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**中銀香港(控股)有限公司**

**BOC HONG KONG (HOLDINGS) LIMITED**

*(Incorporated in Hong Kong with limited liability)*

**(the “Company”, Stock Code: 2388)**

## **2013 INTERIM RESULTS ANNOUNCEMENT**

The Board of Directors of the Company (the “Board”) is pleased to announce the unaudited results of the Company and its subsidiaries for the six months period ended 30 June 2013. This announcement, containing the full text of the 2013 Interim Report of the Company, complies with the relevant requirements of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited in relation to information to accompany preliminary announcements of interim results. Printed version of the Company’s 2013 Interim Report will be delivered to the Company’s shareholders who have chosen to receive printed version and will also be available for viewing on the websites of Hong Kong Exchanges and Clearing Limited at [www.hkexnews.hk](http://www.hkexnews.hk) and of the Company at [www.bochk.com](http://www.bochk.com) in mid September 2013.

# FINANCIAL HIGHLIGHTS

	<b>30 June 2013 HK\$'m</b>	30 June 2012 <sup>6</sup> HK\$'m	31 December 2012 <sup>6</sup> HK\$'m
<b>For the period/year</b>			
Net operating income before impairment allowances	<b>19,791</b>	18,096	35,617
Operating profit	<b>13,728</b>	12,666	23,499
Profit before taxation	<b>13,948</b>	13,825	25,521
Profit for the period/year	<b>11,657</b>	11,649	21,547
Profit attributable to the equity holders of the Company	<b>11,252</b>	11,243	20,930
<b>Per share</b>	<b>HK\$</b>	HK\$	HK\$
Basic earnings per share	<b>1.0642</b>	1.0634	1.9796
Dividend per share	<b>0.5450</b>	0.5450	1.2380
<b>At period/year end</b>	<b>HK\$'m</b>	HK\$'m	HK\$'m
Capital and reserves attributable to the equity holders of the Company	<b>151,806</b>	140,714	150,969
Issued and fully paid share capital	<b>52,864</b>	52,864	52,864
Total assets	<b>1,834,661</b>	1,684,722	1,830,763
<b>Financial ratios</b>	<b>%</b>	%	%
Return on average total assets <sup>1</sup>	<b>1.27</b>	1.35	1.24
Return on average shareholders' equity <sup>2</sup>	<b>14.87</b>	16.63	14.91
Cost to income ratio	<b>28.76</b>	29.41	31.61
Loan to deposit ratio <sup>3</sup>	<b>65.71</b>	63.00	63.32
Average liquidity ratio <sup>4</sup>	<b>38.70</b>	39.87	41.20
Total capital ratio/capital adequacy ratio <sup>5</sup>	<b>16.40</b>	17.43	16.80

1. Return on average total assets =  $\frac{\text{Profit for the period/year}}{\text{Daily average balance of total assets}}$

2. Return on average shareholders' equity

=  $\frac{\text{Profit attributable to the equity holders of the Company}}{\text{Average of the beginning and ending balance of capital and reserves attributable to the equity holders of the Company}}$

3. Loan to deposit ratio is calculated as at 30 June 2013, 30 June 2012 and 31 December 2012. Loan represents gross advances to customers. Deposit represents deposits from customers including structured deposits reported as "Financial liabilities at fair value through profit or loss".

4. Average liquidity ratio is calculated as the simple average of each calendar month's average liquidity ratio of BOCHK for the period/year.

5. Total capital ratio/capital adequacy ratio is computed on the consolidated basis that comprises the positions of BOCHK and certain subsidiaries specified by the HKMA for its regulatory purposes and in accordance with the Banking (Capital) Rules. The bases of regulatory capital calculation for credit risk, market risk and operational risk are described in Note 3.5 to the Interim Financial Information in this Interim Report. As a result of the adoption of Banking (Capital) (Amendment) Rules 2012 since 1 January 2013, the capital ratio shown for 30 June 2013 is not directly comparable to those of 31 December 2012 and 30 June 2012.

6. Certain comparative amounts have been reclassified to conform with current period's presentation.

# CHAIRMAN'S STATEMENT

The global economy witnessed a slow recovery during the first half of 2013. Hong Kong registered moderate growth supported by the strong positive momentum in private consumption, which made up for the shortfall of external demand. During the period, the operating environment was complex and unpredictable amid shrinking real estate transaction volumes, rapid capital flows and volatile capital markets. Against this backdrop, our pursuance of a balanced and sustainable growth strategy continued to deliver satisfactory results, as we remained customer-centric and focused on core business development by flexibly capturing opportunities.

I am pleased to report that the Group demonstrated solid performance in all business segments. For the first six months of 2013, the Group's net operating income before impairment allowances grew by 9.4% year-on-year to HK\$19,791 million. Operating profit before impairment allowances rose by 10.4% year-on-year to HK\$14,099 million. Compared with the same period last year, profit attributable to the equity holders increased by 0.1% to HK\$11,252 million, translating into an earnings per share of HK\$1.064. The Board has declared an interim dividend of HK\$0.545 per share, representing a payout ratio of 51.2%.

As of the end of June 2013, the Group's total assets reached HK\$1,834.7 billion, representing a growth of 0.2% over the last year-end. During the period, customer deposits grew by 2.9% on the back of our flexible deposit taking as well as continuously improved products and services. Facing intensified competition, we leveraged our strong customer base and exploited business opportunities to achieve a customer loan growth of 6.7%. Meanwhile, we maintained our leading position in Hong Kong's residential mortgage market and in the Hong Kong-Macau syndicated loan market. In view of the prolonged low interest rate environment, the Group proactively optimised its asset and liability mix as well as investment strategy and widened its loan-to-deposit spread. Consequently, our net interest margin expanded to 1.67%. With ongoing uncertainties in the external environment, we adhered to our prudent credit policy with stringent customer screening and a strengthened credit approval system. Our loan quality was sound as reflected by the relatively low level of classified or impaired loan ratio of 0.26%. While we continued to make appropriate investment in businesses, our cost-to-income ratio remained at a healthy

level of 28.76%. This was as a result of our policy of assessing income and spend in accordance with stringent cost control measures.

Solid financial strength is an important competitive edge for any financial institution. Starting from 1 January 2013, the Group has adopted Basel III Accord for its capital ratio computation. We remained well-capitalised with a total capital ratio of 16.40% as of end June 2013. Our liquidity was ample with an average liquidity ratio of 38.70%. A sound financial position not only allows us to better withstand market uncertainties, but also provides good support for business development while facilitating the protection of long-term shareholders' interest.

In the first half of the year, the Group consistently implemented its operating strategy. We put customers' interests at heart with the aim to enhance customer value through product innovation and better services. For example, as the leader in the mortgage market, we responded swiftly to market changes and offered customers more choice by launching fixed-rate mortgage products. On the personal banking side, we achieved satisfactory results in meeting needs across different customer segments. This was done through optimal bundling of various wealth management products and services and thematic promotions. We increased customer loyalty by cross-selling quality services to individual customers through our corporate client relationships to suit their personal financial needs. On the corporate banking side, we enhanced customer management and leveraged the newly established Corporate Service Center to increase efficiency in serving large corporate customers. We further deepened industry specialisation to reinforce new customer development and risk management, breaking new ground in various businesses through specific sales and marketing efforts.

The size of the offshore RMB market has continued to expand. Hong Kong, being the first offshore RMB clearing hub, is leading in the areas of RMB fund pooling, trade settlement volume, operating efficiency and service experience. Since our appointment as the RMB Clearing Bank in Hong Kong, we have continued to promote the development of clearing infrastructure and services with a diverse range of products. This year, several measures were taken, including the introduction of RMB term deposit service, extension of service hours

# CHAIRMAN'S STATEMENT

for RMB clearing function and increased deposit rate for participating banks. These will help shore up the competitiveness of Hong Kong as an offshore RMB hub and expedite development of RMB business locally.

The Group has been a major player in the offshore RMB market. After rigorous efforts over the years, we have further enhanced our market influence. This is attributable to our integrated RMB business platform, professional service team and continuous innovation in products with enhanced business functions. Furthermore, our proactive exploration of new customers in foreign enterprises and financial institutions has been on the back of collaboration with the overseas branches of our parent bank. Our RMB business grew healthily with significant developments in various business areas so far this year. Firstly, we completed the first loan transaction under the Qianhai pilot scheme. Secondly, we launched several pioneering products in the treasury market, including the first Certificate of Deposit with the CNH HIBOR, the first CNH/USD Cross-Currency Swap and the first USD/CNH Futures contract. Concurrently, our efforts in innovation and driving development of RMB investment products recorded outstanding results. This was illustrated by the overwhelming market response to the newly launched "BOCHK All Weather RMB High Yield Bond Fund". We partnered with FTSE Group to develop a new series of offshore RMB bond indices, enabling investors to gain access to an array of quality benchmarks. It will help foster the development of offshore RMB bond markets worldwide.

Looking forward to the second half of the year, we see uncertainties in the operating environment. The negative impact of quantitative easing measures undertaken by major economies and the sovereign debt problems originating from certain countries are likely to continue to spill over. Globally, it will be challenging to gain growth. However, the steady development of the offshore RMB market will bring new business opportunities for Hong Kong. With mixed fortunes, on one hand, we will need to stay vigilant. On the other hand, we will keep leveraging our robust financial capability, and solid customer base as well as proactive asset-liability management. We will continue to develop our business while embracing potential market changes.

On 17 March 2013, Mr. XIAO Gang resigned as the Chairman of the Company due to the need of the state financial work. On behalf of the Board, I would like to express our appreciation to Mr. XIAO for the prominent achievements of the Group under his leadership over the past decade and wish him great success in his new leadership post. At the Annual General Meeting on 28 May 2013, Mr. TUNG Chee Chen also retired as an Independent Non-executive Director, Chairman of the Nomination and Remuneration Committee and a member of the Audit Committee. Mr. TUNG served as an Independent Non-executive Director of the Company since our listing. On behalf of the Board, I would like to express my gratitude to Mr. TUNG for his valuable contributions to the Group over the past years and wish him a happy retirement.

Mr. WONG David See Hong retired as the Deputy Chief Executive (Financial Markets) of the Group with effect from 1 July 2013. Mr. HUANG Hong, who succeeded Mr. WONG, was appointed as the Deputy Chief Executive (Financial Markets) of the Group on the same day. On behalf of the Board, I wish to take this opportunity to thank Mr. WONG for his contributions to the Group during his tenure of office and welcome Mr. HUANG to join us in his new position.

The Group's solid development and outstanding results over the years would not have been possible without the diligence of our staff, the long-standing patronage of our customers as well as the wisdom and counsel of the Board. It is my honour to be appointed as the Chairman of the Company on 4 June 2013. Being entrusted with this responsibility, I will devote my best effort, work diligently with my team and colleagues and strive for even better results to reward our shareholders for their trust and support through all these years.



**TIAN Guoli**  
*Chairman*

Hong Kong, 29 August 2013

# CHIEF EXECUTIVE'S REPORT

I am pleased to report that the Group delivered a set of satisfactory results with improved core profitability and a strong financial position for the first six months of 2013. Operating performance was solid with net operating income and operating profit achieving interim highs. Both interest income and non-interest income posted decent growth. We grew our loans and deposits at a healthy pace. All key financial ratios stayed at strong levels.

During the first half, the Hong Kong banking sector faced a mixed and still challenging operating environment. The external environment remained lacklustre with weak demand. In Hong Kong, the economic growth momentum softened. With the government's tightening measures, the residential property market cooled down substantially in the second quarter. As the new banking capital requirement under Basel III came into effect from 1 January 2013, banks are required to operate on a higher capital base. On a positive note, we saw continued expansion of the offshore RMB market with further policy relaxation. Trading volume of the local stock market increased as investment sentiment improved during the period.

## Performance Highlights

The solid performance of the Group in the first half of 2013 reflected the results of our consistent strategy for balanced and sustainable growth. During the period, we continued to apply strict risk policy and actively managed the Group's balance sheet. Through product and service innovation, channel optimisation as well as a more sophisticated customer segmentation strategy, we made respectable progress in enhancing customer experience.

### *Proactive management yielded solid results*

- **Net interest margin expanded.** Under the persistently low interest rate environment and intense competition, it is indeed quite a challenge to manage the pressure on net interest margin. During the period, we took proactive measures to allocate our assets, improve loan pricing

and control deposit costs. As a result of these conscious efforts, the Group's net interest margin improved further both year-on-year and half-on-half with net interest income reaching an interim high.

- **Optimised asset allocation.** Operating conditions continued to be difficult. Genuine loan demand was modest while capital markets were volatile. During the period, we cautiously allocated our assets to ensure efficient use of funds and safeguard asset quality. In terms of asset allocation, funds were deployed to support lending to core customers. We adhered to a strict credit policy, which allows no compromise on quality for growth. Staying close to market developments, we adopted timely risk control measures. We continued to conduct our Know Your Customer work conscientiously, especially for trade finance which experienced unusually fast market growth during the period. We carefully studied the business background and closely monitored the loan arrangement throughout the whole process. The Group's total loan book expanded at a healthy pace and loan quality remained sound with a low classified or impaired loan ratio. In managing our investment book, while seeking good investment opportunities to enhance return, safety and liquidity remained our primary considerations. We increased investments in high-quality financial institutions and corporate bonds with geographical exposure mainly in the US and Asia.
- **Maintained strong financial position.** Starting from this year, the new Basel III requirement came into effect. We have planned and got prepared for it well in advance. The impact of Basel III to the Group's capital level had been thoroughly considered when we formulated the business plan for 2013. After considering the Group's funding needs and cost, we repaid early the Euro sub-loans to BOC, which would be de-recognised as Tier 2 capital under Basel III. Total and Tier 1

# CHIEF EXECUTIVE'S REPORT

capital ratios remained strong as at the end of June 2013. In the latter part of the first half, market volatility increased while liquidity in the Mainland interbank market tightened sharply. We continued to actively manage the Group's liquidity, reinforcing our ability to withstand unexpected market disruptions.

- **Effective cost management.** We judiciously managed expenditure to ensure cost efficiency while allowing sufficient resources to drive business growth. Our cost-to-income ratio remained at a low level in the first half of 2013. Over the years, investment in our franchise to enhance the Group's competitiveness has never subsided. In addition to building new platforms, we took measures to improve operational efficiency by streamlining and centralising business processes.

## ***Enhanced franchise to drive business growth***

- **Continued enhancement in offshore RMB business platform.** The scope of the offshore RMB business expanded on the back of further policy relaxation. The Group maintained its market leadership with steady development of its business. Leveraging the opportunities from the "Cross-border RMB Loan Trial Scheme in Qianhai", the Group acted swiftly and signed agreements with five enterprises registered in Qianhai to provide them with cross-border RMB direct loans. BOCHK was also designated as a market maker for USD/CNH (offshore RMB) futures by the Chicago Mercantile Exchange Group, being the sole bank among the first group of market makers. With the introduction of the CNH HIBOR in Hong Kong, we pioneered the launch of new treasury products using CNH HIBOR as the pricing benchmark. Our asset management company partnered with FTSE Group to develop a new "FTSE-BOCHK Offshore RMB Bond Index Series". This landmark partnership combines BOCHK's unique competitive position in the offshore RMB business with FTSE's leading index expertise.
- **Maintained efficient clearing services.** As the Clearing Bank of the offshore RMB business in Hong Kong, we further enhanced our clearing services to participating banks. During the period, we extended the operating hours for cross-border RMB payments involving the Mainland, introduced fixed deposit products, launched a tiered interest rate offering for participating banks' settlement accounts, and adjusted RMB intra-day repo limits.
- **Solid fee income growth.** In the first half, fee and commission income recorded broad-based growth. In particular, funds distribution sustained the robust growth momentum. This encouraging performance reflected the Group's ongoing efforts to enhance its service platform (e.g. setup of Investment Product Specialist Team) and broaden its product offerings. During the period, our asset management business launched a new retail fund, the "BOCHK All Weather RMB High Yield Bond Fund", which received an overwhelming response from customers. We also conducted themed marketing campaigns and investment seminars helping customers better plan and diversify their investment portfolios.
- **Focused on driving customer segmentation strategy.** With an aim to better serve the diverse needs of our customers, we continued to implement our customer segmentation strategy. During the period, we revamped our banking services for mass retail customers and launched the new i-Free Banking service, which received positive customer response. Launched in the fourth quarter last year, our Private Banking business, which targets top-tier high-net-worth individuals, has shown encouraging results in its business development. Both customer base and assets under management increased in the first half. Our Corporate Banking business continued to enhance its expertise in industry management with better customer segmentation. This facilitated not only growth in the client base but also better risk management.

# CHIEF EXECUTIVE'S REPORT

- **Enhanced e-banking platform.** With advancements in technology, customers are looking for more efficient banking services. The Group has continuously improved the functions and quality of its e-banking platform. The proportion of transaction volume via e-banking increased year-on-year. In particular, transaction volume via mobile banking increased substantially. The corporate internet banking platform has also been optimised with a more user-friendly interface and enhanced transaction flow. We continued to upgrade the e-banking platform of our Mainland operation with new services, longer service hours, real-time processing on holidays and shared use of the payment platform of BOC.
- **Strong cross-border banking capabilities.** In view of the growing demand for cross-border banking services, the Group strives to provide its customers with comprehensive solutions. Together with BOC, we strengthened our cross-border RMB entrusted payments and entrusted loans businesses and established business relationships with our target customers. In custody services, we expanded our client base and successfully secured mandates to provide custody services for RQFII-ETFs, RQFII funds and Qualified Domestic Institutional Investors. In recognition of its outstanding QFII performance, BOCHK was awarded the "Best QFII Custodian" under Regional Specialist in the "Asset Servicing Awards 2013" by The Asset Magazine. In cash management business, we further strengthened our competitive edge as a cross-border fund centre for corporates in Hong Kong through close collaboration with BOC. BOCHK was granted the "Achievement Award for Best Cash Management Bank in Hong Kong" from the "Asian Banker Transaction Banking Awards 2013" organised by Asian Banker. As for our individual customers, we continued to offer a wide range of banking services to bring them added convenience in financial management across the border.

## Financial Results

In the first half of 2013, the Group's net operating income before impairment allowances increased by 9.4% year-on-year to HK\$19,791 million. The growth was mainly driven by the increase in net interest income and net fee and commission income. Operating expenses increased by 7.0% to HK\$5,692 million with an industry low cost-to-income ratio of 28.76%. Operating profit before impairment allowances increased by 10.4% compared to the same period last year.

Despite lower net gain from fair value adjustments on investment properties and higher net impairment charges, profit attributable to the equity holders held steady at HK\$11,252 million, or up 0.1% year-on-year, supported by the growth in core income. Return on average total assets (ROA) and return on average shareholders' equity (ROE) were 1.27% and 14.87% respectively.

Net interest income rose by 5.6% year-on-year to HK\$13,331 million, driven by the expansion in both average interest-earning assets and net interest margin. Net interest margin widened by 3 basis points to 1.67%. The increase was mainly attributable to the improved loan and deposit spread. Average interest-earning assets expanded by 4.0% year-on-year, driven by growth in loans and advances as well as debt securities investments.

Net fee and commission income grew by 16.1% to HK\$4,681 million. The increase was broad-based with strong growth in fee and commission income from credit cards, funds distribution, securities brokerage, insurance and loans.

Net trading gain increased by 2.3% to HK\$1,441 million. This was due mainly to the increase in net trading gain from foreign exchange and related products.

Compared to the second half of 2012, net operating income before impairment allowances, operating profit before impairment allowances and profit attributable to the equity holders increased by 13.0%, 21.7% and 16.2% respectively.



# CHIEF EXECUTIVE'S REPORT

As at 30 June 2013, total assets amounted to HK\$1,834.7 billion, up 0.2% compared to the end of 2012. The growth was driven by higher customer deposits, which grew by 2.9%, but was largely offset by the lower deposit balance the participating banks placed with the RMB Clearing Bank. The Group continued to adopt proactive management to optimise its asset allocation. As at end June 2013, securities investments decreased by 8.6%, with the reduction mainly in lower yielding government-related securities. Advances to customers grew 6.7% to HK\$830.7 billion with growth in both corporate and personal loans. Loan-to-deposit ratio increased to 65.71% from 63.32% at last year-end. Overall loan quality remained sound with classified or impaired loan ratio at 0.26%.

Under the newly applied Basel III capital requirement, the Group maintained a strong capital position with total capital ratio of 16.40% and Tier 1 capital ratio of 11.17% as at end June 2013. Average liquidity ratio for the period stood at 38.70%.

The Board declared an interim dividend of HK\$0.545 per share for the first half of 2013, which is the same as last year.

## Business Review

**Personal Banking** business delivered outstanding performance in the first half of 2013. Net operating income before impairment allowances and profit before taxation grew year-on-year by 22.4% and 29.3% to HK\$6,840 million and HK\$3,572 million respectively.

The Group's residential mortgage business maintained its market leadership with 3.0% increase in loan balance. Demand for mortgage loans softened amid the tighter property measures. We continued to launch new mortgage products and services to seize business opportunities. A "Fixed-Rate Mortgage Scheme" was launched, providing homebuyers with an alternative financing option suited towards their financial needs. Our pioneering "Portable" feature for fixed-rate loans offers customers greater

flexibility when moving to a new property. Investment and insurance business recorded a notable increase in net fee and commission income. Fund sales were strong generating a 90.1% increase in commission income. Credit card business grew steadily with an 8.3% increase in cardholder spending and 20.3% increase in merchant acquiring volumes. The Group's success in the credit card business was widely recognised and it received a total of 30 awards from VISA International, MasterCard and China UnionPay.

**Corporate Banking** business maintained its growth momentum into the first half of 2013. Net operating income before impairment allowances increased by 16.9% to HK\$7,771 million, driven by strong net interest income growth. Profit before taxation grew by 14.2% to HK\$5,873 million.

Our corporate loan book recorded healthy growth of 8.2% with respectable growth in offshore RMB loans. The Group remained the top mandated arranger in the Hong Kong-Macau syndicated loan market. The Group also made solid progress in the "Supply-chain Finance" business launched in 2012. At the end of June 2013, the Group's balance of trade finance grew by 13.9% from the end of 2012. Given the market uncertainties, we maintained our discipline in extending credit to corporate customers. As a result, overall loan quality remained healthy. Meanwhile, we continued to provide "Total Solutions", offering comprehensive banking services to better meet the needs of our corporate customers and strengthen business relationships. A Corporate Services Centre was set up to further improve service efficiency.

**Treasury** segment recorded lower income and profit amid a volatile market and a lower interest rate environment. Net operating income before impairment allowances decreased by 15.9% to HK\$4,449 million. Profit before taxation declined by 16.7% to HK\$3,918 million.

During the period, we actively managed the Group's banking book investments to optimise portfolio mix and return. On the product development front, with timely response to market conditions, we promoted



# CHIEF EXECUTIVE'S REPORT

popular products to meet customer needs. We also made good progress in underwriting bond issuance in different denominated currencies, and saw a considerable increase in turnover over the same period last year.

**Mainland** business achieved encouraging growth amid a tough operating environment. Net operating income increased by 18.2% driven by higher net interest income. Yields improved given our conscious efforts to optimise asset and liability structure. Customer deposits and loans registered steady growth of 8.8% and 6.8% respectively from the end of last year.

During the first half of 2013, two new sub-branches of NCB (China) were opened. The Group's total number of branches and sub-branches in the Mainland increased to 38 as at the end of June 2013. The Group also continued to improve both its personal and corporate e-banking platforms. To meet the increasing demand for wealth management services, a series of products were launched, driving growth in commission income.

**Insurance** business posted satisfactory results through continuous product enhancement. Net operating income before impairment allowances and profit before taxation grew year-on-year by 20.7% and 25.1% to HK\$688 million and HK\$564 million respectively.

The Group maintained its leading position in the RMB insurance market. We continued to receive positive customer response for our RMB insurance products. The Group also actively explored new distribution channels and established partnerships with brokerage houses to promote insurance products. In recognition of its outstanding performance in RMB services, BOC Life was granted the honour of "Outstanding Insurance Business" under the "2013 RMB Business Outstanding Awards" organised by local media.

## Outlook

The global economic recovery is progressing at a slower than expected pace. We are encouraged by some signs of gradual improvement in the US economy and the

stabilising European economies. The Mainland economy is expected to slow down but in a managed manner. Nevertheless, as the key fundamental issues of major economies remain unsettled, this may continue to affect market stability. As in Hong Kong, external demand is still a crucial factor driving Hong Kong's economic growth. Locally, uncertainty surrounding the property market may also weigh on the economy. Against this backdrop, the growth outlook for Hong Kong's economy would be modest for the rest of the year.

Apart from the still challenging macro conditions, banks also need to review their business strategies and get prepared for a changing industry landscape. Under the Basel III regulatory regime, banks need to meet more stringent capital and liquidity requirements. Furthermore, with the recent interest rate liberalisation reform in the Mainland, competition may intensify going forward.

Maintaining a strong financial position has always been a key priority of the Group. We will continue to proactively manage our capital and liquidity. In implementing our business strategy, we will ensure the efficient use of our capital to support growth and drive sustainable return. Although there are signs of improvement in the global economy, the recovery is still vulnerable and sensitive to changing market conditions. We will adhere to our proactive and rigorous risk management to safeguard the Group's financial strength and asset quality.

As for the Group's business development, we see considerable growth potential given our more diversified business platform, deepened customer relationships and close collaboration with BOC. With closer integration between Hong Kong and the Mainland, we have already seen increasing demand for cross-border banking services over the past years. The Group has been strongly positioned and captured good business opportunities. We have in place a wide range of cross-border banking services to meet the needs of both individual and corporate customers. Capitalising on the Global Relationship Manager platform, we have been working closely with BOC to provide one-stop services to cater to the global needs of the leading corporate customers.

# CHIEF EXECUTIVE'S REPORT

This strategy has proved to be successful in capturing new business and securing quality customers. We have invested considerable resources in enhancing our platform to provide efficient cross-border services. For example, the Group's cash management service was upgraded by capitalising on BOC's global cash management platform. This greatly facilitates more convenient and efficient cash management services for multi-national customers. We have also focused on driving innovation in cross-border trade finance products. We will continue to broaden our product and service scope and work closely with BOC to reinforce our competitive edge in the cross-border banking business.

Over the past few years, we have witnessed the robust and healthy development of the offshore RMB markets with RMB transactions becoming more prevalent around the world. Our development progress has been remarkable and we have firmly established our market leadership in the offshore RMB business. With the appointment of BOC's Taiwan Branch as the Clearing Bank in Taiwan in December 2012, the BOC Group's franchise in the offshore RMB business has been strengthened further. We will continue to exploit more business opportunities capitalising on our strong RMB franchise. We will persist in upgrading and optimising our product platform to meet the growing RMB banking needs. In close collaboration with BOC and its overseas branches, the Group is well positioned to capture the emerging market opportunities.

In an increasingly competitive environment, the need to drive innovation and efficiency becomes more apparent. Therefore, investment in enhancing our business platform for the Group's long-term development is a continuous priority. We have been making ongoing investments in upgrading technology to drive efficiency and innovation, introducing new business capabilities to meet the diverse needs of our customers, and equipping our people with the knowledge and skills for greater performance. As inflationary pressure is expected to persist in the near term, we will remain disciplined in cost management to ensure efficiency.

Lastly, I would like to take this opportunity to welcome Mr. TIAN Guoli who joined the Company as the Chairman and Non-executive Director with effect from 4 June 2013. Under Mr. TIAN's leadership, the Group will remain committed to driving balanced and sustainable growth to create greater value for our stakeholders.

With effect from 1 July 2013, Mr. HUANG Hong succeeded Mr. WONG David See Hong as the Deputy Chief Executive (Financial Markets) to oversee the financial market businesses. I would like to welcome Mr. HUANG joining the Group. I also wish Mr. WONG a happy retirement and thank him for his valuable contributions to the Group during his tenure of office.

Looking forward, there will be both good and bad news in the market which will affect overall sentiment and volatility may increase. We will stay vigilant of market developments and continue to pursue our balanced growth strategy. Our consistently solid results reflect the dedication and diligence of every member of the Group. I would like to thank them for their contributions. At the same time, I wish to thank our customers and shareholders for their continuous support and the Board for their wisdom and counsel. With our strong franchise and financial position, I truly believe that the Group will continue to be well positioned to capture quality growth opportunities ahead.



**HE Guangbei**

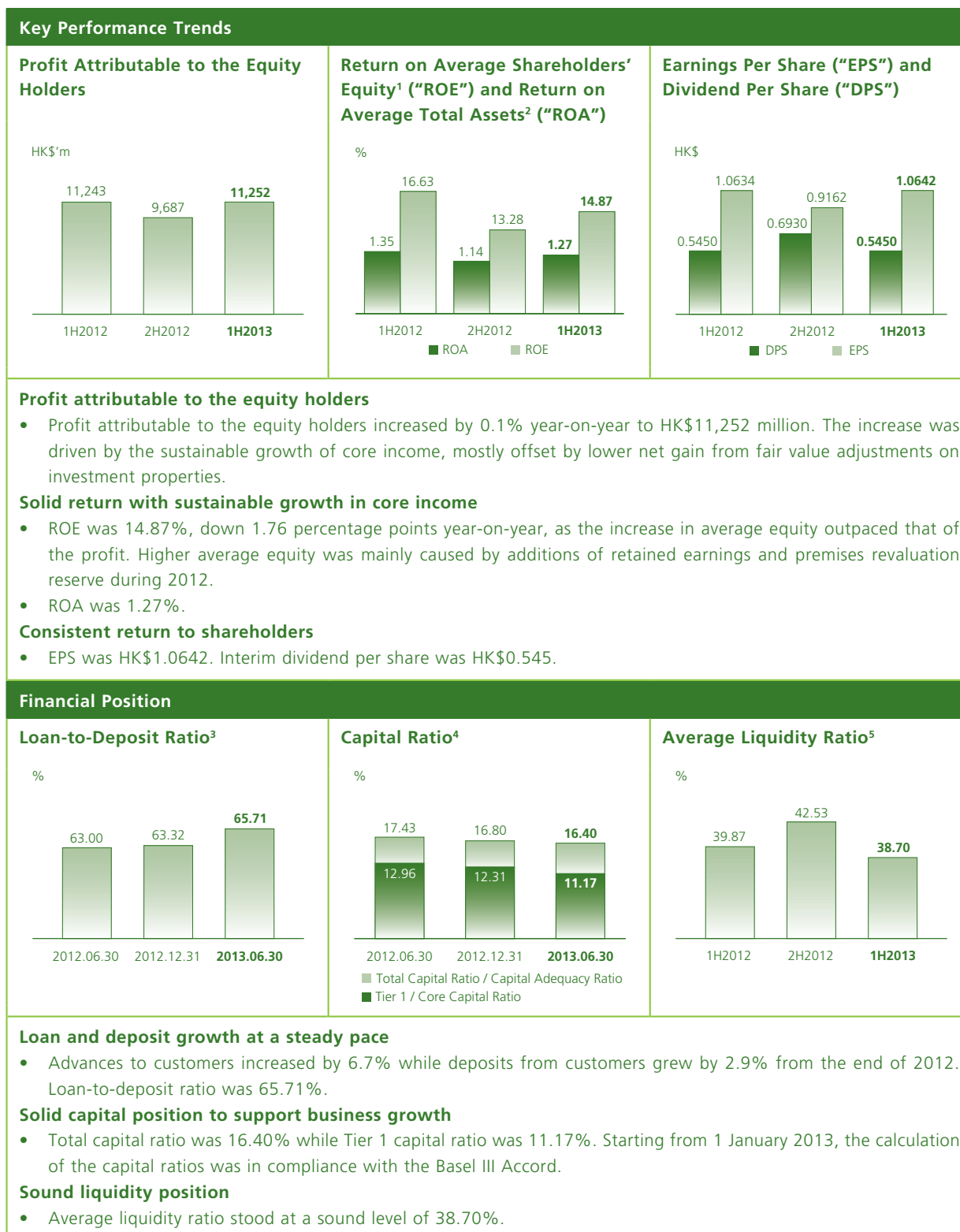
*Vice Chairman & Chief Executive*

Hong Kong, 29 August 2013

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## FINANCIAL PERFORMANCE AND CONDITION AT A GLANCE

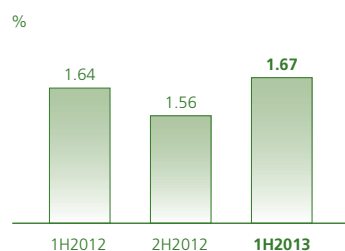
The following table is a summary of the Group's key financial results for the first half of 2013 in comparison with the previous two half-yearly periods.



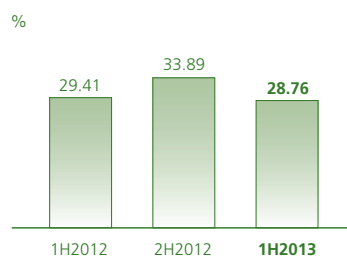
# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Key Operating Ratios

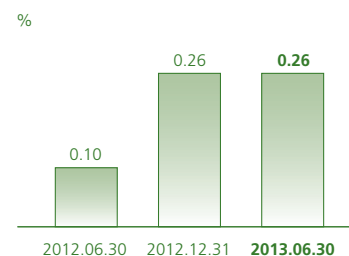
### Net Interest Margin ("NIM")



### Cost-to-Income Ratio<sup>6</sup>



### Classified or Impaired Loan Ratio<sup>7</sup>



#### NIM improved in the first half of 2013

- NIM was 1.67%, up 3 basis points year-on-year and 11 basis points half-on-half, mainly contributed by the improvement in loan-deposit spread.

#### Cautious cost control

- Cost-to-income ratio was 28.76%, down 0.65 percentage point year-on-year, among the lowest in the industry.

#### Classified or impaired loan ratio stayed at a low level

- Classified or impaired loan ratio remained low at 0.26%, below the market average.

1. Return on Average Shareholders' Equity as defined in "Financial Highlights".
2. Return on Average Total Assets as defined in "Financial Highlights".
3. The deposit base also includes structured deposits reported as "Financial liabilities at fair value through profit or loss".
4. The capital ratios are computed on the consolidated basis that comprises the positions of BOCHK and certain subsidiaries specified by the HKMA for its regulatory purposes and in accordance with the Banking (Capital) Rules. The Banking (Capital) (Amendment) Rules 2012 ("BCAR 2012") came into operation on 1 January 2013. The bases of regulatory capital calculation for credit risk, market risk and operational risk are described in Note 3.5 to the Interim Financial Information.
5. The average liquidity ratio is calculated as the simple average of each calendar month's average liquidity ratio of BOCHK for the period.
6. Certain comparative amounts in 2012 have been reclassified to conform with current period's presentation.
7. Classified or impaired loans follow the definitions set out in the Banking (Disclosure) Rules under the Banking Ordinance and represent advances which are either classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## ECONOMIC BACKGROUND AND OPERATING ENVIRONMENT

Global economic conditions remained vulnerable to weakness in the first half of 2013. Although the European debt crisis became less acute and the US economic recovery appeared largely on track, macroeconomic fundamentals in advanced economies remained weak with low GDP growths and elevated unemployment rates. Financial markets were susceptible to volatility towards the end of the first half after the Federal Reserve hinted at the possible phase out of quantitative easing measures. In the Mainland, economic growth also slowed owing to softening external demand and fixed investments.

In spite of weak external demand, the Hong Kong economy continued to grow at a modest pace, led by robust growth in private consumption. The unemployment rate remained at a low level. Inflationary pressure edged up, with the year-on-year Composite CPI increasing by 3.9% in the first half of 2013.

The local residential property market remained fairly upbeat in early 2013 but cooled following the introduction of further proactive measures by the government in February 2013. Prices of residential properties stabilised while transaction volumes plunged. Meanwhile, the local stock market saw increased volatility. Market sentiment turned negative with uncertainty about the Federal Reserve's exit strategy for monetary stimulus and the slowdown of economic growth in the Mainland. At the end of June 2013, the Hang Seng Index was down 8.2% from the end of 2012.

Overall liquidity in the banking sector remained abundant and market interest rates remained low. Average 1-month HIBOR and USD LIBOR was 0.22% and 0.20% in the first half of 2013, down 0.10 and 0.05 percentage point respectively year-on-year.

A number of initiatives were introduced to foster further development of the offshore RMB business in Hong Kong. These included the further relaxation of investment restrictions relating to the RMB Qualified Foreign Institutional Investors ("RQFII") scheme and the announcement of the special funding arrangement to encourage certain industries to operate in the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone ("Qianhai"). The HKMA also removed the limits on RMB net open position and RMB liquidity ratio calculation. In July 2013, operating procedures for cross-border RMB business was simplified. These initiatives gave banks more flexibility to conduct RMB business.

In summary, the operating environment for the banking industry remained challenging in the first half of 2013. While the offshore RMB market continued to develop and provided the banking sector with more opportunities, the low interest rate environment, weak external demand and keen market competition underpinned the profitability of banks.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## CONSOLIDATED FINANCIAL REVIEW

### Financial Highlights

HK\$m	Half-year ended 30 June 2013	Half-year ended 31 December 2012	Half-year ended 30 June 2012
Net operating income before impairment allowances	<b>19,791</b>	17,521	18,096
Operating expenses	<b>(5,692)</b>	(5,937)	(5,322)
Operating profit before impairment allowances	<b>14,099</b>	11,584	12,774
Operating profit after impairment allowances	<b>13,728</b>	10,833	12,666
Profit before taxation	<b>13,948</b>	11,696	13,825
Profit attributable to the equity holders of the Company	<b>11,252</b>	9,687	11,243

Note: Certain comparative amounts in 2012 have been reclassified to conform with current period's presentation.

In the first half of 2013, uncertainties remained in the global financial markets. The Group closely monitored market changes and took proactive measures in managing its assets and liabilities, in conjunction with risk management principles and policies to safeguard its asset quality. It continued to implement a balanced growth strategy while maintaining disciplined cost control. As a result, the Group recorded satisfactory growth in core businesses with its key financial ratios staying at healthy levels.

The Group's net operating income before impairment allowances increased by HK\$1,695 million or 9.4% year-on-year to HK\$19,791 million in the first half of 2013. The increase was driven by the growth in both net interest income and net fee and commission income. Other income also increased, mainly attributable to the higher income of the Group's insurance segment. Operating

expenses rose, as a result of the business expansion. Net charge of impairment allowances increased by HK\$263 million while the net gain from fair value adjustments on investment properties fell by HK\$823 million year-on-year, mostly offsetting the operating income growth. Profit attributable to the equity holders rose mildly by HK\$9 million, or 0.1%, to HK\$11,252 million.

As compared to the second half of 2012, the Group's net operating income before impairment allowances rose by HK\$2,270 million, or 13.0%. The growth in income was driven by the increase in net interest income and net fee and commission income. Net charge of impairment allowances decreased by HK\$380 million and net gain from fair value adjustments on investment properties also declined by HK\$656 million. Profit attributable to the equity holders increased by HK\$1,565 million, or 16.2%, on a half-on-half basis.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## INCOME STATEMENT ANALYSIS

Analyses of the Group's financial performance and business operations are set out in the following sections.

### Net Interest Income and Margin

HK\$m, except percentages	Half-year ended 30 June 2013	Half-year ended 31 December 2012	Half-year ended 30 June 2012
Interest income	18,459	17,641	17,772
Interest expense	(5,128)	(5,552)	(5,153)
Net interest income	13,331	12,089	12,619
Average interest-earning assets	1,607,052	1,540,489	1,544,663
Net interest spread	1.58%	1.44%	1.53%
Net interest margin*	1.67%	1.56%	1.64%

\* Net interest margin is calculated by dividing net interest income by average interest-earning assets.

Compared to the first half of 2012, the Group's net interest income increased by HK\$712 million or 5.6%. The increase was driven by both the growth in average interest-earning assets and the widening of net interest margin.

Average interest-earning assets expanded by HK\$62,389 million or 4.0% year-on-year, with growth in loans and advances as well as debt securities investments. These were supported by the increase in customer deposits,

partly offset by the decrease in participating banks' RMB deposits with the clearing bank.

Net interest margin widened by 3 basis points to 1.67%. The increase was mainly attributable to the improved loan and deposit spread. Loan pricing on corporate lending was higher. The Group exercised cautious control of deposit costs. The positive impact was partly offset by lower yields on placements with banks and debt securities investments as market interest rates lowered during the period.



# MANAGEMENT'S DISCUSSION AND ANALYSIS

The summary below shows the average balances and average interest rates of individual categories of assets and liabilities:

	Half-year ended 30 June 2013		Half-year ended 31 December 2012		Half-year ended 30 June 2012	
	Average balance HK\$'m	Average yield %	Average balance HK\$'m	Average yield %	Average balance HK\$'m	Average yield %
<b>ASSETS</b>						
Balances and placements with banks and other financial institutions	291,332	2.34	283,832	2.43	388,424	2.42
Debt securities investments	510,305	2.06	498,173	1.97	444,859	2.18
Loans and advances to customers	791,467	2.49	744,020	2.42	696,697	2.34
Other interest-earning assets	13,948	1.66	14,464	1.88	14,683	1.55
Total interest-earning assets	1,607,052	2.32	1,540,489	2.27	1,544,663	2.31
Non interest-earning assets	229,264	–	199,111	–	184,455	–
Total assets	1,836,316	2.03	1,739,600	2.01	1,729,118	2.06
<b>LIABILITIES</b>						
	Average balance HK\$'m	Average rate %	Average balance HK\$'m	Average rate %	Average balance HK\$'m	Average rate %
Deposits and balances from banks and other financial institutions	119,554	0.45	96,865	0.60	190,083	0.71
Current, savings and fixed deposits	1,187,636	0.77	1,158,442	0.84	1,066,697	0.77
Subordinated liabilities	28,178	0.59	28,715	0.90	28,640	1.29
Other interest-bearing liabilities	54,593	0.82	45,060	0.90	42,953	0.95
Total interest-bearing liabilities	1,389,961	0.74	1,329,082	0.83	1,328,373	0.78
Non interest-bearing deposits	84,812	–	79,751	–	87,466	–
Shareholders' funds* and non interest-bearing liabilities	361,543	–	330,767	–	313,279	–
Total liabilities	1,836,316	0.56	1,739,600	0.63	1,729,118	0.60

\* Shareholders' funds represent capital and reserves attributable to the equity holders of the Company.

Compared to the second half of 2012, net interest income increased by HK\$1,242 million or 10.3%, driven by higher average interest-earning assets and net interest margin. Average interest-earning assets grew by HK\$66,563 million or 4.3%, which was supported by the increases

in customer deposits and deposits from banks and other financial institutions. Net interest margin was up 11 basis points. This was mainly attributable to the improved loan pricing and lower deposit cost.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Net Fee and Commission Income

HK\$m	Half-year ended 30 June 2013	Half-year ended 31 December 2012	Half-year ended 30 June 2012
Credit card business	1,734	1,684	1,477
Securities brokerage	1,224	1,060	1,054
Loan commissions	1,078	800	974
Insurance	708	369	596
Funds distribution	441	308	232
Bills commissions	387	366	370
Payment services	322	342	325
Trust and custody services	181	181	179
Safe deposit box	122	110	118
Currency exchange	88	87	69
Others	224	195	214
Fee and commission income	6,509	5,502	5,608
Fee and commission expenses	(1,828)	(1,772)	(1,575)
Net fee and commission income	4,681	3,730	4,033

Note: Certain comparative amounts of fee and commission income and fee and commission expense have been reclassified to conform with current period's presentation.

Net fee and commission income grew by HK\$648 million, or 16.1%, year-on-year to HK\$4,681 million. The increase was broad-based with strong growth of fee and commission income from credit cards, funds distribution and securities brokerage. Fee income from the credit card business grew by 17.4%, driven by the increases in cardholder spending and merchant acquiring volume by 8.3% and 20.3% respectively. Commission income from funds distribution rose substantially by 90.1% as the Group rolled out products with effective segmentation to meet targeted customers' needs. Securities brokerage fee income increased by 16.1%, supported by the Group's continuous effort in enhancing its business platform and

the pickup of transaction in the stock market. Commission income from insurance and loans increased by 18.8% and 10.7% respectively. Income from currency exchange and bills commissions also registered satisfactory growth. The increase in fee and commission expenses was mainly caused by higher credit cards and insurance related expenses.

Compared to the second half of 2012, net fee and commission income grew by HK\$951 million or 25.5%. The growth was again broad-based with increases in commission income from insurance, loans, securities brokerage, funds distribution and credit cards.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Net Trading Gain

HK\$m	Half-year ended 30 June 2013	Half-year ended 31 December 2012	Half-year ended 30 June 2012
Foreign exchange and foreign exchange products	1,019	1,052	936
Interest rate instruments and items under fair value hedge	197	595	305
Equity instruments	183	16	104
Commodities	42	58	63
Net trading gain	1,441	1,721	1,408

Net trading gain was HK\$1,441 million, increasing by HK\$33 million, or 2.3% from the first half of 2012. The growth in net trading gain from foreign exchange and foreign exchange products was mainly driven by growing currency exchange activities and the foreign exchange gain on foreign exchange swap contracts\*. The decrease in net trading gain from interest rate instruments and items under fair value hedge was mainly attributable to the mark-to-market changes of certain debt securities,

caused by market interest rate movements. The growth in net trading gain from equity instruments was mainly attributable to the increased gain from equity-linked products that were well received by customers.

Compared to the second half of 2012, net trading gain was down HK\$280 million or 16.3%. The decline was attributed to the mark-to-market changes of certain debt securities, partly offset by the higher gain from equity securities.

\* Foreign exchange swap contracts are usually used for the Group's liquidity management and funding activities. Under the foreign exchange swap contracts, the Group exchanges one currency (original currency) for another (swapped currency) at the spot exchange rate (spot transaction) and commits to reverse the spot transaction by exchanging the same currency pair at a future maturity at a predetermined rate (forward transaction). In this way, surplus funds in original currency are swapped into another currency for liquidity and funding purposes with minimal foreign exchange risk. The exchange difference between the spot and forward contracts is recognised as foreign exchange gain or loss (as included in "net trading gain/(loss)"), while the corresponding interest differential between the surplus funds in original currency and swapped currency is reflected in net interest income.

## Net (Loss)/Gain on Financial Instruments Designated at Fair Value through Profit or Loss ("FVTPL")

HK\$m	Half-year ended 30 June 2013	Half-year ended 31 December 2012	Half-year ended 30 June 2012
Net (loss)/gain on financial instruments designated at fair value through profit or loss	(520)	561	186

The Group recorded a net loss of HK\$520 million on financial instruments designated at FVTPL in the first half of 2013, compared to a net gain of HK\$186 million in the first half of 2012. The net loss in the first half of 2013 was mainly attributable to the mark-to-market changes of debt securities of BOC Life, caused by market interest rate movements. The changes in market value of

its securities portfolio were offset by the corresponding changes in policy reserves, as reflected in the changes in net insurance benefits and claims which were attributable to the movement of market interest rates.

The net gain in the second half of 2012 was mainly attributable to the gain from the investment portfolio of BOC Life amid the recovering financial market.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Operating Expenses

HK\$'m	Half-year ended 30 June 2013	Half-year ended 31 December 2012	Half-year ended 30 June 2012
Staff costs	3,234	3,378	3,028
Premises and equipment expenses (excluding depreciation)	744	775	681
Depreciation on owned fixed assets	810	771	722
Other operating expenses	904	1,013	891
Total operating expenses	5,692	5,937	5,322

	At 30 June 2013	At 31 December 2012	At 30 June 2012
Staff headcount measured in full-time equivalents	14,416	14,638	14,534

Note: Certain comparative amounts of operating expenses have been reclassified to fee and commission expense to conform with current period's presentation.

Total operating expenses increased by HK\$370 million, or 7.0%, to HK\$5,692 million year-on-year, as a result of the Group's business expansion. The Group continued to invest in new business platforms and the Mainland business. At the same time, it adhered to disciplined cost control measures to enhance operational efficiency.

Staff costs increased by 6.8% from the first half of 2012, mainly due to higher salaries following the annual salary increment and the increase in performance-related remuneration.

Premises and equipment expenses were up 9.3% with higher rental for branches in Hong Kong and the Mainland.

Depreciation on owned fixed assets rose by 12.2%, due to larger depreciation charge on premises following the upward property revaluation.

Other operating expenses were up 1.5%, mainly due to higher marketing expenses and business taxes of NCB (China).

Compared to the second half of 2012, operating expenses declined by HK\$245 million or 4.1%. The decrease was due to lower staff costs, advertising, maintenance, business taxes and IT expenses in the first half of 2013.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Net Charge of Loan Impairment Allowances

HK\$m	Half-year ended 30 June 2013	Half-year ended 31 December 2012	Half-year ended 30 June 2012
Net charge of allowances before recoveries			
– individual assessment	(82)	(507)	(5)
– collective assessment	(476)	(368)	(238)
Recoveries	190	108	156
Net charge of loan impairment allowances	(368)	(767)	(87)

The Group maintained stringent risk management and overall loan quality remained solid. The net charge of loan impairment allowances was HK\$368 million in the first half of 2013. Net charge of individually assessed impairment allowances amounted to HK\$82 million, mainly relating to the downgrade of a few corporate loans. The net charge of collectively assessed impairment allowances amounted to HK\$476 million, primarily due to the loan

growth and the periodic update of the parameter values in the assessment model during the period. Meanwhile, recoveries amounted to HK\$190 million, slightly higher year-on-year.

Compared to the second half of 2012, net charge of loan impairment allowances decreased by HK\$399 million or 52.0%. The decline was mainly due to the lower net charge of individually assessed impairment allowances.

## BALANCE SHEET ANALYSIS

### Asset Deployment

HK\$m, except percentages	At 30 June 2013		At 31 December 2012	
	Amount	% of total	Amount	% of total
Cash and balances with banks and other financial institutions	182,450	9.9%	198,748	10.9%
Placements with banks and other financial institutions maturing between one and twelve months	54,511	3.0%	66,025	3.6%
Hong Kong SAR Government certificates of indebtedness	90,080	4.9%	82,930	4.5%
Securities investments <sup>1</sup>	486,134	26.5%	531,696	29.0%
Advances and other accounts	885,267	48.3%	819,739	44.8%
Fixed assets and investment properties	64,256	3.5%	63,107	3.4%
Other assets <sup>2</sup>	71,963	3.9%	68,518	3.8%
Total assets	1,834,661	100.0%	1,830,763	100.0%

1. Securities investments comprise investment in securities and financial assets at fair value through profit or loss.

2. Interests in associates and a joint venture, deferred tax assets and derivative financial instruments are included in other assets.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

As at 30 June 2013, the Group's total assets amounted to HK\$1,834,661 million, up HK\$3,898 million or 0.2% from the end of 2012. The Group maintained its proactive asset and liability management for sustainable growth and profitability. It continued to adopt a balanced strategy to support business growth with focus on optimising asset allocation, enhancing loan pricing and controlling funding costs.

Key changes in the Group's total assets include:

- Cash and balances with banks and other financial institutions decreased by 8.2%, mainly due to the decrease in RMB funds placed with the People's Bank of China by BOCHK's clearing business.
- Placements with banks and other financial institutions maturing between one and twelve months dropped by 17.4% as the Group redeployed its funds for advances to customers.
- Securities investments decreased by 8.6% with reduction mainly in lower yielding government-related securities. Meanwhile, the Group also increased holdings in high-quality financial institutions and corporate bonds.
- Advances and other accounts rose by 8.0%, mainly attributable to the growth in advances to customers by 6.7% and trade bills by 29.8%.
- Other assets grew by 5.0%, which was mainly led by the increase in reinsurance assets.

## Advances to customers and deposits from customers\*



# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Advances to Customers

HK\$m, except percentages	At 30 June 2013		At 31 December 2012	
	Amount	% of total	Amount	% of total
Loans for use in Hong Kong	<b>505,465</b>	<b>60.9%</b>	480,753	61.8%
Industrial, commercial and financial	<b>270,048</b>	<b>32.5%</b>	252,877	32.5%
Individuals	<b>235,417</b>	<b>28.4%</b>	227,876	29.3%
Trade finance	<b>76,494</b>	<b>9.2%</b>	67,137	8.6%
Loans for use outside Hong Kong	<b>248,784</b>	<b>29.9%</b>	230,374	29.6%
Total advances to customers	<b>830,743</b>	<b>100.0%</b>	778,264	100.0%

The Group adhered to stringent risk control and customer selection to achieve quality growth of its loan book. Advances to customers grew by HK\$52,479 million or 6.7% to HK\$830,743 million as at 30 June 2013.

Loans for use in Hong Kong grew by HK\$24,712 million or 5.1%.

- Lending to the industrial, commercial and financial sectors increased by HK\$17,171 million, or 6.8%, to HK\$270,048 million. The increase covered a wide range of industries. Loans to the property investment, property development, transport and transport equipment, wholesale and retail as well as stockbrokers grew by 7.4%, 10.2%, 8.0%, 6.6% and 116.1% respectively.
- Lending to individuals increased by HK\$7,541 million, or 3.3%. Residential mortgage loans (excluding those under the Government-sponsored home purchasing schemes) were up 3.0%. Other loans to individuals increased by 16.7%.

Trade finance rose by HK\$9,357 million, or 13.9% while loans for use outside Hong Kong grew by HK\$18,410 million or 8.0%.



# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Loan Quality

HK\$m, except percentages	At 30 June 2013	At 31 December 2012
Advances to customers	<b>830,743</b>	778,264
Classified or impaired loan ratio	<b>0.26%</b>	0.26%
Impairment allowances	<b>4,120</b>	3,705
Regulatory reserve for general banking risks	<b>8,145</b>	7,754
Total allowances and regulatory reserve	<b>12,265</b>	11,459
Total allowances as a percentage of advances to customers	<b>0.50%</b>	0.48%
Impairment allowances <sup>1</sup> on classified or impaired loan ratio	<b>39.81%</b>	37.44%
Residential mortgage loans <sup>2</sup> – delinquency and rescheduled loan ratio <sup>3</sup>	<b>0.03%</b>	0.02%
Card advances – delinquency ratio <sup>3</sup>	<b>0.26%</b>	0.17%
	<b>Half-year ended 30 June 2013</b>	Half-year ended 30 June 2012
Card advances – charge-off ratio <sup>4</sup>	<b>1.43%</b>	1.23%

1. Referring to impairment allowances on loans classified as “substandard”, “doubtful” or “loss” under the Group’s classification of loan quality, or individually assessed to be impaired.
2. Residential mortgage loans exclude those under the Home Ownership Scheme and other government-sponsored home purchasing schemes.
3. Delinquency ratio is measured by a ratio of total amount of overdue loans (more than three months) to total outstanding loans.
4. Charge-off ratio is measured by a ratio of total write-offs made during the period to average card receivables during the period.

The Group’s overall loan quality remained sound. The classified or impaired loan ratio was at 0.26%. Classified or impaired loans increased by HK\$66 million, or 3.2%, to HK\$2,120 million. Formation of new classified or impaired loans in the first half of 2013 was at a low level and represented approximately 0.05% of total loans outstanding.

Total impairment allowances, including both individual assessment and collective assessment, amounted to HK\$4,120 million. Total impairment allowances on

classified or impaired loans as a percentage of total classified or impaired loans was at 39.81%.

The credit quality of the Group’s residential mortgage loans and credit cards remained sound. The combined delinquency and rescheduled loan ratio of residential mortgage loans stood at 0.03% at the end of June 2013. The charge-off ratio of card advances remained low at 1.43% in the first half of 2013, the year-on-year uptrend was in line with the market.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Deposits from Customers\*

HK\$m, except percentages	At 30 June 2013		At 31 December 2012	
	Amount	% of total	Amount	% of total
Demand deposits and current accounts	99,668	7.9%	97,295	7.9%
Savings deposits	564,485	44.6%	603,565	49.1%
Time, call and notice deposits	595,603	47.1%	525,430	42.8%
	<b>1,259,756</b>	<b>99.6%</b>	1,226,290	99.8%
Structured deposits	4,534	0.4%	2,841	0.2%
Deposits from customers	<b>1,264,290</b>	<b>100.0%</b>	1,229,131	100.0%

\* Including structured deposits.

The Group maintained a flexible deposit strategy to support its business growth. Its deposit base increased by HK\$35,159 million, or 2.9%, in the first half of 2013. Demand deposits and current accounts rose by 2.4%

while time, call and notice deposits grew by 13.4%. Saving deposits decreased by 6.5%. The Group's loan-to-deposit ratio was 65.71% at the end of June 2013, up 2.39 percentage points from the end of 2012.

## Capital and Reserves Attributable to the Equity Holders of the Company

HK\$m	At 30 June 2013	At 31 December 2012
Share capital	52,864	52,864
Premises revaluation reserve	32,503	31,259
Reserve for fair value changes of available-for-sale securities	1,030	5,510
Regulatory reserve	8,145	7,754
Translation reserve	919	771
Retained earnings	56,345	52,811
Reserves	<b>98,942</b>	98,105
Capital and reserves attributable to the Equity Holders of the Company	<b>151,806</b>	150,969

Capital and reserves attributable to the equity holders increased by HK\$837 million, or 0.6% to HK\$151,806 million at 30 June 2013. Retained earnings rose by 6.7%, reflecting the profit for the first half of 2013 after the appropriation of final dividend of 2012. Premises revaluation reserve increased by 4.0%, which was

attributable to the increase in property prices in the first half of 2013. Regulatory reserve rose by 5.0% due to loan growth. Reserve for fair value changes of available-for-sale securities decreased by 81.3%, mainly due to the changes in market interest rates.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Capital and Liquidity Ratio

HK\$m, except percentages	At 30 June 2013
<b>Capital ratios under Basel III</b>	
Consolidated capital after deductions	
Common Equity Tier 1 capital	91,071
Additional Tier 1 capital	1,027
Tier 1 capital	92,098
Tier 2 capital	43,209
Total capital	135,307
Total risk-weighted assets	824,850
Common Equity Tier 1 capital ratio	11.04%
Tier 1 capital ratio	11.17%
Total capital ratio	16.40%

	At 31 December 2012
<b>Capital ratios under Basel II</b>	
Consolidated capital base after deductions	
Core capital	89,096
Supplementary capital	32,452
Total capital base	121,548
Total risk-weighted assets	723,699
Core capital ratio	12.31%
Capital adequacy ratio	16.80%

	Half-year ended 30 June 2013	Half-year ended 30 June 2012
Average liquidity ratio	38.70%	39.87%

The Banking (Capital) (Amendment) Rules 2012 ("BCAR 2012") came into operation on 1 January 2013. The BCAR 2012 mainly addressed the revision to both the minimum capital ratio requirement and the definition of regulatory capital. The rules also included enhancements to the counterparty credit risk framework and amendments on the capital treatment for certain trade financing activities and securities financing transactions. For details of the Group's calculation of capital charges, please refer to Note

3.5 to the Interim Financial Information.

Total capital ratio at 30 June 2013 was 16.40%. As a result of the adoption of the BCAR 2012, the capital ratios shown above are not directly comparable.

The average liquidity ratio in the first half of 2013 remained sound at 38.70%.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## BUSINESS REVIEW

### Business Segment Performance

#### Profit before Taxation by Business Segments

HK\$m, except percentages	Half-year ended 30 June 2013		Half-year ended 30 June 2012	
	Amount	% of total	Amount	% of total
Personal Banking	3,572	25.6%	2,763	20.0%
Corporate Banking	5,873	42.1%	5,142	37.2%
Treasury	3,918	28.1%	4,702	34.0%
Insurance	564	4.0%	451	3.3%
Others	21	0.2%	767	5.5%
Total profit before taxation	13,948	100.0%	13,825	100.0%

Note: For additional segmental information, see Note 40 to the Interim Financial Information.

## PERSONAL BANKING

### Financial Results

Personal Banking recorded a strong increase of HK\$809 million, or 29.3%, in profit before taxation. This was mainly attributable to the increase in net interest income and net fee and commission income.

Net interest income increased by 16.3%. This was made possible by the increase in average balance of loans and deposits with the improvement in loan and deposit spread.

Net fee and commission income rose by 32.2%, mainly attributable to the higher commission income from securities brokerage, funds distribution, insurance, credit cards as well as loans.

Net trading gain also increased by 22.6%, due to higher income from equity instruments and foreign exchange related products.

### Business operation

The Group's personal lending business continued its trajectory of steady growth in the first half of 2013. It remained the market leader in new mortgage loans. The funds distribution and insurance business performed strongly. The wealth management platform was further enhanced while the new Private Banking service made solid progress. Distribution channels were further optimised to enhance customer experience.

### Residential mortgages – reinforcing the market leadership

Despite the slowdown in the residential property market, the Group continued to innovate to provide customers with the widest range of products and services across

all channels. The "Fixed-Rate Mortgage Scheme" was launched to provide homeowners with an alternative financing option to lock in their loan expenses. Subsequently, the new "Portable Fixed-Rate Mortgage Scheme" was introduced to allow customers to carry the fixed rate of the original mortgage plan to a new property during the fixed-rate period. The Group also partnered with the Hong Kong Mortgage Corporation Limited to actively promote Reverse Mortgages. Seminars were conducted to selected segment and Member-Get-Member programme was launched to reach out to existing customers. The extensive range of products and services enabled the Group to remain as the market leader of new mortgage loans underwritten during the period. At the end of June 2013, the balance of the Group's mortgage loans grew by 3.0% compared with the end of last year.

### Investment and insurance businesses – robust growth in funds distribution and insurance business

Market sentiment turned weak with concerns over the monetary stimulus programme in the US and the economic slowdown in the Mainland. Nevertheless, the Group continued to expand its stock brokerage services to lead the market in the personal securities services. IPO placement services, traditionally offered to Private Banking customers only, were introduced to selected personal banking customers. With the aim of enhancing customers' investment knowledge, the Group launched the educational "Virtual Securities Investment Platform". This platform allows customers to conduct virtual securities trading for stocks, ETFs and warrants with virtual money based on real time stock prices, reinforcing the concept of "learn before you invest" to all users.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

For the funds distribution business, the Group continued to broaden its product offerings. A new retail fund, the "BOCHK All Weather RMB High Yield Bond Fund" was launched in March and received overwhelming response from customers. The Group continued to deepen relationships with existing customers and actively pursued new customers. Themed marketing campaigns and investment seminars were conducted to help customers further diversify their investment portfolios. As a result, commission income from funds distribution surged by 90.1% over the same period last year. The Group continued to leverage on its competitive edge in the bond distribution business and became one of the largest placing banks of the third iBond issuance in June this year.

With regards to the Bancassurance business, the Group maintained its competitive edge in life insurance by offering a diversified range of products. It maintained its leading position in the RMB insurance market. The HKD/USD denominated "UltiChoice Universal Life Insurance Plan" was introduced during the period.

## ***Credit card business – recognised leader in CUP card business***

The Group's credit card business registered steady development in the first half of 2013. It maintained its leadership in the China UnionPay ("CUP") merchant acquiring business and card issuing business in Hong Kong. The cardholder spending and merchant acquiring volumes grew by 8.3% and 20.3% respectively year-on-year. The Group's success in the credit card business was widely recognised with a total of 30 awards presented by VISA International, MasterCard and CUP during the period.

## ***Wealth Management service – one-stop wealth management solutions***

Following the consolidation of its Wealth Management service platform in 2012, the Group continued to provide personalised services and professional financial solutions to meet customers' banking and investment needs. Series of marketing programmes were launched to enhance the brand quality and to increase penetration to quality targeted customers.

The Group's Private Banking business made good progress after its launch in late 2012. In collaboration with business units within the Group as well as BOC and NCB (China), it expanded its customer base through a series of client

acquisition and referral activities. Based on the one-stop, holistic service model, a wide range of tailor-made products and services in the area of investment management, liquidity management and estate planning were made to meet the needs of Private Banking clients. Consequently, it achieved encouraging results in both the number of Private Banking customers and the value of assets under management.

## ***Mass retail customers – introducing i-Free Banking***

The Group re-packaged its i-Free Banking services to cater for the basic banking and financial planning service needs of more customers. A selection of savings plans was launched to appeal to younger clientele.

## ***Distribution channels – strengthening automated banking channels***

The Group continued to optimise its distribution channels to meet the needs of customers. At the end of June 2013, the Group's service network in Hong Kong comprised 269 branches, including 141 wealth management centres. It further enhanced its automated banking channels. Voice navigated ATM machine was introduced to aid visually impaired customers to perform automated banking services. The call center offered new services, including the setting of overseas ATM cash withdrawal limits.

In recognition of its well-received electronic platform and outstanding services, the Group received the award of "RMB Business Outstanding Awards 2013 – Outstanding Retail Banking Business – Electronic Banking Business" organised by Metro Finance, Metro Finance Digital and Hong Kong Wen Wei Po. Financial planners of the Group also won the Gold Award and the Best Presentation Award in the "7th HKIB Outstanding Financial Management Planner Awards" presented by The Hong Kong Institute of Bankers.

## **CORPORATE BANKING**

### **Financial Results**

Corporate Banking recorded a satisfactory growth of HK\$731 million, or 14.2%, in profit before taxation.

Net interest income rose by 21.8%, mainly driven by the increase in average balance of loans and deposits coupled with the increase in loan spread. The growth was partly offset by the decrease in deposit spread. Corporate loans and deposits grew by 8.2% and 8.4% respectively from the end of 2012.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

Net fee and commission income increased by 6.2%, largely led by the growth in loan commissions and trust services. The increase was, however, partly offset by the decline in commissions from credit cards and payment services.

## **Business operation**

The Group's Corporate Banking business maintained its growth momentum in the first half of 2013. With the aim of becoming the main banker of its customers, the Group continued to provide comprehensive banking services to better serve customers' needs and strengthen customer relationships. At the same time, it focused on expanding industry coverage and customer base through continuous enhancement of its professional expertise in industry management. As a result, corporate loans grew satisfactorily with improved loan pricing. In the custody business, the Group further expanded its client base from different geographical locations. The service spectrum of the cash management business was expanded to include domestic liquidity management capabilities to its cross-border fund sweeping services on BOC's "Global Cash Management System".

## **Corporate lending business – 8.2% growth of corporate loans**

The Group continued to implement "Total Solutions" for key customers and worked closely with BOC through the "Global Relationship Manager Programme" to provide comprehensive banking services to meet customers' specific demands. Through continuous enhancement of expertise in industry management with better customer segmentation, it was able to expand its client base and improve its risk management. The Group also conducted various market activities to strengthen customer relationships. The Corporate Services Centre was set up to further improve service efficiencies. In the first half of 2013, the Group successfully completed its first RMB cross-border loan to an enterprise in Qianhai. It continued to provide strong support to Chinese enterprises with the strategy of overseas expansion and remained the top mandated arranger in the Hong Kong-Macau syndicated loan market. At the end of June, the Group's balance of corporate loans grew by 8.2% from the end of 2012.

## **SME business – "Best SME's Partner Award" for the sixth consecutive year**

The Group strived to enhance customer experience for SME customers. In addition to the launch of the

"Integrated Branches for Commercial Business" and "Business Integrated Account" in 2012, it continued to enhance its service capacities by introducing cash management services to customers. The corporate internet banking platform, CBS Online, has been optimised to promote a modern and more user-friendly design of the interface and transaction flow to strengthen customer relationships and attract new customers. In addition, the Group launched a privileged guarantee fee subsidy to support the Special Concessionary Measures of the SME Financing Guarantee Scheme of the Hong Kong Mortgage Corporation Limited. This offer is designed to meet the financing needs of commercial customers and help facilitate the development of SMEs in Hong Kong. In recognition of its long-standing support of SMEs in Hong Kong, the Group received for the sixth consecutive year the "Best SME's Partner Award" from the Hong Kong General Chamber of Small and Medium Business.

## **Trade finance – collaboration with BOC to drive growth**

The Group continued to enhance product features to meet changing customer needs in cross-border transactions. In close collaboration with BOC, it strengthened the cross-border RMB entrusted payments and entrusted loans businesses and established business relationships with its target customers. The Group also made solid progress in the "Supply-chain Finance" business launched in 2012. At the end of June 2013, the Group's balance of trade finance grew by 13.9% from the end of 2012.

## **Custody service – further expansion of customer base**

The Group continued to expand its custody services in the first half of 2013. In addition to those institutions with a Mainland background, the Group established business relationships with a number of new RQFII applicants from Hong Kong, Taiwan and other overseas countries or regions. It continued to expand its client base and successfully secured mandates to provide custody services for RQFII-ETFs, RQFII funds and Qualified Domestic Institutional Investors. In recognition of its outstanding QFII performance, BOCHK was awarded the "Best QFII Custodian" under Regional Specialist in the Asset Servicing Awards 2013 by The Asset Magazine. At the end of June 2013, excluding the RMB fiduciary account for participating banks, total assets under the Group's custody were valued at HK\$617 billion.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## **Cash management service – further expansion of service spectrum**

The Group continued to strengthen its cross-border cash management service capabilities. While BOC's Taiwan Branch was included as one of the RMB remittance points in the Greater China region, the Group successfully completed the establishment of domestic liquidity management functions to the cross-border fund sweeping services of BOC's "Global Cash Management System" to strengthen its competitive edge as a cross-border fund centre for customers in Hong Kong. In recognition of its outstanding cash management services, BOCHK was presented the "Achievement Award for Best Cash Management Bank in Hong Kong" in the "Asian Banker Transaction Banking Awards 2013".

## **Risk management – proactive measures to contain risks**

The Group remained highly vigilant of risks and conducted stringent risk management and credit control to safeguard asset quality. It closely monitored corporate customers and industries that could be adversely affected by the volatile economic environment, including the recent slowdown of economic growth in the Mainland and the withdrawal of stimulus in the US. Rigorous post-lending monitoring measures were put in place to track early negative signs with ad hoc credit review and precautionary measures to be taken in a timely manner.

## **MAINLAND BUSINESS**

### **Financial performance – encouraging growth**

The operating environment in the Mainland remained challenging in the first half of 2013. Nevertheless, the Group's Mainland business achieved encouraging growth with optimisation of its asset and liability structure to improve yields. Net operating income increased by 18.2%. Customer deposits and loans registered steady growth of 8.8% and 6.8% respectively from the end of last year. Loan quality remained sound.

### **Product and service offerings – continuous enhancement in capabilities**

The Group continued to enrich its wealth management product offering to meet the increasing demand for wealth management services. During the period, the Group launched the equity-linked "Preferred Equity" and crude oil-linked "Global Energy" series of structured wealth management products. Meanwhile, another series of wealth management products, "Yixiang", continued to make good contribution to commission income. During the period, NCB

(China) commenced its credit card business in the Mainland. By the end of June 2013, over 2,300 Platinum personal RMB CUP credit cards were issued. The SME business platform was further enhanced with the launch of the "Small Micro-Enterprise Loan Programme" and streamlining of processes to provide more efficient services to SME customers.

### **Distribution channels – enhanced e-Banking function**

The Group continued to improve both its personal and corporate e-Banking platforms with the introduction of new services, extension of service hours, real-time processing on holidays and sharing of payment platform of BOC. Meanwhile, enhancements to the "Channel Sharing" model continued with success as the number of new accounts and transaction volume increased notably. The Group also conducted several projects to streamline business processes, in order to shorten turnaround time and enhance customer experience. During the first half of 2013, two new sub-branches of NCB (China) were opened. The Group's total number of branches and sub-branches in the Mainland increased to 38 by the end of June 2013.

## **TREASURY**

### **Financial Results**

Treasury recorded a decrease of 16.7% in profit before taxation.

Net interest income decreased by 22.0%, mainly due to the decline in average yield on interbank placements and debt securities investments. The decrease was partly offset by the growth in debt securities investments.

Net trading gain was up 52.7%. The increase was mainly caused by the higher gain from foreign exchange related products and the improved mark-to-market changes of certain interest rate instruments.

Net gain on other financial assets was down 72.6%. This was mainly due to the higher gain recorded in the first half of 2012 as the Group captured market opportunities to realise gain on certain debt securities investments.

### **Business Operation**

#### **Proactive investment strategy - staying attuned to risk**

The Group continued to manage its banking book investments with a proactive and prudent approach. It closely monitored market changes and adjusted its



# MANAGEMENT'S DISCUSSION AND ANALYSIS

investment portfolio to enhance return while staying vigilant of risks. During the period, the Group selectively increased its investments in high-quality financial institutions and corporate bonds and reduced investments in government-related bonds. In terms of geographical exposure, the increased investments were mainly made in the US and Asia. At the same time, the Group increased its holdings in RMB-denominated bonds, which were issued by high-quality Mainland corporates.

## ***Product sales – responding to market demand***

In line with its customer-centric approach, the Group strived to enhance its core competitive edge by uplifting its transaction capacity, product response efficiency and client marketing. During the period, the Group promptly responded to market conditions and focused on promoting products and services, including structured deposit, equity-linked investment and foreign exchange margin trading, which were well-received by customers. In the bond underwriting business, the Group achieved success in business diversification with underwriting of bond issuance in different denominated currencies, and saw a considerable increase in turnover over the same period last year.

## ***RMB-related business – the leading CNH (offshore RMB) market player***

As the leading market player in the offshore RMB treasury business in Hong Kong, the Group completed the first CNH/USD cross-currency swap transaction using the CNH HIBOR as the pricing benchmark. This transaction served as a tool to hedge against interest rate risks and marked a new milestone in the development of the offshore RMB business. The Group also successfully acted as the arranger for the issuance of the first certificate of deposit with the CNH HIBOR as the benchmark rate, offering the market a wider choice of floating rate debt instruments. BOCHK has been designated as the market maker of the USD/CNH futures for the Chicago Mercantile Exchange Group and Hong Kong Futures Exchange, becoming the only bank that plays such a role in both exchanges.

## ***RMB clearing service – continuous service enhancement***

The Group continued to provide strong support in clearing services. The introduction of RMB fixed deposit service for participating banks, the extension of operating hours for

RMB cross-border payments and the adjustment of RMB intra-day Repo limits helped promote stable and healthy development of its RMB clearing services.

## **INSURANCE**

### **Financial Results**

The Group's Insurance segment recorded a satisfactory growth of 25.1% in its profit before taxation to HK\$564 million in the first half of 2013.

Net insurance premium income registered a strong growth of 75.4%, as a result of the Group's continuous effort in product enhancement as well as marketing and promotional campaigns. Meanwhile, there were lower policy reserves, as reflected in the changes in net insurance benefits and claims, resulting from higher long-term interest rates. This outweighed the mark-to-market losses of its debt securities which were attributable to market interest rate movements.

### **Business Operation**

#### ***Driving growth through product enhancement and diversified distribution channel***

The Group continued to enrich its product offerings. New products were introduced to meet customers' diverse needs. It also actively explored new distribution channels and established partnership with brokerage houses to promote insurance products. This new distribution strategy helped the Group to recruit new customers. The satisfactory performance of the Group's insurance business was reflected in the growth of market ranking. In terms of new business standard premium, BOC Life uplifted its market ranking to No. 1 in the first quarter of 2013.

In recognition of its achievements in the year, BOC Life has been awarded "Best Life Insurance Company of the Year 2013 in Hong Kong" in the "Global Insurance Award" by World Finance, a UK magazine, and the "Outstanding Brand Award 2013" by Economic Digest.

#### ***RMB insurance products – a prominent provider***

The Group continued to maintain its leading position in the Hong Kong RMB insurance market. Products such as the "IncomeGrowth Annuity Insurance Plan", "Target 5 Years Insurance Plan Series", and "RMB Universal Life Insurance Plan" were well received by customers. A new RMB product "Wealth Conquer Universal Life Insurance

# MANAGEMENT'S DISCUSSION AND ANALYSIS

Plan" was launched and tailored for distribution through brokerage houses.

In recognition of its outstanding performance in the RMB services, BOC Life was granted the award of "RMB Business Outstanding Awards 2013 – Outstanding Insurance Business" organised by Metro Finance, Metro Finance Digital and Hong Kong Wen Wei Po.

## OTHERS

### ***Asset management service – expanding geographical foothold***

BOCHK Asset Management Limited ("BOCHK AM"), acting as the vehicle for developing the Group's wealth management platform, continued to make solid progress in the first half of 2013. With strong impetus to focus on developing RMB products, it launched a new retail fund "BOCHK All Weather RMB High Yield Bond Fund", which received an overwhelming response from customers. It also launched another retail fund "BOCHK All Weather HK & China Equity Fund" in June 2013. In respect of its investment advisory services, BOCHK AM expanded its geographical foothold by providing advisory services to overseas entities, acting as the investment advisor for two RMB bond funds launched in Taiwan by a local asset management company. It will also be the advisor for the new "FTSE-BOCHK Offshore RMB Bond Index Series" to be jointly developed by BOCHK and FTSE Group.

With regards to its fund management service, BOCHK AM manages RMB, Asian and Global fixed income funds, in addition to Hong Kong equity and global balanced funds and discretionary portfolios for individual and institutional investors.

In recognition of its outstanding performance, BOCHK AM has been granted five prestigious "2012 Best of the Best Awards" by Asia Asset Management.

## RISK MANAGEMENT

### ***Banking Group***

#### **Overview**

The Group believes that sound risk management is crucial to the success of any organisation. In its daily operation, the Group attaches a high degree of importance to risk management and emphasises that a balance must be struck between risk control and business development. The principal types of risk inherent in the Group's

businesses are credit risk, interest rate risk, market risk, liquidity risk, operational risk, reputation risk, legal and compliance risk, and strategic risk. The Group's risk management objective is to enhance shareholder value by maintaining risk exposures within acceptable limits. The Group has a defined risk appetite statement approved by the Board, which is an expression of the types and level of risk that the Group is willing to take in a controllable way in order to achieve its business goals and to meet the expectations of its stakeholders.

### **Risk Management Governance Structure**

The Group's risk management governance structure is designed to cover all business processes and ensures various risks are properly managed and controlled in the course of conducting business. The Group has a robust risk management organisational structure with a comprehensive set of policies and procedures to identify, measure, monitor and control various risks that may arise. These risk management policies and procedures are regularly reviewed and updated to reflect changes in markets and business strategies. Various groups of risk takers assume their respective responsibilities for risk management.

The Board of Directors, representing the interests of shareholders, is the highest decision-making authority of the Group and has the ultimate responsibility for risk management. The Board, with the assistance of its committees, has the primary responsibility for the formulation of risk management strategies and for ensuring that the Group has an effective risk management system to implement these strategies.

The Risk Committee ("RC"), a standing committee established by the Board of Directors, is responsible for overseeing the Group's various types of risks, approving high-level risk-related policies and monitoring their implementation, reviewing significant or high risk exposures or transactions and exercising its power of veto if it considers that any transaction should not proceed. The Audit Committee assists the Board in fulfilling its role in overseeing the internal control system.

The Chief Executive ("CE") is responsible for managing the Group's various types of risks, approving detailed risk management policies, and approving material risk exposures or transactions within his authority delegated

# MANAGEMENT'S DISCUSSION AND ANALYSIS

by the Board of Directors. The Chief Risk Officer ("CRO") assists the CE in fulfilling his responsibilities for the day-to-day management of risks. The CRO is responsible for initiating new risk management strategies, projects and measures that will enable the Group to better monitor and manage new risk issues or areas that may arise from time to time from new businesses, products and changes in the operating environment. The CRO will also take appropriate initiatives in response to regulatory changes. The CRO is also responsible for reviewing material risk exposures or transactions within his delegated authority and exercising his power of veto if he believes that any transaction should not proceed.

Various units of the Group have their respective risk management responsibilities. Business units act as the first line of defence while risk management units, which are independent from the business units, are responsible for the day-to-day management of different kinds of risks. Risk management units have the primary responsibilities for drafting, reviewing and updating various risk management policies and procedures.

The Group's principal banking subsidiaries, Nanyang, NCB (China) and Chiyu, are subject to risk policies that are consistent with those of the Group. Moreover, the Group's non-banking subsidiaries, such as BOC Life, are subject to the Group's risk management requirements. These subsidiaries are required to formulate their respective risk management policies based on the characteristics of their own industries, perform daily risk management responsibilities and report to BOCHK on a regular basis. Risk management units of BOCHK monitor the risk management status of these subsidiaries respectively.

## **Credit Risk Management**

Credit risk is the risk of loss arising from a customer or counterparty that will be unable to or unwilling to meet its contractual obligations. Credit risk exists in the trading book and banking book, on- and off-balance sheet exposures of a bank. It arises principally from the lending, trade finance and treasury businesses, and covers inter-bank transactions, foreign exchange and derivative transactions as well as investments in bonds and securities. The Chief Credit Officer, who reports directly to the CRO, takes charge of credit risk management and is also responsible for the control of credit risk exposure of subsidiaries in line with the credit risk management

principles and requirements set by the Group. The Chief Analytics Officer, who also reports directly to the CRO, is responsible for the development and maintenance of internal rating models and establishing the rating criteria.

For advances, different credit approval and control procedures are adopted according to the level of risk associated with the customer, counterparty or transaction. The Credit Risk Assessment Committee, comprising experts from credit and other functions, is responsible for making an independent assessment of all credit facilities which require the approval of Deputy Chief Executives ("DCE") or above. Credit applications for non-retail exposures are independently reviewed and objectively assessed by risk management units. Obligor ratings (in terms of probability of default) and facility ratings (in terms of loss given default) are assigned to these portfolios to support credit approval. Retail internal rating systems are deployed in the risk assessment of retail credit transactions, including small business retail exposures, residential mortgage loans, personal loans and credit cards. Loan grades, obligor and facility ratings as well as loss estimates (if applicable) are used to support credit approval.

The Group also uses loan grades, obligor ratings and loss estimates (if applicable) to support credit monitoring, analysis and reporting. For non-retail exposures, more frequent rating review and closer monitoring are required for higher-risk customers. For retail exposures, monthly updated internal ratings and loss estimates are used for credit monitoring on a portfolio basis. More comprehensive review is required for obligors being identified under high-risk pools. In the first half of 2013, the Group continues to adopt loan grading criteria which divide credit assets into 5 categories with reference to HKMA's guidelines. The Risk Management Department ("RMD") provides regular credit management information reports and ad hoc reports to the Management Committee ("MC"), RC and Board of Directors to facilitate their continuous monitoring of credit risk. In addition, credit concentration risk is identified by industry, geography, customer and counterparty risk. The Group monitors changes to counterparties credit risk, quality of the credit portfolio and risk concentrations, and reports regularly to the Group's management.

The Group employs a credit master scale for internal rating purpose that can be mapped to Standard & Poor's external ratings. The credit master scale for internal rating

# MANAGEMENT'S DISCUSSION AND ANALYSIS

is in compliance with the Banking (Capital) Rules under the Hong Kong Banking Ordinance on internal rating structure.

For investments in debt securities and securitisation assets, the obligor ratings or external credit ratings, assessment of the underlying assets and credit limits setting on customer/security issuer basis are used for managing credit risk associated with the investment. For derivatives, the Group sets customer limits to manage the credit risk involved and follows the same approval and control processes as applied for advances. On-going monitoring and stop-loss procedures are established. The methodology and assumptions used for impairment assessments are reviewed regularly. In evaluating impairment of asset backed securities ("ABS") and mortgage backed securities ("MBS"), the Group continued to use a significant decline in market price and credit deterioration of the underlying assets to be the key indicators of impairment. The Group also considered other objective evidences of impairment, taking into account the impact of liquidity on market prices and the movement in loss coverage ratios of individual ABS and MBS held by the Group.

## Market Risk Management

Market risk refers to the risk of losses arising from adverse movements in the value of foreign exchange, commodity, interest rate and equity positions held by the Group due to the volatility of financial market price (debt security price/interest rate, foreign exchange rate, equity price, commodity price). The Group adopts a moderate market risk appetite to achieve a balance between risk and return. The Group's objective in managing market risk is to secure healthy growth of the treasury business, by effective management of potential market risk in the Group's business, according to the Group's overall risk appetite and strategy of treasury business on the basis of a well established risk management regime and related management measures.

In accordance with the Group's corporate governance principles in respect of risk management, the Board and RC, senior management and functional departments/units perform their duties and responsibilities to manage the Group's market risk. The Market Risk Management Division of the RMD is mainly responsible for managing market risk, assisting senior management to perform their

day-to-day duties, independently monitoring the market risk profile and compliance of management policies and limits of the Group and BOCHK, and ensuring that the aggregate and individual market risks are within acceptable levels.

The Group's market risk management covers BOCHK and its subsidiaries. The Group establishes consistent market risk management policies to regulate BOCHK's and subsidiaries' market risk management; meanwhile, the Group sets up the Group VAR and stress test limits, which are allocated and monitored across the Group, according to the subsidiaries' business requirements and risk tolerance levels. In line with the requirements set in the Group policy, the management of subsidiaries may, subject to prior consent by BOCHK, formulate the detailed policies and procedures and are responsible for managing their daily market risk. The subsidiaries set up independent risk monitoring teams to monitor daily market risk and limit compliance, and submit management information and reports to BOCHK on a regular basis.

The Group sets up market risk indicators and limits to identify, measure, monitor and control market risk. Major risk indicators and limits include but are not limited to VAR, Stop Loss, Open Position, Stress Testing and Sensitivity Analysis (Basis Point Value, Greeks), etc. To meet management requirements, major risk indicators and limits are classified into four levels, and are approved by the RC, MC, CRO and the DCE in charge of the treasury business or the head of the respective business unit respectively. Treasury business units of BOCHK and subsidiaries (as for Group Limit) are required to conduct their business within approved market risk indicators and limits.

The Group uses the VAR to measure and report general market risks to the RC and senior management on a periodic basis. The Group adopts a uniformed VAR calculation model, using historical simulation approach and 2-year historical data, to calculate the VAR of the Group and subsidiaries over 1-day holding period with 99% confidence level, and sets up the VAR limit of the Group and subsidiaries.

The Group adopts back-testing to measure the accuracy of VAR model results. The back-testing compares the

# MANAGEMENT'S DISCUSSION AND ANALYSIS

calculated VAR figure of market risk positions of each business day with the actual and hypothetical revenues arising from those positions on the next business day. Generally speaking, the number of back-testing exceptions in a rolling 12-month period will not exceed four times, given a 99% confidence level. BOCHK conducts back-testing for VAR model results on a monthly basis.

## Interest Rate Risk Management

Interest rate risk means the risks to a bank's earnings and economic value arising from adverse movements in interest rate and term structures of the bank's asset and liability positions. The Group's interest rate risk exposures are mainly structural. The major types of interest rate risk from structural positions are:

- Repricing risk: mismatches in the maturity or repricing periods of assets and liabilities that may affect net interest income;
- Basis risk: different pricing basis for different transactions resulting that the yield on assets and cost of liabilities may change by different amounts within the same repricing period;
- Yield curve risk: non-parallel shifts in the yield curve that may have an adverse impact on net interest income or economic value;
- Option risk: exercise of the options embedded in assets, liabilities or off-balance sheet items that can cause a change in the cash flows of assets and liabilities.

The Group's risk management framework applies also to interest rate risk management. The Assets and Liabilities Management Committee ("ALCO") exercises its oversight of interest rate risk in accordance with the "BOCHK Group Banking Book Interest Rate Risk Management Policy" approved by RC. RMD (Interest Rate and Liquidity Risk Management) is responsible for interest rate risk management. With the cooperation of the Asset and Liability Management Division of Financial Management Department and Investment Management, RMD assists the ALCO to manage day-to-day interest rate risk positions. Its roles include, but are not limited

to, the formulation of management policies, selection of methodologies, setting of risk indicators and limits, assessment of target balance sheet, monitoring of the compliance with policies and limits, and submission of interest rate risk management reports to the senior management and RC, etc.

The Group sets out interest rate risk indicators and limits to identify, measure, monitor and control interest rate risk. The indicators and limits include, but are not limited to, repricing gap limits, basis risk, duration, price value of a basis point (PVB), Greeks, net interest income sensitivity ratio, economic value sensitivity ratio (including sub-limit for AFS securities), etc. The indicators and limits are classified into three levels, which are approved by the RC, ALCO and CRO respectively. Risk-taking business units are required to conduct their business within the boundary of the interest rate risk limits. Before launching a new product or business in the banking book, the relevant departments are required to go through a risk assessment process, which includes the assessment of underlying interest rate risk and consideration of the adequacy of current risk monitoring mechanism. Any material impact on interest rate risk noted during the risk assessment process will be submitted to the RC for approval.

Net interest income sensitivity ratio and economic value sensitivity ratio assess the impact of interest rate movement on the Group's net interest income and capital base. They are the Group's key interest rate risk indicators. The former assesses the impact of interest rate movement on net interest income as a percentage to projected net interest income for the year. The latter assesses the impact of interest rate movement on economic value (i.e. the present value of cash flows of assets, liabilities and off-balance sheet items discounted using market interest rate) as a percentage to the latest capital base. Limits are set by the RC on these two indicators to monitor and control the Group's banking book interest rate risk.

The Group uses scenario analyses and stress tests to assess the banking book interest rate risk that the Group would face under adverse circumstances. Scenario analyses and stress tests are also devised to assess the impact on net interest income and economic value arising from the optionality of savings deposits, the prepayment of mortgage loans and the prepayment of debt securities with embedded options.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Liquidity Risk Management

Liquidity risk is the risk that banks fail to provide sufficient funds to grow assets or pay due obligations, and need to bear an unacceptable loss. The Group maintains sound liquidity risk appetite to provide stable, reliable and adequate sources of cash to meet liquidity needs under normal circumstances or stressed scenarios; and to survive with net positive cumulative cash flow in extreme scenarios without requesting HKMA to act as the lender of last resort.

The Group's liquidity risk management objective is to effectively manage the liquidity of on-balance sheet and off-balance sheet items with reasonable cost based on the liquidity risk appetite to achieve sound operation and sustainable profitability. Customer deposits are the Group's primary source of funds. To ensure stable and sufficient source of funds are in place, the Group actively attracts new deposits, keeps the core deposit and obtains supplementary funding from the interbank market or by issuing bills in the capital market. According to different term maturities and the results of funding needs estimated from stressed scenarios, the Group adjusts its asset structure (including loans, bonds investment, interbank placement, etc.) to maintain sufficient liquid assets in support of normal business needs and ensure its ability to raise enough funds at reasonable cost to serve external claims in case of emergency. The Group is committed to diversify the source of funds and the use of funds to avoid excessive concentration of assets and liabilities and prevent triggering liquidity risk due to the break of funding strand when problem occurred in one concentrated funding source. The Group has established intra-group liquidity risk management guideline to manage the liquidity funding among different entities within the Group, and to restrict their reliance of funding on each other. The Group also pays attention to manage liquidity risk created by off-balance sheet activities, such as loan commitments, derivatives, options and other complex structured products. The Group has an overall liquidity risk management strategy to cover the liquidity management of foreign currency assets and liabilities, collaterals, intra-

day liquidity, intra-group liquidity, the liquidity risk arising from other risks, etc., and has formulated corresponding contingency plan.

The RC is the decision-making authority of liquidity risk management, and assumes the ultimate responsibility of liquidity risk management. As authorised by RC, ALCO exercises its oversight of liquidity risk and ensures the daily operations of the Group are in accordance with risk appetite and policies as set by RC. RMD (Interest Rate and Liquidity Risk Management) is responsible for overseeing the Group's liquidity risk. It cooperates with the Asset and Liability Management Division of Financial Management Department, Investment Management, etc. to assist the ALCO to perform liquidity management functions according to their specific responsibilities.

The Group established liquidity risk management indicators and limits to identify, measure, monitor and control liquidity risk on daily basis. Such indicators and limits include, but are not limited to liquidity ratio, loan-to-deposit ratio, Maximum Cumulative Outflow and liquidity buffer asset portfolio. The Group applies cash flow analysis to assess the Group's liquidity condition under normal conditions and also performs liquidity stress test (including institution specific, world wide crisis and combined crisis) and other methods at least on monthly basis to assess the Group's capability to withstand various severe liquidity crises. Also, the Assets and Liabilities Management System is developed to provide data and the preparation for regular management reports to facilitate liquidity risk management duties.

In accordance with the requirements of Supervisory Policy Manual LM-2 "Sound Systems and controls for Liquidity Risk Management" issued by the HKMA in 2011, the Group has embarked on refining the behavior model and assumptions of existing cash flow analysis and stress test to enhance the Group's cash flow analysis under both normal and stressed conditions. In cash flow analysis under normal circumstances, refinements have been made



# MANAGEMENT'S DISCUSSION AND ANALYSIS

to assumptions relating to on-balance sheet items (such as customer deposits) and off-balance sheet items (such as loan commitments). In the liquidity stress test, a new combined scenario which is a combination of institution specific and world wide crisis has been set up to assess the Group's capability to withstand a more severe liquidity crisis, with a more stringent set of assumptions being adopted. In addition, the Group has a policy in place to maintain an asset buffer portfolio which includes high quality marketable securities to ensure funding needs even under stressed scenarios. A contingency plan is being established which details the conditions to trigger the plan based on stress test results and early warning indicators, the action plans and relevant procedures and responsibility of various departments.

The Group's liquidity risk management also covers new product or business development. Before launching a new product or business, the relevant departments are required to go through a risk assessment process, which includes the assessment of underlying liquidity risk and consideration of the adequacy of the current risk management mechanism. Any material impact on liquidity risk noted during the risk assessment process will be reported to RC for approval.

The Group has established a set of uniform liquidity risk management policies which serve as standards and guidance to all the Group's members for liquidity risk management. On the basis of the Group's uniform policy, each of the subsidiaries develops its own liquidity management policies according to its own characteristics (subject to approval by BOCHK), and assumes its own liquidity risk management responsibility. Subsidiaries are required to report their respective liquidity positions on a regular basis to RMD (Interest Rate and Liquidity Risk Management) of BOCHK, which consolidates such information and evaluates group-wide liquidity risk.

## **Operational Risk Management**

Operational risk is the risk of loss resulting from inadequate or failed internal process, staff and information technology

system, or from external events. The risk is inherent in every aspect of business operations and confronted by the Group in its day-to-day operational activities.

The Group has implemented the "Three Lines of Defence" for its operational risk management. All departments or functional units as the first line of defence are the first parties responsible for operational risk management, and carry out the duties and functions of self risk control in the process of business operation through self assessment and self enhancement. The Operational Risk and Compliance Department ("OR&CD"), together with certain specialist functional units in relation to operational risk management within the Group, including the Human Resources Department, Information Technology Department, Corporate Services Department, Financial Management Department and General Accounting & Accounting Policy Department (collectively known as "Specialist functional units"), are the second line of defence. They are responsible for assessing and monitoring the operational risk conditions in the first line of defence, and providing them with guidance. The OR&CD, being independent from the business units, is responsible for assisting the Management in managing the Group's operational risk, including the establishment and review of the operational risk management policy and framework, designing the operational risk management tools and reporting mechanism, and assessing and reporting the overall operational risk position to the Management and RC. Specialist functional units are required to carry out their managerial duties of the second line defence with respect to some specific aspects of operational risk and its related issues. Besides taking charge of operational risk management in their own units, these units are also required to provide other units with professional advice/training in respect of certain operational risk categories and to lead the Group-wide operational risk management. Group Audit is the third line of defence which provides independent assessment to the effectiveness and adequacy of the operational risk management framework and is required to conduct periodic audit of the operational risk management

# MANAGEMENT'S DISCUSSION AND ANALYSIS

activities of various departments or functional units within the Group regarding their compliance and effectiveness and to put forward recommendations for remedial actions.

The Group has put in place an effective internal control process which requires the establishment of policies and control procedures for all the key activities. The Group adheres to the fundamental principle of proper segregation of duties and authorisation. The Group adopts various operational risk management tools or methodologies such as key risk indicators, self-assessment, operational risk events reporting and review to identify, assess, monitor and control the risks inherent in business activities and products, as well as purchase of insurance to mitigate unforeseeable operational risks. Business continuity plans are established to support business operations in the event of an emergency or disaster. Adequate backup facilities are maintained and periodic drills are conducted.

## Reputation Risk Management

Reputation risk is the risk that negative publicity about the Group's business practices, whether genuine or not, will cause a potential decline in the customer base, or lead to costly litigation or revenue decrease. Reputation risk is inherent in other types of risk and every aspect of business operation and covers a wide spectrum of issues.

In order to mitigate reputation risk, the Group has formulated and duly followed its Reputation Risk Management Policy. The policy aims to prevent and manage reputation risk proactively at an early stage when an incident occurs. Since reputation risk is often caused by various types of operational and strategic issues that negatively impact the trust and perception of the Group, all operational and key risks identified are assessed through the established Key Control Self-Assessment framework, including risk assessment tools, to evaluate the severity of their impact on the Group, including the damage to reputation.

In addition, the Group has put in place a comprehensive framework to continuously monitor reputation risk incidents in the financial industry. This continuous monitoring enables the Group to effectively manage, control and mitigate any potential adverse impact from an incident. The Group also adopts robust disclosure practices to keep our stakeholders informed at all times, which helps build confidence in the Group and establish a strong public image.

## Legal and Compliance Risk Management

Legal risk is the risk that unenforceable contracts, lawsuits or adverse judgments may disrupt or otherwise negatively affect the operations or financial conditions of the Group. Compliance risk is the risk of legal or regulatory sanctions, financial losses or losses in reputation the Group may suffer as a result of its failure to comply with all applicable laws and regulations. Legal and compliance risks are managed by the OR&CD, which reports directly to the CRO. All legal matters are handled by the Legal Services Centre ("LSC"), which reports to the Chief Operating Officer. The OR&CD is responsible for legal risk management of the Group with support rendered by the LSC. As part of the Group's corporate governance framework, the policy for the management of legal and compliance risk is approved by the RC as delegated by the Board.

## Strategic Risk Management

Strategic risk generally refers to the risks that may induce some current or future negative impacts on the earnings, or capital or reputation or market position of the Group because of poor business decisions, improper implementation of decisional strategies and lack of response to the market. The Board reviews and approves the strategic risk management policy. Key strategic issues have to be fully evaluated and properly endorsed by the senior management and the Board.

The Group regularly reviews its business strategies to cope with the latest market situation and developments.



# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Capital Management

The major objective of the Group's capital management is to maximise total shareholders' return while maintaining a capital adequacy position in relation to the Group's overall risk profile. The ALCO periodically reviews the Group's capital structure and appropriately adjusts the capital mix to maintain an optimal balance between risk, return and capital adequacy.

To comply with the HKMA's requirements as stated in the Supervisory Policy Manual "Supervisory Review Process", the Group adopts the internal capital adequacy assessment process ("ICAAP") and reviews it annually. Based on the HKMA's guidelines on Pillar II, ICAAP has been initiated to assess the extra capital needed to cover the material risks not captured or not adequately captured under Pillar I, and therefore minimum Common Equity Tier 1 capital ratio, minimum Tier 1 capital ratio and the minimum Total capital ratio are determined. Meanwhile, operating ranges for the aforementioned capital ratios have also been established which enable the flexibility for future business growth and efficiency of capital utilisation.

The Banking (Capital) (Amendment) Rules 2012 ("BCAR 2012") came into operation on 1 January 2013. The BCAR 2012 mainly addressed the revision to both the minimum capital ratio requirement (in terms of expanding the existing capital adequacy ratio into three ratios, namely, a Common Equity Tier 1 capital ratio, a Tier 1 capital ratio and a Total capital ratio) and the definition of regulatory capital. In addition, the BCAR 2012 included the enhancements to the counterparty credit risk framework and amendments on the capital treatment for certain trade financing activities and securities financing transactions. The Group's capital position remains strong after the implementation of the BCAR 2012.

## Stress Testing

The Group supplements the analysis of various types of risks with stress testing. Stress testing is a risk management tool for estimating risk exposures under

stressed conditions arising from extreme but plausible market or macroeconomic movements. These tests are conducted on a regular basis by the Group's various risk management units in accordance with the principles stated in the Supervisory Policy Manual "Stress-testing" published by the HKMA. The ALCO monitors the results against the key risk limit approved by the RC. The Financial Management Department reports the combined stress test results of the Group to the RC and Board regularly.

## BOC Life

BOC Life's principal business is the underwriting of long-term insurance business in life and annuity (Class A), linked long term business (Class C) and retirement scheme management category III (Class I) in Hong Kong. Major types of risk arising from the BOC Life's insurance business are insurance risk, interest rate risk, liquidity risk and credit risk. BOC Life closely monitors these risks and reports to its RC on a regular basis. The key risks of its insurance business and related risk control process are as follows:

### Insurance Risk Management

BOC Life is in the business of insuring against the risk of mortality, morbidity, disability, critical illness, accidents and related risks. These risks are managed through the application of underwriting policies and reinsurance arrangements.

The underwriting strategy is intended to set premium pricing at an appropriate level that corresponds with the underlying exposure of the risks underwritten. Screening processes, such as the review of health condition and family medical history, are also included in BOC Life's underwriting procedures.

The reinsurance arrangement helps to transfer the insurance risk associated with the insurance contracts to the third party. It does not, however, discharge BOC Life's liability as the primary insurer. If a reinsurer fails to pay a claim for any reasons, BOC Life remains liable for

# MANAGEMENT'S DISCUSSION AND ANALYSIS

the payment to the policyholder. The creditworthiness of reinsurers is considered by reviewing the reinsurers' financial strength prior to finalisation of any reinsurance contract. BOC Life directs its reinsurance placement policy and assesses the creditworthiness of all reinsurers and intermediaries by reviewing credit grades provided by rating agencies and other publicly available financial information. BOC Life also monitors the recoverability of its reinsurance assets on an ongoing basis. It maintains records of the payment history for significant contract holders, with whom it conducts regular business.

For details of the Group's Insurance Risk Management, please refer to Note 3.4 to the Interim Financial Information.

## Interest Rate Risk Management

An increase in interest rates may result in the depreciation of the value of BOC Life's bond portfolio. It may also result in customers accelerating surrenders. A decrease in interest rates may result in an increase in insurance liability and an inability to adequately match guarantees or lower returns leading to customer dissatisfaction. BOC Life manages the asset liability matching of its portfolios within an asset liability management (ALM) framework that has been developed to achieve investment returns that match its obligations under insurance contracts.

## Liquidity Risk Management

Liquidity risk is the risk of not being able to fund increases in assets or meet obligations as they fall due without incurring unacceptable loss. BOC Life's asset liability matching framework includes cash flow management to preserve liquidity to match policy payout from time to time. In the normal course of BOC Life's business, new

business and in-force policies premiums generate constant cash inflows and, as a result, the portfolios also grow gradually to meet future liquidity requirements.

## Credit Risk Management

BOC Life has exposure to credit risk, which is the risk that a customer or counterparty will be unable to or unwilling to meet a commitment that they have entered into. Key areas to which BOC Life's insurance business is exposed include:

- Default risk of bond issuers or the counterparties of structured products
- Credit spread widening as a result of credit migration (downgrade)
- Re-insurers' share of insurance unpaid liabilities
- Amounts due from re-insurers in respect of claims already paid
- Amount due from insurance contract holders
- Amount due from insurance intermediaries

BOC Life manages credit risk by placing limits on its exposure to each investment counterparty or group of counterparties. Such limits are subject to annual or more frequent review by the Management.

In order to enhance its credit risk management, BOC Life has strengthened its communication with the Investment Management of the Group while closely monitoring and updating the established Bonds Issuers Disposal and Watch Lists to ensure consistency with the Group's credit risk management and investment strategy.

# CONDENSED CONSOLIDATED INCOME STATEMENT

	Notes	(Unaudited) Half-year ended 30 June 2013 HK\$'m	(Restated) (Unaudited) Half-year ended 30 June 2012 HK\$'m
Interest income		18,459	17,772
Interest expense		(5,128)	(5,153)
<b>Net interest income</b>	4	<b>13,331</b>	12,619
Fee and commission income		6,509	5,608
Fee and commission expense		(1,828)	(1,575)
<b>Net fee and commission income</b>	5	<b>4,681</b>	4,033
Gross earned premiums		10,500	6,490
Gross earned premiums ceded to reinsurers		(5,529)	(3,659)
<b>Net insurance premium income</b>		<b>4,971</b>	2,831
Net trading gain	6	1,441	1,408
Net (loss)/gain on financial instruments designated at fair value through profit or loss		(520)	186
Net gain on other financial assets	7	106	477
Other operating income	8	315	291
<b>Total operating income</b>		<b>24,325</b>	21,845
Gross insurance benefits and claims		(10,107)	(7,469)
Reinsurers' share of benefits and claims		5,573	3,720
<b>Net insurance benefits and claims</b>	9	<b>(4,534)</b>	(3,749)
<b>Net operating income before impairment allowances</b>		<b>19,791</b>	18,096
Net charge of impairment allowances	10	(371)	(108)
<b>Net operating income</b>		<b>19,420</b>	17,988
Operating expenses	11	(5,692)	(5,322)
<b>Operating profit</b>		<b>13,728</b>	12,666
Net gain from disposal of/fair value adjustments on investment properties	12	203	1,030
Net gain from disposal/revaluation of properties, plant and equipment	13	4	116
Share of profits less losses after tax of associates and a joint venture		13	13
<b>Profit before taxation</b>		<b>13,948</b>	13,825
Taxation	14	(2,291)	(2,176)
<b>Profit for the period</b>		<b>11,657</b>	11,649
<b>Profit attributable to:</b>			
Equity holders of the Company		11,252	11,243
Non-controlling interests		405	406
		<b>11,657</b>	11,649
<b>Dividends</b>	15	<b>5,762</b>	5,762
		HK\$	HK\$
<b>Earnings per share for profit attributable to the equity holders of the Company</b>			
Basic and diluted	16	<b>1.0642</b>	1.0634

The notes on pages 45 to 115 are an integral part of this interim financial information.

# CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Notes	<b>(Unaudited) Half-year ended 30 June 2013 HK\$'m</b>	(Unaudited) Half-year ended 30 June 2012 HK\$'m
<b>Profit for the period</b>	<b>11,657</b>	11,649
Items that will not be reclassified subsequently to income statement		
Premises:		
Revaluation of premises	<b>1,490</b>	4,700
Deferred tax	<b>(236)</b>	(753)
	<b>1,254</b>	3,947
Items that may be reclassified subsequently to income statement		
Available-for-sale securities:		
Change in fair value of available-for-sale securities	<b>(5,690)</b>	2,747
Release upon disposal of available-for-sale securities reclassified to income statement	<b>(101)</b>	(474)
Net reversal of impairment allowances on available-for-sale securities reclassified to income statement	–	(1)
Amortisation with respect to available-for-sale securities transferred to held-to-maturity securities reclassified to income statement	–	(8)
Deferred tax	<b>906</b>	(383)
	<b>(4,885)</b>	1,881
Change in fair value of hedging instruments under net investment hedges	<b>(29)</b>	29
Currency translation difference	<b>164</b>	(102)
	<b>(4,750)</b>	1,808
<b>Other comprehensive income for the period, net of tax</b>	<b>(3,496)</b>	5,755
<b>Total comprehensive income for the period</b>	<b>8,161</b>	17,404
<b>Total comprehensive income attributable to:</b>		
Equity holders of the Company	<b>8,164</b>	16,848
Non-controlling interests	<b>(3)</b>	556
	<b>8,161</b>	17,404

The notes on pages 45 to 115 are an integral part of this interim financial information.

# CONDENSED CONSOLIDATED BALANCE SHEET

		(Unaudited) At 30 June 2013 HK\$'m	(Audited) At 31 December 2012 HK\$'m
	Notes		
<b>ASSETS</b>			
Cash and balances with banks and other financial institutions	18	182,450	198,748
Placements with banks and other financial institutions maturing between one and twelve months		54,511	66,025
Financial assets at fair value through profit or loss	19	48,564	49,332
Derivative financial instruments	20	31,532	31,339
Hong Kong SAR Government certificates of indebtedness		90,080	82,930
Advances and other accounts	21	885,267	819,739
Investment in securities	22	437,570	482,364
Interests in associates and a joint venture		270	259
Investment properties	23	14,572	14,364
Properties, plant and equipment	24	49,684	48,743
Deferred tax assets	31	217	89
Other assets	25	39,944	36,831
Total assets		<b>1,834,661</b>	1,830,763
<b>LIABILITIES</b>			
Hong Kong SAR currency notes in circulation		90,080	82,930
Deposits and balances from banks and other financial institutions		144,667	179,206
Financial liabilities at fair value through profit or loss	26	19,082	20,172
Derivative financial instruments	20	21,070	21,214
Deposits from customers	27	1,259,756	1,226,290
Debt securities in issue at amortised cost	28	5,766	5,923
Other accounts and provisions	29	48,103	47,983
Current tax liabilities		3,199	1,873
Deferred tax liabilities	31	6,743	7,406
Insurance contract liabilities	32	59,916	53,937
Subordinated liabilities	33	20,577	28,755
Total liabilities		<b>1,678,959</b>	1,675,689
<b>EQUITY</b>			
Share capital	34	52,864	52,864
Reserves	35	98,942	98,105
Capital and reserves attributable to the equity holders of the Company		<b>151,806</b>	150,969
Non-controlling interests		3,896	4,105
Total equity		<b>155,702</b>	155,074
Total liabilities and equity		<b>1,834,661</b>	1,830,763

The notes on pages 45 to 115 are an integral part of this interim financial information.

# CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	(Unaudited)								
	Attributable to the equity holders of the Company								
	Share capital HK\$m	Premises revaluation reserve HK\$m	Reserve for fair value changes of available- for-sale securities HK\$m	Regulatory reserve* HK\$m	Translation reserve HK\$m	Retained earnings HK\$m	Total HK\$m	Non- controlling interests HK\$m	Total equity HK\$m
At 1 January 2012	52,864	23,150	1,787	6,967	674	44,323	129,765	3,418	133,183
Profit for the period	-	-	-	-	-	11,243	11,243	406	11,649
Other comprehensive income:									
Premises	-	3,912	-	-	-	-	3,912	35	3,947
Available-for-sale securities	-	-	1,772	-	-	(8)	1,764	117	1,881
Change in fair value of hedging instruments under net investment hedges	-	-	-	-	27	-	27	2	29
Currency translation difference	-	(1)	6	-	(103)	-	(98)	(4)	(102)
Total comprehensive income	-	3,911	1,778	-	(76)	11,235	16,848	556	17,404
Release upon disposal of premises	-	(16)	-	-	-	16	-	-	-
Transfer from retained earnings	-	-	-	263	-	(263)	-	-	-
Dividends	-	-	-	-	-	(5,899)	(5,899)	(276)	(6,175)
At 30 June 2012	52,864	27,045	3,565	7,230	598	49,412	140,714	3,698	144,412
At 1 July 2012	52,864	27,045	3,565	7,230	598	49,412	140,714	3,698	144,412
Profit for the period	-	-	-	-	-	9,687	9,687	211	9,898
Other comprehensive income:									
Premises	-	4,214	-	-	-	-	4,214	34	4,248
Available-for-sale securities	-	-	1,943	-	-	(4)	1,939	190	2,129
Change in fair value of hedging instruments under net investment hedges	-	-	-	-	(33)	-	(33)	(3)	(36)
Currency translation difference	-	2	2	-	206	-	210	7	217
Total comprehensive income	-	4,216	1,945	-	173	9,683	16,017	439	16,456
Release upon disposal of premises	-	(2)	-	-	-	2	-	-	-
Transfer from retained earnings	-	-	-	524	-	(524)	-	-	-
Dividends	-	-	-	-	-	(5,762)	(5,762)	(32)	(5,794)
At 31 December 2012	52,864	31,259	5,510	7,754	771	52,811	150,969	4,105	155,074

# CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	(Unaudited)								
	Attributable to the equity holders of the Company								
	Share capital HK\$'m	Premises revaluation reserve HK\$'m	Reserve for fair value changes of available- for-sale securities HK\$'m	Regulatory reserve* HK\$'m	Translation reserve HK\$'m	Retained earnings HK\$'m	Total HK\$'m	Non- controlling interests HK\$'m	Total equity HK\$'m
At 1 January 2013	52,864	31,259	5,510	7,754	771	52,811	150,969	4,105	155,074
Profit for the period	-	-	-	-	-	11,252	11,252	405	11,657
Other comprehensive income:									
Premises	-	1,242	-	-	-	-	1,242	12	1,254
Available-for-sale securities	-	-	(4,461)	-	-	-	(4,461)	(424)	(4,885)
Change in fair value of hedging instruments under net investment hedges	-	-	-	-	(27)	-	(27)	(2)	(29)
Currency translation difference	-	2	(19)	-	175	-	158	6	164
Total comprehensive income	-	1,244	(4,480)	-	148	11,252	8,164	(3)	8,161
Transfer from retained earnings	-	-	-	391	-	(391)	-	-	-
Dividends	-	-	-	-	-	(7,327)	(7,327)	(206)	(7,533)
At 30 June 2013	52,864	32,503	1,030	8,145	919	56,345	151,806	3,896	155,702
Representing:									
2013 interim dividend (Note 15)						5,762			
Others						50,583			
Retained earnings as at 30 June 2013						56,345			

\* In accordance with the requirements of the HKMA, the amounts are set aside for general banking risks, including future losses or other unforeseeable risks, in addition to the loan impairment allowances recognised under HKAS 39.

The notes on pages 45 to 115 are an integral part of this interim financial information.

# CONDENSED CONSOLIDATED CASH FLOW STATEMENT

	Notes	(Unaudited) Half-year ended 30 June 2013 HK\$'m	(Unaudited) Half-year ended 30 June 2012 HK\$'m
<b>Cash flows from operating activities</b>			
Operating cash outflow before taxation	36(a)	(36,525)	(129,233)
Hong Kong profits tax paid		(917)	(755)
Overseas profits tax paid		(168)	(133)
<b>Net cash outflow from operating activities</b>		<b>(37,610)</b>	<b>(130,121)</b>
<b>Cash flows from investing activities</b>			
Purchase of properties, plant and equipment		(252)	(307)
Purchase of investment properties		–	(1)
Proceeds from disposal of properties, plant and equipment		3	152
Proceeds from disposal of investment properties		–	66
Dividend received from associates and a joint venture		2	2
<b>Net cash outflow from investing activities</b>		<b>(247)</b>	<b>(88)</b>
<b>Cash flows from financing activities</b>			
Dividend paid to the equity holders of the Company		(7,327)	(5,899)
Dividend paid to non-controlling interests		(206)	(198)
Repayment of subordinated loans		(6,668)	–
Interest paid for subordinated liabilities		(279)	(298)
<b>Net cash outflow from financing activities</b>		<b>(14,480)</b>	<b>(6,395)</b>
Decrease in cash and cash equivalents		(52,337)	(136,604)
Cash and cash equivalents at 1 January		242,955	340,446
Effect of exchange rate changes on cash and cash equivalents		(2,510)	(2,796)
<b>Cash and cash equivalents at 30 June</b>	36(b)	<b>188,108</b>	<b>201,046</b>

The notes on pages 45 to 115 are an integral part of this interim financial information.



# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 1. Basis of preparation and significant accounting policies

### (a) Basis of preparation

The unaudited interim financial information has been prepared in accordance with HKAS 34 “Interim Financial Reporting” issued by the HKICPA.

### (b) Significant accounting policies

Except as described below, the significant accounting policies adopted and methods of computation used in the preparation of the unaudited interim financial information are consistent with those adopted and used in the Group’s annual financial statements for the year ended 31 December 2012 and should be read in conjunction with the Group’s Annual Report for 2012.

#### **Standards and amendments to standards that are relevant to the Group and mandatory for the first time for the financial year beginning on 1 January 2013**

- HKAS 1 (Revised), “Presentation of Financial Statements”. The amendments to HKAS 1 (Revised) require companies preparing financial statements in accordance with HKFRSs to group together items within other comprehensive income (OCI) that may be reclassified to the profit or loss section of the income statement. The amendments also reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements. The adoption of this revised standard affects the presentation of the Group’s statement of comprehensive income.
- HKAS 19 (2011), “Employee Benefits”. The revised standard mainly amends the part related to accounting for changes in defined benefit obligations and plan assets, and related presentation and disclosure. The amendments do not have impact on the Group’s financial statements.
- HKAS 27 (2011), “Separate Financial Statements”. Please refer to the below on HKFRS 10, “Consolidated Financial Statements”.
- HKAS 28 (2011), “Investments in Associates and Joint Ventures”. Please refer to the below on HKFRS 11, “Joint Arrangements”.
- HKFRS 7 (Amendment), “Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities”. The amendments require new disclosures to include information that enable users of an entity’s financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with the entity’s recognised financial assets and recognised financial liabilities, on the entity’s financial position. New disclosure for the adoption of this amended standard is disclosed in Note 41 to the Group’s interim financial information.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 1. Basis of preparation and significant accounting policies (continued)

### (b) Significant accounting policies (continued)

#### Standards and amendments to standards that are relevant to the Group and mandatory for the first time for the financial year beginning on 1 January 2013 (continued)

- HKFRS 10, "Consolidated Financial Statements". HKFRS 10 builds on existing principles by identifying the concept of control as the determining factor when considering whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. It also replaces all of the guidance on control and consolidation stipulated in HKAS 27 (Revised), "Consolidated and Separate Financial Statements", and HK(SIC)-Int 12, "Consolidation – Special Purpose Entities". The remainder of HKAS 27 (Revised) is renamed as HKAS 27 (2011), "Separate Financial Statements" as a standard dealing solely with separate financial statements without changing the existing guidance for separate financial statements.
- HKFRS 11, "Joint Arrangements". Changes in the definitions stipulated in HKFRS 11 have reduced the types of joint arrangements to two: joint operations and joint ventures. A joint operation is a joint arrangement that gives parties to the arrangement direct rights to the assets and obligations for the liabilities. The "jointly controlled assets" classification in HKAS 31, "Interests in Joint Ventures", has been merged into joint operations, as both types of arrangements generally result in the same accounting outcome. A joint venture, in contrast, gives the parties rights to the net assets or outcome of the arrangement. Joint ventures are accounted for using the equity method in accordance with HKAS 28, "Investments in Associates" which is renamed as HKAS 28 (2011), "Investments in Associates and Joint Ventures". The standard is amended to include the requirements of joint ventures accounting and to merge with the requirements of HK(SIC)-Int 13, "Jointly Controlled Entities – Non-Monetary Contributions by Venturers". After the application of HKAS 28 (2011), entities can no longer account for an interest in a joint venture using the proportionate consolidation method.
- HKFRS 12, "Disclosure of Interests in Other Entities". The standard sets out the required disclosures for entities reporting under the two new standards, HKFRS 10 and HKFRS 11, and the revised standard HKAS 28 (2011). The existing guidance and disclosure requirements for separate financial statements stipulated in HKAS 27 (Revised) are unchanged. HKFRS 12 requires entities to disclose information that helps financial statements users to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities.

The above HKFRS 10, HKFRS 11, HKFRS 12, HKAS 27 (2011) and HKAS 28 (2011) issued in June 2011 are a group of five new standards that address the scope of reporting entity and supersede HKAS 27 (Revised), HKAS 28, HKAS 31, HK(SIC)-Int 12 and HK(SIC)-Int 13. The adoption of these standards does not have a material impact on the Group's financial statements.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 1. Basis of preparation and significant accounting policies (continued)

### (b) Significant accounting policies (continued)

#### Standards and amendments to standards that are relevant to the Group and mandatory for the first time for the financial year beginning on 1 January 2013 (continued)

- HKFRS 10, 11 and 12 (Amendment), on transition guidance. The amendments provide additional transition relief to HKFRS 10, 11 and 12, limiting the requirement to provide adjusted comparative information to only the preceding comparative period. The adoption of this amendment does not affect the disclosure of the Group's financial statements.
- HKFRS 13, "Fair Value Measurement". The new standard which was issued in June 2011 replaces the fair value measurement guidance contained in individual HKFRSs by providing a revised definition of fair value and a single source of fair value measurement and disclosure requirements for use across HKFRSs. The requirements do not extend the use of fair value accounting, but provide guidance on how it should be applied when its use is already required or permitted by other standards within HKFRSs. The adoption of this standard does not have a material impact on the Group's financial statements.
- In addition, "Annual Improvements to HKFRS 2009 – 2011 Cycle" contains numerous amendments to HKFRSs which the HKICPA considers not urgent but necessary. It comprises amendments that result in accounting changes for presentation and classification. The adoption of these improvements does not have a material impact on the Group's financial statements.

#### Standards and amendments issued that are relevant to the Group but not yet effective and have not been early adopted by the Group in 2013

Standard	Content	Applicable for financial years beginning on/after
HKAS 32 (Amendment)	Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities	1 January 2014
HKFRS 7 (Amendment)	Financial Instruments: Disclosures – Transition to HKFRS 9	1 January 2015
HKFRS 9	Financial Instruments	1 January 2015

- Please refer to Note 2.1(b) of the Group's Annual Report for 2012 for brief explanations of the above-mentioned standards and amendments.

## 2. Critical accounting estimates and judgements in applying accounting policies

The nature and assumptions related to the Group's accounting estimates are consistent with those used in the Group's financial statements for the year ended 31 December 2012.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management

The Group is exposed to financial risks as a result of engaging in a variety of business activities. The principal financial risks are credit risk, market risk (including currency risk and interest rate risk) and liquidity risk. This note summarises the Group's exposures to these risks.

### 3.1 Credit Risk

#### (A) Gross advances and other accounts

##### (a) Impaired advances

Advances are impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred and that loss event(s) has an impact on the estimated future cash flows of the advances that can be reliably estimated.

If there is objective evidence that an impairment loss on advances has been incurred, the amount of loss is measured as the difference between the carrying amount and the present value of estimated future cash flows generated by the advances. Objective evidence that advances are impaired includes observable data that comes to the attention of the Group about the loss events.

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Gross impaired advances to customers	1,844	1,807
Individually assessed loan impairment allowances made in respect of such advances	800	736
Current market value of collateral held against the covered portion of such advances to customers	1,483	1,426
Covered portion of such advances to customers	1,154	1,177
Uncovered portion of such advances to customers	690	630
Gross impaired advances to customers as a percentage of gross advances to customers	0.22%	0.23%

The loan impairment allowances were made after taking into account the value of collateral in respect of impaired advances.

As at 30 June 2013 and 31 December 2012, there were no impaired trade bills.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.1 Credit Risk (continued)

#### (A) Gross advances and other accounts (continued)

##### (a) Impaired advances (continued)

Classified or impaired advances to customers are analysed as follows:

	<b>At 30 June 2013 HK\$m</b>	At 31 December 2012 HK\$m
Gross classified or impaired advances to customers	<b>2,120</b>	2,054
Gross classified or impaired advances to customers as a percentage of gross advances to customers	<b>0.26%</b>	0.26%

Classified or impaired advances to customers follow the definitions set out in the Banking (Disclosure) Rules under the Banking Ordinance and represent advances which are either classified as "substandard", "doubtful" or "loss" under the Group's classification of loan quality, or individually assessed to be impaired.

##### (b) Advances overdue for more than three months

Advances with a specific repayment date are classified as overdue when the principal or interest is past due and remains unpaid. Advances repayable by regular instalments are classified as overdue when an instalment payment is past due and remains unpaid. Advances repayable on demand are classified as overdue either when a demand for repayment has been served on the borrower but repayment has not been made in accordance with the instruction or when the advances have remained continuously outside the approved limit that was advised to the borrower.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.1 Credit Risk (continued)

#### (A) Gross advances and other accounts (continued)

##### (b) Advances overdue for more than three months (continued)

The gross amount of advances overdue for more than three months is analysed as follows:

	At 30 June 2013		At 31 December 2012	
	Amount HK\$'m	% of gross advances to customers	Amount HK\$'m	% of gross advances to customers
Gross advances to customers which have been overdue for:				
– six months or less but over three months	295	0.03%	153	0.02%
– one year or less but over six months	147	0.02%	129	0.02%
– over one year	385	0.05%	323	0.04%
Advances overdue for over three months	827	0.10%	605	0.08%
Individually assessed loan impairment allowances made in respect of such advances	476		303	

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Current market value of collateral held against the covered portion of such advances to customers	779	1,115
Covered portion of such advances to customers	258	253
Uncovered portion of such advances to customers	569	352

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.1 Credit Risk (continued)

#### (A) Gross advances and other accounts (continued)

##### (b) Advances overdue for more than three months (continued)

Collateral held against overdue or impaired loans is principally represented by charges over business assets such as commercial and residential premises for corporate loans and mortgages over residential properties for personal loans.

As at 30 June 2013 and 31 December 2012, there were no trade bills overdue for more than three months.

##### (c) Rescheduled advances

	At 30 June 2013		At 31 December 2012	
	Amount HK\$'m	% of gross advances to customers	Amount HK\$'m	% of gross advances to customers
Rescheduled advances to customers net of amounts included in "Advances overdue for more than three months"	1,014	0.12%	1,119	0.14%

Rescheduled advances are those advances that have been restructured or renegotiated because of deterioration in the financial position of the borrower or of the inability of the borrower to meet the original repayment schedule. Rescheduled advances, which have been overdue for more than three months under the revised repayment terms, are included in "Advances overdue for more than three months".

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.1 Credit Risk (continued)

#### (A) Gross advances and other accounts (continued)

##### (d) Concentration of advances to customers

##### (i) Sectoral analysis of gross advances to customers

The information concerning gross advances to customers has been analysed into loans used inside or outside Hong Kong by industry sectors of the borrowers as follows:

	At 30 June 2013					
	Gross advances to customers HK\$'m	% covered by collateral or other security	Classified or impaired HK\$'m	Overdue HK\$'m	Individually assessed loan impairment allowances HK\$'m	Collectively assessed loan impairment allowances HK\$'m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development	34,610	39.75%	1	4	–	153
– Property investment	82,672	87.92%	31	276	5	474
– Financial concerns	6,498	12.28%	–	2	–	46
– Stockbrokers	2,477	45.70%	–	–	–	13
– Wholesale and retail trade	32,025	50.08%	59	216	34	188
– Manufacturing	21,383	34.88%	78	152	38	126
– Transport and transport equipment	29,418	30.55%	974	50	272	159
– Recreational activities	540	15.68%	–	–	–	2
– Information technology	19,588	0.75%	2	5	–	74
– Others	40,837	34.10%	65	238	22	185
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	9,364	99.97%	31	267	–	7
– Loans for purchase of other residential properties	192,267	99.99%	95	1,680	1	108
– Credit card advances	10,561	–	33	394	–	81
– Others	23,225	64.05%	35	328	11	36
Total loans for use in Hong Kong	505,465	69.54%	1,404	3,612	383	1,652
Trade finance	76,494	14.48%	196	224	154	367
Loans for use outside Hong Kong	248,784	26.41%	520	963	263	1,301
Gross advances to customers	830,743	51.55%	2,120	4,799	800	3,320



# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.1 Credit Risk (continued)

#### (A) Gross advances and other accounts (continued)

##### (d) Concentration of advances to customers (continued)

##### (i) Sectoral analysis of gross advances to customers (continued)

	At 31 December 2012					
	Gross advances to customers HK\$'m	% covered by collateral or other security	Classified or impaired HK\$'m	Overdue HK\$'m	Individually assessed loan impairment allowances HK\$'m	Collectively assessed loan impairment allowances HK\$'m
Loans for use in Hong Kong						
Industrial, commercial and financial						
– Property development	31,408	38.05%	1	2	–	115
– Property investment	76,975	83.98%	49	424	4	458
– Financial concerns	5,984	27.09%	–	3	–	52
– Stockbrokers	1,146	45.39%	–	–	–	11
– Wholesale and retail trade	30,031	57.89%	70	175	33	173
– Manufacturing	21,758	32.25%	53	158	24	125
– Transport and transport equipment	27,241	41.75%	1,104	4	313	166
– Recreational activities	614	21.77%	6	–	6	6
– Information technology	21,369	0.62%	2	2	1	74
– Others	36,351	34.12%	60	264	25	151
Individuals						
– Loans for the purchase of flats in Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	9,847	99.97%	34	304	–	8
– Loans for purchase of other residential properties	186,601	99.98%	68	1,835	–	110
– Credit card advances	11,534	–	28	431	–	79
– Others	19,894	62.98%	31	290	11	29
Total loans for use in Hong Kong	480,753	69.92%	1,506	3,892	417	1,557
Trade finance	67,137	14.94%	186	202	151	294
Loans for use outside Hong Kong	230,374	26.45%	362	720	168	1,118
Gross advances to customers	778,264	52.31%	2,054	4,814	736	2,969

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.1 Credit Risk (continued)

#### (A) Gross advances and other accounts (continued)

##### (d) Concentration of advances to customers (continued)

##### (ii) Geographical analysis of gross advances to customers

The following geographical analysis of advances to customers is based on the location of the counterparties, after taking into account the transfer of risk. In general, such transfer of risk takes place if the advances to customers are guaranteed by a party in a country which is different from that of the customer.

#### Gross advances to customers

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Hong Kong	651,876	607,965
Mainland China	139,524	138,345
Others	39,343	31,954
	<b>830,743</b>	<b>778,264</b>
<b>Collectively assessed loan impairment allowances in respect of the gross advances to customers</b>		
Hong Kong	2,324	2,074
Mainland China	789	729
Others	207	166
	<b>3,320</b>	<b>2,969</b>

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.1 Credit Risk (continued)

#### (A) Gross advances and other accounts (continued)

(d) Concentration of advances to customers (continued)

(ii) Geographical analysis of gross advances to customers (continued)

#### Overdue advances

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Hong Kong	3,581	3,937
Mainland China	1,058	639
Others	160	238
	<b>4,799</b>	<b>4,814</b>
<b>Individually assessed loan impairment allowances in respect of the overdue advances</b>		
Hong Kong	214	198
Mainland China	249	175
Others	46	33
	<b>509</b>	<b>406</b>
<b>Collectively assessed loan impairment allowances in respect of the overdue advances</b>		
Hong Kong	85	76
Mainland China	9	6
Others	2	3
	<b>96</b>	<b>85</b>

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.1 Credit Risk (continued)

#### (A) Gross advances and other accounts (continued)

(d) Concentration of advances to customers (continued)

(ii) Geographical analysis of gross advances to customers (continued)

#### Classified or impaired advances

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Hong Kong	1,546	1,631
Mainland China	441	385
Others	133	38
	<b>2,120</b>	<b>2,054</b>
<b>Individually assessed loan impairment allowances in respect of the classified or impaired advances</b>		
Hong Kong	488	526
Mainland China	249	177
Others	63	33
	<b>800</b>	<b>736</b>
<b>Collectively assessed loan impairment allowances in respect of the classified or impaired advances</b>		
Hong Kong	40	29
Mainland China	3	3
Others	1	1
	<b>44</b>	<b>33</b>

#### (B) Repossessed assets

The estimated market value of repossessed assets held by the Group as at 30 June 2013 amounted to HK\$71 million (31 December 2012: HK\$27 million). They comprise properties in respect of which the Group has acquired access or control (e.g. through court proceedings or voluntary actions by the proprietors concerned) for release in full or in part of the obligations of the borrowers.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.1 Credit Risk (continued)

#### (C) Debt securities and certificates of deposit

The following tables present an analysis of the carrying value of debt securities and certificates of deposit by issue rating. In the absence of such issue ratings, the ratings designated for the issuers are reported.

	At 30 June 2013					
	Aaa HK\$m	Aa1 to Aa3 HK\$m	A1 to A3 HK\$m	Lower than A3 HK\$m	Unrated HK\$m	Total HK\$m
Available-for-sale securities	96,118	131,785	126,737	31,083	25,104	410,827
Held-to-maturity securities	2,493	2,649	3,164	1,296	509	10,111
Loans and receivables	–	130	11,655	–	1,233	13,018
Financial assets at fair value through profit or loss	15,255	14,312	10,525	2,447	3,527	46,066
<b>Total</b>	<b>113,866</b>	<b>148,876</b>	<b>152,081</b>	<b>34,826</b>	<b>30,373</b>	<b>480,022</b>

	At 31 December 2012					
	Aaa HK\$m	Aa1 to Aa3 HK\$m	A1 to A3 HK\$m	Lower than A3 HK\$m	Unrated HK\$m	Total HK\$m
Available-for-sale securities	97,987	142,536	168,142	22,606	19,826	451,097
Held-to-maturity securities	4,828	6,173	5,569	1,319	509	18,398
Loans and receivables	–	–	8,277	–	957	9,234
Financial assets at fair value through profit or loss	16,977	13,842	11,420	1,669	3,351	47,259
<b>Total</b>	<b>119,792</b>	<b>162,551</b>	<b>193,408</b>	<b>25,594</b>	<b>24,643</b>	<b>525,988</b>

As at 30 June 2013, the Group's exposure to MBS/ABS amounted to HK\$12,581 million (31 December 2012: HK\$12,016 million), representing 2.6% (31 December 2012: 2.3%) of the total debt securities and certificates of deposit of the Group.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.1 Credit Risk (continued)

#### (C) Debt securities and certificates of deposit (continued)

The following tables present an analysis of impaired debt securities by issue rating. In the absence of such issue ratings, the ratings designated for the issuers are reported.

	At 30 June 2013						
	Carrying values						Of which accumulated impairment allowances
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total	
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Available-for-sale securities	-	7	-	-	-	7	-
Held-to-maturity securities	53	30	1	-	-	84	8
<b>Total</b>	<b>53</b>	<b>37</b>	<b>1</b>	<b>-</b>	<b>-</b>	<b>91</b>	<b>8</b>
Of which accumulated impairment allowances	<b>5</b>	<b>3</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>8</b>	

	At 31 December 2012						
	Carrying values						Of which accumulated impairment allowances
	Aaa	Aa1 to Aa3	A1 to A3	Lower than A3	Unrated	Total	
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Available-for-sale securities	-	-	9	-	-	9	1
Held-to-maturity securities	70	31	1	-	-	102	9
<b>Total</b>	<b>70</b>	<b>31</b>	<b>10</b>	<b>-</b>	<b>-</b>	<b>111</b>	<b>10</b>
Of which accumulated impairment allowances	<b>6</b>	<b>3</b>	<b>1</b>	<b>-</b>	<b>-</b>	<b>10</b>	

As at 30 June 2013 and 31 December 2012, there were no impaired certificates of deposit and no overdue debt securities and certificates of deposit.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.2 Market Risk

#### (A) VAR

The Group uses the VAR to measure and report general market risks to the RC and senior management on a periodic basis. The Group adopts a uniformed VAR calculation model, using historical simulation approach and 2-year historical data, to calculate the VAR of the Group and subsidiaries over 1-day holding period with 99% confidence level, and sets up the VAR limit of the Group and subsidiaries.

The following table sets out the VAR for all general market risk exposure<sup>1</sup> of the Group.

	Year	At 30 June HK\$'m	Minimum for the first half of year HK\$'m	Maximum for the first half of year HK\$'m	Average for the first half of year HK\$'m
VAR for all market risk	2013	21.6	13.9	27.0	20.5
	2012	30.8	17.9	35.1	24.6
VAR for foreign exchange risk	2013	15.4	10.3	27.6	14.8
	2012	13.4	11.6	25.7	17.9
VAR for interest rate risk	2013	18.7	8.8	21.7	16.2
	2012	22.3	9.7	29.5	16.9
VAR for equity risk	2013	1.7	0.0	2.4	1.0
	2012	1.7	0.0	2.3	0.4
VAR for commodity risk	2013	0.1	0.0	0.7	0.2
	2012	0.0	0.0	1.0	0.2

In the first half of 2013, the average daily revenue<sup>2</sup> of the Group earned from market risk-related trading activities was HK\$8.1 million (first half of 2012: HK\$7.7 million).

#### Notes:

- 1 Structural FX positions have been excluded. In the first half of 2013, all general market risk exposure are presented on the Group basis, comparative amounts are presented on the same basis accordingly.
- 2 Revenues from structural FX positions and back-to-back transactions have been excluded.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.2 Market Risk (continued)

#### (A) VAR (continued)

Although a valuable guide to market risk, VAR should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a one-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a one-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99% confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The Group recognises these limitations by formulating stress test indicators and limits to assess and manage the market risk uncovered by VAR. The stress testing programme of the market risk includes sensitivity testing on changes in risk factors with various degrees of severity, as well as scenario analysis on historical events such as the 1987 Equity Market Crash, 1994 Bond Market Crash, 1997 Asian Financial Crisis, 2001 9-11 event and 2008 Financial Tsunami, etc.

#### (B) Currency risk

The Group's assets and liabilities are denominated in major currencies, particularly the HK dollar, the US dollar and Renminbi. To ensure the currency risk exposure of the Group is kept to an acceptable level, risk limits (e.g. Position and VAR limit) are used to serve as a monitoring tool. Moreover, the Group seeks to minimise the gap between assets and liabilities in the same currency. Foreign exchange contracts (e.g. FX swaps) are usually used to manage FX risk associated with foreign currency-denominated assets and liabilities.



# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.2 Market Risk (continued)

#### (B) Currency risk (continued)

The tables below summarise the Group's exposure to foreign currency exchange rate risk as at 30 June 2013 and 31 December 2012. Included in the tables are the assets and liabilities at carrying amounts in HK dollars equivalent, categorised by the original currency.

	At 30 June 2013							
	Renminbi HK\$'m	US Dollars HK\$'m	HK Dollars HK\$'m	Euro HK\$'m	Japanese Yen HK\$'m	Pound Sterling HK\$'m	Others HK\$'m	Total HK\$'m
<b>Assets</b>								
Cash and balances with banks and other financial institutions	143,377	14,198	21,001	937	544	824	1,569	182,450
Placements with banks and other financial institutions maturing between one and twelve months	22,094	27,665	4,324	110	-	-	318	54,511
Financial assets at fair value through profit or loss	6,583	11,404	30,336	-	-	-	241	48,564
Derivative financial instruments	331	6,433	24,743	2	-	2	21	31,532
Hong Kong SAR Government certificates of indebtedness	-	-	90,080	-	-	-	-	90,080
Advances and other accounts	110,648	214,787	546,585	6,421	632	120	6,074	885,267
Investment in securities								
– Available-for-sale securities	72,406	218,744	93,396	6,065	315	327	23,188	414,441
– Held-to-maturity securities	633	6,226	1,467	-	157	-	1,628	10,111
– Loans and receivables	1,698	8,464	1,500	-	-	1,356	-	13,018
Interests in associates and a joint venture	-	-	270	-	-	-	-	270
Investment properties	115	-	14,457	-	-	-	-	14,572
Properties, plant and equipment	836	4	48,844	-	-	-	-	49,684
Other assets (including deferred tax assets)	21,313	1,403	15,700	659	124	215	747	40,161
<b>Total assets</b>	<b>380,034</b>	<b>509,328</b>	<b>892,703</b>	<b>14,194</b>	<b>1,772</b>	<b>2,844</b>	<b>33,786</b>	<b>1,834,661</b>
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation	-	-	90,080	-	-	-	-	90,080
Deposits and balances from banks and other financial institutions	44,304	67,110	31,397	288	33	425	1,110	144,667
Financial liabilities at fair value through profit or loss	1,740	101	16,008	-	-	6	1,227	19,082
Derivative financial instruments	412	4,415	15,912	208	-	2	121	21,070
Deposits from customers	270,912	243,447	679,276	10,321	2,595	13,364	39,841	1,259,756
Debt securities in issue at amortised cost	-	5,762	4	-	-	-	-	5,766
Other accounts and provisions (including current and deferred tax liabilities)	13,551	13,862	27,631	682	103	784	1,432	58,045
Insurance contract liabilities	24,143	6,407	29,366	-	-	-	-	59,916
Subordinated liabilities	-	20,577	-	-	-	-	-	20,577
<b>Total liabilities</b>	<b>355,062</b>	<b>361,681</b>	<b>889,674</b>	<b>11,499</b>	<b>2,731</b>	<b>14,581</b>	<b>43,731</b>	<b>1,678,959</b>
Net on-balance sheet position	24,972	147,647	3,029	2,695	(959)	(11,737)	(9,945)	155,702
Off-balance sheet net notional position*	(9,768)	(139,589)	138,275	(2,515)	669	11,686	10,209	8,967
Contingent liabilities and commitments	65,245	106,608	331,318	4,894	489	1,160	3,297	513,011

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.2 Market Risk (continued)

#### (B) Currency risk (continued)

	At 31 December 2012							
	Renminbi HK\$'m	US Dollars HK\$'m	HK Dollars HK\$'m	Euro HK\$'m	Japanese Yen HK\$'m	Pound Sterling HK\$'m	Others HK\$'m	Total HK\$'m
<b>Assets</b>								
Cash and balances with banks and other financial institutions	156,693	24,087	12,051	1,796	376	889	2,856	198,748
Placements with banks and other financial institutions maturing between one and twelve months	28,365	31,872	4,525	419	–	201	643	66,025
Financial assets at fair value through profit or loss	5,178	11,273	32,801	–	–	–	80	49,332
Derivative financial instruments	367	5,074	25,871	–	–	–	27	31,339
Hong Kong SAR Government certificates of indebtedness	–	–	82,930	–	–	–	–	82,930
Advances and other accounts	97,641	191,418	517,998	6,125	758	148	5,651	819,739
Investment in securities								
– Available-for-sale securities	61,840	193,050	89,735	8,080	77,766	353	23,908	454,732
– Held-to-maturity securities	948	10,672	2,042	–	1,912	–	2,824	18,398
– Loans and receivables	1,157	5,846	–	–	–	2,231	–	9,234
Interests in associates and a joint venture	–	–	259	–	–	–	–	259
Investment properties	112	–	14,252	–	–	–	–	14,364
Properties, plant and equipment	855	4	47,884	–	–	–	–	48,743
Other assets (including deferred tax assets)	14,982	1,998	18,794	548	226	51	321	36,920
<b>Total assets</b>	<b>368,138</b>	<b>475,294</b>	<b>849,142</b>	<b>16,968</b>	<b>81,038</b>	<b>3,873</b>	<b>36,310</b>	<b>1,830,763</b>
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation	–	–	82,930	–	–	–	–	82,930
Deposits and balances from banks and other financial institutions	82,762	48,667	45,710	102	50	26	1,889	179,206
Financial liabilities at fair value through profit or loss	776	48	18,525	7	–	6	810	20,172
Derivative financial instruments	382	3,682	16,621	337	–	–	192	21,214
Deposits from customers	234,719	246,065	683,270	11,156	3,393	12,127	35,560	1,226,290
Debt securities in issue at amortised cost	–	5,919	4	–	–	–	–	5,923
Other accounts and provisions (including current and deferred tax liabilities)	9,995	16,162	28,536	645	298	685	941	57,262
Insurance contract liabilities	17,550	6,400	29,987	–	–	–	–	53,937
Subordinated liabilities	–	22,006	–	6,749	–	–	–	28,755
<b>Total liabilities</b>	<b>346,184</b>	<b>348,949</b>	<b>905,583</b>	<b>18,996</b>	<b>3,741</b>	<b>12,844</b>	<b>39,392</b>	<b>1,675,689</b>
Net on-balance sheet position	21,954	126,345	(56,441)	(2,028)	77,297	(8,971)	(3,082)	155,074
Off-balance sheet net notional position*	(12,217)	(105,886)	190,779	1,917	(77,231)	8,714	3,305	9,381
Contingent liabilities and commitments	47,614	90,233	315,496	3,756	538	1,074	5,058	463,769

\* Off-balance sheet net notional position represents the net notional amounts of foreign currency derivative financial instruments, which are principally used to reduce the Group's exposure to currency movements.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.2 Market Risk (continued)

#### (C) Interest rate risk

The tables below summarise the Group's exposure to interest rate risk as at 30 June 2013 and 31 December 2012. Included in the tables are the assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

	At 30 June 2013						
	Up to 1 month HK\$'m	1-3 months HK\$'m	3-12 months HK\$'m	1-5 years HK\$'m	Over 5 years HK\$'m	Non-interest bearing HK\$'m	Total HK\$'m
<b>Assets</b>							
Cash and balances with banks and other financial institutions	164,567	-	-	-	-	17,883	182,450
Placements with banks and other financial institutions maturing between one and twelve months	-	27,384	27,127	-	-	-	54,511
Financial assets at fair value through profit or loss	4,729	9,305	8,478	16,883	6,671	2,498	48,564
Derivative financial instruments	-	-	-	-	-	31,532	31,532
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	90,080	90,080
Advances and other accounts	629,479	164,036	72,769	12,883	515	5,585	885,267
Investment in securities							
– Available-for-sale securities	54,535	71,819	48,129	149,982	86,362	3,614	414,441
– Held-to-maturity securities	926	799	1,671	5,815	900	-	10,111
– Loans and receivables	1,103	2,500	9,415	-	-	-	13,018
Interests in associates and a joint venture	-	-	-	-	-	270	270
Investment properties	-	-	-	-	-	14,572	14,572
Properties, plant and equipment	-	-	-	-	-	49,684	49,684
Other assets (including deferred tax assets)	-	-	-	-	-	40,161	40,161
<b>Total assets</b>	<b>855,339</b>	<b>275,843</b>	<b>167,589</b>	<b>185,563</b>	<b>94,448</b>	<b>255,879</b>	<b>1,834,661</b>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation	-	-	-	-	-	90,080	90,080
Deposits and balances from banks and other financial institutions	131,576	1,446	342	-	-	11,303	144,667
Financial liabilities at fair value through profit or loss	10,348	6,898	1,492	217	127	-	19,082
Derivative financial instruments	-	-	-	-	-	21,070	21,070
Deposits from customers	905,289	167,081	111,518	8,270	167	67,431	1,259,756
Debt securities in issue at amortised cost	4	-	-	5,762	-	-	5,766
Other accounts and provisions (including current and deferred tax liabilities)	14,013	2,561	3,160	242	-	38,069	58,045
Insurance contract liabilities	-	-	-	-	-	59,916	59,916
Subordinated liabilities	-	-	-	-	20,577	-	20,577
<b>Total liabilities</b>	<b>1,061,230</b>	<b>177,986</b>	<b>116,512</b>	<b>14,491</b>	<b>20,871</b>	<b>287,869</b>	<b>1,678,959</b>
Interest sensitivity gap	(205,891)	97,857	51,077	171,072	73,577	(31,990)	155,702

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.2 Market Risk (continued)

#### (C) Interest rate risk (continued)

	At 31 December 2012						
	Up to 1 month HK\$'m	1-3 months HK\$'m	3-12 months HK\$'m	1-5 years HK\$'m	Over 5 years HK\$'m	Non-interest bearing HK\$'m	Total HK\$'m
<b>Assets</b>							
Cash and balances with banks and other financial institutions	188,266	-	-	-	-	10,482	198,748
Placements with banks and other financial institutions maturing between one and twelve months	-	24,152	41,873	-	-	-	66,025
Financial assets at fair value through profit or loss	11,403	4,853	6,732	17,257	7,014	2,073	49,332
Derivative financial instruments	-	-	-	-	-	31,339	31,339
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	82,930	82,930
Advances and other accounts	620,505	118,455	64,651	9,495	22	6,611	819,739
Investment in securities							
– Available-for-sale securities	69,387	117,085	66,886	131,589	66,150	3,635	454,732
– Held-to-maturity securities	2,600	5,666	811	7,402	1,919	-	18,398
– Loans and receivables	-	1,558	7,676	-	-	-	9,234
Interests in associates and a joint venture	-	-	-	-	-	259	259
Investment properties	-	-	-	-	-	14,364	14,364
Properties, plant and equipment	-	-	-	-	-	48,743	48,743
Other assets (including deferred tax assets)	-	-	-	-	-	36,920	36,920
<b>Total assets</b>	<b>892,161</b>	<b>271,769</b>	<b>188,629</b>	<b>165,743</b>	<b>75,105</b>	<b>237,356</b>	<b>1,830,763</b>
<b>Liabilities</b>							
Hong Kong SAR currency notes in circulation	-	-	-	-	-	82,930	82,930
Deposits and balances from banks and other financial institutions	159,083	1,483	208	-	-	18,432	179,206
Financial liabilities at fair value through profit or loss	10,017	6,286	3,475	255	139	-	20,172
Derivative financial instruments	-	-	-	-	-	21,214	21,214
Deposits from customers	919,431	129,374	110,938	5,969	38	60,540	1,226,290
Debt securities in issue at amortised cost	4	-	-	5,919	-	-	5,923
Other accounts and provisions (including current and deferred tax liabilities)	13,990	1,710	3,350	25	-	38,187	57,262
Insurance contract liabilities	-	-	-	-	-	53,937	53,937
Subordinated liabilities	-	-	6,749	-	22,006	-	28,755
<b>Total liabilities</b>	<b>1,102,525</b>	<b>138,853</b>	<b>124,720</b>	<b>12,168</b>	<b>22,183</b>	<b>275,240</b>	<b>1,675,689</b>
Interest sensitivity gap	(210,364)	132,916	63,909	153,575	52,922	(37,884)	155,074

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.3 Liquidity Risk

#### (A) Liquidity ratio

	Half-year ended 30 June 2013	Half-year ended 30 June 2012
Average liquidity ratio	38.70%	39.87%

The average liquidity ratio is calculated as the simple average of each calendar month's average liquidity ratio of BOCHK for the period.

The liquidity ratio is computed on the solo basis (the Hong Kong offices only) and is in accordance with the Fourth Schedule to the Banking Ordinance.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.3 Liquidity Risk (continued)

#### (B) Maturity analysis

Tables below analyse assets and liabilities of the Group as at 30 June 2013 and 31 December 2012 into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

	At 30 June 2013							Total HK\$'m
	On demand HK\$'m	Up to 1 month HK\$'m	1-3 months HK\$'m	3-12 months HK\$'m	1-5 years HK\$'m	Over 5 years HK\$'m	Indefinite HK\$'m	
<b>Assets</b>								
Cash and balances with banks and other financial institutions	132,888	49,562	-	-	-	-	-	182,450
Placements with banks and other financial institutions maturing between one and twelve months	-	-	27,384	27,127	-	-	-	54,511
Financial assets at fair value through profit or loss								
- held for trading								
- certificates of deposit	-	16	54	33	2	-	-	105
- debt securities	-	4,145	8,761	4,807	7,770	4,595	-	30,078
- designated at fair value through profit or loss								
- certificates of deposit	-	-	260	8	370	-	-	638
- debt securities	-	255	266	2,321	10,380	2,023	-	15,245
- fund and equity securities	-	-	-	-	-	-	2,498	2,498
Derivative financial instruments	16,198	1,389	2,866	6,013	1,512	3,554	-	31,532
Hong Kong SAR Government certificates of indebtedness	90,080	-	-	-	-	-	-	90,080
Advances and other accounts								
- advances to customers	66,883	25,634	59,850	144,179	308,290	220,198	1,589	826,623
- trade bills	1	14,897	21,406	22,340	-	-	-	58,644
Investment in securities								
- held for available-for-sale								
- certificates of deposit	-	9,076	18,270	33,237	14,400	18	-	75,001
- debt securities	-	18,132	27,333	37,371	165,005	87,978	7	335,826
- held for held-to-maturity								
- certificates of deposit	-	-	-	233	77	-	-	310
- debt securities	-	143	189	1,755	6,592	1,038	84	9,801
- debt securities held for loans and receivables	-	1,103	2,500	9,415	-	-	-	13,018
- equity securities	-	-	-	-	-	-	3,614	3,614
Interests in associates and a joint venture	-	-	-	-	-	-	270	270
Investment properties	-	-	-	-	-	-	14,572	14,572
Properties, plant and equipment	-	-	-	-	-	-	49,684	49,684
Other assets (including deferred tax assets)	11,971	12,055	120	296	9,970	5,707	42	40,161
<b>Total assets</b>	<b>318,021</b>	<b>136,407</b>	<b>169,259</b>	<b>289,135</b>	<b>524,368</b>	<b>325,111</b>	<b>72,360</b>	<b>1,834,661</b>

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.3 Liquidity Risk (continued)

#### (B) Maturity analysis (continued)

	At 30 June 2013							Total HK\$'m
	On demand HK\$'m	Up to 1 month HK\$'m	1-3 months HK\$'m	3-12 months HK\$'m	1-5 years HK\$'m	Over 5 years HK\$'m	Indefinite HK\$'m	
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation	90,080	-	-	-	-	-	-	90,080
Deposits and balances from banks and other financial institutions	91,788	51,091	1,446	342	-	-	-	144,667
Financial liabilities at fair value through profit or loss	-	10,348	6,898	1,492	217	127	-	19,082
Derivative financial instruments	11,531	1,306	2,166	2,580	2,810	677	-	21,070
Deposits from customers	666,883	303,316	167,101	112,048	10,241	167	-	1,259,756
Debt securities in issue at amortised cost	-	4	-	32	5,730	-	-	5,766
Other accounts and provisions (including current and deferred tax liabilities)	29,488	12,772	2,004	6,429	7,352	-	-	58,045
Insurance contract liabilities	6,394	79	148	3,162	24,682	25,451	-	59,916
Subordinated liabilities	-	-	419	-	-	20,158	-	20,577
<b>Total liabilities</b>	<b>896,164</b>	<b>378,916</b>	<b>180,182</b>	<b>126,085</b>	<b>51,032</b>	<b>46,580</b>	<b>-</b>	<b>1,678,959</b>
Net liquidity gap	(578,143)	(242,509)	(10,923)	163,050	473,336	278,531	72,360	155,702

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.3 Liquidity Risk (continued)

#### (B) Maturity analysis (continued)

	At 31 December 2012							
	On demand HK\$'m	Up to 1 month HK\$'m	1-3 months HK\$'m	3-12 months HK\$'m	1-5 years HK\$'m	Over 5 years HK\$'m	Indefinite HK\$'m	Total HK\$'m
<b>Assets</b>								
Cash and balances with banks and other financial institutions	145,534	53,214	-	-	-	-	-	198,748
Placements with banks and other financial institutions maturing between one and twelve months	-	-	24,152	41,873	-	-	-	66,025
Financial assets at fair value through profit or loss								
- held for trading								
- certificates of deposit	-	67	64	14	-	-	-	145
- debt securities	-	11,075	3,855	3,454	6,585	4,159	-	29,128
- designated at fair value through profit or loss								
- certificates of deposit	-	-	509	310	378	-	-	1,197
- debt securities	-	31	369	2,350	11,207	2,832	-	16,789
- fund and equity securities	-	-	-	-	-	-	2,073	2,073
Derivative financial instruments	17,690	2,535	2,032	3,421	1,600	4,061	-	31,339
Hong Kong SAR Government certificates of indebtedness	82,930	-	-	-	-	-	-	82,930
Advances and other accounts								
- advances to customers	60,076	19,055	53,963	138,157	288,680	213,106	1,522	774,559
- trade bills	76	10,150	15,765	19,189	-	-	-	45,180
Investment in securities								
- held for available-for-sale								
- certificates of deposit	-	3,001	15,580	45,533	8,708	19	-	72,841
- debt securities	-	49,064	76,254	40,775	143,730	68,424	9	378,256
- held for held-to-maturity								
- certificates of deposit	-	465	-	332	77	-	-	874
- debt securities	-	430	2,822	3,792	8,276	2,102	102	17,524
- debt securities held for loans and receivables	-	-	1,558	7,676	-	-	-	9,234
- equity securities	-	-	-	-	-	-	3,635	3,635
Interests in associates and a joint venture	-	-	-	-	-	-	259	259
Investment properties	-	-	-	-	-	-	14,364	14,364
Properties, plant and equipment	-	-	-	-	-	-	48,743	48,743
Other assets (including deferred tax assets)	10,563	13,904	73	47	8,857	3,452	24	36,920
<b>Total assets</b>	<b>316,869</b>	<b>162,991</b>	<b>196,996</b>	<b>306,923</b>	<b>478,098</b>	<b>298,155</b>	<b>70,731</b>	<b>1,830,763</b>



# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.3 Liquidity Risk (continued)

#### (B) Maturity analysis (continued)

	At 31 December 2012							Total HK\$'m
	On demand HK\$'m	Up to 1 month HK\$'m	1-3 months HK\$'m	3-12 months HK\$'m	1-5 years HK\$'m	Over 5 years HK\$'m	Indefinite HK\$'m	
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation	82,930	-	-	-	-	-	-	82,930
Deposits and balances from banks and other financial institutions	140,245	37,270	1,483	208	-	-	-	179,206
Financial liabilities at fair value through profit or loss	-	10,017	6,287	3,475	254	139	-	20,172
Derivative financial instruments	13,022	668	865	1,766	3,602	1,291	-	21,214
Deposits from customers	701,678	276,068	129,269	111,327	7,910	38	-	1,226,290
Debt securities in issue at amortised cost	-	4	-	32	5,887	-	-	5,923
Other accounts and provisions (including current and deferred tax liabilities)	28,005	14,148	2,999	4,545	7,559	6	-	57,262
Insurance contract liabilities	3,281	493	3,068	1,070	24,655	21,370	-	53,937
Subordinated liabilities	-	-	418	-	-	28,337	-	28,755
<b>Total liabilities</b>	969,161	338,668	144,389	122,423	49,867	51,181	-	1,675,689
Net liquidity gap	(652,292)	(175,677)	52,607	184,500	428,231	246,974	70,731	155,074

The above maturity classifications have been prepared in accordance with relevant provisions under the Banking (Disclosure) Rules. The Group has reported assets such as advances and debt securities which have been overdue for not more than one month as "On demand". In the case of an asset that is repayable by different payments or instalments, only that portion of the asset that is actually overdue is reported as overdue. Any part of the asset that is not due is reported according to the residual maturity unless the repayment of the asset is in doubt in which case the amount is reported as "Indefinite". The above assets are stated after deduction of provisions, if any.

The analysis of debt securities by remaining period to maturity is disclosed in order to comply with relevant provisions under the Banking (Disclosure) Rules. The disclosure does not imply that the securities will be held to maturity.

The above analysis in respect of insurance contract liabilities represents the estimated timing of net cash outflows resulting from recognised insurance contract liabilities on the balance sheet.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.4 Insurance Risk

The Group is in the business of insuring against the risk of mortality, morbidity, disability, critical illness, accidents and related risks. The Group manages these risks through the application of its underwriting policies and reinsurance arrangements.

The underwriting strategy is intended to set premium pricing at an appropriate level that corresponds with the underlying exposure of the risks underwritten. Screening processes, such as the review of health condition and family medical history, are also included in the Group's underwriting procedures.

Within the insurance process, concentrations of risk may arise where a particular event or series of events could impact heavily on the Group's liabilities. Such concentrations may arise from a single insurance contract or through a small number of related contracts, and relate to circumstances where significant liabilities could arise.

For the in-force insurance contracts, most of the underlying insurance liabilities are related to endowment, whole life and unit-linked insurance products. For most of the insurance policies issued, the Group has a retention limit on any single life insured. The Group cedes the excess of the insured benefit over the limit to reinsurer under an excess of loss reinsurance arrangement. For some of the insurance liabilities denominated in Renminbi, the Group has entered into reinsurance arrangements that reinsure most of insurance risk.

Uncertainty in the estimation of future benefit payments and premium receipts for long-term insurance contracts arises from the unpredictability of long-term changes in overall levels of mortality, morbidity and persistency. The Group conducted relevant experience studies. The results of the studies are considered in determining the assumptions which include appropriate level of prudential margins.

### 3.5 Capital Management

The Group has adopted the foundation internal ratings-based ("FIRB") approach to calculate the credit risk capital charge for the majority of its non-securitisation exposures and the internal ratings-based (securitisation) approach to calculate the credit risk capital charge for its securitisation exposures. A small residual credit exposures remain under the standardised (credit risk) ("STC") approach. In view of the Banking (Capital) (Amendment) Rules 2012 which came into operation on 1 January 2013, the Group has adopted the standardised method to calculate credit valuation adjustment capital charge for all its counterparties in respect of the derivative contracts and securities financing transactions booked in banking book and trading book. The Group has adopted the internal models ("IMM") approach to calculate general market risk capital charge for foreign exchange and interest rate exposures and has been approved by HKMA to exclude its structural FX positions arising from Nanyang and Chiyu in the calculation of the market risk capital charge, while the Group continues to adopt the standardised (market risk) ("STM") approach to calculate the market risk capital charge for the remaining exposures. The Group has adopted the standardised (operational risk) ("STO") approach to calculate the minimum capital charge for operational risk.

As a result of the adoption of Banking (Capital) (Amendment) Rules 2012 since 1 January 2013, the amounts shown for 30 June 2013 are not directly comparable to those of 31 December 2012.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.5 Capital Management (continued)

#### (A) Capital ratio

	At 30 June 2013
CET1 capital ratio	11.04%
Tier 1 capital ratio	11.17%
Total capital ratio	16.40%

	At 31 December 2012
Core capital ratio	12.31%
Capital adequacy ratio	16.80%

The capital ratios are computed on the consolidated basis that comprises the positions of BOCHK and certain subsidiaries specified by the HKMA for its regulatory purposes and in accordance with the Banking (Capital) Rules.

Subsidiaries which are not included in the consolidation group for the calculation of capital ratios are denoted in "Appendix – Subsidiaries of the Company" on pages 124 to 126.

The differences between the basis of consolidation for accounting and regulatory purposes are described in "Appendix – Subsidiaries of the Company" on page 126.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.5 Capital Management (continued)

#### (B) Components of capital base after deductions

The consolidated capital base after deductions used in the calculation of the above capital ratios as at 30 June 2013 and 31 December 2012 and reported to the HKMA is analysed as follows:

	At 30 June 2013 HK\$'m
CET1 capital: instruments and reserves	
Directly issued qualifying CET1 capital instruments plus any related share premium	43,043
Retained earnings	57,186
Disclosed reserves	40,858
Minority interests arising from CET1 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in CET1 capital of the consolidation group)	507
CET1 capital before regulatory deductions	141,594
CET1 capital: regulatory deductions	
Valuation adjustments	(84)
Deferred tax assets net of deferred tax liabilities	(78)
Gains and losses due to changes in own credit risk on fair valued liabilities	(121)
Cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties)	(42,095)
Regulatory reserve for general banking risks	(8,145)
Total regulatory deductions to CET1 capital	(50,523)
CET1 capital	91,071
AT1 capital: instruments	
AT1 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in AT1 capital of the consolidation group)	1,027
AT1 capital	1,027
Tier 1 capital	92,098

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.5 Capital Management (continued)

#### (B) Components of capital base after deductions (continued)

	At 30 June 2013 HK\$'m
Tier 2 capital: instruments and provisions	
Capital instruments subject to phase out arrangements from Tier 2 capital	19,294
Tier 2 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in Tier 2 capital of the consolidation group)	145
Collective impairment allowances and regulatory reserve for general banking risks eligible for inclusion in Tier 2 capital	4,827
Tier 2 capital before regulatory deductions	24,266
Tier 2 capital: regulatory deductions	
Add back of cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties) eligible for inclusion in Tier 2 capital	18,943
Total regulatory deductions to Tier 2 capital	18,943
Tier 2 capital	43,209
<b>Total capital</b>	<b>135,307</b>

As at 30 June 2013, there were no shareholdings in any subsidiaries deducted from the CET1 capital.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.5 Capital Management (continued)

#### (B) Components of capital base after deductions (continued)

	At 31 December 2012 HK\$'m
Core capital:	
Paid up ordinary share capital	43,043
Reserves	38,987
Profit and loss account	5,820
Non-controlling interests	1,658
Deductible item	(25)
	89,483
Deductions from core capital	(387)
Core capital	89,096
Supplementary capital:	
Fair value gains arising from holdings of available-for-sale securities	2,067
Fair value gains arising from holdings of securities designated at fair value through profit or loss	35
Collective loan impairment allowances	192
Regulatory reserve	539
Surplus provisions	3,963
Term subordinated debt	26,043
	32,839
Deductions from supplementary capital	(387)
Supplementary capital	32,452
Total capital base after deductions	121,548

To comply with the Banking (Disclosure) Rules, a section "Regulatory Disclosures" will be available on the Company's website at [www.bochk.com](http://www.bochk.com) before 30 September 2013 and will include the following information:

- A detailed breakdown of the Group's capital base and regulatory deductions, using the standard template as specified by the HKMA.
- A reconciliation of capital components to the Group's balance sheet, using the standard template as specified by the HKMA.
- A description of the main features and the full terms and conditions of the Group's issued capital instruments.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.6 Fair values of financial assets and liabilities

#### (A) Financial instruments not measured at fair value

Fair value estimates are made at a specific point in time based on relevant market information and information about various financial instruments. The following methods and assumptions have been used to estimate the fair value of each class of financial instrument as far as practicable.

#### *Balances with banks and other financial institutions and trade bills*

The maturities of these financial assets and liabilities are within one year and the carrying value approximates fair value.

#### *Advances to customers, banks and other financial institutions*

Substantially all the advances to customers, banks and other financial institutions are on floating rate terms, bear interest at prevailing market interest rates and their carrying value approximates fair value.

#### *Held-to-maturity securities*

Fair value for held-to-maturity securities is based on market prices or broker/dealer price quotations. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics. Their carrying value approximates fair value.

#### *Loans and receivables*

A discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity and their carrying value approximates fair value.

#### *Deposits from customers*

Substantially all the deposits from customers mature within one year from the balance sheet date and their carrying value approximates fair value.

#### *Debt securities in issue at amortised cost*

Fair value for senior notes and other debt securities in issue is based on market prices or broker/dealer price quotations. The carrying value and fair value of senior notes as at 30 June 2013 amounted to HK\$5,762 million and HK\$6,254 million respectively. The carrying value of other debt securities in issue approximates fair value.

#### *Subordinated liabilities*

Fair value for subordinated notes is based on market prices or broker/dealer price quotations and their carrying value approximates fair value.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.6 Fair values of financial assets and liabilities (continued)

#### (B) Financial instruments measured at fair value

The Group has an established governance structure and controls framework to ensure that fair values are either determined or validated by control units independent of the front offices. Control units have overall responsibility for independent verification of valuation results from front line businesses and all other significant fair value measurements. Specific controls include verification of observable pricing inputs; review and approval for new models and changes to models; calibration and back-testing of models against observed market transactions; analysis and investigation of significant daily valuation movements; review of significant unobservable inputs and valuation adjustments. Significant valuation issues are reported to senior management, Risk Committee and Audit Committee.

Financial instruments measured at fair value are classified into following three levels:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities, including listed equity securities on exchange, debt instruments issued by certain governments and certain exchange-traded derivative contracts.
- Level 2: Valuation technique using inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly. This level includes the majority of the OTC derivative contracts, debt securities with quote from pricing services providers and issued structured deposits.
- Level 3: Valuation technique using inputs for the asset or liability that is not based on observable market data (unobservable inputs). This level includes equity investment and debt instruments with significant unobservable components.

The Group's policy is to recognise transfers between levels of fair value hierarchy as at the end of the reporting period in which they occur.

The Group uses valuation techniques or broker/dealer quotations to determine the fair value of financial instruments when unable to obtain the open market quotation in active markets.

The main parameters used in valuation techniques for financial instruments held by the Group include bond prices, interest rates, foreign exchange rates, equity and stock prices, volatilities, counterparty credit spreads and others, which are mostly observable and obtainable from open market.



# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.6 Fair values of financial assets and liabilities (continued)

#### (B) Financial instruments measured at fair value (continued)

The technique used to calculate the fair value of the following financial instruments is as below:

##### *Debt securities and certificates of deposit*

The fair value of these instruments is determined by obtaining quoted market prices from exchange, dealer or independent pricing service vendors. Where market price is not available from market sources, valuation techniques are used with inputs derived from observable or unobservable market data.

##### *Asset backed securities*

For this class of instruments, external prices are obtained from independent third parties. The valuation of these securities, depending on the nature of transaction, is estimated from market standard cash flow models with input parameter assumptions which include spreads to discount rates, default and recovery rates and prepayment rates that may be observable or compiled through matrix pricing for similar issues.

##### *Derivatives*

Over-the-counter derivative contracts include forward, swap and option contracts on foreign exchange, interest rate, equity or commodity. The derivative contracts are valued using valuation techniques such as discounted cash flow models and option pricing models. The inputs can be observable or unobservable market data. Observable inputs include interest rate, foreign exchange rates, equity and stock prices, commodity prices and volatilities. Unobservable inputs include volatility surface for less commonly traded option products which are embedded in structured deposits.

Credit Valuation Adjustments (CVA) and Debit Valuation Adjustments (DVA) are applied to the Group's over-the-counter derivatives. These adjustments reflect interest rates, expectations of counterparty creditworthiness and the Group's own credit spread respectively. They are determined for each counterparty and are dependent on expected future values of exposures, default probabilities and recovery rates.

##### *Financial liabilities designated at fair value through profit or loss*

This class of instruments includes certain deposits received from customers that are embedded with derivatives. The plain vanilla contracts are valued in the similar way described in previous debt securities section. The fair value of structured deposits is derived from the fair value of the underlying deposit by using discounted cash flow analysis taking the Group's own credit risk into account, and the fair value of the embedded derivatives determined as described in the paragraph above on derivatives.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.6 Fair values of financial assets and liabilities (continued)

#### (B) Financial instruments measured at fair value (continued)

##### (i) Fair value hierarchy

	At 30 June 2013			
	Level 1 HK\$'m	Level 2 HK\$'m	Level 3 HK\$'m	Total HK\$'m
<b>Financial assets</b>				
Financial assets at fair value through profit or loss (Note 19)				
– Trading securities				
– Debt securities	–	30,078	–	30,078
– Certificates of deposit	–	105	–	105
– Equity securities	6	248	–	254
– Financial assets designated at fair value through profit or loss				
– Debt securities	375	14,527	343	15,245
– Certificates of deposit	–	638	–	638
– Fund	595	–	–	595
– Equity securities	1,649	–	–	1,649
Derivative financial instruments (Note 20)	16,203	15,329	–	31,532
Available-for-sale securities (Note 22)				
– Debt securities	12,113	321,911	1,802	335,826
– Certificates of deposit	–	70,378	4,623	75,001
– Equity securities	2,383	1,011	220	3,614
<b>Financial liabilities</b>				
Financial liabilities at fair value through profit or loss (Note 26)				
– Trading liabilities	–	14,548	–	14,548
– Financial liabilities designated at fair value through profit or loss	–	2,794	1,740	4,534
Derivative financial instruments (Note 20)	11,550	9,520	–	21,070

During the first half of 2013, there have been no asset and liability transfers between level 1 and level 2.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.6 Fair values of financial assets and liabilities (continued)

#### (B) Financial instruments measured at fair value (continued)

##### (ii) Reconciliation of level 3 items

	At 30 June 2013				
	Financial assets				Financial liabilities
	Financial assets designated at fair value through profit or loss	Available-for-sale securities			Financial liabilities designated at fair value through profit or loss
		Debt securities HK\$'m	Debt securities HK\$'m	Certificates of deposit HK\$'m	
At 1 January 2013	333	1,449	1,188	205	771
Gains/(losses)					
– Income statement					
– Net gain/(loss) on financial instruments designated at fair value through profit or loss	7	–	–	–	(5)
– Other comprehensive income					
– Change in fair value of available-for-sale securities	–	(86)	(1)	15	–
Purchases	172	613	1,819	–	–
Issues	–	–	–	–	1,745
Sales	–	–	(381)	–	–
Settlements	–	–	–	–	(771)
Transfers into level 3	–	–	2,315	–	–
Transfers out of level 3	(169)	(174)	(317)	–	–
At 30 June 2013	343	1,802	4,623	220	1,740
Total unrealised loss for the period included in income statement for financial assets and liabilities held as at 30 June 2013					
– Net loss on financial instruments designated at fair value through profit or loss	(14)	–	–	–	(5)
	(14)	–	–	–	(5)

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 3. Financial risk management (continued)

### 3.6 Fair values of financial assets and liabilities (continued)

#### (B) Financial instruments measured at fair value (continued)

##### (ii) Reconciliation of level 3 items (continued)

As at 30 June 2013, financial instruments categorised as level 3 are mainly comprised of debt securities, certificates of deposit and financial liabilities designated at fair value through profit or loss.

The transfers of debt securities and certificates of deposit into and out of level 3, comprising bonds issued by financial institutions and corporate entities, were due to change in valuation observability. For certain illiquid debt securities, the Group obtains valuation quotations from counterparties which may be based on unobservable inputs with significant impact on the valuation. Therefore, these instruments have been classified by the Group as level 3. The Group has established internal control procedures to control the Group's exposure to such financial instruments.

Financial liabilities designated at fair value through profit or loss categorised in level 3 are deposits received from customers that are embedded with options bought by the Group. During the first half of 2013, there has been no transfer into and out of level 3. The fair values of embedded options are determined using the market standard option pricing model by using estimated interest rate volatilities.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 4. Net interest income

	Half-year ended 30 June 2013 HK\$m	Half-year ended 30 June 2012 HK\$m
<b>Interest income</b>		
Due from banks and other financial institutions	3,387	4,687
Advances to customers	9,757	8,138
Listed investments	2,382	2,165
Unlisted investments	2,818	2,669
Others	115	113
	<b>18,459</b>	17,772
<b>Interest expense</b>		
Due to banks and other financial institutions	(267)	(677)
Deposits from customers	(4,557)	(4,090)
Debt securities in issue	(72)	(81)
Subordinated liabilities	(83)	(184)
Others	(149)	(121)
	<b>(5,128)</b>	(5,153)
<b>Net interest income</b>	<b>13,331</b>	12,619

Included within interest income is HK\$9 million (first half of 2012: HK\$4 million) of interest with respect to income recognised on advances classified as impaired for the first half of 2013. Interest income accrued on impaired investment in securities amounted to HK\$3 million (first half of 2012: HK\$8 million).

Included within interest income and interest expense are HK\$18,522 million (first half of 2012: HK\$17,664 million) and HK\$5,436 million (first half of 2012: HK\$5,449 million), before hedging effect, for financial assets and financial liabilities that are not recognised at fair value through profit or loss respectively.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 5. Net fee and commission income

	Half-year ended 30 June 2013 HK\$'m	(Restated) Half-year ended 30 June 2012 HK\$'m
<b>Fee and commission income</b>		
Credit card business	1,734	1,477
Securities brokerage	1,224	1,054
Loan commissions	1,078	974
Insurance	708	596
Funds distribution	441	232
Bills commissions	387	370
Payment services	322	325
Trust and custody services	181	179
Safe deposit box	122	118
Currency exchange	88	69
Others	224	214
	<b>6,509</b>	5,608
<b>Fee and commission expense</b>		
Credit card business	(1,291)	(1,106)
Securities brokerage	(150)	(161)
Payment services	(44)	(45)
Others	(343)	(263)
	<b>(1,828)</b>	(1,575)
<b>Net fee and commission income</b>	<b>4,681</b>	4,033
Of which arise from		
– financial assets or financial liabilities not at fair value through profit or loss		
– Fee and commission income	1,125	993
– Fee and commission expense	(4)	(3)
	<b>1,121</b>	990
– trust and other fiduciary activities		
– Fee and commission income	272	276
– Fee and commission expense	(9)	(5)
	<b>263</b>	271

Certain comparative amounts of fee and commission income, fee and commission expense and operating expenses have been reclassified to conform with current period's presentation.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 6. Net trading gain

	Half-year ended 30 June 2013 HK\$'m	Half-year ended 30 June 2012 HK\$'m
Net gain from:		
– foreign exchange and foreign exchange products	1,019	936
– interest rate instruments and items under fair value hedge	197	305
– equity instruments	183	104
– commodities	42	63
	<b>1,441</b>	<b>1,408</b>

## 7. Net gain on other financial assets

	Half-year ended 30 June 2013 HK\$'m	Half-year ended 30 June 2012 HK\$'m
Net gain on available-for-sale securities	101	474
Net gain on held-to-maturity securities	–	2
Others	5	1
	<b>106</b>	<b>477</b>

## 8. Other operating income

	Half-year ended 30 June 2013 HK\$'m	Half-year ended 30 June 2012 HK\$'m
Dividend income from investment in securities		
– listed investments	54	49
– unlisted investments	21	16
Gross rental income from investment properties	238	208
Less: Outgoings in respect of investment properties	(27)	(27)
Others	29	45
	<b>315</b>	<b>291</b>

Included in the “Outgoings in respect of investment properties” is HK\$2 million (first half of 2012: HK\$1 million) of direct operating expenses related to investment properties that were not let during the period.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 9. Net insurance benefits and claims

	Half-year ended 30 June 2013 HK\$'m	Half-year ended 30 June 2012 HK\$'m
<b>Gross insurance benefits and claims</b>		
Claims, benefits and surrenders paid	(4,410)	(2,725)
Movement in liabilities	(5,697)	(4,744)
	(10,107)	(7,469)
<b>Reinsurers' share of benefits and claims</b>		
Claims, benefits and surrenders recovered	46	21
Movement in assets	5,527	3,699
	5,573	3,720
<b>Net insurance benefits and claims</b>	<b>(4,534)</b>	<b>(3,749)</b>

## 10. Net charge of impairment allowances

	Half-year ended 30 June 2013 HK\$'m	Half-year ended 30 June 2012 HK\$'m
<b>Advances to customers</b>		
Individually assessed		
– new allowances	(170)	(51)
– releases	88	46
– recoveries	175	141
Net reversal of individually assessed loan impairment allowances	93	136
Collectively assessed		
– new allowances	(479)	(241)
– releases	3	3
– recoveries	15	15
Net charge of collectively assessed loan impairment allowances	(461)	(223)
Net charge of loan impairment allowances	(368)	(87)
<b>Available-for-sale securities</b>		
Net reversal of impairment allowances on available-for-sale securities		
– Individually assessed	–	1
<b>Held-to-maturity securities</b>		
Net reversal/(charge) of impairment allowances on held-to-maturity securities		
– Individually assessed	1	(17)
<b>Others</b>	(4)	(5)
<b>Net charge of impairment allowances</b>	<b>(371)</b>	<b>(108)</b>



# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 11. Operating expenses

	Half-year ended 30 June 2013 HK\$'m	(Restated) Half-year ended 30 June 2012 HK\$'m
Staff costs (including directors' emoluments)		
– salaries and other costs	2,985	2,796
– pension cost	249	232
	<b>3,234</b>	3,028
Premises and equipment expenses (excluding depreciation)		
– rental of premises	386	326
– information technology	187	196
– others	171	159
	<b>744</b>	681
Depreciation	810	722
Auditor's remuneration		
– audit services	3	4
– non-audit services	1	1
Other operating expenses	900	886
	<b>5,692</b>	5,322

Certain comparative amounts of operating expenses have been reclassified to fee and commission expense to conform with current period's presentation.

## 12. Net gain from disposal of/fair value adjustments on investment properties

	Half-year ended 30 June 2013 HK\$'m	Half-year ended 30 June 2012 HK\$'m
Net gain from disposal of investment properties	–	4
Net gain from fair value adjustments on investment properties	203	1,026
	<b>203</b>	1,030

## 13. Net gain from disposal/revaluation of properties, plant and equipment

	Half-year ended 30 June 2013 HK\$'m	Half-year ended 30 June 2012 HK\$'m
Net gain from disposal of premises	–	119
Net loss from disposal of other fixed assets	–	(2)
Net gain/(loss) from revaluation of premises	4	(1)
	<b>4</b>	116

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 14. Taxation

Taxation in the income statement represents:

	Half-year ended 30 June 2013 HK\$'m	Half-year ended 30 June 2012 HK\$'m
Current tax		
Hong Kong profits tax		
– current period taxation	2,180	1,970
– over-provision in prior periods	–	(1)
	2,180	1,969
Overseas taxation	231	219
	2,411	2,188
Deferred tax	(120)	(12)
	2,291	2,176

Hong Kong profits tax has been provided at the rate of 16.5% (2012: 16.5%) on the estimated assessable profits arising in Hong Kong for the first half of 2013. Taxation on overseas profits has been calculated on the estimated assessable profits for the first half of 2013 at the rates of taxation prevailing in the countries in which the Group operates.

The taxation on the Group's profit before taxation that differs from the theoretical amount that would arise using the taxation rate of Hong Kong is as follows:

	Half-year ended 30 June 2013 HK\$'m	Half-year ended 30 June 2012 HK\$'m
Profit before taxation	13,948	13,825
Calculated at a taxation rate of 16.5% (2012: 16.5%)	2,301	2,281
Effect of different taxation rates in other countries	9	21
Income not subject to taxation	(105)	(296)
Expenses not deductible for taxation purposes	26	96
Utilisation of previously unrecognised tax losses	(82)	(70)
Over-provision in prior periods	–	(1)
Foreign withholding tax	142	145
Taxation charge	2,291	2,176
Effective tax rate	16.4%	15.7%

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 15. Dividends

	Half-year ended 30 June 2013		Half-year ended 30 June 2012	
	Per share HK\$	Total HK\$m	Per share HK\$	Total HK\$m
Interim dividend	0.545	5,762	0.545	5,762

At a meeting held on 29 August 2013, the Board declared an interim dividend of HK\$0.545 per ordinary share for the first half of 2013 amounting to approximately HK\$5,762 million. This declared dividend is not reflected as a dividend payable in this interim financial information, but will be reflected as an appropriation of retained earnings for the year ending 31 December 2013.

## 16. Earnings per share for profit attributable to the equity holders of the Company

The calculation of basic earnings per share is based on the consolidated profit attributable to the equity holders of the Company for the first half of 2013 of approximately HK\$11,252 million (first half of 2012: HK\$11,243 million) and on the ordinary shares in issue of 10,572,780,266 shares (2012: 10,572,780,266 ordinary shares).

There was no dilution of earnings per share as no potential ordinary shares were in issue for the first half of 2013 (first half of 2012: Nil).

## 17. Retirement benefit costs

The principal defined contribution schemes for the Group's employees are ORSO schemes exempted under the MPF Schemes Ordinance and the BOC-Prudential Easy Choice MPF Scheme. Under the ORSO schemes, employees make monthly contributions to the ORSO schemes equal to 5% of their basic salaries, while the employer makes monthly contributions equal to 5% to 15% of the employees' monthly basic salaries, depending on years of service. The employees are entitled to receive 100% of the employer's contributions upon termination of employment after completing 10 years of service, or at a scale ranging from 30% to 90% for employees who have completed between 3 to 10 years of service, on conditions of retirement, early retirement, permanent incapacity and ill-health or termination of employment other than summary dismissal.

With the implementation of the MPF Schemes Ordinance on 1 December 2000, the Group also participates in the BOC-Prudential Easy Choice MPF Scheme, of which the trustee is BOCI-Prudential Trustee and the investment manager is BOCI-Prudential Manager, which are related parties of the Company.

The Group's total contributions made to the ORSO schemes for the first half of 2013 amounted to approximately HK\$175 million (first half of 2012: approximately HK\$170 million), after a deduction of forfeited contributions of approximately HK\$2 million (first half of 2012: approximately HK\$1 million). For the MPF Scheme, the Group contributed approximately HK\$33 million (first half of 2012: approximately HK\$29 million) for the first half of 2013.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 18. Cash and balances with banks and other financial institutions

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Cash	6,666	6,688
Balances with central banks	59,249	84,387
Balances with banks and other financial institutions	78,370	64,735
Placements with banks and other financial institutions maturing within one month	38,165	42,938
	<b>182,450</b>	<b>198,748</b>

## 19. Financial assets at fair value through profit or loss

	Trading securities		Financial assets designated at fair value through profit or loss		Total	
	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
At fair value						
Debt securities						
– Listed in Hong Kong	7,318	5,378	704	959	8,022	6,337
– Listed outside Hong Kong	5,239	4,982	7,118	7,119	12,357	12,101
	<b>12,557</b>	<b>10,360</b>	<b>7,822</b>	<b>8,078</b>	<b>20,379</b>	<b>18,438</b>
– Unlisted	17,521	18,768	7,423	8,711	24,944	27,479
	<b>30,078</b>	<b>29,128</b>	<b>15,245</b>	<b>16,789</b>	<b>45,323</b>	<b>45,917</b>
Certificates of deposit						
– Unlisted	105	145	638	1,197	743	1,342
Fund						
– Unlisted	–	–	595	636	595	636
Equity securities						
– Listed in Hong Kong	6	13	1,486	1,126	1,492	1,139
– Listed outside Hong Kong	–	–	163	86	163	86
	<b>6</b>	<b>13</b>	<b>1,649</b>	<b>1,212</b>	<b>1,655</b>	<b>1,225</b>
– Unlisted	248	212	–	–	248	212
	<b>254</b>	<b>225</b>	<b>1,649</b>	<b>1,212</b>	<b>1,903</b>	<b>1,437</b>
Total	<b>30,437</b>	<b>29,498</b>	<b>18,127</b>	<b>19,834</b>	<b>48,564</b>	<b>49,332</b>

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 19. Financial assets at fair value through profit or loss (continued)

Financial assets at fair value through profit or loss are analysed by type of issuer as follows:

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Sovereigns	23,193	22,729
Public sector entities*	193	267
Banks and other financial institutions	13,172	15,006
Corporate entities	12,006	11,330
	<b>48,564</b>	<b>49,332</b>

\* Included financial assets at fair value through profit or loss of HK\$177 million (31 December 2012: HK\$168 million) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

Financial assets at fair value through profit or loss are analysed as follows:

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Treasury bills	14,627	17,210
Certificates of deposit	743	1,342
Other financial assets at fair value through profit or loss	33,194	30,780
	<b>48,564</b>	<b>49,332</b>

## 20. Derivative financial instruments

The Group enters into the following exchange rate, interest rate, commodity and equity related derivative financial instrument contracts for trading and risk management purposes:

Currency forwards represent commitments to purchase and sell foreign currency on a future date. Interest rate futures are contractual obligations to receive or pay a net amount based on changes in interest rates or buy or sell interest rate financial instruments on a future date at an agreed price in the financial market under the administration of the stock 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 contract rate of interest and the current market rate, based on a notional principal amount.

Currency, interest rate and precious metal swaps are commitments to exchange one set of cash flows or commodity for another. Swaps result in an exchange of currencies, interest rates (for example, fixed rate for floating rate), or precious metals (for example, silver swaps) or a combination of all these (for example, cross-currency interest rate swaps). Except for certain currency swap contracts, no exchange of principal takes place.

Foreign currency, interest rate, precious metal and equity options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, either to buy (a call option) or sell (a put option) at or by a set date or during a set period, a specific amount of the financial instrument at a predetermined price. In consideration for the assumption of foreign exchange and interest rate risk, the seller receives a premium from the purchaser. Options are negotiated over-the-counter ("OTC") between the Group and its counterparty or traded through the stock exchange (for example, exchange-traded stock option).

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 20. Derivative financial instruments (continued)

The contract/notional amounts and fair values of derivative financial instruments held by the Group are set out in the following tables. The contract/notional amounts of these instruments indicate the volume of transactions outstanding at the balance sheet dates and certain of them provide a basis for comparison with fair value instruments recognised on the balance sheet. However, they do not necessarily indicate the amounts of future cash flows involved or the current fair values of the instruments and, therefore, do not indicate the Group's exposure to credit or market risks. The derivative financial instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in foreign exchange rates, market interest rates, metal prices or equity prices relative to their terms. The aggregate fair values of derivative financial instruments assets and liabilities can fluctuate significantly from time to time.

The following tables summarise the contract/notional amounts of each class of derivative financial instrument as at 30 June 2013 and 31 December 2012:

	At 30 June 2013			
	Trading HK\$m	Hedging HK\$m	Not qualified for hedge accounting HK\$m	Total HK\$m
Exchange rate contracts				
Spot, forwards and futures	293,550	–	–	293,550
Swaps	664,178	2,828	8,969	675,975
Foreign currency options				
– Options purchased	8,479	–	–	8,479
– Options written	8,299	–	–	8,299
	<b>974,506</b>	<b>2,828</b>	<b>8,969</b>	<b>986,303</b>
Interest rate contracts				
Futures	754	–	–	754
Swaps	281,678	70,497	9,993	362,168
Interest rate options				
– Swaptions written	690	–	–	690
	<b>283,122</b>	<b>70,497</b>	<b>9,993</b>	<b>363,612</b>
Commodity contracts	23,772	–	–	23,772
Equity contracts	2,687	–	86	2,773
Other contracts	67	–	–	67
<b>Total</b>	<b>1,284,154</b>	<b>73,325</b>	<b>19,048</b>	<b>1,376,527</b>

Not qualified for hedge accounting: derivative transactions which do not qualify as hedges for accounting purposes but are managed in conjunction with the financial instruments designated at fair value through profit or loss are separately disclosed in compliance with the requirements set out in the Banking (Disclosure) Rules.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 20. Derivative financial instruments (continued)

	At 31 December 2012			
	Trading HK\$m	Hedging HK\$m	Not qualified for hedge accounting HK\$m	Total HK\$m
Exchange rate contracts				
Spot, forwards and futures	270,913	–	–	270,913
Swaps	680,377	3,174	7,451	691,002
Foreign currency options				
– Options purchased	4,821	–	–	4,821
– Options written	9,096	–	–	9,096
	965,207	3,174	7,451	975,832
Interest rate contracts				
Futures	235	–	–	235
Swaps	284,906	46,872	8,646	340,424
	285,141	46,872	8,646	340,659
Commodity contracts	20,481	–	–	20,481
Equity contracts	1,507	–	–	1,507
Other contracts	69	–	–	69
Total	1,272,405	50,046	16,097	1,338,548

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 20. Derivative financial instruments (continued)

The following tables summarise the fair values of each class of derivative financial instrument as at 30 June 2013 and 31 December 2012:

	At 30 June 2013							
	Fair value assets				Fair value liabilities			
	Trading HK\$'m	Hedging HK\$'m	Not qualified for hedge accounting HK\$'m	Total HK\$'m	Trading HK\$'m	Hedging HK\$'m	Not qualified for hedge accounting HK\$'m	Total HK\$'m
Exchange rate contracts								
Spot, forwards and futures	14,590	–	–	14,590	(10,031)	–	–	(10,031)
Swaps	9,339	38	141	9,518	(5,183)	(48)	(152)	(5,383)
Foreign currency options								
– Options purchased	81	–	–	81	–	–	–	–
– Options written	–	–	–	–	(94)	–	–	(94)
	<b>24,010</b>	<b>38</b>	<b>141</b>	<b>24,189</b>	<b>(15,308)</b>	<b>(48)</b>	<b>(152)</b>	<b>(15,508)</b>
Interest rate contracts								
Futures	2	–	–	2	(1)	–	–	(1)
Swaps	1,607	3,238	7	4,852	(2,125)	(1,225)	(67)	(3,417)
Interest rate options								
– Swaptions written	–	–	–	–	(3)	–	–	(3)
	<b>1,609</b>	<b>3,238</b>	<b>7</b>	<b>4,854</b>	<b>(2,129)</b>	<b>(1,225)</b>	<b>(67)</b>	<b>(3,421)</b>
Commodity contracts	<b>2,356</b>	–	–	<b>2,356</b>	<b>(2,006)</b>	–	–	<b>(2,006)</b>
Equity contracts	<b>131</b>	–	2	<b>133</b>	<b>(135)</b>	–	–	<b>(135)</b>
Total	<b>28,106</b>	<b>3,276</b>	<b>150</b>	<b>31,532</b>	<b>(19,578)</b>	<b>(1,273)</b>	<b>(219)</b>	<b>(21,070)</b>



# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 20. Derivative financial instruments (continued)

	At 31 December 2012							
	Fair value assets				Fair value liabilities			
	Trading HK\$m	Hedging HK\$m	Not qualified for hedge accounting HK\$m	Total HK\$m	Trading HK\$m	Hedging HK\$m	Not qualified for hedge accounting HK\$m	Total HK\$m
Exchange rate contracts								
Spot, forwards and futures	17,257	-	-	17,257	(13,001)	-	-	(13,001)
Swaps	7,476	42	119	7,637	(2,557)	(55)	(136)	(2,748)
Foreign currency options								
- Options purchased	23	-	-	23	-	-	-	-
- Options written	-	-	-	-	(28)	-	-	(28)
	24,756	42	119	24,917	(15,586)	(55)	(136)	(15,777)
Interest rate contracts								
Futures	1	-	-	1	-	-	-	-
Swaps	2,231	3,338	24	5,593	(3,157)	(1,693)	(89)	(4,939)
	2,232	3,338	24	5,594	(3,157)	(1,693)	(89)	(4,939)
Commodity contracts	818	-	-	818	(488)	-	-	(488)
Equity contracts	10	-	-	10	(10)	-	-	(10)
Total	27,816	3,380	143	31,339	(19,241)	(1,748)	(225)	(21,214)

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 20. Derivative financial instruments (continued)

The credit risk weighted amounts of the above derivative financial instruments are as follows:

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Exchange rate contracts		
Forwards	744	462
Swaps	5,468	3,746
Foreign currency options		
– Options purchased	61	10
Interest rate contracts		
Swaps	1,363	913
Commodity contracts	9	6
Equity contracts	105	38
	<b>7,750</b>	<b>5,175</b>

The credit risk weighted amounts are calculated in accordance with the Banking (Capital) Rules. The amounts are dependent upon the status of the counterparty and the maturity characteristics of each type of contract.

There is no effect of valid bilateral netting agreement on the fair values or the credit risk weighted amounts of the derivative financial instruments.

## 21. Advances and other accounts

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Personal loans and advances	247,168	238,702
Corporate loans and advances	583,575	539,562
Advances to customers*	<b>830,743</b>	778,264
Loan impairment allowances		
– Individually assessed	(800)	(736)
– Collectively assessed	(3,320)	(2,969)
	<b>826,623</b>	774,559
Trade bills	58,644	45,180
Total	<b>885,267</b>	<b>819,739</b>

As at 30 June 2013, advances to customers included accrued interest of HK\$1,339 million (31 December 2012: HK\$1,434 million).

As at 30 June 2013 and 31 December 2012, no impairment allowance was made in respect of trade bills.

\* Included advances to customers denominated in HK dollars of HK\$549,501 million (31 December 2012: HK\$520,638 million) and US dollars equivalent to HK\$189,156 million (31 December 2012: HK\$177,027 million).

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 22. Investment in securities

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
<b>(a) Available-for-sale securities</b>		
Debt securities, at fair value		
– Listed in Hong Kong	28,301	20,252
– Listed outside Hong Kong	128,154	110,594
	156,455	130,846
– Unlisted	179,371	247,410
	335,826	378,256
Certificates of deposit, at fair value		
– Listed in Hong Kong	501	–
– Listed outside Hong Kong	1,078	1,375
	1,579	1,375
– Unlisted	73,422	71,466
	75,001	72,841
Equity securities, at fair value		
– Listed in Hong Kong	2,383	2,592
– Unlisted	1,231	1,043
	3,614	3,635
	414,441	454,732
<b>(b) Held-to-maturity securities</b>		
Debt securities, at amortised cost		
– Listed in Hong Kong	710	948
– Listed outside Hong Kong	5,317	7,807
	6,027	8,755
– Unlisted	3,782	8,778
	9,809	17,533
Certificates of deposit, at amortised cost		
– Unlisted	310	874
	10,119	18,407
Impairment allowances	(8)	(9)
	10,111	18,398
<b>(c) Loans and receivables</b>		
Unlisted, at amortised cost	13,018	9,234
<b>Total</b>	<b>437,570</b>	<b>482,364</b>
Market value of listed held-to-maturity securities	6,174	8,983

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 22. Investment in securities (continued)

Investment in securities is analysed by type of issuer as follows:

	At 30 June 2013			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Sovereigns	66,180	2,305	–	68,485
Public sector entities*	45,242	321	–	45,563
Banks and other financial institutions	229,715	6,263	11,320	247,298
Corporate entities	73,304	1,222	1,698	76,224
	<b>414,441</b>	<b>10,111</b>	<b>13,018</b>	<b>437,570</b>

	At 31 December 2012			
	Available-for-sale securities	Held-to-maturity securities	Loans and receivables	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Sovereigns	152,583	3,208	–	155,791
Public sector entities*	39,913	1,278	–	41,191
Banks and other financial institutions	211,561	12,115	8,077	231,753
Corporate entities	50,675	1,797	1,157	53,629
	<b>454,732</b>	<b>18,398</b>	<b>9,234</b>	<b>482,364</b>

\* Included available-for-sale securities of HK\$24,499 million (31 December 2012: HK\$20,974 million) and held-to-maturity securities of HK\$241 million (31 December 2012: HK\$248 million) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

Available-for-sale and held-to-maturity securities are analysed as follows:

	Available-for-sale securities		Held-to-maturity securities	
	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Treasury bills	40,548	115,637	568	885
Certificates of deposit	75,001	72,841	310	874
Others	298,892	266,254	9,233	16,639
	<b>414,441</b>	<b>454,732</b>	<b>10,111</b>	<b>18,398</b>

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 23. Investment properties

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
At 1 January	14,364	12,441
Additions	–	2
Disposals	–	(62)
Fair value gains	203	1,885
Reclassification from properties, plant and equipment (Note 24)	5	98
At period/year end	<b>14,572</b>	14,364

## 24. Properties, plant and equipment

	Premises HK\$'m	Equipment, fixtures and fittings HK\$'m	Total HK\$'m
Net book value at 1 January 2013	46,178	2,565	48,743
Additions	53	199	252
Disposals	(1)	(2)	(3)
Revaluation	1,494	–	1,494
Depreciation for the period (Note 11)	(469)	(341)	(810)
Reclassification to investment properties (Note 23)	(5)	–	(5)
Exchange difference	8	5	13
Net book value at 30 June 2013	<b>47,258</b>	<b>2,426</b>	<b>49,684</b>
At 30 June 2013			
Cost or valuation	47,258	7,842	55,100
Accumulated depreciation and impairment	–	(5,416)	(5,416)
Net book value at 30 June 2013	<b>47,258</b>	<b>2,426</b>	<b>49,684</b>
Net book value at 1 January 2012	37,049	2,601	39,650
Additions	358	687	1,045
Disposals	(147)	(9)	(156)
Revaluation	9,792	–	9,792
Depreciation for the year	(778)	(715)	(1,493)
Reclassification to investment properties (Note 23)	(98)	–	(98)
Exchange difference	2	1	3
Net book value at 31 December 2012	46,178	2,565	48,743
At 31 December 2012			
Cost or valuation	46,178	7,793	53,971
Accumulated depreciation and impairment	–	(5,228)	(5,228)
Net book value at 31 December 2012	46,178	2,565	48,743

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 24. Properties, plant and equipment (continued)

The analysis of cost or valuation of the above assets is as follows:

	Premises HK\$'m	Equipment, fixtures and fittings HK\$'m	Total HK\$'m
At 30 June 2013			
At cost	–	7,842	7,842
At valuation	47,258	–	47,258
	<b>47,258</b>	<b>7,842</b>	<b>55,100</b>
At 31 December 2012			
At cost	–	7,793	7,793
At valuation	46,178	–	46,178
	<b>46,178</b>	<b>7,793</b>	<b>53,971</b>

## 25. Other assets

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Repossessed assets	45	18
Precious metals	4,840	6,610
Reinsurance assets	20,424	14,671
Accounts receivable and prepayments	14,635	15,532
	<b>39,944</b>	<b>36,831</b>

## 26. Financial liabilities at fair value through profit or loss

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Trading liabilities		
– Short positions in Exchange Fund Bills and Notes	14,548	17,331
Financial liabilities designated at fair value through profit or loss		
– Structured deposits (Note 27)	4,534	2,841
	<b>19,082</b>	<b>20,172</b>

The carrying amount of financial liabilities designated at fair value through profit or loss as at 30 June 2013 is less than the amount that the Group would be contractually required to pay at maturity to the holders by HK\$4 million (the carrying amount of financial liabilities designated at fair value through profit or loss as at 31 December 2012 is more than the amount that the Group would be contractually required to pay at maturity to the holders by HK\$1 million). The amount of change in the fair values of financial liabilities at fair value through profit or loss, during the period and cumulatively, attributable to changes in own credit risk is insignificant.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 27. Deposits from customers

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Current, savings and other deposit accounts (per balance sheet)	1,259,756	1,226,290
Structured deposits reported as financial liabilities at fair value through profit or loss (Note 26)	4,534	2,841
	<b>1,264,290</b>	<b>1,229,131</b>
Analysed by:		
Demand deposits and current accounts		
– corporate	78,676	76,742
– personal	20,992	20,553
	<b>99,668</b>	<b>97,295</b>
Savings deposits		
– corporate	183,410	202,846
– personal	381,075	400,719
	<b>564,485</b>	<b>603,565</b>
Time, call and notice deposits		
– corporate	364,994	298,902
– personal	235,143	229,369
	<b>600,137</b>	<b>528,271</b>
	<b>1,264,290</b>	<b>1,229,131</b>

## 28. Debt securities in issue at amortised cost

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Senior notes under the Medium Term Note Programme	5,762	5,919
Other debt securities	4	4
	<b>5,766</b>	<b>5,923</b>

## 29. Other accounts and provisions

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Other accounts payable	47,768	47,639
Provisions	335	344
	<b>48,103</b>	<b>47,983</b>

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 30. Assets pledged as security

As at 30 June 2013, liabilities of the Group amounting to HK\$16,817 million (31 December 2012: HK\$18,029 million) were secured by assets deposited with central depositories to facilitate settlement operations. In addition, the liabilities of the Group amounting to HK\$92 million (31 December 2012: HK\$438 million) were secured by debt securities and bills related to sale and repurchase arrangements. The amount of assets pledged by the Group to secure these liabilities was HK\$16,957 million (31 December 2012: HK\$18,596 million) mainly included in "Trading securities", "Available-for-sale securities" and "Trade bills".

## 31. Deferred taxation

Deferred tax is recognised in respect of the temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in this interim financial information in accordance with HKAS 12 "Income Taxes".

The major components of deferred tax (assets)/liabilities recorded in the balance sheet, and the movements during the first half of 2013 and the year ended 31 December 2012 are as follows:

	At 30 June 2013					
	Accelerated tax depreciation	Property revaluation	Losses	Impairment allowance	Other temporary differences	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
At 1 January 2013	564	6,772	(144)	(492)	617	7,317
(Credited)/charged to income statement (Note 14)	(14)	(50)	1	(72)	15	(120)
Charged/(credited) to other comprehensive income	–	236	–	–	(906)	(670)
Exchange difference	–	1	–	(1)	(1)	(1)
At 30 June 2013	550	6,959	(143)	(565)	(275)	6,526

	At 31 December 2012					
	Accelerated tax depreciation	Property revaluation	Losses	Impairment allowance	Other temporary differences	Total
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
At 1 January 2012	547	5,299	(131)	(451)	(109)	5,155
Charged/(credited) to income statement	17	(128)	(13)	(41)	(4)	(169)
Charged to other comprehensive income	–	1,601	–	–	730	2,331
At 31 December 2012	564	6,772	(144)	(492)	617	7,317



# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 31. Deferred taxation (continued)

Deferred tax assets and liabilities are offset on an individual entity basis when there is a legal right to set off current tax assets against current tax liabilities and when the deferred taxation relates to the same authority. The following amounts, determined after appropriate offsetting, are shown in the balance sheet:

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Deferred tax assets	(217)	(89)
Deferred tax liabilities	6,743	7,406
	<b>6,526</b>	<b>7,317</b>

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Deferred tax assets to be recovered after more than twelve months	(167)	(154)
Deferred tax liabilities to be settled after more than twelve months	6,975	6,847
	<b>6,808</b>	<b>6,693</b>

As at 30 June 2013, the Group has not recognised deferred tax assets in respect of tax losses amounting to HK\$126 million (31 December 2012: HK\$718 million). These tax losses do not expire under the current tax legislation.

## 32. Insurance contract liabilities

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
At 1 January	53,937	47,220
Benefits paid	(4,222)	(7,169)
Claims incurred and movement in liabilities	10,201	13,886
At period/year end	<b>59,916</b>	<b>53,937</b>

The insurance contract liabilities that are covered by reinsurance arrangements amounted to HK\$20,398 million (31 December 2012: HK\$14,644 million) and the associated reinsurance assets of HK\$20,424 million (31 December 2012: HK\$14,671 million) are included in "Other assets" (Note 25).

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 33. Subordinated liabilities

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
<b>Subordinated loans, at amortised cost</b> EUR660m*	–	6,749
<b>Subordinated notes, at amortised cost with fair value hedge adjustment</b> USD2,500m**	<b>20,577</b>	22,006
Total	<b>20,577</b>	28,755

In 2008, BOCHK obtained floating-rate subordinated loans from BOC, the intermediate holding company of the Group. The subordinated loans are repayable prior to maturity after the first 5-year tenure at the option of the borrower. During the period, HKMA has approved BOCHK to early repay the subordinated loans.

In 2010, BOCHK issued listed subordinated notes with an aggregate amount of USD2,500 million.

Amounts qualified as Tier 2 capital instruments/supplementary capital for regulatory purposes are shown in Note 3.5(B).

\* Interest rate at 6-month EURIBOR plus 0.85% for the first 5 years, 6-month EURIBOR plus 1.35% for the remaining tenure payable semi-annually, due June 2018. It has been fully repaid during the period.

\*\* Interest rate at 5.55% per annum payable semi-annually, due February 2020.

## 34. Share capital

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Authorised: 20,000,000,000 ordinary shares of HK\$5 each	<b>100,000</b>	100,000
Issued and fully paid: 10,572,780,266 ordinary shares of HK\$5 each	<b>52,864</b>	52,864

## 35. Reserves

The Group's reserves and the movements therein for the current and prior periods are presented in the condensed consolidated statement of changes in equity on pages 42 to 43.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 36. Notes to condensed consolidated cash flow statement

### (a) Reconciliation of operating profit to operating cash outflow before taxation

	Half-year ended 30 June 2013 HK\$'m	Half-year ended 30 June 2012 HK\$'m
Operating profit	13,728	12,666
Depreciation	810	722
Net charge of impairment allowances	371	108
Unwind of discount on impairment allowances	(9)	(4)
Advances written off net of recoveries	46	59
Change in subordinated liabilities	(1,231)	398
Change in balances with banks and other financial institutions with original maturity over three months	1,872	(8,875)
Change in placements with banks and other financial institutions with original maturity over three months	12,706	590
Change in financial assets at fair value through profit or loss	(681)	142
Change in derivative financial instruments	(337)	(380)
Change in advances and other accounts	(65,943)	(30,841)
Change in investment in securities	(1,160)	(24,129)
Change in other assets	(3,117)	(9,375)
Change in deposits and balances from banks and other financial institutions	(34,539)	(122,649)
Change in financial liabilities at fair value through profit or loss	(1,090)	6,986
Change in deposits from customers	33,466	36,906
Change in debt securities in issue at amortised cost	(157)	(76)
Change in other accounts and provisions	120	1,230
Change in insurance contract liabilities	5,979	4,565
Effect of changes in exchange rates	2,641	2,724
Operating cash outflow before taxation	<b>(36,525)</b>	<b>(129,233)</b>
Cash flows from operating activities included:		
– Interest received	18,077	17,165
– Interest paid	5,148	4,822
– Dividend received	75	65

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 36. Notes to condensed consolidated cash flow statement (continued)

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

	At 30 June 2013 HK\$'m	At 30 June 2012 HK\$'m
Cash and balances with banks and other financial institutions with original maturity within three months	164,885	132,524
Placements with banks and other financial institutions with original maturity within three months	9,344	22,799
Treasury bills with original maturity within three months	13,032	44,513
Certificates of deposit with original maturity within three months	847	1,210
	<b>188,108</b>	<b>201,046</b>

## 37. Contingent liabilities and commitments

The following is a summary of the contractual amounts of each significant class of contingent liability and commitment and the aggregate credit risk weighted amount:

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Direct credit substitutes	17,339	14,168
Transaction-related contingencies	16,715	11,681
Trade-related contingencies	47,419	45,412
Commitments that are unconditionally cancellable without prior notice	360,207	320,777
Other commitments with an original maturity of		
– up to one year	13,623	18,988
– over one year	57,708	52,743
	<b>513,011</b>	<b>463,769</b>
Credit risk weighted amount	<b>57,931</b>	<b>59,008</b>

The credit risk weighted amount is calculated in accordance with the Banking (Capital) Rules. The amount is dependent upon the status of the counterparty and the maturity characteristics of each type of contract.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 38. Capital commitments

The Group has the following outstanding capital commitments not provided for in this interim financial information:

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Authorised and contracted for but not provided for	456	325
Authorised but not contracted for	20	1
	<b>476</b>	<b>326</b>

The above capital commitments mainly relate to commitments to purchase computer equipment and software, and to renovate the Group's premises.

## 39. Operating lease commitments

### (a) *As lessee*

The Group has commitments to make the following future minimum lease payments under non-cancellable operating leases:

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Land and buildings		
– not later than one year	709	697
– later than one year but not later than five years	1,240	1,209
– later than five years	399	446
	<b>2,348</b>	<b>2,352</b>

Certain non-cancellable operating leases included in the table above were subject to renegotiation and rent adjustment with reference to market rates prevailing at specified agreed dates or according to the special conditions as stipulated in the leases.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 39. Operating lease commitments (continued)

### (b) As lessor

The Group has contracted with tenants for the following future minimum lease receivables under non-cancellable operating leases:

	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
Land and buildings		
– not later than one year	371	410
– later than one year but not later than five years	391	272
	<b>762</b>	<b>682</b>

The Group leases its investment properties (Note 23) under operating lease arrangements, with leases typically for a period from one to three years. The terms of the leases generally require the tenants to pay security deposits and provide for rent adjustments according to the prevailing market conditions at the expiration of the lease.

## 40. Segmental reporting

The Group manages the business mainly from a business segment perspective and over 90% of the Group's revenues, profits before tax and assets are derived from Hong Kong. Currently, four operating segments are identified which are Personal Banking, Corporate Banking, Treasury and Insurance. The classification of the Group's operating segments is based on customer segment and product type, which is aligned with the RPC (relationship, product and channel) management model of the Group.

Both Personal Banking and Corporate Banking provide general banking services including various deposit products, overdrafts, loans, credit cards, trade related products and other credit facilities, investment and insurance products, and foreign currency and derivative products, etc. Personal Banking mainly serves retail customers while Corporate Banking mainly deals with corporate customers. Treasury manages the funding and liquidity, and the interest rate and foreign exchange positions of the Group in addition to proprietary trades. The Insurance segment represents business relating to life insurance products, including traditional and unit-linked individual life insurance and group life insurance products. "Others" mainly represents Group's holdings of premises, investment properties, equity investments and interests in associates and a joint venture.

Measurement of segment assets, liabilities, income, expenses, results and capital expenditure is based on the Group's accounting policies. The segment information includes items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Inter-segment funding is charged according to the internal funds transfer pricing mechanism of the Group, which is primarily based on market rates with the consideration of specific features of the product.

As the Group derives a majority of revenue from interest and the senior management relies primarily on net interest income in managing the business, interest income and expense for all reportable segments are presented on a net basis. Under the same consideration, insurance premium income and insurance benefits and claims are also presented on a net basis.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 40. Segmental reporting (continued)

	Personal Banking HK\$'m	Corporate Banking HK\$'m	Treasury HK\$'m	Insurance HK\$'m	Others HK\$'m	Subtotal HK\$'m	Eliminations HK\$'m	Consolidated HK\$'m
<b>Half-year ended 30 June 2013</b>								
Net interest income/(expense)								
– external	849	4,982	6,591	908	1	13,331	–	13,331
– inter-segment	2,846	759	(3,396)	5	(214)	–	–	–
	3,695	5,741	3,195	913	(213)	13,331	–	13,331
Net fee and commission income/(expense)	2,797	1,863	55	(28)	136	4,823	(142)	4,681
Net insurance premium income	–	–	–	4,979	–	4,979	(8)	4,971
Net trading gain/(loss)	336	161	1,136	(163)	(35)	1,435	6	1,441
Net loss on financial instruments designated at fair value through profit or loss	–	–	(34)	(486)	–	(520)	–	(520)
Net gain on other financial assets	–	5	97	4	–	106	–	106
Other operating income	12	1	–	3	826	842	(527)	315
<b>Total operating income</b>	<b>6,840</b>	<b>7,771</b>	<b>4,449</b>	<b>5,222</b>	<b>714</b>	<b>24,996</b>	<b>(671)</b>	<b>24,325</b>
Net insurance benefits and claims	–	–	–	(4,534)	–	(4,534)	–	(4,534)
<b>Net operating income before impairment allowances</b>	<b>6,840</b>	<b>7,771</b>	<b>4,449</b>	<b>688</b>	<b>714</b>	<b>20,462</b>	<b>(671)</b>	<b>19,791</b>
Net (charge)/reversal of impairment allowances	(115)	(257)	1	–	–	(371)	–	(371)
<b>Net operating income</b>	<b>6,725</b>	<b>7,514</b>	<b>4,450</b>	<b>688</b>	<b>714</b>	<b>20,091</b>	<b>(671)</b>	<b>19,420</b>
Operating expenses	(3,153)	(1,641)	(532)	(124)	(913)	(6,363)	671	(5,692)
<b>Operating profit/(loss)</b>	<b>3,572</b>	<b>5,873</b>	<b>3,918</b>	<b>564</b>	<b>(199)</b>	<b>13,728</b>	<b>–</b>	<b>13,728</b>
Net gain from disposal of/fair value adjustments on investment properties	–	–	–	–	203	203	–	203
Net gain from disposal/revaluation of properties, plant and equipment	–	–	–	–	4	4	–	4
Share of profits less losses after tax of associates and a joint venture	–	–	–	–	13	13	–	13
<b>Profit before taxation</b>	<b>3,572</b>	<b>5,873</b>	<b>3,918</b>	<b>564</b>	<b>21</b>	<b>13,948</b>	<b>–</b>	<b>13,948</b>
<b>At 30 June 2013</b>								
<b>Assets</b>								
Segment assets	276,028	630,301	799,027	73,174	67,027	1,845,557	(11,166)	1,834,391
Interests in associates and a joint venture	–	–	–	–	270	270	–	270
	276,028	630,301	799,027	73,174	67,297	1,845,827	(11,166)	1,834,661
<b>Liabilities</b>								
Segment liabilities	702,005	597,602	309,407	69,231	11,880	1,690,125	(11,166)	1,678,959
<b>Half-year ended 30 June 2013</b>								
<b>Other information</b>								
Capital expenditure	6	1	–	–	245	252	–	252
Depreciation	166	89	38	5	512	810	–	810
Amortisation of securities	–	–	298	134	–	432	–	432

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 40. Segmental reporting (continued)

	Personal Banking HK\$'m	Corporate Banking HK\$'m	Treasury HK\$'m	Insurance HK\$'m	Others HK\$'m	Subtotal HK\$'m	Eliminations HK\$'m	Consolidated HK\$'m
(Restated)								
<b>Half-year ended 30 June 2012</b>								
Net interest income/(expense)								
– external	426	4,408	6,897	883	5	12,619	–	12,619
– inter-segment	2,752	306	(2,800)	–	(258)	–	–	–
	3,178	4,714	4,097	883	(253)	12,619	–	12,619
Net fee and commission income	2,115	1,755	72	77	68	4,087	(54)	4,033
Net insurance premium income	–	–	–	2,838	–	2,838	(7)	2,831
Net trading gain/(loss)	274	177	744	230	(17)	1,408	–	1,408
Net gain on financial instruments designated at fair value through profit or loss	–	–	24	159	–	183	3	186
Net gain on other financial assets	–	1	354	122	–	477	–	477
Other operating income	20	–	–	10	744	774	(483)	291
<b>Total operating income</b>	5,587	6,647	5,291	4,319	542	22,386	(541)	21,845
Net insurance benefits and claims	–	–	–	(3,749)	–	(3,749)	–	(3,749)
<b>Net operating income before impairment allowances</b>	5,587	6,647	5,291	570	542	18,637	(541)	18,096
Net (charge)/reversal of impairment allowances	(77)	(15)	7	(23)	–	(108)	–	(108)
<b>Net operating income</b>	5,510	6,632	5,298	547	542	18,529	(541)	17,988
Operating expenses	(2,745)	(1,489)	(596)	(96)	(937)	(5,863)	541	(5,322)
<b>Operating profit/(loss)</b>	2,765	5,143	4,702	451	(395)	12,666	–	12,666
Net gain from disposal of/fair value adjustments on investment properties	–	–	–	–	1,030	1,030	–	1,030
Net (loss)/gain from disposal/revaluation of properties, plant and equipment	(2)	(1)	–	–	119	116	–	116
Share of profits less losses after tax of associates and a joint venture	–	–	–	–	13	13	–	13
<b>Profit before taxation</b>	2,763	5,142	4,702	451	767	13,825	–	13,825
<b>At 31 December 2012</b>								
<b>Assets</b>								
Segment assets	266,839	573,803	870,488	66,150	65,760	1,843,040	(12,536)	1,830,504
Interests in associates and a joint venture	–	–	–	–	259	259	–	259
	266,839	573,803	870,488	66,150	66,019	1,843,299	(12,536)	1,830,763
<b>Liabilities</b>								
Segment liabilities	716,696	551,508	346,561	61,904	11,556	1,688,225	(12,536)	1,675,689
<b>Half-year ended 30 June 2012</b>								
<b>Other information</b>								
Capital expenditure	15	3	–	5	285	308	–	308
Depreciation	159	83	45	3	432	722	–	722
Amortisation of securities	–	–	48	49	–	97	–	97

Certain comparative amounts of operating expenses have been reclassified to net fee and commission income to conform with current period's presentation.



# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 41. Offsetting financial instruments

The following tables present details of financial instruments subject to offsetting, enforceable master netting arrangements and similar agreements.

	At 30 June 2013					
	Gross amounts of recognised financial assets HK\$'m	Gross amounts of recognised financial liabilities set off in the balance sheet HK\$'m	Net amounts of financial assets presented in the balance sheet HK\$'m	Related amounts not set off in the balance sheet		Net amount HK\$'m
			Financial instruments HK\$'m	Cash collateral received HK\$'m		
<b>Assets</b>						
Derivative financial instruments	15,017	–	15,017	(7,254)	(1,966)	5,797
Other assets	11,639	(9,212)	2,427	–	–	2,427
Total	26,656	(9,212)	17,444	(7,254)	(1,966)	8,224

	At 30 June 2013					
	Gross amounts of recognised financial liabilities HK\$'m	Gross amounts of recognised financial assets set off in the balance sheet HK\$'m	Net amounts of financial liabilities presented in the balance sheet HK\$'m	Related amounts not set off in the balance sheet		Net amount HK\$'m
			Financial instruments HK\$'m	Cash collateral pledged HK\$'m		
<b>Liabilities</b>						
Derivative financial instruments	9,414	–	9,414	(7,254)	–	2,160
Other liabilities	9,754	(9,212)	542	–	–	542
Total	19,168	(9,212)	9,956	(7,254)	–	2,702

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 41. Offsetting financial instruments (continued)

	At 31 December 2012					
	Gross amounts of recognised financial assets HK\$m	Gross amounts of recognised financial liabilities set off in the balance sheet HK\$m	Net amounts of financial assets presented in the balance sheet HK\$m	Related amounts not set off in the balance sheet		Net amount HK\$m
			Financial instruments HK\$m	Cash collateral received HK\$m		
<b>Assets</b>						
Derivative financial instruments	13,542	–	13,542	(6,292)	(3,245)	4,005
Other assets	15,452	(9,939)	5,513	–	–	5,513
<b>Total</b>	<b>28,994</b>	<b>(9,939)</b>	<b>19,055</b>	<b>(6,292)</b>	<b>(3,245)</b>	<b>9,518</b>

	At 31 December 2012					
	Gross amounts of recognised financial liabilities HK\$m	Gross amounts of recognised financial assets set off in the balance sheet HK\$m	Net amounts of financial liabilities presented in the balance sheet HK\$m	Related amounts not set off in the balance sheet		Net amount HK\$m
			Financial instruments HK\$m	Cash collateral pledged HK\$m		
<b>Liabilities</b>						
Derivative financial instruments	8,182	–	8,182	(6,292)	–	1,890
Other liabilities	10,456	(9,939)	517	–	–	517
<b>Total</b>	<b>18,638</b>	<b>(9,939)</b>	<b>8,699</b>	<b>(6,292)</b>	<b>–</b>	<b>2,407</b>

For master netting agreements of OTC derivative transactions entered into by the Group, related amounts with the same counterparty can be offset if an event of default or other predetermined events occur.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 42. Significant related party transactions

The Group is subject to the control of the State Council of the PRC Government through China Investment Corporation (“CIC”), its wholly-owned subsidiary Central Huijin Investment Ltd. (“Central Huijin”), and BOC in which Central Huijin has controlling equity interests.

### **(a) Transactions with the parent companies and the other companies controlled by the parent companies**

#### **General information of the parent companies:**

The Group is controlled by BOC. Central Huijin is the controlling entity of BOC, and it is a wholly-owned subsidiary of CIC which is a wholly state-owned company engaging in foreign currency investment management.

Central Huijin has controlling equity interests in certain other entities in the PRC.

The Group enters into banking and other transactions with these entities in the normal course of business which include loans, investment securities, money market and reinsurance transactions.

The majority of transactions with BOC arise from money market activities. As at 30 June 2013, the related aggregate amounts due from and to BOC of the Group are HK\$56,357 million (31 December 2012: HK\$59,739 million) and HK\$45,195 million (31 December 2012: HK\$46,429 million) respectively. The aggregate amounts of income and expenses of the Group arising from these transactions with BOC for the first half of 2013 are HK\$752 million (first half of 2012: HK\$1,238 million) and HK\$50 million (first half of 2012: HK\$59 million) respectively. Transactions with other companies controlled by BOC are not considered material.

### **(b) Transactions with government authorities, agencies, affiliates and other state controlled entities**

The Group is subject to the control of the State Council of the PRC Government through CIC and Central Huijin, which also directly and indirectly controls a significant number of entities through its government authorities, agencies, affiliates and other state controlled entities. The Group enters into banking transactions with government authorities, agencies, affiliates and other state controlled entities in the normal course of business at commercial terms.

These transactions include, but are not limited to, the following:

- lending, provision of credits and guarantees, and deposit taking;
- inter-bank balance taking and placing;
- sales, purchase, underwriting and redemption of bonds issued by other state controlled entities;
- rendering of foreign exchange, remittance and investment related services;
- provision of fiduciary activities; and
- purchase of utilities, transport, telecommunication and postage services.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 42. Significant related party transactions (continued)

### (c) Summary of transactions entered into during the ordinary course of business with associates, a joint venture and other related parties

The aggregate income/expenses and balances arising from related party transactions with associates, a joint venture and other related parties of the Group are summarised as follows:

	Half-year ended 30 June 2013		Half-year ended 30 June 2012	
	Associates and a joint venture HK\$m	Other related parties HK\$m	Associates and a joint venture HK\$m	Other related parties HK\$m
Income statement items:				
Administrative services fees received/receivable	–	4	–	4
Other expenses	21	–	–	–

	At 30 June 2013		At 31 December 2012	
	Associates and a joint venture HK\$m	Other related parties HK\$m	Associates and a joint venture HK\$m	Other related parties HK\$m
Balance sheet items:				
Deposits from customers	26	–	34	–
Other accounts and provisions	5	–	5	–

### (d) Key management personnel

Key management are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including directors, senior management and company secretary. The Group accepts deposits from and grants loans and credit facilities to key management personnel in the ordinary course of business. During both the current and prior periods, no material transaction was conducted with key management personnel of BOCHK, its holding companies and parties related to them.

The key management compensation is detailed as follows:

	Half-year ended 30 June 2013 HK\$m	Half-year ended 30 June 2012 HK\$m
Salaries and other short-term employee benefits	24	23
Post-employment benefits	1	1
	25	24

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 43. Currency concentrations

The following is a summary of the major foreign currency exposures arising from trading, non-trading and structural positions and is prepared with reference to the Completion Instructions for the prudential return “Foreign Currency Position of an Authorized Institution” issued by the HKMA. The net options position is calculated based on the basis of delta-weighted positions of all foreign exchange options contracts.

	At 30 June 2013							
	Equivalent in million of HK\$							
	US Dollars	Japanese Yen	Euro	Australian Dollars	Pound Sterling	Renminbi	Other foreign currencies	Total foreign currencies
Spot assets	505,083	1,738	14,459	24,428	3,261	397,249	13,951	960,169
Spot liabilities	(367,906)	(2,697)	(11,603)	(29,578)	(14,997)	(373,488)	(18,685)	(818,954)
Forward purchases	422,619	68,823	45,454	36,323	26,856	169,484	38,359	807,918
Forward sales	(552,448)	(68,160)	(48,123)	(30,916)	(15,172)	(187,297)	(33,597)	(935,713)
Net options position	463	-	(4)	(15)	(3)	(1,208)	(7)	(774)
Net long/(short) position	7,811	(296)	183	242	(55)	4,740	21	12,646
Net structural position	333	-	-	-	-	8,995	-	9,328

	At 31 December 2012							
	Equivalent in million of HK\$							
	US Dollars	Japanese Yen	Euro	Australian Dollars	Pound Sterling	Renminbi	Other foreign currencies	Total foreign currencies
Spot assets	480,099	81,033	17,279	24,874	4,336	374,118	17,313	999,052
Spot liabilities	(357,163)	(3,736)	(19,074)	(25,594)	(13,308)	(359,234)	(19,321)	(797,430)
Forward purchases	438,027	39,150	36,876	27,824	32,925	169,229	30,962	774,993
Forward sales	(543,759)	(116,379)	(35,207)	(27,018)	(24,226)	(184,128)	(28,746)	(959,463)
Net options position	(53)	(3)	5	(4)	8	(17)	(21)	(85)
Net long/(short) position	17,151	65	(121)	82	(265)	(32)	187	17,067
Net structural position	321	-	-	-	-	8,583	-	8,904

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 44. Cross-border claims

The information on cross-border claims discloses exposures to foreign counterparties on which the ultimate risk lies, and is derived according to the location of the counterparties after taking into account any transfer of risk. In general, such transfer of risk takes place if the claims are guaranteed by a party in a country which is different from that of the counterparty, or if the claims are on an overseas branch of a bank whose head office is located in another country. Only regions constituting 10% or more of the aggregate cross-border claims are analysed by geographical areas and disclosed as follows:

	At 30 June 2013			
	Public sector			Total HK\$'m
	Banks HK\$'m	entities* HK\$'m	Others HK\$'m	
Asia, other than Hong Kong				
– Mainland China	292,859	45,725	139,399	477,983
– Japan	7,669	5,389	549	13,607
– Others	42,495	4,525	31,025	78,045
	343,023	55,639	170,973	569,635
North America				
– United States	3,712	37,464	39,715	80,891
– Others	6,029	1,960	304	8,293
	9,741	39,424	40,019	89,184
Total	352,764	95,063	210,992	658,819

	At 31 December 2012			
	Public sector			Total HK\$'m
	Banks HK\$'m	entities* HK\$'m	Others HK\$'m	
Asia, other than Hong Kong				
– Mainland China	272,511	81,892	128,295	482,698
– Japan	7,283	81,320	158	88,761
– Others	49,874	4,410	24,687	78,971
	329,668	167,622	153,140	650,430
North America				
– United States	2,439	46,397	34,290	83,126
– Others	12,990	1,392	276	14,658
	15,429	47,789	34,566	97,784
Total	345,097	215,411	187,706	748,214

\* Included United States of HK\$11,364 million (31 December 2012: HK\$10,442 million) and other countries in North America of HK\$1,960 million (31 December 2012: HK\$1,355 million) which are eligible to be classified as public sector entities under the Banking (Capital) Rules.

# NOTES TO THE INTERIM FINANCIAL INFORMATION

## 45. Non-bank Mainland China exposures

The analysis of non-bank Mainland China exposures is based on the categories of non-bank counterparties and the type of direct exposures with reference to the HKMA return for non-bank Mainland China exposures. The Group's exposures in Mainland China arising from non-bank counterparties are summarised as follows:

	At 30 June 2013			
	On-balance sheet exposure	Off-balance sheet exposure	Total exposure	Individually assessed impairment allowances
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Mainland China entities	348,178	78,783	426,961	251
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	56,383	15,892	72,275	16
Other non-bank Mainland China exposures	27,135	1,855	28,990	56
	<b>431,696</b>	<b>96,530</b>	<b>528,226</b>	<b>323</b>

	At 31 December 2012			
	On-balance sheet exposure	Off-balance sheet exposure	Total exposure	Individually assessed impairment allowances
	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Mainland China entities	317,910	70,998	388,908	142
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	44,283	16,191	60,474	16
Other non-bank Mainland China exposures	23,213	2,600	25,813	67
	<b>385,406</b>	<b>89,789</b>	<b>475,195</b>	<b>225</b>

## 46. Compliance with HKAS 34

The unaudited interim financial information for the first half of 2013 complies with HKAS 34 "Interim Financial Reporting" issued by the HKICPA.

## 47. Statutory accounts

The information in this interim report is unaudited and does not constitute statutory accounts. The statutory accounts for the year ended 31 December 2012 have been delivered to the Registrar of Companies and the HKMA. The former auditor expressed an unqualified opinion on those statutory accounts in their report dated 26 March 2013.

# ADDITIONAL INFORMATION

## 1. Corporate information

### Board of Directors

<b>Chairman</b>	TIAN Guoli# (appointment effective from 4 June 2013)
<b>Vice Chairmen</b>	LI Lihui# HE Guangbei
<b>Directors</b>	LI Zaohang# ZHOU Zaiqun# CHEN Siqing# GAO Yingxin FUNG Victor Kwok King* KOH Beng Seng* NING Gaoning* SHAN Weijian* TUNG Savio Wai-Hok* TUNG Chee Chen* (retirement effective from 28 May 2013)

# Non-executive Directors

\* Independent Non-executive Directors

### Senior Management

<b>Chief Executive</b>	HE Guangbei
<b>Deputy Chief Executive</b>	GAO Yingxin
<b>Chief Financial Officer</b>	ZHUO Chengwen
<b>Deputy Chief Executive</b>	YEUNG Jason Chi Wai
<b>Chief Risk Officer</b>	LI Jiuzhong
<b>Chief Operating Officer</b>	LEE Alex Wing Kwai
<b>Deputy Chief Executives</b>	ZHU Yanlai (appointment effective from 15 April 2013) HUANG Hong (appointment effective from 1 July 2013) WONG David See Hong (retirement effective from 1 July 2013)

### Company Secretary

CHAN Chun Ying

### Registered Office

52nd Floor  
Bank of China Tower  
1 Garden Road  
Hong Kong

### Auditor

Ernst & Young

### Share Registrar

Computershare Hong Kong Investor Services Limited  
17M Floor  
Hopewell Centre  
183 Queen's Road East  
Wan Chai  
Hong Kong

### ADR Depositary Bank

Citibank, N.A.  
388 Greenwich Street  
14th Floor  
New York, NY 10013  
United States of America

### Credit Ratings (Long Term)

Standard & Poor's	A+
Moody's Investors Service	Aa3
Fitch Ratings	A

### Index Constituent

The Company is a constituent of the following indices:  
Hang Seng Index Series  
Hang Seng Corporate Sustainability Index Series  
MSCI Index Series  
FTSE Index Series

### Stock Codes

Ordinary shares:	
The Stock Exchange of Hong Kong Limited	2388
Reuters	2388.HK
Bloomberg	2388 HK
Level 1 ADR Programme:	
CUSIP No.	096813209
OTC Symbol	BHKLY

### Website

www.bochk.com



# ADDITIONAL INFORMATION

## 2. Dividend and closure of register of members

The Board has declared an interim dividend of HK\$0.545 per share (2012: HK\$0.545), payable on Friday, 27 September 2013 to shareholders whose names appear on the Register of Members of the Company on Thursday, 19 September 2013.

The Register of Members of the Company will be closed, for the purpose of determining shareholders' entitlement to the interim dividend, from Monday, 16 September 2013 to Thursday, 19 September 2013 (both days inclusive), during which period no transfer of shares will be registered. In order to qualify for the interim dividend, shareholders should ensure that all transfer documents, accompanied by the relevant share certificates, are lodged with the Company's Share Registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong, not later than 4:30 p.m. on Friday, 13 September 2013. Shares of the Company will be traded ex-dividend as from Thursday, 12 September 2013.

## 3. Substantial interests in share capital

The register maintained by the Company pursuant to section 336 of the SFO recorded that, as at 30 June 2013, the following parties had the following interests (as defined in the SFO) in the Company set opposite their respective names:

Name of Corporation	No. of shares of HK\$5.00 each in the Company	% of total issued shares
Central Huijin	6,984,274,213	66.06%
BOC	6,984,274,213	66.06%
BOCHKG	6,984,175,056	66.06%
BOC (BVI)	6,984,175,056	66.06%

Notes:

1. Following the reorganisation of BOC in August 2004, Central Huijin holds the controlling equity capital of BOC on behalf of the State. Accordingly, for the purpose of the SFO, Central Huijin is deemed to have the same interests in the Company as BOC.
2. BOC holds the entire issued share capital of BOCHKG, which in turn holds the entire issued share capital of BOC (BVI). Accordingly, BOC and BOCHKG are deemed to have the same interests in the Company as BOC (BVI) for the purpose of the SFO. BOC (BVI) beneficially held 6,984,175,056 shares of the Company.
3. BOC holds the entire issued share capital of BOCI, which in turn holds the entire issued share capital of BOCI Asia Limited and BOCI Financial Products Limited. Accordingly, BOC is deemed to have the same interests in the Company as BOCI Asia Limited and BOCI Financial Products Limited for the purpose of the SFO. BOCI Asia Limited had an interest in 24,479 shares of the Company and an interest in 72,000 shares held under physically settled equity derivatives while BOCI Financial Products Limited had an interest in 2,678 shares of the Company.

All the interests stated above represented long positions. Save as disclosed above, as at 30 June 2013, BOCI Financial Products Limited had an interest in 143,522 shares which represented short positions. BOC and Central Huijin are deemed to be interested in such amount of shares for the purpose of the SFO. Save as disclosed, no other interests or short positions were recorded in the register maintained by the Company under section 336 of the SFO as at 30 June 2013.

# ADDITIONAL INFORMATION

## 4. Directors' and Chief Executive's interests in shares, underlying shares and debentures

As at 30 June 2013, the Directors, the Chief Executive and their respective associates had the following interests in the shares and underlying shares of the Company, as recorded in the register required to be kept by the Company pursuant to section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers:

Name of Director	Number of shares/underlying shares held				Total	% of the issued share capital
	Personal interests	Family interests	Corporate interests	Other interests		
HE Guangbei	100,000	–	–	–	100,000	0.0009%
NING Gaoning	–	25,000 <sup>Note</sup>	–	–	25,000	0.0002%
Total	100,000	25,000	–	–	125,000	0.0011%

Note: Such shares are held by the spouse of Mr. NING Gaoning.

Save as disclosed above, as at 30 June 2013, none of the Directors or the Chief Executive of the Company or their respective associates had any interests or short positions in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be kept by the Company pursuant to section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers.

## 5. Changes of information in respect of Directors

In accordance with Rule 13.51B(1) of the Listing Rules, the changes in information required to be disclosed by Directors pursuant to paragraphs (a) to (e) and (g) of Rule 13.51(2) of the Listing Rules after the publication of the Company's Annual Report 2012 on 26 March 2013 up to 29 August 2013 (being the approval date of this Interim Report) are set out below:

### ***Experience including other directorships and major appointments***

- (a) Mr. TIAN Guoli has been appointed as the Chairman and Non-executive Director of the Company and BOCHK with effect from 4 June 2013. On the same day, Mr. TIAN has also been appointed as a Director of BOC (BVI) and BOCHKG.
- (b) Mr. HE Guangbei, Chief Executive of the Company, has been appointed as a Deputy Officer of the Finance Committee of the Guangdong's Association for promotion of cooperation between Guangdong, Hong Kong & Macao with effect from 28 June 2013.
- (c) Dr. FUNG Victor Kwok King, an Independent Non-executive Director of the Company, completed his term as the Honorary Chairman of the International Chamber of Commerce ("ICC") on 30 June 2013 and continued to chair ICC World Trade Agenda Initiative. Also, Dr. FUNG ceased as a member of the WTO Panel on Defining the Future of Trade when his term expired in April 2013.
- (d) Mr. TUNG Chee Chen retired as an Independent Non-executive Director and ceased to be the Chairman of Nomination and Remuneration Committee and a member of Audit Committee of the Company on 28 May 2013. Following Mr. TUNG Chee Chen's retirement, Mr. TUNG Savio Wai-Hok and Mr. KOH Beng Seng, both are Independent Non-executive Directors of the Company, have been appointed as the Chairman and a member of Nomination and Remuneration Committee respectively.

# ADDITIONAL INFORMATION

## 6. Purchase, sale or redemption of the Company's shares

During the period under review, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's shares.

## 7. Audit Committee

The Audit Committee consists only of Non-executive Directors, the majority of whom are Independent Non-executive Directors. It is chaired by Independent Non-executive Director Mr. SHAN Weijian. Other members include Mr. ZHOU Zaiqun, Dr. FUNG Victor Kwok King, Mr. KOH Beng Seng, Mr. TUNG Chee Chen<sup>Note</sup> and Mr. TUNG Savio Wai-Hok.

Based on the principle of independence, the Audit Committee assists the Board in monitoring the financial reports, internal control, internal audit and external audit of the Group.

At the request of the Audit Committee of the Company, the Group's external auditor has carried out a review of the interim financial information in accordance with the Hong Kong Standard on Review Engagements 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the HKICPA. The Audit Committee has reviewed with management the accounting principles and practices adopted by the Group and discussed auditing, internal control and financial reporting matters including the review of the unaudited interim financial reports.

Note: Mr. TUNG Chee Chen retired as an Independent Non-executive Director and ceased to be a member of the Audit Committee with effect from 28 May 2013. The Independent Non-executive Directors nevertheless make up the majority of the Committee members, and the independence of the Committee is not affected by the relevant change.

## 8. Compliance with the "Corporate Governance Code and Corporate Governance Report"

The Company is committed to embracing and enhancing good corporate governance principles and practices. During the period under review, the Company has been in full compliance with all code provisions of the Corporate Governance Code and Corporate Governance Report as contained in Appendix 14 of the Listing Rules (the "Corporate Governance Code"). The Company has also complied with nearly all the recommended best practices set out in the Corporate Governance Code throughout the period. For further details, please refer to the section titled "Corporate Governance" contained in the Annual Report 2012 of the Company.

## 9. Compliance with the Codes for Securities Transactions by Directors

The Company has established and implemented the "Code for Securities Transactions by Directors" (the "Company's Code") to govern securities transactions by Directors. Terms of the Company's Code are more stringent than the mandatory standards set out in the "Model Code for Securities Transactions by Directors of Listed Issuers" contained in Appendix 10 of the Listing Rules (the "Model Code"). Apart from the securities of the Company, the Company's Code also applies to the Director's dealings in the securities of BOC which has been listing on the Hong Kong Stock Exchange in June 2006. In this connection, the Company had made specific enquiry of all Directors, who confirmed that they had complied with the standards set out in both the Company's Code and the Model Code throughout the period under review. The Company had undertaken a review of the Company's Code in March 2012. There were no fundamental amendments to the Company's Code and changes were in adaptive nature mainly to refine the Company's Code.

# ADDITIONAL INFORMATION

## 10. Compliance with the Banking (Disclosure) Rules and the Listing Rules

The unaudited interim report complies with the applicable requirements set out in the Banking (Disclosure) Rules under the Banking Ordinance and the applicable disclosure provisions of the Listing Rules.

## 11. Interim Report

This Interim Report is available in both English and Chinese. A copy prepared in the language different from that in which you have received is available by writing to the Company's Share Registrar, Computershare Hong Kong Investor Services Limited, at 17M Floor, Hopewell Centre, 183 Queen's Road East, Wan Chai, Hong Kong or email to [bochk.ecom@computershare.com.hk](mailto:bochk.ecom@computershare.com.hk).

This Interim Report is also available (in both English and Chinese) on the Company's website at [www.bochk.com](http://www.bochk.com) and the Stock Exchange's website at [www.hkexnews.hk](http://www.hkexnews.hk). You are encouraged to access the Interim Report and other corporate communications of the Company through these websites in lieu of receiving printed copies to help protect the environment. We believe that it is also the most efficient and convenient method of communication with our shareholders.

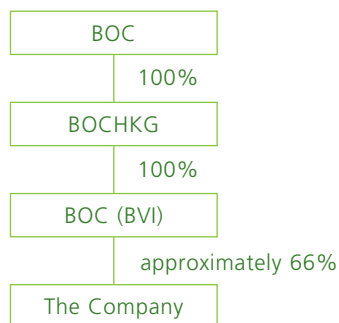
If you have any queries about how to obtain copies of this Interim Report or how to access those corporate communications on the Company's website, please call the Company's hotline at (852) 2846 2700.

## 12. Reconciliation between HKFRSs vs IFRS/CAS

The Company understands that BOC, an intermediate holding company as well as controlling shareholder of the Company, will prepare and disclose consolidated financial information in accordance with IFRS and CAS for which the Company and its subsidiaries will form part of the interim financial information. CAS is the new set of PRC accounting standards that has been effective for annual periods beginning on or after 1 January 2007 for companies publicly listed in PRC. The requirements of CAS have substantially converged with HKFRSs and IFRS.

The consolidated financial information of "BOC Hong Kong Group" for the periods disclosed by BOC in its interim financial information is not the same as the consolidated financial information of the Group for the periods published by the Company pursuant to applicable laws and regulations in Hong Kong. There are two reasons for this.

First, the definitions of "BOC Hong Kong Group" (as adopted by BOC for the purpose of its own financial disclosure) and "Group" (as adopted by the Company in preparing and presenting its consolidated financial information) are different: "BOC Hong Kong Group" refers to BOCHKG and its subsidiaries, whereas "Group" refers to the Company and its subsidiaries (see the below organisation chart). Though there is difference in definitions between "BOC Hong Kong Group" and "Group", their financial results for the periods presented are substantially the same. This is because BOCHKG and BOC (BVI) are holding companies only and have no substantive operations of their own.



## 12. Reconciliation between HKFRSs vs IFRS/CAS (continued)

Second, the Group has prepared its interim financial information in accordance with HK GAAP prior to 1 January 2005 and as from 1 January 2005 onwards in accordance with HKFRSs; whereas the consolidated financial information reported to BOC is prepared in accordance with IFRS and CAS respectively. Despite the fact that HKFRSs have converged with IFRS, there is a timing difference in the initial adoption of HKFRSs and IFRS by the Group and by BOC respectively.

The Board considers that the best way to ensure that shareholders and the investing public understand the material differences between the consolidated financial information of the Group published by the Company on the one hand, and the consolidated financial information of BOC Hong Kong Group disclosed by BOC in its interim financial information on the other hand, is to present reconciliations of the profit after tax/net assets of the Group prepared under HKFRSs to the profit after tax/net assets of the Group prepared under IFRS and CAS respectively for the periods presented.

The major differences between HKFRSs and IFRS/CAS, which arise from the difference in measurement basis in IFRS or CAS and the timing difference in the initial adoption of HKFRSs and IFRS relate to the following:

- restatement of carrying value of bank premises; and
- deferred taxation impact arising from the above different measurement basis.

### (a) *Restatement of carrying value of bank premises*

The Company has elected for a revaluation model rather than cost model to account for bank premises and investment properties under HKFRSs. On the contrary, BOC has elected for the cost model for bank premises and revaluation model for investment properties under IFRS and CAS. Therefore, adjustments have been made to the carrying value of bank premises as well as to re-calculate the depreciation charge and disposal gain/loss under IFRS and CAS.

### (b) *Deferred tax adjustments*

These represent the deferred tax effect of the aforesaid adjustments.

The difference in classification and measurement of certain investment securities under HKFRSs and IFRS due to the different timing in first adoption of HKFRSs and IFRS by the Group and BOC are vanished as those investment securities were all matured before 31 December 2012.

# ADDITIONAL INFORMATION

## 12. Reconciliation between HKFRSs vs IFRS/CAS (continued)

### *Profit after tax/net assets reconciliation*

#### HKFRSs vs IFRS/CAS

	Profit after tax		Net assets	
	Half-year ended 30 June 2013 HK\$'m	Half-year ended 30 June 2012 HK\$'m	At 30 June 2013 HK\$'m	At 31 December 2012 HK\$'m
<b>Profit after tax/net assets of BOC Hong Kong (Holdings) Limited prepared under HKFRSs</b>	<b>11,657</b>	11,649	<b>155,702</b>	155,074
Add: IFRS/CAS adjustments				
Re-measurement of carrying value of treasury products	–	(8)	–	–
Restatement of carrying value of bank premises	<b>354</b>	343	<b>(36,265)</b>	(35,148)
Deferred tax adjustments	<b>(43)</b>	(33)	<b>5,990</b>	5,798
<b>Profit after tax/net assets of BOC Hong Kong (Holdings) Limited prepared under IFRS/CAS</b>	<b>11,968</b>	11,951	<b>125,427</b>	125,724

# INDEPENDENT REVIEW REPORT



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

## **REPORT ON REVIEW OF INTERIM FINANCIAL INFORMATION TO THE BOARD OF DIRECTORS OF BOC HONG KONG (HOLDINGS) LIMITED** (Incorporated in Hong Kong with limited liability)

### **Introduction**

We have reviewed the interim financial information set out on pages 39 to 115, which comprises the condensed consolidated balance sheet of BOC Hong Kong (Holdings) Limited (the "Company") and its subsidiaries (together, the "Group") as at 30 June 2013 and the related condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed consolidated statement of changes in equity and the condensed consolidated cash flow statement for the six-month period then ended, and a summary of significant accounting policies and other explanatory notes. The Main Board Listing Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of a report on interim financial information to be in compliance with the relevant provisions thereof and Hong Kong Accounting Standard 34 "Interim Financial Reporting" ("HKAS 34") issued by the Hong Kong Institute of Certified Public Accountants. The directors of the Company are responsible for the preparation and presentation of this interim financial information in accordance with HKAS 34. Our responsibility is to express a conclusion on this interim financial information based on our review. Our report is made solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

### **Scope of review**

We conducted our review in accordance with Hong Kong Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Hong Kong Institute of Certified Public Accountants. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### **Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the interim financial information is not prepared, in all material respects, in accordance with HKAS 34.

**Ernst & Young**  
*Certified Public Accountants*  
Hong Kong, 29 August 2013

# APPENDIX

## Subsidiaries of the Company

The particulars of our subsidiaries are as follows:

Name of company	Place and date of incorporation/operation/registration	Issued and fully paid up share capital/registered capital/units in issue	Interest held	Principal activities	At 30 June 2013	
					Total assets HK\$'m	Total equity HK\$'m
<b>Directly held:</b>						
Bank of China (Hong Kong) Limited	Hong Kong 16 October 1964	Ordinary shares HK\$43,042,840,858	100.00%	Banking business	1,482,346	116,625
BOC Group Life Assurance Company Limited*	Hong Kong 12 March 1997	Ordinary shares HK\$3,038,000,000	51.00%	Life insurance business	73,173	3,943
BOCHK Asset Management (Cayman) Limited*	Cayman Islands 7 October 2010	Ordinary shares HK\$50,000,000	100.00%	Investment holding	50	50
<b>Indirectly held:</b>						
Nanyang Commercial Bank, Limited	Hong Kong 2 February 1948	Ordinary shares HK\$700,000,000	100.00%	Banking business	174,141	28,966
Chiyu Banking Corporation Limited	Hong Kong 24 April 1947	Ordinary shares HK\$300,000,000	70.49%	Banking business	47,935	5,781
BOC Credit Card (International) Limited	Hong Kong 9 September 1980	Ordinary shares HK\$480,000,000	100.00%	Credit card services	11,775	3,412
Bank of China (Hong Kong) Nominees Limited*	Hong Kong 1 October 1985	Ordinary shares HK\$2	100.00%	Nominee services	–	–
Bank of China (Hong Kong) Trustees Limited*	Hong Kong 6 November 1987	Ordinary shares HK\$3,000,000	100.00%	Trustee and agency services	9	9
BNPP Flexi III China Fund*	Luxembourg 15 December 2009	Units in issue HK\$1,847,596,280	51.00%	Investment	1,849	1,848
BOC Group Trustee Company Limited*	Hong Kong 1 December 1997	Ordinary shares HK\$200,000,000	64.20%	Trustee services	200	200
BOC Travel Services Limited*	Hong Kong 24 August 1982	Ordinary shares HK\$2,000,000	100.00%	Travel services	2	2
BOCHK Asset Management Limited*	Hong Kong 28 October 2010	Ordinary shares HK\$39,500,000	100.00%	Asset management	34	27
BOCHK Financial Products (Cayman) Limited	Cayman Islands 10 November 2006	Ordinary shares US\$50,000	100.00%	Issuing structured notes	4	–



## Subsidiaries of the Company (continued)

Name of company	Place and date of incorporation/operation/registration	Issued and fully paid up registered capital/ share capital/ units in issue	Interest held	Principal activities	At 30 June 2013	
					Total assets HK\$'m	Total equity HK\$'m
BOCHK Information Technology (Shenzhen) Co., Ltd.*	PRC 16 April 1990	Registered capital HK\$70,000,000	100.00%	Property holding and investment	200	177
BOCHK Information Technology Services (Shenzhen) Ltd.*	PRC 26 May 1993	Registered capital HK\$40,000,000	100.00%	Information technology services	265	230
BOCI-Prudential Trustee Limited*	Hong Kong 11 October 1999	Ordinary shares HK\$300,000,000	41.10%	Trustee services	420	383
Che Hsing (Nominees) Limited*	Hong Kong 23 April 1980	Ordinary shares HK\$10,000	100.00%	Nominee services	1	1
Chiyu Banking Corporation (Nominees) Limited*	Hong Kong 3 November 1981	Ordinary shares HK\$100,000	70.49%	Investment holding	94	94
Grace Charter Limited*	Hong Kong 4 May 2001	Ordinary shares HK\$2	70.49%	Investment holding	–	(11)
G.Z.Y. Microfilm Technology (Shenzhen) Co., Ltd.*	PRC 24 September 1993	Registered capital HK\$40,000,000	100.00%	Property holding and investment	67	67
Kincheng Investments & Developments (H.K.) Limited	Hong Kong 15 May 1981	Ordinary shares HK\$6,000	100.00%	Property holding and investment	–	–
Kwong Li Nam Investment Agency Limited*	Hong Kong 25 May 1984	Ordinary shares HK\$3,050,000	100.00%	Investment agency	4	4
Nanyang Commercial Bank (China), Limited	PRC 14 December 2007	Registered capital RMB6,500,000,000	100.00%	Banking business	101,810	10,358
Nanyang Commercial Bank (Nominees) Limited*	Hong Kong 22 August 1980	Ordinary shares HK\$50,000	100.00%	Nominee services	1	1
Nanyang Commercial Bank Trustee Limited*	Hong Kong 22 October 1976	Ordinary shares HK\$3,000,000	100.00%	Trustee services	17	16
Po Sang Financial Investment Services Company Limited*	Hong Kong 23 September 1980	Ordinary shares HK\$95,000,000	100.00%	Gold trading and investment holding	122	105

# APPENDIX

## Subsidiaries of the Company (continued)

Name of company	Place and date of incorporation/ operation/ registration	Issued and fully paid up share capital/ registered capital/ units in issue	Interest held	Principal activities	At 30 June 2013	
					Total assets HK\$'m	Total equity HK\$'m
Po Sang Futures Limited*	Hong Kong 19 October 1993	Ordinary shares HK\$95,000,000	100.00%	Securities and futures brokerage	299	164
Seng Sun Development Company, Limited*	Hong Kong 11 December 1961	Ordinary shares HK\$2,800,000	70.49%	Investment holding	39	36
Sin Chiao Enterprises Corporation, Limited*	Hong Kong 13 September 1961	Ordinary shares HK\$3,000,000	100.00%	Property holding and investment	120	120
Sin Hua Trustee Limited*	Hong Kong 27 October 1978	Ordinary shares HK\$3,000,000	100.00%	Trustee services	4	4
Sino Information Services Company Limited*	Hong Kong 11 February 1993	Ordinary shares HK\$7,000,000	100.00%	Information services	21	19

G.Z.Y. Microfilm Technology (Shenzhen) Co., Ltd. commenced winding up on 26 December 2011.

BOC Travel Services Limited commenced members' voluntary winding up on 23 November 2012.

Sin Mei (Nominee) Limited, Kincheng (Nominees) Limited, Sin Yeh Shing Company Limited, Track Link Investment Limited, Po Hay Enterprises Limited and Kiu Nam Investment Corporation Limited were dissolved on 19 January 2013.

Chung Chiat Company Limited and The China-South Sea (Nominees) Services Limited were dissolved on 23 February 2013.

Kincheng Investments & Developments (H.K.) Limited has been dissolved on 21 August 2013.

### Remarks:

Name of subsidiaries which are not included in the consolidation group for regulatory purposes in respect of capital ratios is marked with \* in the above table. BOCHK and its subsidiaries specified by the HKMA form the basis of consolidation for its regulatory purposes in accordance with the Banking (Capital) Rules. For accounting purposes, subsidiaries are consolidated in accordance with the accounting standards issued by the HKICPA pursuant to section 18A of the Professional Accountants Ordinance.

# DEFINITIONS

In this Interim Report, unless the context otherwise requires, the following terms shall have the meanings set out below:

Terms	Meanings
"ABS"	Asset-backed Securities
"ADR"	American Depositary Receipt
"ALCO"	the Asset and Liability Management Committee
"AT1"	Additional Tier 1
"ATM"	Automated Teller Machine
"BOC"	Bank of China Limited, a joint stock commercial bank with limited liability established under the laws of the PRC, the H shares and A shares of which are listed on the Hong Kong Stock Exchange and the Shanghai Stock Exchange respectively
"BOC (BVI)"	BOC Hong Kong (BVI) Limited, a company incorporated under the laws of the British Virgin Islands and a wholly-owned subsidiary of BOCHKG
"BOCG Insurance"	Bank of China Group Insurance Company Limited, a company incorporated under the laws of Hong Kong and a wholly-owned subsidiary of BOC
"BOCHK Charitable Foundation"	Bank of China (Hong Kong) Limited Charitable Foundation (formerly known as the "Bank of China Group Charitable Foundation"), a charitable foundation being established in July 1994
"BOCHKG"	BOC Hong Kong (Group) Limited, a company incorporated under the laws of Hong Kong and a wholly-owned subsidiary of BOC
"BOCHK" or "the Bank"	Bank of China (Hong Kong) Limited, a company incorporated under the laws of Hong Kong and a wholly-owned subsidiary of the Company
"BOCI"	BOC International Holdings Limited, a company incorporated under the laws of Hong Kong and a wholly-owned subsidiary of BOC
"BOCI-Prudential Manager"	BOCI-Prudential Asset Management Limited, a company incorporated under the laws of Hong Kong, in which BOCI Asset Management Limited, a wholly-owned subsidiary of BOC International Holdings Limited, and Prudential Corporation Holdings Limited hold equity interests of 64% and 36% respectively
"BOCI-Prudential Trustee"	BOCI-Prudential Trustee Limited, a company incorporated under the laws of Hong Kong, in which BOC Group Trustee Company Limited and Prudential Corporation Holdings Limited hold equity interests of 64% and 36% respectively
"BOC Life"	BOC Group Life Assurance Company Limited, a company incorporated under the laws of Hong Kong, in which the Group and BOCG Insurance hold equity interests of 51% and 49% respectively
"Board" or "Board of Directors"	the Board of Directors of the Company
"CAS"	China Accounting Standards for Business Enterprises
"CE"	Chief Executive

# DEFINITIONS

Terms	Meanings
"CET1"	Common Equity Tier 1
"CFO"	Chief Financial Officer
"CIC"	China Investment Corporation
"CRO"	Chief Risk Officer
"Central Huijin"	Central Huijin Investment Ltd.
"Chiyu"	Chiyu Banking Corporation Limited, a company incorporated under the laws of Hong Kong, in which BOCHK holds an equity interest of 70.49%
"DCE"	Deputy Chief Executive
"ETF"	Exchange Traded Fund
"EURIBOR"	Euro Interbank Offered Rate
"FIRB"	Foundation Internal Ratings-based
"Fitch"	Fitch Ratings
"GDP"	Gross Domestic Product
"HIBOR"	Hong Kong Interbank Offered Rate
"HKAS(s)"	Hong Kong Accounting Standard(s)
"HKFRS(s)"	Hong Kong Financial Reporting Standard(s)
"HK GAAP"	Generally Accepted Accounting Principles in Hong Kong
"HKICPA"	Hong Kong Institute of Certified Public Accountants
"HKMA"	Hong Kong Monetary Authority
"HK(SIC)-Int"	Hong Kong (SIC) Interpretation
"Hong Kong" or "Hong Kong SAR"	Hong Kong Special Administrative Region
"ICAAP"	Internal Capital Adequacy Assessment Process
"IFRS"	International Financial Reporting Standards
"IMM"	Internal Models
"IPO"	Initial Public Offering
"IT"	Information Technology
"LGD"	Loss Given Default

# DEFINITIONS

Terms	Meanings
"LSC"	Legal Services Centre
"Listing Rules"	the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
"MBS"	Mortgage-backed Securities
"MC"	the Management Committee
"MPF"	Mandatory Provident Fund
"MPF Schemes Ordinance"	the Mandatory Provident Fund Schemes Ordinance, Chapter 485 of the Laws of Hong Kong, as amended
"MSCI Index"	Morgan Stanley Capital International Index
"Mainland" or "Mainland China"	the mainland of the PRC
"Medium Term Note Programme"	the medium term note programme was established by BOCHK on 2 September 2011
"Moody's"	Moody's Investors Service
"NCB (China)"	Nanyang Commercial Bank (China), Limited, a company incorporated under the laws of the PRC and a wholly-owned subsidiary of Nanyang
"Nanyang"	Nanyang Commercial Bank, Limited, a company incorporated under the laws of Hong Kong and a wholly-owned subsidiary of BOCHK
"OR&CD"	the Operational Risk & Compliance Department
"ORSO schemes"	the Occupational Retirement Schemes under Occupational Retirement Schemes Ordinance, Chapter 426 of the Laws of Hong Kong
"PD"	Probability of Default
"PRC"	the People's Republic of China
"PVBP"	Price Value of a Basis Point
"QFII"	Qualified Foreign Institutional Investors
"RC"	the Risk Committee
"RMB" or "Renminbi"	Renminbi, the lawful currency of the PRC
"RMD"	the Risk Management Department
"RQFII"	Renminbi Qualified Foreign Institutional Investors
"SFO"	the Securities and Futures Ordinance, Chapter 571 of the Laws of Hong Kong
"STC"	Standardised (Credit Risk)

# DEFINITIONS

Terms	Meanings
"STM"	Standardised (Market Risk)
"STO"	Standardised (Operational Risk)
"Standard & Poor's"	Standard & Poor's Ratings Services
"Stock Exchange" or "Hong Kong Stock Exchange" or "Stock Exchange of Hong Kong"	The Stock Exchange of Hong Kong Limited
"the Company"	BOC Hong Kong (Holdings) Limited, a company incorporated under the laws of Hong Kong
"the Group"	the Company and its subsidiaries collectively referred as the Group
"UK"	United Kingdom
"US"	the United States of America
"VAR"	Value at Risk

By Order of the Board  
CHAN Chun Ying  
Company Secretary

Hong Kong, 29 August 2013

*As at the date of this announcement, the Board comprises Mr. TIAN Guoli\* (Chairman), Mr. LI Lihui\* (Vice Chairman), Mr. HE Guangbei (Vice Chairman and Chief Executive), Mr. LI Zaohang\*, Mr. ZHOU Zaiqun\*, Mr. CHEN Siqing\*, Mr. GAO Yingxin, Dr. FUNG Victor Kwok King\*\*, Mr. KOH Beng Seng\*\*, Mr. NING Gaoning\*\*, Mr. SHAN Weijian\*\* and Mr. TUNG Savio Wai-Hok\*\*.*

\* *Non-executive Directors*

\*\* *Independent Non-executive Directors*