# BANK OF SHANGHAI (HONG KONG) LIMITED

## 2018 INTERIM FINANCIAL DISCLOSURE STATEMENTS

**BANK OF SHANGHAI (HONG KONG) LIMITED**
**INTERIM FINANCIAL DISCLOSURE STATEMENTS**
**FOR THE FIRST SIX MONTHS ENDED 30 JUNE 2018**

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**FOR THE FIRST SIX MONTHS ENDED 30 JUNE 2018**

Bank of Shanghai (Hong Kong) Limited (the "Company") is pleased to present the interim financial disclosure statement of the Company and its subsidiaries (the "Group") for the first half of 2018 ended 30 June 2018. The condensed consolidated statement of comprehensive income, the condensed consolidated statement of cash flows, and the condensed consolidated statement of changes in equity for the six months period ended 30 June 2018, and the condensed consolidated statement of financial position as at 30 June 2018 of the Group, (all of which are unaudited) along with the explanatory notes are illustrated on pages 2 to 32 of this interim financial disclosure statements.

## Financial Review

The Group's pre-tax profit for the period was HK$146 million, which increased by 85% as compared with the same period of the previous year. It should be noted that the Group's operating results included a foreign exchange translation loss of HK$7 million (2017: gain of HK$33 million) on the capital denominated in Renminbi ("RMB") due to depreciation of RMB against HK Dollar during the period and an impairment charge for a non-performing loan. Before accounting for these two items, the Group's operating profit before taxation was HK$199 million, an increase of HK$17 million or 9% as compared with the same period of the previous year.

Total loans and advances to customers were up by 1.5% to HK$15,282 million from 2017 year end, while customer deposits dropped by 33% to HK$9,122 million.

The Group's financial position continued sound. Total capital adequacy ratio was maintained at a comfortable level at 25.2%, and the average liquidity maintenance ratio ("LMR") at 55.6%. Both ratios are calculated on unconsolidated basis and adequately met the statutory requirements.

**BANK OF SHANGHAI (HONG KONG) LIMITED**
**INTERIM FINANCIAL DISCLOSURE STATEMENTS**
**FOR THE FIRST SIX MONTHS ENDED 30 JUNE 2018**

## CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (UNAUDITED)

| | Notes | 6 months ended 30 Jun 2018 HK$'000 | 6 months ended 30 Jun 2017 HK$'000 |
|---|---|---|---|
| Interest income | | 530,210 | 365,475 |
| Interest expense | | (300,161) | (171,601) |
| **Net interest income** | 5 | 230,049 | 193,874 |
| Net fee and commission income | 6 | 70,838 | 39,888 |
| Net income from financial instruments measured at fair value | 7 | 23,665 | 59,486 |
| Net income from investment securities | | (953) | (647) |
| Other operating income | | 3,548 | 1 |
| **Total operating income** | | 327,147 | 292,602 |
| Operating expenses | 8 | (102,141) | (77,796) |
| **Operating profit before impairment losses** | | 225,006 | 214,806 |
| Allowances for credit and other losses | 9 | (79,192) | (136,218) |
| **Profit before taxation** | | 145,814 | 78,588 |
| Taxation | 10 | (25,982) | (11,063) |
| **Profit for the period** | | 119,832 | 67,525 |
| **Other comprehensive income for the period, net of tax** | | | |
| *Items that may be reclassified subsequently to profit or loss* | | | |
| Foreign currency translation differences for Mainland China subsidiaries | | (7,444) | – |
| Net movement in revaluation reserve | 11 | (112,262) | 9,760 |
| **Total comprehensive income for the period** | | 126 | 77,285 |

## CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION (UNAUDITED)

| | Note | 30 Jun 2018<br>HK$'000 | 31 Dec 2017<br>HK$'000 |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances with banks and central bank | 12 | 353,490 | 424,887 |
| Placements with and advances to banks | 13 | 1,358,522 | 7,065,494 |
| Trading assets | | 4,869 | 51,230 |
| Derivative financial assets | 21 | 53,379 | 19,535 |
| Loans and advances to customers | 14 | 15,282,488 | 15,062,895 |
| Investment securities | 15 | 7,984,167 | 2,914,030 |
| Investment in associate | | 1,184 | 1,199 |
| Property and equipment | 16 | 18,541 | 20,169 |
| Intangible assets | | 5,098 | 6,139 |
| Current tax recoverable | | – | 1,128 |
| Deferred tax assets | | 41,141 | 8,030 |
| Other assets | 17 | 412,377 | 202,324 |
| **TOTAL ASSETS** | | 25,515,256 | 25,777,060 |
| **Liabilities** | | | |
| Deposits from customers | 18 | 9,121,697 | 13,628,287 |
| Deposits from banks | | 3,281,056 | 4,424,141 |
| Trading liabilities | | 167 | – |
| Derivative financial liabilities | 21 | 130,974 | 19,294 |
| Certificates of deposit and other debt securities issued | 19 | 8,053,069 | 3,028,315 |
| Current tax payable | | 37,216 | 7,955 |
| Deferred tax liabilities | | – | 437 |
| Other liabilities | 20 | 477,503 | 214,262 |
| **TOTAL LIABILITIES** | | 21,101,682 | 21,322,691 |
| **Capital and reserves** | | | |
| Share capital | | 4,000,000 | 4,000,000 |
| Retained profits | | 485,681 | 350,080 |
| Other reserves | | (72,107) | 104,289 |
| **TOTAL EQUITY** | | 4,413,574 | 4,454,369 |
| **TOTAL EQUITY AND LIABILITIES** | | 25,515,256 | 25,777,060 |

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (UNAUDITED)

| | Share capital HK$'000 | Retained profits HK$'000 | Revaluation reserve/ (deficit) HK$'000 | Regulatory reserve HK$'000 | Exchange reserve HK$'000 | Total HK$'000 |
|---|---|---|---|---|---|---|
| **Balance at 1 January 2017** | 4,000,000 | 149,506 | (27,372) | 87,557 | – | 4,209,691 |
| Total comprehensive income | – | 67,525 | 9,760 | – | – | 77,285 |
| Transfer to regulatory reserve | – | (5,253) | – | 5,253 | – | – |
| **Balance at 30 June 2017 and 1 July 2017** | 4,000,000 | 211,778 | (17,612) | 92,810 | – | 4,286,976 |
| Total comprehensive income | – | 153,885 | 10,136 | – | 3,372 | 167,393 |
| Transfer to regulatory reserve | – | (15,583) | – | 15,583 | – | – |
| **Balance at 31 December 2017 and 1 January 2018** | 4,000,000 | 350,080 | (7,476) | 108,393 | 3,372 | 4,454,369 |
| Impact of adopting HKFRS 9 on 1 January 2018 | – | (2,702) | 2,572 | (40,791) | – | (40,921) |
| Total comprehensive income | – | 119,832 | (112,262) | – | (7,444) | 126 |
| Transfer to regulatory reserve | – | 18,471 | – | (18,471) | – | – |
| **Balance at 30 June 2018** | 4,000,000 | 485,681 | (117,166) | 49,131 | (4,072) | 4,413,574 |

The regulatory reserve is maintained to satisfy the provisions of Hong Kong Banking Ordinance for prudential supervision purposes. Movement in this reserve was made directly through retained profits after consultation with the Hong Kong Monetary Authority. The regulatory reserve is non-distributable.

## CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)

| | Notes | 6 months ended 30 Jun 2018 HK$'000 | 6 months ended 30 Jun 2017 HK$'000 |
|---|---|---|---|
| **Net cash inflow/(outflow) from operating activities** | 22(a) | (2,097,711) | 218,336 |
| **Investing activities** | | | |
| Proceeds from sale and redemption of investment securities | | 6,309,472 | 783,823 |
| Purchase of investment securities | | (10,237,536) | (1,189,454) |
| Purchases of property and equipment and intangible assets | | (2,432) | (3,827) |
| Interest received from investment securities | | 101,764 | 15,350 |
| **Net cash outflow from investing activities** | | (3,828,732) | (394,108) |
| **Financing activities** | | | |
| Proceeds from issuance of other debt securities | | 3,894,179 | – |
| Redemption of other debt securities | | (781,945) | – |
| Interest paid for the other debt securities | | (75,533) | – |
| **Net cash inflow from financing activities** | | 3,036,701 | – |
| **Decrease in cash and cash equivalents** | | (2,889,742) | (175,772) |
| **Cash and cash equivalents at 1 January** | | 5,822,341 | 6,231,465 |
| **Cash and cash equivalents at 30 June** | 22(b) | 2,932,599 | 6,055,693 |

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

### (1) BASIS OF CONSOLIDATION

The interim financial disclosure statements cover the consolidated positions of the Company and its subsidiaries.

For regulatory reporting purposes, the Company is required to compute its capital adequacy ratios and leverage ratio on an unconsolidated basis that is different from the basis of consolidation for accounting purposes. The basis is illustrated in the Note 3(a) of the Regulatory Disclosure Statements.

### (2) BASIS OF PREPARATION

#### (a) Accounting policies

These condensed consolidated financial statements have been prepared in accordance with the Hong Kong Accounting Standard ("HKAS") 34, Interim Financial Reporting, issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). These interim financial disclosure statements were authorised for issuance on 28 September 2018.

The accounting policies applied in preparing the condensed consolidated financial statements are the same as those applied in preparing the financial statements for the year ended 31 December 2017 as disclosed in the Group's Directors' Report and Consolidated Financial Statements for the year ended 31 December 2017, which were prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs").

#### (b) New and amended standards and interpretations

***HKFRS 9 Financial Instruments***

During the period, the Group has adopted the HKFRS 9, which replaces the existing guidance in HKAS 39, includes revised guidance on the classification and measurement of financial instruments; more timely recognition of expected credit losses ("ECL") of financial assets; and introduces revised requirements for general hedge accounting. All the requirements of HKFRS 9 were adopted from 1 January 2018.

***Classification and subsequent measurement of financial assets***

HKFRS 9 replaces the classification and measurement model in HKAS 39 with a model that categorises debt- like financial assets based on the business model within which the assets are managed, and whether the assets constitute a "basic lending arrangement" where their contractual cash flows represent solely payments of principal and interest ("SPPI").

- Debt instruments are measured at amortised cost when they are in a "hold to collect" ("HTC") business model and have contractual cash flows that are SPPI in nature. The objective of a HTC business model is to collect contractual principal and interest cash flows. Sales are incidental to the objective and expected to be either insignificant or infrequent.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)**

## (2) BASIS OF PREPARATION (CONTINUED)

### (b) New and amended standards and interpretations (continued)

***Classification and subsequent measurement of financial assets (continued)***

- Debt instruments are measured at fair value through other comprehensive income ("FVOCI") when they are in a "hold to collect & sell" ("HTC&S") business model and have cash flows that are SPPI in nature. Both the collection of contractual cash flows and sales are integral to achieving the objective of the HTC&S business model.

  Unrealised gains or losses on FVOCI debt instruments are recorded in other comprehensive income and accumulated in FVOCI reserves. When they are sold, the accumulated fair value adjustments in FVOCI are reclassified to profit or loss as "Net income from investment securities".

- Debt instruments are measured at fair value through profit or loss ("FVPL") when:

  i. the assets are not SPPI in nature;

  ii. the assets are not part of a "HTC" or "HTC & S" business model; or

  iii. the assets are designated at FVPL so as to eliminate or significantly reduce the measurement or recognition inconsistencies that would otherwise arise from measuring assets or liabilities on different bases.

  Realised and unrealised gains or losses on FVPL financial assets, except interest income, are taken to "Net income from financial instruments measured at fair value" in the Statement of Comprehensive Income in the period they arise.

- Subsequent changes in fair value of non-trading equity instruments can be taken through profit or loss or other comprehensive income, as elected. Other than dividend income, gains and losses on FVOCI equity instruments are recorded in other comprehensive income and accumulated in FVOCI reserves, and are not reclassified to profit or loss upon derecognition.

- Derivatives (including derivatives embedded in financial liabilities but separated for accounting purposes) are also classified as held for trading unless they are designated as hedging instruments. Derivatives are classified as assets when the fair value is positive and as liabilities when the fair value is negative. Changes in the fair value of derivatives other than those designated as hedging instruments in cash flow or net investment hedges are included in "Net income from financial instruments measured at fair value".

- Reclassification of financial assets are prohibited unless the Group changes its business model for managing financial assets. In practice, this is expected to be infrequent.

## (2) BASIS OF PREPARATION (CONTINUED)

### (b) New and amended standards and interpretations (continued)

***Expected Credit Loss ("ECL")***

HKFRS 9 introduces a new impairment model that requires the recognition of ECL for all financial assets, except for financial assets classified or designated as FVPL and equity securities, which are not subject to impairment assessment. Off-balance sheet items that are subject to ECL include financial guarantees and undrawn loan commitments.

Under HKFRS 9, ECL is assessed using an approach which classifies financial assets into three stages, each of which is associated with an ECL requirement that is reflective of the assessed credit risk profile. A financial asset is classified under:

- Stage 1, if it was not credit-impaired upon origination, and there has not been a significant increase in its credit risk. The ECL of a Stage 1 financial asset will be the credit loss that is expected to result from a default occurring over the next 12 months;

- Stage 2, if it was not credit-impaired upon origination but has since experienced a significant increase in credit risk. The ECL of a Stage 2 financial asset will be the credit loss that is expected over the expected remaining life of the financial asset;

- Stage 3, if it has been credit-impaired with objective evidence of default. The assessed ECL for a Stage 3 financial asset is also the credit loss that is expected over the expected remaining life of the financial asset.

The impairment requirements of HKFRS 9 require management judgements, estimates and assumptions, particularly in the areas discussed below.

*Measurement of ECLs*

ECLs are unbiased probability-weighted estimates of credit losses determined by evaluating a range of possible outcomes and taking into account past events, current conditions and assessments of future economic conditions. The measurement of ECL is based primarily on the product of the instrument's probability of default ("PD"), loss given default ("LGD") and exposure at default ("EAD") discounted using the Effective Interest Rate to the reporting date. The main difference between Stage 1 and Stage 2 ECL is the respective calculation horizon. Stage 1 estimates project PD, LGD and EAD over a maximum period of 12 months while Stage 2 estimates these parameters over the expected remaining life of the financial asset.

*Expected Life*

When measuring the ECL for Stage 2 assets, cashflows over the expected remaining life of the financial asset are considered. For most financial instruments, this is the same as the remaining contractual life which represents the maximum contractual period over which the Group is exposed to the credit risk of the customers.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)

## (2) BASIS OF PREPARATION (CONTINUED)

### (b) New and amended standards and interpretations (continued)

***Expected Credit Loss ("ECL") (continued)***

*Assessment of significant increase in credit risk*

The analysis underpinning the assessment of whether a financial asset has experienced a significant increase in credit risk since origination is multi-factor in nature, with a range of qualitative and quantitative parameters taken into consideration.

Financial assets are deemed to have experienced a significant increase in credit risk when: (1) observed changes in the probability of default, as measured in the downgrade in internal credit risk rating for each obligor between initial recognition and reporting date, are more than pre-specified thresholds; (2) exposures are placed on certain categories of internal credit "watchlists" for closer scrutiny of developing credit issues;

In any event, all exposures that are more than 30 days past due are considered to have demonstrated a significant increase in credit risk and are classified as Stage 2.

A Stage 2 exposure can migrate back to Stage 1 if it is assessed that there is assurance of a sustainable improvement in its credit profile.

*Definition of default for credit-impaired financial assets*

Exposures are classified as Stage 3 if deemed to be credit-impaired or have suffered objective evidence of default as at the reporting date. The definition of default that is applied upon adoption of HKFRS 9 is consistent with that specified in the Basel regulatory capital rules.

The Group assesses whether there is evidence that a financial asset or a group of financial assets is impaired at the end of each reporting period, The Group carries out regular and systematic reviews of all credit facilities extended to customers. The criteria that the Group uses to determine whether there is evidence of an impairment loss include:

- Significant financial difficulty of the issuer or obligor, including breach of covenants and/ or financial conditions;
- A breach of contract, such as a default or delinquency in interest or principal payments;
- Granting of a concession to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, that the Group would not otherwise consider;
- High probability of bankruptcy or other financial reorganisation of the borrower.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)**

## (2) BASIS OF PREPARATION (CONTINUED)

### (b) New and amended standards and interpretations (continued)

***Expected Credit Loss ("ECL") (continued)***

*Definition of default for credit-impaired financial assets (continued)*

In any event, all exposures that are 90 days past due or more are classified under Stage 3.

A Stage 3 exposure can be upgraded to Stage 2 if there are reasonable grounds to conclude that the obligor is able to service future principal and interest payments on the credit facility in accordance with the restructured terms.

*Management overlay and judgements*

In determining the final ECL, management evaluates a range of possible outcomes, taking into account past events, current conditions and the economic outlook. Additional considerations that are assessed to have been inadequately addressed in the ECL model estimates are addressed through the application of a structured management overlay framework. This incorporates considerations such as: (1) potential loss assessments on watchlist cases, based on expert credit judgement; (2) observed model limitations; and (3) thematic events.

ECL adjustments arising from the exercise of the management overlay are subject to a robust review and governance process.

Experienced credit judgment is an integral part of ECL quantification in view of the close integration with the credit risk management process of the Group. This includes, for example, risk rating assignment, watchlist process, as well as input into the assessment of significant increase in credit risk, expected remaining life and macroeconomic forecast.

***Hedge accounting***

HKFRS 9 introduces a more principles-based approach to assess hedge effectiveness. Since the Group currently does not apply Hedge accounting, there is no impact to the Group on this area.

***Transition***

Comparative information in the prior financial periods is not restated as the Group adopted the optional exemption in HKFRS 1. Similarly, the Group's policies and disclosures for financial instruments up to 31 December 2017 remain unchanged from the Group's 2017 Annual Report.

Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of HKFRS 9 are recognised in retained earnings and reserves as at 1 January 2018.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)**

## (2) BASIS OF PREPARATION (CONTINUED)

### (b) New and amended standards and interpretations (continued)

***Transition impact of adopting HKFRS 9 on 1 January 2018***

The table below reflects the impact of adopting HKFRS 9 on the Group's opening balance sheet as at 1 January 2018.

| In HK$'000 | 31 Dec 2017 HKAS 39 | Transitional impact | 1 Jan 2018 HKFRS 9 |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances from banks and central bank | 424,887 | – | 424,887 |
| Placements with and advances to banks | 7,065,494 | (465) | 7,065,029 |
| Trading assets | 51,230 | – | 51,230 |
| Derivative financial assets | 19,535 | – | 19,535 |
| Loans and advances to customers | 15,062,895 | (40,791) | 15,022,104 |
| Investment securities | 2,914,030 | (642) | 2,913,388 |
| Investment in associate | 1,199 | – | 1,199 |
| Property and equipment | 20,169 | – | 20,169 |
| Intangible assets | 6,139 | – | 6,139 |
| Current tax recoverable | 1,128 | – | 1,128 |
| Deferred tax assets | 8,030 | 8,085 | 16,115 |
| Other assets | 202,324 | (47) | 202,277 |
| **Total assets** | 25,777,060 | (33,860) | 25,743,200 |
| **Liabilities** | | | |
| Trading liabilities | – | – | – |
| Deposits from customers | 13,628,287 | – | 13,628,287 |
| Deposits from banks | 4,424,141 | – | 4,424,141 |
| Derivative financial liabilities | 19,294 | – | 19,294 |
| Certificates of deposit and other debt securities issued | 3,028,315 | – | 3,028,315 |
| Current tax payable | 7,955 | – | 7,955 |
| Deferred tax liabilities | 437 | – | 437 |
| Other liabilities | 214,262 | 7,062 | 221,324 |
| **Total liabilities** | 21,322,691 | 7,062 | 21,329,753 |
| **Total equity** | 4,454,369 | (40,922) | 4,413,447 |

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)

### (2) BASIS OF PREPARATION (CONTINUED)

#### (b) New and amended standards and interpretations (continued)

***Additional information on impact of ECL***

The following table is a comparison of impairment allowances determined in accordance with HKAS 39 to the corresponding ECL allowances determined in accordance with HKFRS 9 as at 1 January 2018.

| | 31 Dec 2017 HKAS 39 | | 1 Jan 2018 HKFRS 9 | | | |
|---|---|---|---|---|---|---|
| In HK$'000 | Collectively assessed | Individually assessed | Stage 1 | Stage 2 | Stage 3 | Impact of ECL |
| Assets | | | | | | |
| Placements with and advances to banks | – | – | 465 | – | – | (465) |
| Loans and advances to customers | 44,892 | 220,743 | 85,683 | – | 220,743 | (40,791) |
| Investment securities | – | – | 642 | – | – | (642) |
| Other assets | – | 184 | 47 | – | 184 | (47) |
| Liabilities | | | | | | |
| Other liabilities[1] | – | – | 7,062 | – | – | (7,062) |
| Total | 44,892 | 220,927 | 93,899 | – | 220,927 | (49,007) |
| Tax impact | – | – | – | – | – | 8,085 |
| | 44,892 | 220,927 | 93,899 | – | 220,927 | (40,922) |

Note:

1 The ECL on guarantees and other off balance sheet exposures are recorded in "Other liabilities"

***HKFRS 15 Revenue from Contracts with Customers***

From 1 January 2018, HKFRS 15 replaced the existing revenue recognition guidance and established a comprehensive framework for determining whether, how much and when revenue is recognised. Revenue is recognised when a performance obligation is satisfied, which could either be at a point in time or when the obligation is satisfied over time. HKFRS 15 applies mainly to "fee and commission income".

The adoption of HKFRS 15 does not have a material impact on the Group's consolidated financial statements.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)**

## (2) BASIS OF PREPARATION (CONTINUED)

### (b) New and amended standards and interpretations (continued)

***Other new standards and interpretations***

Information on future accounting development and their potential effect on the condensed consolidated financial statements are provided in note 2 on the consolidated financial statements of the Group's 2017 Annual Report.

### (c) Critical accounting estimates

The preparation of interim financial statements requires management to exercise judgements, use estimates and make assumptions that affect the application of policies and reported amounts in the financial statements. Although these estimates are based on management's best knowledge of current events and actions, actual results may differ from these estimates. In preparing this condensed consolidated financial statements, critical accounting estimates and assumptions used that are significant to the interim financial statements, and areas involving a higher degree of judgement and complexity were the same as those disclosed in the consolidated financial statements for the year ended 31 December 2017.

## (3) CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND STATUTORY FINANCIAL STATEMENTS

The financial information relating to the year ended 31 December 2017 that is included in the condensed consolidated financial statements as comparative information does not constitute the Group's statutory annual consolidated financial statements for that year but is derived from those financial statements. Further information relating to these statutory financial statements required to be disclosed in accordance with section 436 of the Hong Kong Companies Ordinance is stated below:

The Company has delivered the financial statements for the year ended 31 December 2017 to the Registrar of Companies as required by section 662(3) of, and Part 3 of Schedule 6 to, the Hong Kong Companies Ordinance.

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

## (4) STATEMENT OF COMPLIANCE

In preparing the unaudited interim financial disclosure statements and the Regulatory Disclosure Statements for the first half of 2018, the Company has fully complied with the disclosure requirements stipulated in the Banking (Disclosure) Rules.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)**

## (5) NET INTEREST INCOME

Interest income recognised on financial assets that was not measured at fair value through profit or loss amounted to HK$530,210,000 (first half of 2017: HK$365,475,000).

Interest expense recognised on financial liabilities that was not measured at fair value through profit or loss amounted to HK$300,161,000 (first half of 2017: HK$171,601,000).

There was no interest income accrued on impaired financial assets and on unwinding of discount on loan impairment allowances for the six months ended 30 June 2018 and 30 June 2017.

## (6) NET FEE AND COMMISSION INCOME

| | 6 months ended 30 Jun 2018 HK$'000 | 6 months ended 30 Jun 2017 HK$'000 |
|---|---|---|
| Fee and commission income | | |
| – Credit facilities | 14,719 | 15,701 |
| – Trade services | 417 | 571 |
| – IPO sponsorship | 500 | – |
| – Underwriting | – | 252 |
| – Corporate advisory | 52,669 | 11,215 |
| – Asset management | 6,132 | 7,068 |
| – Brokerage | 283 | 4,402 |
| – Others | 3,106 | 1,282 |
| | 77,826 | 40,491 |
| Fee and commission expense | (6,988) | (603) |
| Net fee and commission income | 70,838 | 39,888 |

Fee and commission income of HK$15,876,000 (first half of 2017: HK$16,743,000) and fee and commission expense of HK$6,621,000 (first half of 2017: HK$262,000) for the six months ended 30 June 2018 arose from financial assets and financial liabilities that were not measured at fair value through profit or loss.

Net fee and commission income arose from trust or other fiduciary activities in which the Group held or invested on behalf of its customers for the six months ended 30 June 2018 was HK$6,132,000 (first half of 2017: HK$7,068,000).

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)

### (7) NET INCOME FROM FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

| | 6 months ended 30 Jun 2018 HK$'000 | 6 months ended 30 Jun 2017 HK$'000 |
|---|---|---|
| Foreign exchange | 24,116 | 58,493 |
| Interest rate and others | (451) | 993 |
| | 23,665 | 59,486 |

The foreign exchange gain in 2018 included the translation loss of HK$7 million (2017: gain of HK$33 million) on those Renminbi ("RMB") assets funded by the Company's capital denominated in RMB (which was recorded on these financial statements at historical exchange rate) due to the depreciation of RMB against HKD in 2018. Excluding this translation loss, foreign exchange trading gain from normal activities was HK$31 million (2017: HK$25 million).

### (8) OPERATING EXPENSES

| | 6 months ended 30 Jun 2018 HK$'000 | 6 months ended 30 Jun 2017 HK$'000 |
|---|---|---|
| Staff costs | | |
| – Salaries and other benefits | 62,700 | 46,079 |
| – Pension and provident funds | 2,682 | 2,082 |
| | 65,382 | 48,161 |
| Premises and equipment expenses excluding depreciation | | |
| – Rental of premises | 10,630 | 9,866 |
| – Maintenance and office facility expenses | 1,656 | 1,492 |
| – Others | 742 | 759 |
| | 13,028 | 12,117 |
| Auditors' remuneration | 420 | 336 |
| Depreciation of property and equipment | 3,400 | 4,264 |
| Amortisation of intangible assets | 1,702 | 1,326 |
| Legal and professional fees | 1,556 | 3,032 |
| IT and systems expenses | 4,266 | 3,683 |
| Data subscription fees | 2,020 | 1,275 |
| Advertising | 4,009 | 32 |
| Other operating expenses | 6,358 | 3,570 |
| | 23,731 | 17,518 |
| | 102,141 | 77,796 |

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)**

## (9) ALLOWANCES FOR CREDIT AND OTHER LOSSES

| | 6 months ended 30 Jun 2018 HK$'000 | 6 months ended 30 Jun 2017 HK$'000 |
|---|---|---|
| Placements with and advances to banks | (455) | – |
| Loans and advances to customers | 66,134 | 134,382 |
| Investment securities | 16,459 | – |
| Other assets | – | 1,836 |
| Off-balance sheet credit exposures | (2,946) | – |
| | 79,192 | 136,218 |
| Placements with and advances to banks | | |
| – New allowances | – | – |
| – Releases | (455) | – |
| | (455) | – |
| Loans and advances to customers | | |
| – New allowances | 94,757 | 134,515 |
| – Releases | (28,623) | (133) |
| | 66,134 | 134,382 |
| Investment securities | | |
| – New allowances | 16,459 | – |
| – Releases | – | – |
| | 16,459 | – |
| Other assets | | |
| – New allowances | – | 1,836 |
| – Releases | – | – |
| | – | 1,836 |
| Off-balance sheet credit exposures | | |
| – New allowances | – | – |
| – Releases | (2,946) | – |
| | (2,946) | – |

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)

### (10) TAXATION

Taxation in the consolidated statement of comprehensive income is illustrated below:

| | 6 months ended 30 Jun 2018 HK$'000 | 6 months ended 30 Jun 2017 HK$'000 |
|---|---|---|
| **Current tax** | | |
| Hong Kong profits tax | | |
| Tax for the period | 27,075 | 10,651 |
| Taxation outside Hong Kong | | |
| Tax for the period | 5,057 | – |
| | 32,132 | 10,651 |
| **Deferred tax** | | |
| Origination and reversal of temporary differences | (6,150) | 412 |
| | 25,982 | 11,063 |

The provision for Hong Kong profits tax was calculated at 16.5% (2016: 16.5%) on the estimated assessable profits for the period. Taxation on overseas profits has been calculated on the estimated assessable profit for the periods at the rates of taxation prevailing in the countries in which the Group operates.

### (11) OTHER COMPREHENSIVE INCOME

**Components of other comprehensive income**

| | 6 months ended 30 Jun 2018 $'000 | 6 months ended 30 Jun 2017 $'000 |
|---|---|---|
| **Fair value through other comprehensive income/ available-for-sale financial assets:** | | |
| Changes in fair value recognised during the period | (132,745) | 12,627 |
| Reclassification adjustments for amounts transferred to profit or loss upon disposal | 953 | 647 |
| Net deferred tax (debited)/credited to revaluation reserve | 19,530 | (3,514) |
| Net movement in revaluation reserve during the period recognised in other comprehensive income | (112,262) | 9,760 |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)

## (12) CASH AND BALANCES WITH BANKS AND CENTRAL BANK

| | 30 Jun 2018<br>HK$'000 | 31 Dec 2017<br>HK$'000 |
|---|---|---|
| Balances with banks | 343,870 | 255,764 |
| Balances with central bank | 9,620 | 199,123 |
| | 353,490 | 424,887 |

## (13) PLACEMENTS WITH AND ADVANCES TO BANKS

| | 30 Jun 2018<br>HK$'000 | 31 Dec 2017<br>HK$'000 |
|---|---|---|
| Gross placements with and advances to banks | | |
| – maturing within one month | 1,358,533 | 5,097,766 |
| – maturing between one and twelve months | – | 1,967,728 |
| – maturing of more than one year | – | – |
| | 1,358,533 | 7,065,494 |
| Allowance for credit and other losses | (11) | – |
| Net placements with and advances to banks | 1,358,522 | 7,065,494 |

There were no overdue, impaired or rescheduled placements with and advances to banks for the periods indicated.

## (14) LOANS AND ADVANCES TO CUSTOMERS

### (a) Loans and advances to customers

| | 30 Jun 2018<br>HK$'000 | 31 Dec 2017<br>HK$'000 |
|---|---|---|
| Gross loans and advances to customers | 15,655,919 | 15,328,531 |
| Less: Allowance for credit and other losses | | |
| – Stage 1 & 2 ECL | (107,428) | – |
| – Stage 3 ECL | (266,003) | – |
| – individually assessed | – | (220,744) |
| – collectively assessed | – | (44,892) |
| | 15,282,488 | 15,062,895 |

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)**

## (14) LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

### (b) Gross loans and advances to customers by industry sector

| | 30 Jun 2018 | | 31 Dec 2017 | |
|---|---|---|---|---|
| | HK$'000 | % of gross advances covered by collaterals | HK$'000 | % of gross advances covered by collaterals |
| **Gross loans and advances to customers for use in Hong Kong** | | | | |
| Industrial, commercial and financial sectors | | | | |
| – property development | 265,006 | – | 416,805 | 30.9 |
| – property investment | 894,823 | 100.0 | 893,447 | 100.0 |
| – financial concerns | 3,318,948 | 55.1 | 2,780,580 | 21.6 |
| – wholesale and retail trade | 144,592 | 97.6 | 170,961 | 98.0 |
| – manufacturing | 269,987 | – | 359,576 | – |
| – transport and transport equipment | – | – | 280,285 | 2.6 |
| – information technology | 86,318 | 100.0 | – | – |
| – others | 371,274 | 32.7 | 1,050,396 | 62.9 |
| | 5,350,948 | – | 5,952,050 | 41.3 |
| **Individuals** | 78,172 | – | 79,049 | – |
| **Total gross loans and advances for use in Hong Kong** | 5,429,120 | 56.6 | 6,031,099 | 40.8 |
| **Trade finance** | 587,712 | 1.7 | 319,655 | 3.8 |
| **Gross loans and advances for use outside Hong Kong** | 9,639,087 | 36.8 | 8,977,777 | 37.3 |
| **Gross loans and advances to customers** | 15,655,919 | 42.4 | 15,328,531 | 38.0 |

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)

### (14) LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

#### (c) Segmental analysis of loans and advances to customers by geographical area

Loans and advances to customers by geographical area are classified according to the location of the counterparties after taking into account the transfer of risk. In general, risk transfer applies when a loan is guaranteed by a party located in an area that is different from that of the counterparty.

| | Gross loans and advances to customers HK$'000 | Impaired loans and advances HK$'000 | Overdue loans and advances HK$'000 | Stage 3 ECL/ Individually assessed allowances HK$'000 | Stage 1&2 ECL/ Collectively assessed allowances HK$'000 |
|---|---|---|---|---|---|
| At 30 June 2018 | | | | | |
| – Hong Kong | 3,603,326 | 6,990 | 6,990 | (6,990) | (25,176) |
| – Mainland China | 11,817,529 | 259,013 | 259,013 | (259,013) | (78,177) |
| – Others | 235,064 | – | – | – | (4,075) |
| | 15,655,919 | 266,003 | 266,003 | (266,003) | (107,428) |
| At 31 December 2017 | | | | | |
| – Hong Kong | 4,260,488 | 6,990 | 6,990 | (6,990) | (15,311) |
| – Mainland China | 10,823,878 | 267,192 | 267,192 | (213,754) | (28,702) |
| – Others | 244,165 | – | – | – | (879) |
| | 15,328,531 | 274,182 | 274,182 | (220,744) | (44,892) |

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)

### (14) LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

#### (d) Overdue loans and advances to customers

The overdue loans and advances of the Company are analysed as follows:

| | **As at 30 June 2018** | | As at 31 December 2017 | |
|---|---|---|---|---|
| | **HK$'000** | **% of gross loans and advances to customers** | HK$'000 | % of gross loans and advances to customers |
| Six months or less but over three months | – | – | 85,144 | 0.56 |
| One year or less but over six months | 85,314 | 0.54 | 189,038 | 1.23 |
| Over one year | 180,689 | 1.15 | – | – |
| | 266,003 | 1.69 | 274,182 | 1.79 |
| Allowance for credit and other losses made in respect of the above overdue loans and advances | 266,003 | | 220,744 | |
| Current market value of collateral held against the covered portion of the above overdue loans and advances | – | | – | |
| Covered portion of the above overdue loans and advances | – | | – | |
| Uncovered portion of the above overdue loans and advances | 266,003 | | 274,182 | |

#### (e) Rescheduled loans and advances

There were no rescheduled loans and advances as at 30 June 2018 and 31 December 2017.

#### (f) Repossessed assets

There were no repossessed assets as at 30 June 2018 and 31 December 2017.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)**

## (14) LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

### (g) Overdue other assets

The overdue other assets of the Company are analysed as follows:

| In HK$'000 | As at 30 June 2018 | As at 31 December 2017 |
|---|---|---|
| Six months or less but over three months | – | 183 |
| One year or less but over six months | 183 | – |
| | 183 | 183 |

## (15) INVESTMENT SECURITIES

| | 30 Jun 2018 HK$'000 | 31 Dec 2017 HK$'000 |
|---|---|---|
| Fair value through other comprehensive income/available-for-sale | 5,933,956 | 2,680,735 |
| Amortised cost/held-to-maturity | 2,061,449 | 233,295 |
| | 7,995,405 | 2,914,030 |
| Allowance for credit and other losses | (11,238) | – |
| | 7,984,167 | 2,914,030 |

As at 30 June 2018 and 31 December 2017, there were no investment securities individually determined to be impaired.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)

## (16) PROPERTY AND EQUIPMENT

Details of movement of property and equipment are as follows:

| | Leasehold improvements HK$'000 | Furniture, computer and other equipments HK$'000 | Motor vehicles HK$'000 | Total HK$'000 |
|---|---|---|---|---|
| **Cost:** | | | | |
| At 1 January 2017 | 21,300 | 19,219 | 1,007 | 41,526 |
| Additions | 199 | 2,775 | – | 2,974 |
| Write-off | – | (1,704) | – | (1,704) |
| Exchange adjustments | – | 5 | – | 5 |
| At 31 December 2017 | 21,499 | 20,295 | 1,007 | 42,801 |
| At 1 January 2018 | 21,499 | 20,295 | 1,007 | 42,801 |
| Additions | 300 | 723 | 749 | 1,772 |
| Exchange adjustments | – | (4) | – | (4) |
| At 30 June 2018 | 21,799 | 21,014 | 1,756 | 44,569 |
| **Accumulated depreciation:** | | | | |
| At 1 January 2017 | (3,651) | (12,082) | (902) | (16,635) |
| Charge for the year | (3,671) | (3,933) | (105) | (7,709) |
| Write-off | – | 1,704 | – | 1,704 |
| Exchange adjustments | – | 8 | – | 8 |
| At 31 December 2017 | (7,322) | (14,303) | (1,007) | (22,632) |
| At 1 January 2018 | (7,322) | (14,303) | (1,007) | (22,632) |
| Charge for the period | (1,869) | (1,526) | (5) | (3,400) |
| Exchange adjustments | – | 4 | – | 4 |
| At 30 June 2018 | (9,191) | (15,825) | (1,012) | (26,028) |
| **Net book value:** | | | | |
| At 30 June 2018 | 12,608 | 5,189 | 744 | 18,541 |
| At 31 December 2017 | 14,177 | 5,992 | – | 20,169 |

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)

### (17) OTHER ASSETS

| | 30 Jun 2018<br>HK$'000 | 31 Dec 2017<br>HK$'000 |
|---|---|---|
| Interest receivables (Note a) | 144,698 | 142,571 |
| Collaterals placed (Note b) | 56,734 | – |
| Fees receivable | 4,308 | 3,457 |
| Customer liability under acceptances | 12,708 | 16,852 |
| Prepaid expenses | 18,925 | 5,810 |
| Accounts receivable | 11,864 | 25,738 |
| Others | 163,140 | 7,896 |
| | 412,377 | 202,324 |

Note a: Included Stage 3 ECL of $183,000 (2017: $183,000).

Note b: Mainly relates to cash collaterals placed in respect of derivative financial liabilities.

### (18) DEPOSITS FROM CUSTOMERS

| | 30 Jun 2018<br>HK$'000 | 31 Dec 2017<br>HK$'000 |
|---|---|---|
| Deposits from customers | | |
| – time, call and notice deposits | 9,121,697 | 13,628,287 |

### (19) CERTIFICATES OF DEPOSIT AND OTHER DEBT SECURITIES ISSUED

| | 30 Jun 2018<br>HK$'000 | 31 Dec 2017<br>HK$'000 |
|---|---|---|
| Measured at amortised costs | | |
| – Certificates of deposits issued | 4,149,861 | 2,246,775 |
| – Other debt securities issued | 3,903,208 | 781,540 |
| | 8,053,069 | 3,028,315 |

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)**

## (20) OTHER LIABILITIES

| | 30 Jun 2018 HK$'000 | 31 Dec 2017 HK$'000 |
|---|---|---|
| Interest payable | 111,900 | 102,185 |
| Acceptance outstanding | 12,708 | 16,852 |
| Account payable | 145,820 | 10,861 |
| Accrued expenses | 44,720 | 3,271 |
| Provision for short term employee benefits | 51,898 | 58,596 |
| Collateral received | 3,932 | 3,676 |
| Others | 106,525 | 18,821 |
| | 477,503 | 214,262 |

## (21) DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are presented in net when there is a legally enforceable right to set off the recognised amounts, and there is an intention to settle them on a net basis or realise the asset and settle the liability simultaneously. As at 30 June 2018, no derivative financial instruments have fulfilled the above criteria, therefore no derivative financial instruments were offset on the consolidated statement of financial position (2017: Nil).

**Derivatives – held for trading**

| | At 30 Jun 2018 | | | | At 31 Dec 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | Notional amount HK$'000 | Derivative financial assets HK$'000 | Derivative financial liabilities HK$'000 | Credit risk-weighted amounts HK$'000 | Notional amount HK$'000 | Derivative financial assets HK$'000 | Derivative financial liabilities HK$'000 | Credit risk-weighted amounts HK$'000 |
| Exchange rate contracts | | | | | | | | |
| – Spot and forward | 5,263,818 | 31,103 | 119,494 | 20,569 | – | – | – | – |
| – Swap | – | – | – | – | 1,243,705 | 7,754 | 19,294 | 9,775 |
| Interest rate contracts | | | | | | | | |
| – Swap | 1,165,144 | 22,276 | 11,480 | 15,269 | 1,122,126 | 11,781 | – | 10,672 |
| | 6,428,962 | 53,379 | 130,974 | 35,838 | 2,365,831 | 19,535 | 19,294 | 20,447 |

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)

### (22) NOTES TO CONSOLIDATED STATEMENT OF CASH FLOWS

#### (a) Reconciliation of profit before taxation to net cash inflow/(outflow) from the operating activities

| | 6 months ended 30 Jun 2018 HK$'000 | 6 months ended 30 Jun 2017 HK$'000 |
|---|---|---|
| Profit before taxation | 145,814 | 78,588 |
| Adjustments for: | | |
| Interest income | (530,210) | (365,475) |
| Interest expense | 300,161 | 171,601 |
| Depreciation of property and equipment | 3,400 | 4,264 |
| Amortisation of intangible assets | 1,702 | 1,326 |
| Impairment charges | 79,192 | 136,218 |
| Net loss on sale of investment securities | 953 | 647 |
| Interest received | 404,557 | 320,624 |
| Interest paid | (182,431) | (150,342) |
| **Operating profit before changes in working capital** | 223,138 | 197,451 |
| Changes in trading assets | (4,702) | – |
| Change in balances and placements with banks with original maturity beyond three months | 1,668,040 | (858,101) |
| Change in gross loans and advances to customers | (303,154) | (486,569) |
| Change in other assets | (212,070) | 28,911 |
| Change in deposits from banks | (1,143,085) | 2,127,691 |
| Change in deposits from customers | (4,506,590) | (1,464,247) |
| Change in certificates of deposit issued | 1,933,405 | 688,641 |
| Change in other liabilities | 253,562 | 6,005 |
| Elimination of exchange differences and other non-cash items | (4,504) | (20,611) |
| **Cash generated from/(used in) operating activities** | (2,095,960) | 219,171 |
| Hong Kong profits tax paid | – | (835) |
| Tax paid outside Hong Kong | (1,751) | – |
| **Net cash inflow/(outflow) from operating activities** | (2,097,711) | 218,336 |

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)

### (22) NOTES TO CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)

#### (b) Cash and cash equivalents in the consolidated statement of cash flows

| | 30 Jun 2018<br>HK$'000 | 30 Jun 2017<br>HK$'000 |
|---|---|---|
| Cash and balances with banks and central bank | 353,490 | 259,016 |
| Gross placements with banks with original maturity within three months | 1,358,533 | 5,796,677 |
| Investment securities with original maturity within three months | 1,220,576 | – |
| | 2,932,599 | 6,055,693 |

#### (c) Reconciliation with the consolidated statement of financial position

| | 30 Jun 2018<br>HK$'000 | 30 Jun 2017<br>HK$'000 |
|---|---|---|
| Cash and balances with banks and central bank | 353,490 | 259,381 |
| Gross placements with and advances to banks | 1,358,533 | 7,280,493 |
| Investment securities | 7,984,167 | – |
| Amounts shown in the consolidated statement of financial position | 9,696,190 | 7,539,874 |
| Less: Balances, gross placements with and advances to banks and investment securities with an original maturity beyond three months | 6,763,591 | 1,484,181 |
| | 2,932,599 | 6,055,693 |

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)

### (22) NOTES TO CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)

#### (d) Reconciliation of liabilities arising from financing activities:

The table below details changes in the Group's liabilities from financing activities, including both cash and non-cash change. Liabilities arising from financing activities are liabilities for which cash flows were, or future cash flows will be, classified in the cash flow statement as cash flows from financing activities.

| | Other debt securities issued $'000 |
|---|---|
| **At 1 January 2018** | 781,540 |
| **Changes from financing cash flows:** | |
| Cash inflow from financing activities | 3,112,234 |
| Other movements | 9,434 |
| **At 30 June 2018** | 3,903,208 |

### (23) CONTINGENT LIABILITIES AND COMMITMENTS

| | 30 Jun 2018 HK$'000 | 31 Dec 2017 HK$'000 |
|---|---|---|
| Contract amounts | | |
| − Direct credit substitutes | 118,286 | 119,734 |
| − Trade-related contingencies | 17,081 | 4,571 |
| − Other commitments: | | |
| − which are unconditionally cancellable | 1,580,764 | 1,551,325 |
| − with an original maturity under one year | – | 398,241 |
| − with an original maturity over one year | 120,927 | 160,769 |
| | 1,837,058 | 2,234,640 |
| Credit risk weighted amount | 63,377 | 160,144 |

## (24) FAIR VALUE OF FINANCIAL INSTRUMENT

### (a) Financial assets and liabilities measured at fair value

Fair value estimates are generally subjective in nature, and are made as of a specific point in time based on the characteristics of the financial instruments and relevant market information. The Group measures fair value using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

Level 1: fair value measured using quoted market prices (unadjusted) in active markets for identical assets and liabilities.

Level 2: fair value measured using valuation techniques based on observable inputs, either directly or indirectly. This category includes quoted prices in active markets for similar financial instruments, or quoted prices for identical or similar instruments in markets that are considered less than active, or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

Level 3: fair value measured using significant unobservable inputs. This category includes inputs to valuation techniques not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect difference between the instruments.

Where available, the most suitable measure for fair value is the quoted market price. In the absence of organised secondary markets for most of the unlisted securities and over-the-counter derivatives, direct market prices of these financial instruments may not be available. The fair values of such instruments are therefore calculated based on established valuation techniques using current market parameters or market prices provided by counterparties.

The fair value of forward foreign exchange contracts is determined using forward exchange market rates at the reporting date. For other derivative financial instruments, the Group uses estimated discounted cash flows to determine their fair value and the discount rate used is a discount rate at the end of the reporting period applicable for an instrument with similar terms and conditions.

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)**

## (24) FAIR VALUE OF FINANCIAL INSTRUMENT (CONTINUED)

### (a) Financial assets and liabilities measured at fair value (continued)

The table below analyses financial instruments, measured at fair value as at 30 June 2018 and 31 December 2017, by the level in the fair value hierarchy into which the fair value treatment is categorised.

**At 30 June 2018**

| | Level 1<br>HK$'000 | Level 2<br>HK$'000 | Level 3<br>HK$'000 | Total<br>HK$'000 |
|---|---|---|---|---|
| **Recurring fair value measurements** | | | | |
| **Assets** | | | | |
| Trading assets | 4,869 | – | – | 4,869 |
| Derivative financial assets | – | 53,379 | – | 53,379 |
| Investment securities | 1,631,201 | 4,172,180 | 130,575 | 5,933,956 |
| **Liabilities** | | | | |
| Derivative financial liabilities | – | 130,947 | – | 130,947 |

**At 31 December 2017**

| | Level 1<br>HK$'000 | Level 2<br>HK$'000 | Level 3<br>HK$'000 | Total<br>HK$'000 |
|---|---|---|---|---|
| **Recurring fair value measurements** | | | | |
| **Assets** | | | | |
| Derivative financial assets | – | 19,535 | – | 19,535 |
| Investment securities | 644,793 | 1,925,058 | 110,884 | 2,680,735 |
| Trading securities | – | 51,230 | – | 51,230 |
| **Liabilities** | | | | |
| Derivative financial liabilities | – | 19,294 | – | 19,294 |

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)

### (24) FAIR VALUE OF FINANCIAL INSTRUMENT (CONTINUED)

#### (a) Financial assets and liabilities measured at fair value (continued)

During the six months ended 30 June 2018 and the year of 2017, there were no transfers of financial instruments between Level 1 and Level 2. 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 fair value of the debt securities in Level 2 is determined using broker quotes as at the end of the reporting period.

*Valuation of financial instruments with significant unobservable inputs*

The fair value of fair value through other comprehensive income/available-for-sale investment securities in Level 3 is determined using significant inputs from the most recent transactions. As at 30 June 2018, it is estimated that with all other variable held constant, an increase/decrease in the price of same products by 5% would have increased/decreased the Group's equity by $4.9 million (2017: $4.6 million).

The following table shows a reconciliation from the beginning balance to the ending balance for fair value measurements in Level 3 of the fair value hierarchy:

| | 30 Jun 2018<br>HK$'000 | 31 Dec 2017<br>HK$'000 |
|---|---|---|
| At 1 January | 110,884 | – |
| Purchases/Initiation | 130,575 | 110,884 |
| Sales | – | – |
| Settlements | (110,884) | – |
| Transfer in | – | – |
| Transfer out | – | – |
| Changes in fair value recognised in the profit or loss | – | – |
| – Net income from financial instruments measured at fair value | – | – |
| At 30 June 2018/31 December 2017 | 130,575 | 110,884 |
| Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period recorded in: | | |
| – Net income from financial instruments measured at fair value | – | – |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (CONTINUED)

## (24) FAIR VALUE OF FINANCIAL INSTRUMENT (CONTINUED)

### (a) Financial assets and liabilities measured at fair value (continued)

The gains arising from the settlements of the fair value through other comprehensive income/available-for-sale investment securities are presented in "Net income from investment securities" in the consolidated statement of profit or loss and other comprehensive income. The fair value adjustments on the newly purchased fair value through other comprehensive income/available-for-sale investment securities are recognised in revaluation reserve in other comprehensive income.

### (b) Financial assets and liabilities not measured at fair value

Financial assets and liabilities that were presented not at their fair value on the consolidated statement of financial position mainly represented cash and balances with banks and central bank, placements with and advances to banks, loans and advances to customers and investment securities at amortised costs. These financial assets were measured at amortised cost less impairment. Financial liabilities not presented at their fair value on the consolidated statement of financial position mainly included deposits from banks, deposits from customers and certificates of deposit issued. These financial liabilities were measured at amortised cost.

The Group assessed that the differences between fair values and carrying amounts of those financial assets and liabilities not presented on the Group's statement of financial position at their fair values are minimal as most of the Group's financial assets and liabilities are either short-term or priced at floating rates, except for the following financial instruments, for which their carrying amounts and fair value and the level of fair value hierarchy are disclosed below:

| | | | Fair value measurements as at 30 June 2018 categorised into | | |
|---|---|---|---|---|---|
| | Carrying amounts at 30 June 2018 $'000 | Fair value at 30 June 2018 $'000 | Level 1 $'000 | Level 2 $'000 | Level 3 $'000 |
| **Assets** | | | | | |
| Investments securities at amortised cost (Note 15) | 2,061,449 | 1,903,192 | – | 1,903,192 | – |

## (25) MATERIAL RELATED PARTY TRANSACTIONS

There were no changes in the related party transactions described in the Group's Directors' Report and Consolidated Financial Statements for the year ended 31 December 2017 that have had a material impact on the financial position or performance of the Group in the first half of 2018.