. Assets and Liabilities Management Committee

ALCO reviews and assesses the risk profile and consolidated statement of financial position structure of the Bank, sets out the objectives for the assets and liabilities management function and implements relevant risk management strategy. The Committee monitors and manages the aforesaid matters within a framework of approved policies and limits, and reports to the RMC. The members of ALCO comprise the Chief Executive, two Alternate Chief Executives, Head of Treasury, Financial Controller and Head of Risk Management.

8. Human Resources Committee

Human Resources Committee assists the Board in formulating and implementing human resources policies including staff recruitment, promotion, career development, performance appraisal and remuneration package of all staff. The members of the Committee comprise the Chief Executive, two Alternate Chief Executives, Senior Deputy General Manager and Head of Human Resources.

9. Information Technology Steering Committee

Information Technology Steering Committee is responsible for establishing policies and strategies for the computerisation of the Bank, recommending to the Board on major acquisitions of computer hardware and software, and monitoring the progress of the implementation of all information technology related projects. The members of the Committee comprise the Chief Executive, Alternate Chief Executive, Heads of Business Units, Head of Internal Audit, Heads of Operations, Financial Controller and Head of Information Technology.

10. Finance Committee

Finance Committee assists the Board in the financial planning and budgeting process of the business of the Bank and the review of the business performance, medium-term financial strategic business plan, statutory and half-year accounts. The members of the Committee comprise the Chief Executive, Alternate Chief Executive, Senior Deputy General Manager, Head of Branch Banking, Head of Credit and Financial Controller.

11. Operational Risk Management Committee

ORMC is responsible for the implementation of the operational risk management framework approved by the Board, and the development of specific policies, processes and procedures for managing operational risk in the material products, activities, processes and systems. The members of ORMC comprise the Chief Executive, Alternate Chief Executive, Head of Information Technology, Heads of Operations, Financial Controller and Head of Risk Management.

Supplementary Financial Information (Unaudited)

(E) CORPORATE GOVERNANCE (Continued)

12. Anti-money Laundering and Counter Terrorist Financing (AML) and Compliance Committee

AML and Compliance Committee is responsible for overseeing Compliance Department to carry out compliance functions, including prevention of money laundering and terrorist financing, providing guidance on compliance related issues raised by Compliance Department or other units of the Bank and reporting material compliance related issues to the RMC, other relevant committees, senior management and Heads of relevant departments/units. The members of the Committee comprise the Chief Executive, two Alternate Chief Executives, Senior Deputy General Manager, Financial Controller, Head of Risk Management, Head of Branch Banking and Head of Compliance.

13. Credit Risk Management Committee

CRMC is responsible for establishing the framework for identifying, measuring, monitoring and controlling credit risk of the existing and new products. The Committee reviews credit risk management policies and credit risk tolerable limits, and reports to RMC. The members of CRMC comprise the Chief Executive, two Alternate Chief Executives, Financial Controller and Head of Risk Management.

14. Business Strategy Steering Committee

Business Strategy Steering Committee is responsible for establishing effective business strategies to meet corporate goals and objectives taking into account operating conditions in the market and formulating strategic business plans to achieve growth and return, efficiency and competitive advantage in the financial industry. The members of the Committee comprise the Chief Executive, two Alternate Chief Executives, Senior Deputy General Manager, Financial Controller, Head of Treasury and Heads of Business Units.

15. Business Continuity Committee

Business Continuity Committee is responsible for managing the overall formulation, implementation and maintenance of the Business Resumption Continuity Plan ("BRCP") of the Bank. It plans for BRCP testing at least once a year and ensures the necessary measures for BRCP are taken for meeting the regulatory and business requirements. The members of the Committee comprise the Chief Executive, Alternate Chief Executive, Senior Deputy General Manager, Deputy General Manager, Head of Branch Banking, Head of Information Technology, Head of Credit, Head of Human Resources, Heads of Operations, Head of General Affairs, Financial Controller and Head of Internal Audit.