



BANK OF SHANGHAI (HONG KONG) LIMITED

**DIRECTORS' REPORT AND CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2018**

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

CONTENTS

	Page(s)
Report of the directors	1
Independent auditor's report	4
Consolidated statement of profit or loss and other comprehensive income	7
Consolidated statement of financial position	8
Consolidated statement of changes in equity	10
Consolidated statement of cash flows	11
Notes to the consolidated financial statements	12
Corporate Governance Report (unaudited)	93

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

REPORT OF THE DIRECTORS

The directors submit herewith their annual report together with the audited financial statements for the year ended 31 December 2018.

Principal place of business

Bank of Shanghai (Hong Kong) Limited (“the Company”) is a restricted licence bank incorporated and domiciled in Hong Kong and has its registered office and principal place of business at 34th Floor, Champion Tower, 3 Garden Road, Central, Hong Kong.

Principal activities

The principal activities of the Company are to provide financial services to corporations and individuals. The principal activities and other particulars of the Company’s subsidiaries are stated in Note 19 to the financial statements.

Transfer to reserves

The profit attributable to shareholders of HK\$218,129,000 (2017: HK\$221,410,000) has been transferred to reserves. Other movements in reserves are shown in the consolidated statement of changes in equity on page 10.

Recommended dividend

The directors do not recommend payment of a final dividend for the financial year ended 31 December 2018 (2017: Nil).

Share capital

Details of the movements in share capital of the Company are set out in Note 27(a) to the financial statements. There was no movement during the year.

Charitable donations

No charitable donations was made by the Group during the financial year (2017: HK\$30,000).

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

REPORT OF THE DIRECTORS (CONTINUED)

Directors

The directors of the Company during the financial year and up to the date of this report were:

Huang, Tao
Jin, Yu (resigned on 1 February 2019)
Tsien, James Steed
Cheng, Kwok Kin Paul
Fong, Wo Felix
Zhang, Xuhong (appointed on 12 February 2018)
Li, Xiaohong (appointed on 11 January 2019)
Ma, Charles Chi Man (resigned on 7 June 2018)

Directors of subsidiaries

The names of directors who had served on the board of the Company's subsidiaries during the financial year and up to the date of this report were:

Cai, Wei Song
Chan, Ho Sun Sunny
Chen, Che
Chen, Tao
Du, Jian
Guo, Chuhua (appointed on 7 August 2018)
Han, Chia Lin
Huang, Tao
Li, Li (resigned on 4 October 2018)
Li, Yong (resigned on 7 September 2018)
Li, Xiaohong (appointed on 7 September 2018)
Lin, Liqun (appointed on 7 September 2018)
Ma, Charles Chi Man (resigned on 7 June 2018)
Ma, Yijia
Wu, Jun
Wang, Jian
Yang, Chen (appointed on 11 January 2018)
Zhang, Xuhong

There being no provision in the Company's articles of association in connection with the retirement of directors, all existing directors continue in office for the following year.

At no time during the year was the Company, or any of its holding companies, subsidiaries or fellow subsidiaries a party to any arrangement to enable the directors of the Company to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

REPORT OF THE DIRECTORS (CONTINUED)

Directors' interests in transactions, arrangements or contracts

No transaction, arrangement or contract of significance to which the Company, or any of its holding companies, subsidiaries or fellow subsidiaries was a party, and in which a director of the Company or an entity connected with a director had a material interest, subsisted at the end of the year or at any time during the year.

Management contracts

No contracts concerning the management and administration of the whole or any substantial part of any business of the Company were entered into or subsisting during the year.

Indemnity of directors

A permitted indemnity provision (as defined in section 469 of the Hong Kong Companies Ordinance) for the benefit of the directors of the Company is currently in force and was in force throughout this year.

Auditors

KPMG retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

By order of the board

Zhang, Xuhong
Director
Hong Kong, 29 April 2019



**Independent auditor's report to the members of
Bank of Shanghai (Hong Kong) Limited**
(Incorporated in Hong Kong with limited liability)

Opinion

We have audited the consolidated financial statements of Bank of Shanghai (Hong Kong) Limited and its subsidiaries ("the Group") set out on pages 7 to 92, which comprise the consolidated statement of financial position as at 31 December 2018, the consolidated statement of profit or loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2018 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

The directors are assisted by audit committee in discharging their responsibilities for overseeing the Group's financial reporting process.

Basis for opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAAs") issued by the HKICPA. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the Group in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code") and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Information other than the consolidated financial statements and auditor's report thereon

The directors are responsible for the other information. The other information comprises all the information included in the annual report, other than the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.



**Independent auditor's report to the members of
Bank of Shanghai (Hong Kong) Limited**
(Incorporated in Hong Kong with limited liability)

Responsibilities of the directors for the consolidated financial statements

The directors are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with HKFRSs issued by the HKICPA and the Hong Kong Companies Ordinance and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

The directors are assisted by the audit committee in discharging their responsibilities for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. This report is made solely to you, as a body, in accordance with section 405 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with HKSAAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with HKSAAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.



**Independent auditor's report to the members of
Bank of Shanghai (Hong Kong) Limited**
(Incorporated in Hong Kong with limited liability)

Auditor's responsibilities for the audit of the consolidated financial statements (continued)

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

KPMG

Certified Public Accountants
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong
29 April 2019

BANK OF SHANGHAI (HONG KONG) LIMITED
CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2018

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2018
(EXPRESSED IN HONG KONG DOLLARS)

	Note	2018 \$'000	2017 \$'000
Interest income	6	1,137,251	794,396
Interest expense	6	(619,037)	(390,210)
Net interest income		<u>518,214</u>	<u>404,186</u>
Fee and commission income	7	150,695	148,436
Fee and commission expense	7	(16,022)	(1,148)
Net fee and commission income		<u>134,673</u>	<u>147,288</u>
Net income from financial instruments measured at fair value	8	9,770	119,436
Net income from investment securities	13(b)	1,310	16,709
Other operating income		4,335	474
Total operating income		<u>668,302</u>	<u>688,093</u>
Operating expenses	9	(222,817)	(204,219)
Operating profit before impairment losses		<u>445,485</u>	<u>483,874</u>
Allowances for credit and other losses	10	(176,812)	(224,811)
Profit before taxation		<u>268,673</u>	<u>259,063</u>
Taxation	12(a)	(50,544)	(37,653)
Profit for the year		<u>218,129</u>	<u>221,410</u>
Other comprehensive income for the year, net of tax	13		
<i>Item that may be reclassified subsequently to profit or loss</i>			
Foreign currency translation differences for Mainland China subsidiaries		(15,539)	3,372
Net movement in revaluation reserve	13(b)	(132,669)	19,896
Total comprehensive income for the year		<u><u>69,921</u></u>	<u><u>244,678</u></u>

The notes on pages 12 to 92 form part of these financial statements.

BANK OF SHANGHAI (HONG KONG) LIMITED
CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2018

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2018
(EXPRESSED IN HONG KONG DOLLARS)

	Note	2018 \$'000	2017 \$'000
Assets			
Cash and balances with banks and central bank	14	1,394,837	424,887
Placements with and advances to banks	15	2,592,414	7,065,494
Financial assets at fair value through profit and loss		287,024	51,230
Derivative financial assets	29	32,787	19,535
Loans and advances to customers	16(a)	14,830,120	15,062,895
Investment securities	17	9,118,004	2,914,030
Interests in associates	18	228	1,199
Property and equipments	20	16,437	20,169
Intangible assets	21	5,134	6,139
Current tax recoverable	24(a)	2,000	1,128
Deferred tax assets	24(b)	54,567	8,030
Other assets	22	256,907	202,324
TOTAL ASSETS		28,590,459	25,777,060
Liabilities			
Deposits from customers	23	9,503,353	13,628,287
Deposits from banks		4,981,828	4,424,141
Trading liabilities		8,159	–
Derivative financial liabilities	29	48,430	19,294
Certificates of deposit and other debt securities issued	25	9,126,264	3,028,315
Current tax payable	24(a)	42,275	7,955
Deferred tax liabilities	24(b)	–	437
Other liabilities	26	397,208	214,262
TOTAL LIABILITIES		24,107,517	21,322,691

**BANK OF SHANGHAI (HONG KONG) LIMITED
CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2018**

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)
AS AT 31 DECEMBER 2018
(EXPRESSED IN HONG KONG DOLLARS)**

	Note	2018 \$'000	2017 \$'000
Capital and reserves			
Share capital	27(a)	4,000,000	4,000,000
Retained profits		626,045	350,080
Other reserves		(143,103)	104,289
TOTAL EQUITY		<u>4,482,942</u>	<u>4,454,369</u>
TOTAL EQUITY AND LIABILITIES		<u>28,590,459</u>	<u>25,777,060</u>

Approved and authorised for issue by the board of directors on 29 April 2019

)	
)	
)	
Zhang, Xuhong)	
)	Directors
)	
)	
Cheng, Kwok Kin Paul)	
)	

The notes on pages 12 to 92 form part of these financial statements.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2018
(EXPRESSED IN HONG KONG DOLLARS)

	Note	Share capital \$'000	Retained profits \$'000	Revaluation reserve/ (deficit) \$'000	Regulatory reserve \$'000	Exchange reserve \$'000	Total \$'000
Balance at 1 January 2017		4,000,000	149,506	(27,372)	87,557	–	4,209,691
Profit for the year		–	221,410	–	–	–	221,410
Other comprehensive income	13(a)	–	–	19,896	–	3,372	23,268
Total comprehensive income		–	221,410	19,896	–	3,372	244,678
Transfer to regulatory reserve		–	(20,836)	–	20,836	–	–
Balance at 31 December 2017		4,000,000	350,080	(7,476)	108,393	3,372	4,454,369
Impact of adopting HKFRS 9 on 1 January 2018		–	(43,819)	2,471	–	–	(41,348)
Adjusted balance as at 1 January 2018		4,000,000	306,261	(5,005)	108,393	3,372	4,413,021
Profit for the year		–	218,129	–	–	–	218,129
Other comprehensive income	13(a)	–	–	(132,669)	–	(15,539)	(148,208)
Total comprehensive income		–	218,129	(132,669)	–	(15,539)	69,921
Transfer to regulatory reserve		–	101,655	–	(101,655)	–	–
Balance at 31 December 2018		4,000,000	626,045	(137,674)	6,738	(12,167)	4,482,942

The notes on pages 12 to 92 form part of these financial statements.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2018
(EXPRESSED IN HONG KONG DOLLARS)

	Note	2018 \$'000	2017 \$'000
Net cash inflow from operating activities	32(a)	1,209,995	399,727
Investing activities			
Proceeds from sales and redemption of investment securities		7,450,905	4,624,689
Purchases of property and equipments and intangible assets	20, 21	(5,548)	(5,871)
Purchase of investment securities		(13,370,389)	(6,254,793)
Purchase of interests in associates	18	(228)	(1,199)
Sale of interests in associates	18	1,199	–
Interest received from investment securities		275,460	46,783
Net cash outflow from investing activities		(5,648,601)	(1,590,391)
Financing activity			
Proceeds from the issuance of other debt securities	32(d)	3,894,179	781,540
Redemption of other debt securities		(781,945)	–
Interest paid for the other debt securities		(82,952)	–
Proceeds from short-term borrowing		102,123	–
Interest paid for short-term borrowing		(2,241)	–
Net cash inflow from financing activity		3,129,164	781,540
Decrease in cash and cash equivalents		(1,309,442)	(409,124)
Cash and cash equivalents at 1 January		5,822,341	6,231,465
Cash and cash equivalents at 31 December	32(b)	4,512,899	5,822,341

The notes on pages 12 to 92 form part of these financial statements.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES

(a) General information

The principal activities of the Group are to provide financial services to corporations and individuals.

Founded in 2013, Bank of Shanghai (Hong Kong) Limited (the “Company”), a wholly owned subsidiary of Bank of Shanghai Company Ltd., is a restricted license bank incorporated and domiciled in Hong Kong with the registered office and principal place of business at 34th Floor, Champion Tower, 3 Garden Road, Central, Hong Kong. The Bank and its wholly owned subsidiary, BOSCI International Company Limited (the “BOSCI”) (together the “Group”), a Licensed Corporation in Hong Kong under Securities and Futures Ordinance, provide banking, Financial and related activities to corporate and individual clients.

Principal activities and other particulars of the Group’s subsidiaries are set out in Note 19 to the financial statements.

For regulatory reporting purposes, the Company is required to compute its capital adequacy ratios and leverage ratio on unconsolidated basis that is different from the basis of consolidation for accounting purposes. The basis is set out in the Note 3(a) to the Regulatory Disclosure Statements. The disclosures of capital adequacy ratios, leverage ratio and liquidity ratio as required by Banking (Disclosure) Rules are available in the section of Regulatory Disclosures on our website <http://www.bosc-hk.com/en/Channel/xinxi.html>

(b) Statement of compliance

These consolidated financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (“HKFRSs”), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (“HKASs”) and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. Significant accounting policies adopted by the Company are disclosed below.

The HKICPA has issued certain new and revised HKFRSs that are first effective or available for early adoption for the current accounting period of the Group. Note 2 provides information on any changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these financial statements.

(c) Basis of preparation

The consolidated financial statements for the year ended 31 December 2018 comprise the Company and its subsidiaries (together the “Group”).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c) Basis of preparation (continued)

The measurement basis used in the preparation of the financial statements is the historical cost basis except that financial instruments measured at fair value through profit or loss, or measured at fair value through other comprehensive income are stated at their fair value as explained in the accounting policies set out in Note 1(f).

The preparation of financial statements in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of HKFRSs that have significant effect on the financial statements and major sources of estimation uncertainty are discussed in Note 3.

(d) Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. When assessing whether the Group has power, only substantive rights (held by the Group and other parties) are considered.

An investment in a subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases.

Intra-group balances, transactions and cash flows and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

In the Company's statement of financial position, an investment in a subsidiary is stated at cost less impairment losses (see Note 1(k)), unless the investment is classified as held for sale (or included in a disposal group that is classified as held for sale).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(e) Associates

An associate is an entity in which the Group or Company has significant influence, but not control, over its management, including participation in the financial and operating policy decisions.

An investment in an associate is accounted for in the consolidated financial statements under the equity method, unless it is classified as held for sale (or included in a disposal group that is classified as held for sale). Under the equity method, the investment is initially recorded at cost, adjusted for any excess of the Group's share of the acquisition-date fair values of the investee's identifiable net assets over the cost of the investment (if any). Thereafter, the investment is adjusted for the post acquisition change in the Group's share of the investee's net assets and any impairment loss relating to the investment (see Notes 1(k)). Any acquisition-date excess over cost, the Group's share of the post-acquisition, post-tax results of the investees, any impairment losses for the year and the Group's share of the post-acquisition post-tax items of the investees' other comprehensive income are recognised in the consolidated statement of profit or loss and other comprehensive income.

When the Group's share of losses exceeds its interest in the associate, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the investee. For this purpose, the Group's interest is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associate.

Unrealised profits and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interest in the investee, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

When the Group ceases to have significant influence over an associate, it is accounted for as a disposal of the entire interest in that investee, with a resulting gain or loss being recognised in profit or loss. Any interest retained in that former investee at the date when significant influence is lost is recognised at fair value and this amount is regarded as the fair value on initial recognition of a financial asset.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(f) Financial instruments

Policy applicable from 1 January 2018

HKFRS 9 categorises financial assets into three principal classification categories: measured at amortised cost, at fair value through other comprehensive income (FVOCI) and at fair value through profit or loss (FVPL). These supersede HKAS 39's categories of held-to-maturity investments, loans and receivables, available-for-sale financial assets and financial assets measured at FVPL. The classification of financial assets under HKFRS 9 is based on the business model under which the financial asset is managed and its contractual cash flow characteristics. Under HKFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are not separated from the host. Instead, the hybrid instrument as a whole is assessed for classification.

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.
- 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(f) Financial instruments (continued)

- 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.

Policy applicable before 1 January 2018

(i) Initial recognition

The Group classifies its financial instruments into different categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are: fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets and other financial liabilities.

Financial instruments are measured initially at fair value, which normally will be equal to the transaction price plus, in case of a financial asset or financial liability not held at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset or issue of the financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately.

The Group recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument. A regular way purchase or sale of financial assets and financial liabilities is recognised using trade date accounting. From these dates, any gains and losses arising from changes in fair value of the financial assets or financial liabilities at fair value through profit or loss and available-for-sale financial assets are recorded.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(f) Financial instruments (continued)

(ii) Classification

Fair value through profit or loss

This category comprises financial assets and financial liabilities held for trading. Trading financial instruments are financial assets or financial liabilities which are acquired or incurred principally for the purpose of trading, or are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Financial assets and financial liabilities under this category are carried at fair value. Changes in the fair value are included in profit or loss in the period in which they arise. Upon disposal or repurchase, the difference between the net sale proceeds or the net payment and the carrying value is included in profit or loss.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (a) those that the Group intends to sell immediately or in the near term, which will be classified as held for trading; (b) those that the Group, upon initial recognition, designates as at fair value through profit or loss or as available-for-sale; or (c) those where the Group may not recover substantially all of its initial investment, other than because of credit deterioration, which will be classified as available-for-sale. Loans and receivables mainly comprise loans and advances to customers and placements with banks.

Loans and receivables are carried at amortised cost using the effective interest method, less impairment losses, if any (see Note 1(k)).

Held-to-maturity investments

Held-to-maturity investment are non-derivative financial assets with fixed or determinable payments and fixed maturity for which the Group has the positive intention and ability to hold to maturity, other than (a) those that the Group, upon initial recognition, designates as at fair value through profit or loss or as available-for-sale; and (b) those that meet the definition of loans and receivables.

Held-to-maturity investments are carried at amortised cost using effective interest method less impairment loss, if any (see Note 1(k)).

If, as a result of a change in intention or ability, it is no longer appropriate to classify an investment as held-to-maturity, it shall be reclassified as available-for-sale and remeasured at fair value.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(f) Financial instruments (continued)

(ii) Classification (continued)

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three categories. They include financial assets intended to be held for an indefinite period of time, but which may be sold in response to needs for liquidity or changes in the market environment.

Available-for-sale financial assets are carried at fair value. Unrealised gains and losses arising from changes in the fair value are recognised in other comprehensive income and accumulated separately in equity, except for impairment losses and foreign exchange gains and losses on monetary items such as debt securities which are recognised directly in profit or loss.

Investments in equity securities that do not have a quoted market price in an active market and which fair value cannot be measured reliably, and derivatives that are linked to and must be settled by delivery of such unquoted equity securities are carried at cost less impairment losses, if any (see Note 1(k)).

When the available-for-sale financial assets are sold, gains or losses on disposal include the difference between the net sale proceeds and the carrying value, and the accumulated fair value adjustments which are previously recognised in other comprehensive income shall be reclassified from equity to profit or loss.

Other financial liabilities

Financial liabilities, other than trading liabilities, are measured at amortised cost using the effective interest method.

(iii) Fair value measurement principles

The fair value of financial instruments is based on their quoted market prices at the reporting date without any deduction for estimated future selling costs. Financial assets are priced at current bid prices, while financial liabilities are priced at current offer prices.

If there is no publicly available latest traded price nor a quoted market price on a recognised stock exchange or a price from a broker/dealer for non-exchange-traded financial instruments, or if the market for it is not active, the fair value of the instrument is estimated using valuation techniques that provide a reliable estimate of prices which could be obtained in actual market transactions.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(f) Financial instruments (continued)

(iii) Fair value measurement principles (continued)

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the reporting date applicable for an instrument with similar terms and conditions. Where other pricing models are used, inputs are based on market data at the reporting date.

(iv) Derecognition

A financial asset is derecognised when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset together with substantially all the risks and rewards of ownership have been transferred.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

(v) Offsetting

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position where there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(vi) Embedded derivatives

An embedded derivative is a component of a hybrid (combined) instrument that includes both the derivative and a host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. The embedded derivatives are separated from the host contract and accounted for as a derivative when (a) the economic characteristics and risks of the embedded derivative are not closely related to the host contract; and (b) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in profit or loss.

When the embedded derivative is separated, the host contract is accounted for in accordance with Note 1(f)(ii) above.

(g) Property and equipments

Property and equipments are stated in the statement of financial position at cost less accumulated depreciation and impairment losses (see Note 1(k)).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(g) Property and equipments (continued)

Gains or losses arising from the retirement or disposal of an item of property and equipments are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in profit or loss on the date of retirement or disposal.

Depreciation is calculated to write off the cost or valuation of items of property and equipments, less their estimated residual value, if any, using the straight-line method over the estimated useful lives as follows:

– Leasehold improvements	Shorter of the lease term or their estimated useful lives to the Group, being no more than 50 years after the date of completion
– Furniture, computer and other equipments	2 – 5 years
– Motor vehicles	4 – 5 years

Where parts of an item of property and equipments have different useful lives, the cost of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reviewed annually.

(h) Intangible assets

Intangible assets included software and club membership. Intangible assets are stated in the statement of financial position at cost less accumulated amortisation and impairment losses (see Note 1(k)).

Amortisation of intangible assets with finite useful lives is charged to the consolidated statement of profit or loss and other comprehensive income on a straight-line basis over the assets' estimated useful lives. The following intangible assets with finite useful lives are amortised from the date they are available for use and their estimated useful lives are as follow:

– Software	1 – 5 years
------------	-------------

Both the period and method of amortisation are reviewed annually.

Intangible assets are not amortised while their useful lives are assessed to be indefinite. Any conclusion that the useful life of an intangible asset is indefinite is reviewed annually to determine whether events and circumstances continue to support the indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to definite is accounted for prospectively from the date of change and in accordance with the policy for amortisation of intangible assets with finite lives as set out above.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(i) Leases and hire purchase contracts

An arrangement, comprising a transaction or a series of transactions, is or contains a lease if the Group determines that the arrangement conveys a right to use a specific asset or assets for an agreed period of time in return for a payment or a series of payments. Such a determination is made based on an evaluation of the substance of the arrangement and is regardless of whether the arrangement takes the legal form of a lease.

(i) Classification

Assets that are held by group under leases which transfer substantially all the risks and rewards of ownership to the lessee are classified as finance leases. Leases which do not transfer substantially all the risks and rewards of ownership to the lessee are classified as operating leases.

(ii) Finance leases

Where the Group is a lessor under finance leases, an amount representing the net investment in the lease is included in the statement of financial position as "Loans and advances to customers". Hire purchase contracts having the characteristics of finance leases are accounted for in the same manner as finance leases. Impairment losses are accounted for in accordance with the accounting policy as set out in Note 1(k).

Where the Group acquires the use of assets under finance leases, the amounts representing the fair value of the leased assets, or, if lower, the present values of the minimum lease payments of such assets, are recognised as property and equipment and the corresponding liabilities, net of finance charges, are recorded as obligations under finance leases. Depreciation is provided at rates which write off the cost or valuation of the assets over the term of the relevant leases or, where it is likely the Group will obtain ownership of the asset, the life of the asset, as set out in Note 1(g). Impairment losses are accounted for in accordance with the accounting policy as set out in Note 1(k). Finance charges implicit in the lease payments are charged to profit or loss over the period of the leases so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each accounting period. Contingent rentals are charged to profit or loss in the accounting period in which they are incurred.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(i) Leases and hire purchase contracts (continued)

(iii) Operating leases

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to profit or loss in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in profit or loss as an integral part of the aggregate net lease payments made. Contingent rentals are charged to profit or loss in the accounting period in which they are incurred.

The cost of acquiring land held under an operating lease is amortised on a straight-line basis over the period of the lease term.

(j) Repossessed assets

In the recovery of impaired loans and advances, the Group may take possession of assets held as collaterals through court proceedings or voluntary delivery of possession by the borrowers. Where it is intended to achieve an orderly realisation of the impaired assets and the Group is no longer seeking repayment from the borrowers, repossessed assets are reported in "Other assets". The Group does not hold the repossessed assets for its own use.

Repossessed assets are recorded at the lower of the amount of the related loans and advances and fair value less costs to sell at the date of repossession, and the related loans and advances together with the related impairment allowances are derecognised from the consolidated statement of financial position. They are not depreciated or amortised.

(k) Credit losses and impairment of assets

Policy applicable from 1 January 2018

HKFRS 9 replaces the "incurred loss" model in HKAS 39 with the "expected credit loss" ("ECL") model. The ECL model required an ongoing measurement of credit risk associated with a financial asset and a more timely recognition of the expected credit losses of financial assets.

The Group applies the new ECL model to 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(k) Credit losses and impairment of assets (continued)

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 subsequently 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 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.

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 THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(k) Credit losses and impairment of assets (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.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(k) Credit losses and impairment of assets (continued)

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

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 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.

Policy applicable before 1 January 2018

(i) Financial assets

The carrying amount of the Group's assets is reviewed at each reporting date to determine whether there is objective evidence of impairment. Objective evidence that financial assets are impaired includes observable data that comes to the attention of the Group about one or more of the following loss events which has an impact on the future cash flows on the assets that can be estimated reliably:

- significant financial difficulty of the debtor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- it becoming probable that the debtor will enter bankruptcy or other financial reorganisation;
- significant changes in the technological, market, economic or legal environment that have an adverse effect on the debtor; and

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(k) Credit losses and impairment of assets (continued)

Management overlay and judgements (continued)

(i) Financial assets (continued)

- a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

If any such evidence exists, the carrying amount is reduced to the estimated recoverable amount by means of a charge to profit or loss.

Impairment losses are written off against the corresponding assets directly, except for impairment losses recognised in respect of loans and receivables which are measured at amortised cost, whose recovery is considered doubtful but not remote. In this case, the impairment losses are recorded using an allowance account. When the Group is satisfied that recovery is remote, the amount considered irrecoverable is written off against loans and receivables directly and any amounts held in the allowance account relating to that borrower are reversed. Subsequent recoveries of amounts previously charged to the allowance account are reversed against the allowance account. Other changes in the allowance account and subsequent recoveries of amounts previously written off are recognised in profit or loss.

Loans and receivables

Impairment losses on loans and receivables are measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets). Receivables with a short duration are not discounted if the effect of discounting is immaterial.

The total allowance for credit losses consists of two components: individually assessed impairment allowances and collectively assessed impairment allowances.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(k) Credit losses and impairment of assets (continued)

(i) Financial assets (continued)

Loans and receivables (continued)

The individually assessed impairment allowance is based upon management's best estimate of the present value of the cash flows which are expected to be received discounted at the original effective interest rate. In estimating these cash flows, management makes judgements about the borrower's financial situation and the net realisable value of any underlying collaterals or guarantees in favour of the Group. Each impaired asset is assessed on its own merits.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with credit risk characteristics similar to those of the Group. Historical loss experience is adjusted on the basis of current observable data on economic and credit environment to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates that can be linked objectively to an event occurring after the write-down, will result in a change in the impairment allowances on loans and receivables and be charged or credited to profit or loss. A reversal of impairment losses is limited to the loans and receivables' carrying amount that would have been determined had no impairment loss been recognised in prior years.

When there is no reasonable prospect of recovery, the loan and the related interest receivables are written off.

Loans and receivables with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Group has made concessions that it would not otherwise consider. Renegotiated loans and receivables are subject to ongoing monitoring to determine whether they remain impaired or past due.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(k) Credit losses and impairment of assets (continued)

(i) Financial assets (continued)

Available-for-sale financial assets

When there is objective evidence that an available-for-sale financial asset is impaired, the cumulative loss that had been recognised in the fair value reserve is reclassified to profit or loss. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value, less any impairment loss on that asset previously recognised in profit or loss.

For unquoted available-for-sale equity securities that are carried at cost, the impairment loss is measured as the difference between the carrying amount of the equity securities and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material.

Impairment losses recognised in profit or loss in respect of available-for-sale equity securities are not reversed through profit or loss. Any subsequent increase in the fair value of such assets is recognised in other comprehensive income.

Impairment losses in respect of available-for-sale debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in profit or loss.

(ii) Non-financial assets

Internal and external sources of information are reviewed at the end of each reporting period to identify indications that the property and equipments and intangible assets may be impaired or an impairment loss previously recognised no longer exists or may have decreased.

If any such indication exists, the asset's recoverable amount is estimated. In addition, for intangible assets that are not yet available for use and intangible assets that have indefinite useful lives, the recoverable amount is estimated annually whether or not there is any indication of impairment.

– Calculation of recoverable amount

The recoverable amount of an asset is the greater of its fair value less costs of disposal and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(k) Credit losses and impairment of assets (continued)

(ii) Non-financial assets (continued)

– Recognition of impairment losses

An impairment loss is recognised in profit or loss if the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro-rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs of disposal, if measurable, or value in use, if determinable.

– Reversals of impairment losses

An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to profit or loss in the year in which the reversals are recognised.

(l) Cash and cash equivalents

Cash and cash equivalents comprise cash and balances with banks and central bank, and short-term, highly liquid inter-bank placements and investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

For the purpose of the consolidated statement of cash flows, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash and balances with banks and central bank, placements with banks and investment securities.

(m) Employee benefits

Salaries, annual bonuses, paid annual leave, contributions to defined contribution retirement plans and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees of the Group. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(n) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in profit or loss except to the extent that they relate to items recognised in other comprehensive income or directly in equity, in which case the relevant amounts of tax are recognised in other comprehensive income or directly in equity, respectively.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the end of the reporting period, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The carrying amount of a deferred tax asset is reviewed at the end of each reporting period and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

Current tax balances and deferred tax balances, and movements therein are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if the Group or the Company has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Group or the Company intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(n) Income tax (continued)

- the same taxable entity; or
- different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

(o) Loan commitments, letters of credit, financial guarantees and provisions

(i) Loan commitments

Loan commitments are typically not financial instruments and are not recognised on statement of financial position but are disclosed as off-balance sheet in accordance with HKAS 37. They form part of the disclosures in Note 30. Upon a loan draw-down, the amount of the loan is accounted for as described in Note 1(f).

(ii) Letters of credit

Letters of credit are recorded off-balance sheet as contingent liabilities upon issuance, and corresponding payables to the beneficiaries and receivables from the applicants are recognised on-balance sheet upon acceptance of the underlying documents.

(iii) Financial guarantees

A financial guarantee is initially recognised in the financial statements at fair value on the date the guarantee is given. Financial guarantees are subsequently measured at the higher of:

- The amount of the ECL (note 1(k)), and
- The unamortised portion of the fees that were received on initial recognition. The fee is recognised over time as income in accordance with the principles in Note 1(p).

Off-balance sheet credit exposures are managed for credit risk in the same manner as financial assets.

(iv) Provisions

Provisions are recognised when:

- the Group has a present legal or constructive obligation as a result of asset events;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate of the amount of the obligation can be made.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(p) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Provided it is probable that economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in profit or loss as follows:

(i) Interest income

Interest income for all interest-bearing financial instruments is recognised in the profit or loss on a time proportion basis using the effective interest method as prescribed by HKFRSs.

The calculation includes significant fees and transaction costs that are an integral to the effective interest rate, as well as premiums or discounts.

For impaired loans, the accrual of interest income based on the original terms of the loan is discontinued, but any increase in the present value of impaired loans due to the passage of time is reported as interest income.

(ii) Fee and commission income

The Group earns fee and commission income from a diverse range of products and services provided to its customers.

Fee and commission income are recognised when the Group has satisfied its performance obligation in providing the promised products and services to the customer, and are recognised based on contractual rates agreed with customers, net of expected waivers based on historical experience, and net of expenses directly related to it. The Group generally satisfies its performance obligation and recognises the fee and commission income on the following basis:

- Transaction-based fee and commission income is recognised on the completion of the transaction. Such fees include underwriting fee, brokerage fees, and fees related to the completion of corporate finance transactions.
- For a service that is provided over a period of time, fee and commission income is recognised on equal proportion basis over the period during which the related service is provided or credit risk is undertaken. This basis of recognition most appropriately reflects the nature and pattern of provision of these services to the customers over time. Fees for these services can be billed to customers in advance or periodically over time. Such fees include the income from issuance of financial guarantees and loan agency service fees.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(p) Revenue recognition (continued)

(ii) Fee and commission income (continued)

The Group does not provide any significant credit terms to customers for the above products and services.

Directly related expenses typically include brokerage fees and commission paid, but do not include expenses for services delivered over a period (such as service contracts) and other expenses that are not specifically related to fee and commission income transactions.

(iii) Dividend income

Dividend income from unlisted investments is recognised when the shareholder's right to receive payment is established. Dividend income from listed investments is recognised when the share price of the investment is quoted ex-dividend.

(q) Translation of foreign currencies

Foreign currency transactions during the year are translated at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rates ruling at the end of the reporting period. Exchange gains and losses are recognised in profit or loss.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates. The transaction date is the date on which the company initially recognises such non-monetary assets or liabilities. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was measured.

The results of foreign operations are translated into Hong Kong dollars at the exchange rates approximating the foreign exchange rates ruling at the dates of the transactions. Statement of financial position items are translated into Hong Kong dollars at the closing foreign exchange rates at the end of the reporting period. The resulting exchange differences are recognised in other comprehensive income and accumulated separately in equity in the exchange reserve. On disposal of a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation is reclassified from equity to profit or loss when the profit or loss on disposal is recognised.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

1 GENERAL INFORMATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(r) Related parties

- (a) A person, or a close member of that person's family, is related to the Group if that person:
- (i) has control or joint control over the Group;
 - (ii) has significant influence over the Group; or
 - (iii) is a member of the key management personnel of the Group or the Group's parent.
- (b) An entity is related to the Group if any of the following conditions applies:
- (i) The entity and the Group are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
 - (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
 - (iii) Both entities are joint ventures of the same third party.
 - (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
 - (v) The entity is a post-employment benefit plan for the benefit of employees of either the Group or an entity related to the Group.
 - (vi) The entity is controlled or jointly controlled by a person identified in (a).
 - (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).
 - (viii) The entity, or any member of a group of which it is a part, provides key management personnel services to the Group or to the Group's parent.

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

2 CHANGES IN ACCOUNTING POLICIES

The HKICPA has issued a number of new HKFRSs and amendments to HKFRSs that are first effective for the current accounting period of the Group. Of these, the following developments are relevant to the Group's financial statements:

- (a) HKFRS 9, *Financial instruments*
- (b) HKFRS 15, *Revenue from contracts with customers*
- (c) HK(IFRIC) 22, *Foreign currency transactions and advance consideration*

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period.

(a) HKFRS 9 *Financial Instruments*

HKFRS 9 replaces HKAS 39, *Financial instruments: recognition and measurement*. It set out the requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items.

The Group has applied HKFRS 9 retrospectively to items that existed at 1 January 2018 in accordance with the transition requirements. The company has recognised the cumulative effect of initial application as an adjustment to the opening equity at 1 January 2018. Therefore, comparative information continues to be reported under HKAS 39.

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. The aggregate impact from the transition to HKFRS 9 was a net decrease of \$41,348,000 in the Group's equity.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

2 CHANGES IN ACCOUNTING POLICIES (CONTINUED)

(a) HKFRS 9 *Financial Instruments* (continued)

A Transition impact of adopting HKFRS 9 on 1 Jan 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	Reclassification	Remeasurement	1 Jan 2018
	HKAS 39			HKFRS 9
Assets				
Cash and balances with banks and central bank	424,887	–	(2)	424,885
Placements with and advances to banks	7,065,494	–	(463)	7,065,031
Financial assets at fair value through profit and loss	51,230	59,654	–	110,884
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	(59,654)	(1,200)	2,853,176
Interests in associates	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	–	8,170	16,200
Other assets	202,324	–	–	202,324
Total assets	25,777,060	–	(34,286)	25,742,774
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	–	(41,348)	4,413,021

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

2 CHANGES IN ACCOUNTING POLICIES (CONTINUED)

(a) HKFRS 9 *Financial Instruments* (continued)

B Credit Losses

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.

In HK\$'000	31 Dec 2017 HKAS 39		1 Jan 2018 HKFRS 9			Impact of ECL
	Collectively assessed	Individually assessed	Stage 1	Stage 2	Stage 3	
Assets						
Cash and balances with banks and central bank	-	-	2	-	-	(2)
Placements with and advances to banks	-	-	463	-	-	(463)
Loans and advances to customers	44,892	220,743	85,683	-	220,743	(40,791)
Investment securities at amortised cost	-	-	1,200	-	-	(1,200)
Other assets	-	183	-	-	183	-
Liabilities						
Other liabilities ¹	-	-	7,062	-	-	(7,062)
Total	44,892	220,926	94,410	-	220,926	(49,518)
Tax impact						8,170
Net decrease in equity at 1 January 2018						(41,348)

Note:

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

C 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

2 CHANGES IN ACCOUNTING POLICIES (CONTINUED)

(a) HKFRS 9 *Financial Instruments* (continued)

D Transition

Changes in accounting policies resulting from the adoption of HKFRS 9 have been applied retrospectively, except as described below:

- Comparative information in the prior financial periods is not restated as the Group adopted the optional exemption in HKFRS 9. 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. Accordingly, the information presented for 2017 continues to be reported under HKAS 39 and thus may not be comparable with the current period.
- The determination of the business model within which a financial asset is held has been made on the basis of the facts and circumstances that existed at 1 January 2018 (the date of initial application of HKFRS 9 by the Group).
- If, at the date of initial application, the assessment of whether there has been a significant increase in credit risk since initial recognition would have involved undue cost or effort, a lifetime ECL has been recognised for that financial instrument.

(b) 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 THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

2 CHANGES IN ACCOUNTING POLICIES (CONTINUED)

(c) HK(IFRIC) 22, *Foreign currency transactions and advance consideration*

This interpretation provides guidance on determining “the date of the transaction” for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) arising from a transaction in which an entity receives or pays advance consideration in a foreign currency. The adoption of HK(IFRIC) 22 does not have any material impact on the financial position and the financial result of the Group.

3 CRITICAL ACCOUNTING ESTIMATES

The Group’s accounting policies and use of estimates are integral to the reported results. Certain accounting estimates require management’s judgement in determining the appropriate methodology for valuation of assets and liabilities. Procedures are in place to ensure that methodologies are reviewed and revised as appropriate. The Group believes its estimates for determining the valuation of its financial assets and liabilities are appropriate.

The following is a brief description of the Group’s critical accounting estimates that involve management’s valuation judgement.

(a) Impairment of financial assets

It is the Group’s policy to recognise, through charges against profit, allowances in respect of estimated and inherent credit losses in its portfolio as described in Note 1(k).

The Group applied the impairment requirements under HKFRS 9 for financial year ended 2018, resulting in changes in assumptions used in the computation of impairment allowance using the ECL model. The numbers in the comparative period have not been restated.

ECLs are probability-weighted amounts determined by evaluating a range of possible outcomes and taking into account past events, current conditions and assessments of future economic conditions, which will necessarily involve the use of judgement.

In estimating specific allowances under HKFRS 9, the Group assesses the gap between borrowers’ obligations to the Group and their repayment ability. The assessment takes into account various factors, including the economic or business outlook, the future profitability of the borrowers and the liquidation value of collateral. Such assessment requires considerable judgement.

The general allowances under HKFRS 9 are determined after taking into account historical data and management’s assessment of the current economic and credit environment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

3 CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

(b) Fair value of financial instruments

The majority of the Group's financial instruments reported at fair value are based on quoted and observable market prices or on internally developed models that are based on independently sourced market parameters.

The fair value of financial instruments without an observable market price in a liquid market may be determined using valuation models. The choice of model requires significant judgement for complex products.

Policies and procedures have been established to facilitate the exercise of judgement in determining the risk characteristics of various financial instruments, discount rates, estimates of future cash flows and other factors used in the valuation process.

Please refer to Note 5(e) for details on valuation process and the fair value hierarchy of the Group's financial instruments measured at fair value.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

4 COMPANY-LEVEL STATEMENT OF FINANCIAL POSITION

	Note	2018 \$'000	2017 \$'000
Assets			
Cash and balances with banks and central bank		1,172,010	289,368
Placements with and advances to banks		2,592,410	7,048,990
Financial assets at fair value through profit and loss		19,192	–
Derivative financial assets		32,787	19,535
Loans and advances to customers		14,830,120	15,062,895
Investment securities		4,811,895	1,562,489
Investment in subsidiaries	19	780,000	780,000
Property and equipments		12,247	16,330
Intangible assets		5,038	5,878
Current tax recoverable		–	1,128
Deferred tax assets		32,012	8,030
Other assets		178,007	155,267
TOTAL ASSETS		<u>24,465,718</u>	<u>24,949,910</u>
Liabilities			
Deposits from customers		9,523,480	13,706,562
Deposits from banks		4,981,828	4,424,141
Derivative financial liabilities		48,430	19,294
Certificates of deposit issued		5,227,536	2,246,775
Current tax payable		16,911	–
Other liabilities		168,494	145,279
Total liabilities		<u>19,966,679</u>	<u>20,542,051</u>
Share capital and reserves	27(b)		
Share capital		4,000,000	4,000,000
Retained profits		529,121	309,061
Other reserves		(30,082)	98,798
Total equity		<u>4,499,039</u>	<u>4,407,859</u>
TOTAL EQUITY AND LIABILITIES		<u>24,465,718</u>	<u>24,949,910</u>

Approved and authorised for issue by the board of directors on 29 April 2019

)	
)	
)	
Zhang, Xuhong)	
)	Directors
)	
)	
Cheng, Kwok Kin Paul)	

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT

The Group's activities expose it to a variety of financial and operational risks and those activities involve analysis, evaluation, acceptance and management of some degree of risk or combination of risks. The most important types of financial risks are credit risk, market risk and liquidity risk. Market risk includes currency risk, interest rate and price risk.

Taking risk is core to the financial business, and the financial and operational risks are an inevitable consequence of being in business. The Group's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Group's financial performance.

The Group's risk management policies are designed to identify and analyse these risks so as to set appropriate risk limits and controls, and to monitor the risks and adhere to limits by means of reliable and up-to-date information systems. The Group regularly reviews its risk management policies and systems to cope with changes in markets, products and industry best practice.

Risk management functions are carried out by the specialised committees and the functional departments under the oversight of the Board of Directors. The Board provides guiding principles and directives for overall risk management including necessary policies covering the important risks as described below.

The Group has adopted a "Three Lines of Defense" risk management structure. The first line of defense comprises the Bank's business units, which are responsible for the management of the risks that they incur in the course of their activities. The Risk Management Department and Compliance Department provide independent oversight over the risk takers as the second line of defense. Reporting directly to the Audit Committee, the Group's Internal Audit Department serves as the third line of defense.

The Board, through Audit Committee, assesses the effectiveness of the Bank's risk management and internal control systems which cover all material controls, including financial, operational and compliance controls. The Bank has established an Audit Committee with specific written Terms of Reference which deal clearly with its authority and duties. The Terms of Reference of the Audit Committee have included the duties set out in the Corporate Governance Policy, with appropriate modifications where necessary. The Internal Audit Department assists the Audit Committee in its oversight of the Bank's overall risk management and internal control systems by conducting periodic reviews to assess the adequacy of the Bank's risk management framework, control, and governance processes as designed by the first and second lines of defense.

Pursuant to a risk based approach, the Bank's Internal Audit Department prepares an annual audit plan to determine the extent, nature and frequency of audit assignments every year. The Internal Audit Department conducts independent reviews of control mechanism over various operations and activities according to the plan. The senior management of the Bank and regulator may also engage Internal Audit Department to conduct ad-hoc and specific reviews from time to time. Significant audit findings and the implementation status of audit recommendations are reported to the Audit Committee twice each year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(a) Credit risk

Credit risk is the potential losses caused by obligor's inability to fulfil their contractual debt obligations. It arises from lending, treasury, derivatives and other activities undertaken by the Group. Credit exposures arise principally in loans and advances and debt securities in the Group's asset portfolio. There is also credit risk in off-balance sheet financial arrangements such as loan commitments.

The Group has established core procedures to foster its credit discipline in accordance with its credit policies.

The Group's approach to credit risk management focuses on monitoring and managing credit portfolios. Regular portfolio analysis is conducted to track the asset quality and determine credit underwriting strategies on an ongoing basis. The Group's exposures to individuals, counterparties and products are subject to various risk control limits which are reviewed and approved from time to time. The senior management of the Group evaluates and approves new product proposals, credit criteria for new account relationship, and sets appropriate limits. As a rule, credit quality takes precedence over opportunistic business development.

Facility requests are processed in the prescribed format, and those conforming to defined credit criteria are approved within the delegated credit approval authorities in compliance with established policies, standards and procedures. The Group's credit risk is being mitigated by taking security in secured lending transactions. Credit exceptions to established underwriting criteria must be approved by an officer with sufficient exception approval authority. Exceptions are documented, tracked and submitted to senior management for review on a regular basis.

All credit exposures are subject to stringent collection, classification and charge-off policies. In addition, the Group performs loan loss analyses, taking into consideration the economic factors and loss identification periods, to determine the appropriate level of impairment allowances.

(i) Maximum exposure

The table below shows the maximum exposure to credit risk at the reporting date without taking account of any collaterals held or other credit enhancements. For on-balance sheet assets, the exposures shown below are based on the carrying amount of each financial asset in the consolidated statement of financial position after deducting any impairment allowance. For loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities or revocable in the extent of significant adverse change, the maximum exposure to credit risk is disclosed as the full amount of the committed facilities sought on these balances.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(a) Credit risk (continued)

(i) Maximum exposure (continued)

	2018 \$'000	2017 \$'000
Cash and balances with banks and central bank	1,394,837	424,887
Placements with and advances to banks	2,592,414	7,065,494
Financial assets at fair value through profit and loss	287,024	51,230
Derivative financial assets	32,787	19,535
Loans and advances to customers	14,830,120	15,062,895
Investment securities	9,118,004	2,914,030
Interests in associates	228	1,199
Other assets	256,907	202,324
Financial guarantees and other credit related contingent liabilities	114,279	124,306
Loan commitments and other credit related commitments	1,850,622	2,110,335
	<u>30,477,222</u>	<u>27,976,235</u>

Credit risk mitigation, collaterals and other credit enhancement

The Group uses a variety of techniques to reduce the credit risk arising from its lending activities. Enforceable legal documentation establishes the Group's direct, irrevocable and unconditional recourse to any collaterals, security or other credit enhancement provided. The table below describes the nature of collaterals held and their financial effect by class of financial asset:

Balances and placements with banks and central bank	:	These exposures are generally considered to be low risk due to the nature of the counterparties. Collaterals is generally not sought on these balances.
Derivative financial assets	:	Master netting agreements are typically used to enable the effects of derivative financial assets and liabilities with the same counterparty to be offset in case of default.
Financial assets at fair value through profit and loss and investment securities	:	No collaterals is sought directly from the issuer. The fair value of these assets has reflected the credit risk element.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(a) Credit risk (continued)

(i) Maximum exposure (continued)

Loans and advances to customers : These exposures are secured, partially secured or unsecured depending on the type of customers and the products offered to them. Collaterals accepted by the Group includes residential properties, commercial real estates, share listed on a recognised stock exchange, standby letter of credit issued by banks accepted by the Group, bank deposits, etc.

Contingent liabilities and commitments : The components and the nature of contingent liabilities and commitments are disclosed in Note 30. For commitments that are unconditionally cancellable, the Group would assess whether the credit facilities should be withdrawn whenever the Group is aware of the deterioration of borrower's credit quality. Accordingly, these commitments do not expose the Group to significant credit risk.

For commitments that are not unconditionally cancellable, including letter of credit issued and other credit facilities, they are secured, partially secured or unsecured depending on the type of customers and the products offered to them.

(ii) Credit quality of loans and advances

As at 31 December 2018 and 2017, all placements with banks were neither past due nor impaired. Note 16(e) provides information on credit quality of the loans and advances to customers.

(iii) Credit quality of investment securities

As at 31 December 2018, all investment securities were neither past due nor impaired. The following table presents an analysis of investment securities by rating agency designation at the reporting date, based on Standard and Poor's Rating Services, Moody's Investors Services or Fitch Ratings, to the respective issues of the investment securities. In the absence of such issue ratings, the ratings designated for the issuers are reported. If there are different ratings for the same securities, the securities are reported against the lowest rating.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(a) Credit risk (continued)

(iii) Credit quality of investment securities (continued)

	2018 \$'000	2017 \$'000
AAA	–	37,984
AA+ to A-	2,933,611	1,051,269
BBB+ to BBB-	3,306,850	821,894
BB+ or below	2,720,003	748,459
Unrated	157,540	254,424
	<u>9,118,004</u>	<u>2,914,030</u>

(iv) Enforceable netting arrangements or similar agreements

For the financial assets and liabilities subject to enforceable netting arrangements or similar agreements, each agreement between the Group and the counterparty allows for net settlement of the relevant financial assets and liabilities when both elect to settle on a net basis, in the absence of such an election, financial assets and liabilities will be settled on a gross basis. However, each party to the master netting arrangement or similar agreement will have the option to settle all such amounts on a net basis in the event of default of the other party.

These agreements include derivative master agreements (including the International Swaps and Derivatives Association Master Agreement), etc. The collaterals received and placed under these agreements are generally conducted under terms that are in accordance with normal market practices.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(a) Credit risk (continued)

(iv) Enforceable netting arrangements or similar agreements (continued)

The tables below present details of financial instruments subject to enforceable netting arrangements and similar agreements.

As at 31 December 2018

	Gross amounts of recognised financial assets \$'000	Gross amounts of recognised financial liabilities set off in the consolidated statement of financial position \$'000	Gross amounts of recognised financial liabilities set off in the consolidated statement of financial position \$'000	Net amounts of financial assets presented in the consolidated statement of financial position \$'000	Related amounts not set off in the consolidated statement of financial position		Net amount \$'000
					Financial instruments \$'000	Cash collaterals received \$'000	
Derivative financial assets	<u>32,787</u>	<u>–</u>	<u>32,787</u>	<u>(10,710)</u>	<u>(5,843)</u>	<u>16,234</u>	

As at 31 December 2018

	Gross amounts of recognised financial liabilities \$'000	Gross amounts of recognised financial assets set off in the consolidated statement of financial position \$'000	Gross amounts of recognised financial liabilities set off in the consolidated statement of financial position \$'000	Net amounts of financial liabilities presented in the consolidated statement of financial position \$'000	Related amounts not set off in the consolidated statement of financial position		Net amount \$'000
					Financial instruments \$'000	Cash collaterals pledged \$'000	
Derivative financial liabilities	<u>48,430</u>	<u>–</u>	<u>48,430</u>	<u>(10,710)</u>	<u>(14,649)</u>	<u>23,071</u>	

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(a) Credit risk (continued)

(iv) Enforceable netting arrangements or similar agreements (continued)

As at 31 December 2017

	Gross amounts of recognised financial liabilities set off in the consolidated statement of financial position \$'000	Gross amounts of recognised financial assets position \$'000	Net amounts of financial assets presented in the consolidated statement of financial position \$'000	Related amounts not set off in the consolidated statement of financial position		
				Financial instruments \$'000	Cash collaterals received \$'000	Net amount \$'000
Derivative financial assets	19,535	–	19,535	(7,668)	(2,347)	9,520

As at 31 December 2017

	Gross amounts of recognised financial assets set off in the consolidated statement of financial position \$'000	Gross amounts of recognised financial liabilities position \$'000	Net amounts of financial liabilities presented in the consolidated statement of financial position \$'000	Related amounts not set off in the consolidated statement of financial position		
				Financial instruments \$'000	Cash collaterals pledged \$'000	Net amount \$'000
Derivative financial liabilities	19,294	–	19,294	(7,668)	–	11,626

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(b) Market risk

Market risk is the risk of loss on assets, liabilities and commitments arising from the net effect of changes in market rates, such as foreign exchange rates and interest rates.

The Group entered into foreign exchange, interest rate and money market transactions, solely for the purpose of hedging, funding or deployment of surplus liquidity. Financial instruments entered into in respect of the above objectives mainly include forward foreign exchange contracts and money market transactions.

(i) Currency risk

The Group took on exposure due to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board set limits on the level of certain foreign exchange exposures, which were managed by Treasury Department and monitored by Risk Management Department. The Group employed forward foreign currency exchange contracts, if applicable, to maintain its overall foreign currency exposure within such currency limit. The table below summarises the Group's exposures to foreign currency exchange rate risks that are recorded in the statement of financial position.

The following table indicates the currency concentration of the assets and liabilities at carrying amounts in Hong Kong dollars equivalent, categorised by original currency.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(b) Market risk (continued)

(i) Currency risk (continued)

At 31 December 2018

	HKD \$'000	USD \$'000	EUR \$'000	RMB \$'000	Others \$'000	Total \$'000
Assets						
Cash and balances with banks and central bank	74,506	1,263,152	1,622	54,002	1,555	1,394,837
Placements with and advances to banks	349,526	2,106,270	–	136,618	–	2,592,414
Financial assets at fair value through profit and loss	–	19,192	–	267,832	–	287,024
Derivative financial assets	–	23,395	722	–	8,670	32,787
Loans and advances to customers	3,382,680	10,253,841	513,697	314,788	365,114	14,830,120
Investment securities	1,348,378	6,977,817	–	791,809	–	9,118,004
Interests in associates	–	–	–	228	–	228
Property and equipments	15,353	–	–	1,084	–	16,437
Intangible assets	5,123	–	–	11	–	5,134
Current tax recoverable	2,000	–	–	–	–	2,000
Deferred tax assets	32,011	22,238	–	318	–	54,567
Other assets	29,430	203,958	1,245	19,882	2,392	256,907
Spot assets	5,239,007	20,869,863	517,286	1,586,572	377,731	28,590,459
Liabilities						
Deposits from customers	3,893,683	4,912,799	5,788	691,083	–	9,503,353
Deposits from banks	1,478,000	2,560,410	–	500,918	442,500	4,981,828
Trading liabilities	–	8,159	–	–	–	8,159
Derivative financial liabilities	–	37,378	2,025	–	9,027	48,430
Certificates of deposit and other debt securities issued	1,816,228	5,465,106	–	1,844,930	–	9,126,264
Current tax payable	30,663	1,205	–	10,407	–	42,275
Other liabilities	88,423	220,964	1	87,212	608	397,208
Spot liabilities	7,306,997	13,206,021	7,814	3,134,550	452,135	24,107,517
Net long position	(2,067,990)	7,663,842	509,472	(1,547,978)	(74,404)	4,482,942

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(b) Market risk (continued)

(i) Currency risk (continued)

At 31 December 2017

	HKD \$'000	USD \$'000	EUR \$'000	RMB \$'000	Others \$'000	Total \$'000
Assets						
Cash and balances with banks and central bank	272,429	130,111	426	21,057	864	424,887
Placements with and advances to banks	216,500	5,337,918	495,730	1,015,346	–	7,065,494
Financial assets at fair value through profit and loss	–	51,230	–	–	–	51,230
Derivative financial assets	–	19,381	154	–	–	19,535
Loans and advances to customers	3,291,941	10,745,970	831,330	140,915	52,739	15,062,895
Investment securities	199,241	2,400,840	–	313,949	–	2,914,030
Interests in associates	–	–	–	1,199	–	1,199
Property and equipments	19,959	–	–	210	–	20,169
Intangible assets	6,126	–	–	13	–	6,139
Current tax recoverable	1,128	–	–	–	–	1,128
Deferred tax assets	8,030	–	–	–	–	8,030
Other assets	22,157	167,480	4,447	7,803	437	202,324
Spot assets	4,037,511	18,852,930	1,332,087	1,500,492	54,040	25,777,060
Liabilities						
Deposits from customers	1,731,157	10,980,156	6,170	910,804	–	13,628,287
Deposits from banks	195,000	3,712,315	495,730	–	21,096	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	6,441	–	–	1,514	–	7,955
Deferred tax liabilities	437	–	–	–	–	437
Other liabilities	80,835	118,926	1,125	13,282	94	214,262
Spot liabilities	2,013,870	17,839,712	522,319	925,600	21,190	21,322,691
Net long position	2,023,641	1,013,218	809,768	574,892	32,850	4,454,369

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(b) Market risk (continued)

(ii) Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates.

The Group took on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow interest rate risk. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The Board set limits on the level of mismatch of interest rate repricing that may be undertaken, which were managed by Treasury Department and monitored by Risk Management Department daily.

As at 31 December 2018, if market interest rates were 1% higher while other variables maintained constant, profit before taxation for the year would have been \$71 million higher (2017: \$50.0 million higher). However, if market interest rates were 1% lower while other variables held constant, profit before taxation for the year would have been \$73 million lower (2017: \$55.0 million lower).

The table below summarises the Group's exposure to interest rate risk. It includes the Group's financial instruments at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(b) Market risk (continued)

(ii) Interest rate risk (continued)

At 31 December 2018

	Within 1 month \$'000	Over 1 month but within 3 months \$'000	Over 3 months but within 1 year \$'000	Over 1 year but within 5 years \$'000	Over 5 years \$'000	Undated \$'000	Total \$'000
Assets							
Cash and balances with banks and central bank	222,827	–	–	–	–	1,172,010	1,394,837
Placements with and advances to banks	2,592,414	–	–	–	–	–	2,592,414
Financial assets at fair value through profit and loss	113,845	–	167,190	–	–	5,989	287,024
Derivative financial assets	–	–	–	–	–	32,787	32,787
Loans and advances to customers	7,650,526	5,872,999	925,801	445,632	–	(64,838)	14,830,120
Investment securities	425,811	1,190,022	2,283,581	4,055,806	1,193,298	(30,514)	9,118,004
Interests in associates	–	–	–	–	–	228	228
Property and equipments	–	–	–	–	–	16,437	16,437
Intangible assets	–	–	–	–	–	5,134	5,134
Current tax recoverable	–	–	–	–	–	2,000	2,000
Deferred tax assets	–	–	–	–	–	54,567	54,567
Other assets	–	–	–	–	–	256,907	256,907
Total assets	11,005,423	7,063,021	3,376,572	4,501,438	1,193,298	1,450,707	28,590,459
Liabilities							
Deposits from customers	3,123,829	3,398,009	1,748,763	1,232,752	–	–	9,503,353
Deposits from banks	1,810,400	2,215,624	591,500	364,304	–	–	4,981,828
Trading liabilities	–	–	–	–	–	8,159	8,159
Derivative financial liabilities	–	–	–	–	–	48,430	48,430
Certificates of deposit and other debt securities issued	–	2,535,303	2,692,233	3,898,728	–	–	9,126,264
Current tax payable	–	–	–	–	–	42,275	42,275
Deferred tax liabilities	–	–	–	–	–	–	–
Other liabilities	102,123	–	–	–	–	295,085	397,208
Spot liabilities	5,036,352	8,148,936	5,032,496	5,495,784	–	393,949	24,107,517
Net repricing gap	5,969,071	(1,085,915)	(1,655,924)	(994,346)	1,193,298	1,056,758	4,482,942

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(b) Market risk (continued)

(ii) Interest rate risk (continued)

At 31 December 2017

	Within 1 month \$'000	Over 1 month but within 3 months \$'000	Over 3 months but within 1 year \$'000	Over 1 year but within 5 years \$'000	Over 5 years \$'000	Undated \$'000	Total \$'000
Assets							
Cash and balances with banks and central bank	–	–	–	–	–	424,887	424,887
Placements with and advances to banks	5,097,767	1,471,997	495,730	–	–	–	7,065,494
Financial assets at fair value through profit and loss	51,230	–	–	–	–	–	51,230
Derivative financial assets	–	–	–	–	–	19,535	19,535
Loans and advances to customers	7,024,605	6,735,813	1,462,528	105,585	–	(265,636)	15,062,895
Investment securities	367,460	523,457	182,215	1,341,650	388,364	110,884	2,914,030
Interests in associates	–	–	–	–	–	1,199	1,199
Property and equipments	–	–	–	–	–	20,169	20,169
Intangible assets	–	–	–	–	–	6,139	6,139
Current tax recoverable	–	–	–	–	–	1,128	1,128
Deferred tax assets	–	–	–	–	–	8,030	8,030
Other assets	–	–	–	–	–	202,324	202,324
Total assets	12,541,062	8,731,267	2,140,473	1,447,235	388,364	528,659	25,777,060
Liabilities							
Deposits from customers	6,439,865	3,187,960	4,000,462	–	–	–	13,628,287
Deposits from banks	255,558	3,047,621	1,120,962	–	–	–	4,424,141
Derivative financial liabilities	–	–	–	–	–	19,294	19,294
Certificates of deposit and other debt securities issued	–	625,177	2,168,779	234,359	–	–	3,028,315
Current tax payable	–	–	–	–	–	7,955	7,955
Deferred tax liabilities	–	–	–	–	–	437	437
Other liabilities	–	–	–	–	–	214,262	214,262
Spot liabilities	6,695,423	6,860,758	7,290,203	234,359	–	241,948	21,322,691
Net repricing gap	5,845,639	1,870,509	(5,149,730)	1,212,876	388,364	286,711	4,454,369

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(c) Liquidity risk

Liquidity risk is the risk that the Group may not be able to fund its increase in assets or meet its financial obligations as they fall due. This may be caused by market disruption or liquidity squeeze whereby the Group may only unwind specific exposures at significantly discounted values. The Group adopts a prudent risk appetite in setting liquidity risk tolerance. Risk appetite is set in the form of liquidity risk limit and metrics.

The Asset and Liability Committee (“ALCO”) is a management committee delegated by the Board to oversee the liquidity risk of the Group. ALCO is responsible for reviewing and approving liquidity risk management strategies and, with the delegation to the Market Risk Division, monitoring the Group’s liquidity position.

Monitoring and reporting took the form of cash flow measurement and projections for the next day, week and month respectively, as these were key periods for liquidity management. Sources of liquidity are reviewed to maintain a diversification of provider, product and term.

Liquidity stress testing is regularly conducted to project the Group’s cash flow condition under stress scenarios and evaluate the sufficiency of liquidity. The stress test results are regularly reported to the ALCO.

Treasury Department is responsible for the day-to-day liquidity management, includes:

- day-to-day funding management by monitoring future cash flows to ensure that requirements can be met. This includes replenishment of funds as they mature or provision of funds to be borrowed by customers;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- managing the concentration and profile of debt maturities; and
- monitoring unmatched medium-term assets, the level and type of undrawn lending commitments and the impact of contingent liabilities.

Market Risk Division and the Finance Department produce relevant liquidity reports for internal monitoring and regulatory reporting purpose.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(c) Liquidity risk (continued)

(i) Maturity analysis

The table below shows the maturity profile of assets and liabilities analysed by the remaining period to repayment as at the reporting date:

At 31 December 2018

	Repayable on demand \$'000	Within 1 month \$'000	Over 1 month but within 3 months \$'000	Over 3 months but within 1 year \$'000	Over 1 year but within 5 years \$'000	Over 5 years \$'000	Undated \$'000	Total \$'000
Assets								
Cash and balances with banks and central bank	1,395,044	-	-	-	-	-	(207)	1,394,837
Placements with and advances to banks	-	2,592,888	-	-	-	-	(474)	2,592,414
Financial assets at fair value through profit and loss	-	113,845	-	167,190	-	-	5,989	287,024
Derivative financial assets	-	-	-	-	-	-	32,787	32,787
Loans and advances to customers	-	3,318,330	1,661,702	3,960,897	5,948,736	5,293	(64,838)	14,830,120
Investment securities	-	229,752	768,125	2,154,086	4,534,386	1,462,169	(30,514)	9,118,004
Interests in associates	-	-	-	-	-	-	228	228
Property and equipments	-	-	-	-	-	-	16,437	16,437
Intangible assets	-	-	-	-	-	-	5,134	5,134
Current tax recoverable	-	-	-	2,000	-	-	-	2,000
Deferred tax assets	-	-	-	-	-	-	54,567	54,567
Other assets	1,583	71,053	83,606	50,926	15,950	3,907	29,882	256,907
Total assets	1,396,627	6,325,868	2,513,433	6,335,099	10,499,072	1,471,369	48,991	28,590,459
Liabilities								
Deposits from customers	-	4,356,580	3,398,010	1,748,763	-	-	-	9,503,353
Deposits from banks	-	2,174,704	2,215,624	591,500	-	-	-	4,981,828
Trading liabilities	8,159	-	-	-	-	-	-	8,159
Derivative financial liabilities	-	-	-	-	-	-	48,430	48,430
Certificates of deposit and other debt securities issued	-	-	2,300,459	2,692,233	4,133,572	-	-	9,126,264
Current tax payable	-	-	-	42,275	-	-	-	42,275
Other liabilities	102,123	100,941	146,818	33,264	152	-	13,910	397,208
Total liabilities	110,282	6,632,225	8,060,911	5,108,035	4,133,724	-	62,340	24,107,517
Net liquidity gap	1,286,345	(306,357)	(5,547,478)	1,227,064	6,365,348	1,471,369	(13,349)	4,482,942

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(c) Liquidity risk (continued)

(i) Maturity analysis (continued)

At 31 December 2017

	Repayable on demand \$'000	Within 1 month \$'000	Over 1 month but within 3 months \$'000	Over 3 months but within 1 year \$'000	Over 1 year but within 5 years \$'000	Over 5 years \$'000	Undated \$'000	Total \$'000
Assets								
Cash and balances with banks and central bank	424,887	-	-	-	-	-	-	424,887
Placements with and advances to banks	-	5,097,766	1,471,998	495,730	-	-	-	7,065,494
Financial assets at fair value through profit and loss	-	51,230	-	-	-	-	-	51,230
Derivative financial assets	-	-	-	-	-	-	19,535	19,535
Loans and advances to customers	274,182	2,378,279	1,416,292	4,998,532	6,249,352	11,894	(265,636)	15,062,895
Investment securities	-	351,653	155,899	282,200	1,267,262	746,132	110,884	2,914,030
Interests in associates	-	-	-	-	-	-	1,199	1,199
Property and equipments	-	-	-	-	-	-	20,169	20,169
Intangible assets	-	-	-	-	-	-	6,139	6,139
Current tax recoverable	-	-	-	1,128	-	-	-	1,128
Deferred tax assets	-	-	-	-	-	-	8,030	8,030
Other assets	14,259	56,828	71,773	37,245	12,019	-	10,200	202,324
Total assets	713,328	7,935,756	3,115,962	5,814,835	7,528,633	758,026	(89,480)	25,777,060
Liabilities								
Deposits from customers	-	6,439,864	3,187,960	4,000,463	-	-	-	13,628,287
Deposits from banks	-	255,558	3,047,621	1,120,962	-	-	-	4,424,141
Derivative financial liabilities	-	-	-	-	-	-	19,294	19,294
Certificates of deposit and other debt securities issued	-	-	625,177	2,168,779	234,359	-	-	3,028,315
Current tax payable	-	-	1,514	6,441	-	-	-	7,955
Deferred tax liabilities	-	-	-	-	-	-	437	437
Other liabilities	-	37,935	81,226	69,812	13,026	-	12,263	214,262
Total liabilities	-	6,733,357	6,943,498	7,366,457	247,385	-	31,994	21,322,691
Net liquidity gap	713,328	1,202,399	(3,827,536)	(1,551,622)	7,281,248	758,026	(121,474)	4,454,369

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(c) Liquidity risk (continued)

(ii) Undiscounted cash flows by contractual maturities

The table below presents the cash flows payable by the Group under non-derivative financial liabilities and derivative financial instruments by remaining contractual maturities at the reporting date, and also the cash flows payable in respect of other off-balance sheet items by the earliest date they could be called. The amounts disclosed in the table were the contractual undiscounted cash flows (including interest payments computed using contractual rates or, if floating based on rates prevailing at the reporting date), whereas the Group manages the inherent liquidity risk based on expected undiscounted cash flows.

At 31 December 2018

	Within 1 month \$'000	Over 1 month but within 3 months \$'000	Over 3 months but within 1 year \$'000	Over 1 year \$'000	Total \$'000	Carrying amount \$'000
Non-derivative financial liabilities						
Deposits from customers	4,371,234	3,426,861	1,788,353	–	9,586,448	9,503,353
Deposits from banks	2,190,953	2,234,056	603,108	–	5,028,117	4,981,828
Trading liabilities	8,159	–	–	–	8,159	8,159
Certificates of deposit and other debt securities issued	61,172	2,365,788	2,836,444	4,344,274	9,607,678	9,126,264
Other liabilities	121,985	74,650	24,420	–	221,055	276,110
	<u>6,753,503</u>	<u>8,101,355</u>	<u>5,252,325</u>	<u>4,344,274</u>	<u>24,451,457</u>	<u>23,895,714</u>
Derivative cash flow settled on a net basis	<u>461</u>	<u>769</u>	<u>1,677</u>	<u>7,800</u>	<u>10,707</u>	
Derivative cash flow settled on a gross basis						
Total inflow	5,532,312	3,609,361	–	–	9,141,673	
Total outflow	(5,537,790)	(3,631,709)	–	–	(9,169,499)	
	<u>(5,478)</u>	<u>(22,348)</u>	<u>–</u>	<u>–</u>	<u>(27,826)</u>	
Other off-balance sheet items (note 30(a))						
Loan commitments and other credit related commitments	1,850,622	–	–	–	1,850,622	
Financial guarantees and other credit related contingent liabilities	114,279	–	–	–	114,279	
	<u>1,964,901</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>1,964,901</u>	

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(c) Liquidity risk (continued)

(ii) Undiscounted cash flows by contractual maturities (continued)

At 31 December 2017

	Within 1 month \$'000	Over 1 month but within 3 months \$'000	Over 3 months but within 1 year \$'000	Over 1 year \$'000	Total \$'000	Carrying amount \$'000
Non-derivative financial liabilities						
Deposits from customers	6,466,181	3,217,165	4,087,297	–	13,770,643	13,628,287
Deposits from banks	256,273	3,067,546	1,131,321	–	4,455,140	4,424,141
Certificates of deposit and other debt securities issued	–	632,524	2,219,367	247,462	3,099,353	3,028,315
Other liabilities	16,824	53,900	27,771	1,319	99,814	99,814
	<u>6,739,278</u>	<u>6,971,135</u>	<u>7,465,756</u>	<u>248,781</u>	<u>21,424,950</u>	<u>21,180,557</u>
Derivative cash flow settled on a net basis	<u>–</u>	<u>704</u>	<u>2,092</u>	<u>9,456</u>	<u>12,252</u>	
Derivative cash flow settled on a gross basis						
Total inflow	514,187	100,227	629,291	–	1,243,705	
Total outflow	(507,197)	(100,204)	(642,392)	–	(1,249,793)	
	<u>6,990</u>	<u>23</u>	<u>(13,101)</u>	<u>–</u>	<u>(6,088)</u>	
Other off-balance sheet items (note 30(a))						
Loan commitments and other credit related commitments	2,110,335	–	–	–	2,110,335	
Financial guarantees and other credit related contingent liabilities	124,306	–	–	–	124,306	
	<u>2,234,641</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>2,234,641</u>	

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(d) Capital management

Being an authorised institution incorporated in Hong Kong, the Group is regulated by the Hong Kong Monetary Authority (“HKMA”) which sets and monitors capital requirements for the Group.

The HKMA has issued the Banking (Capital) Rules, which require the Group to maintain adequate regulatory capital to support credit risk, market risk and operational risk.

In addition to meeting the regulatory requirements, the Group’s primary objective in managing its capital is to ensure the Group’s ability to continue as a going concern so that it can continue to provide returns and benefits to shareholders and other stakeholders. To achieve the targeted return, products and services are priced to commensurate with the level of risk and funds are acquired at a reasonable cost.

The Group actively and regularly reviews and manages its capital structure to maintain a balance between satisfactory shareholder returns and adequate security afforded by a sound capital position, and makes adjustments to the capital structure in light of any significant changes in economic conditions.

The Group monitors its capital structure with due consideration of the capital adequacy ratio as calculated in accordance with the Banking (Capital) Rules. The Group has adopted the Standardised (Credit Risk) Approach in calculating credit risk for non-securitisation exposures.

Throughout the years of 2018 and 2017, the Group fully complied with the capital requirements imposed by the HKMA.

(e) Fair value of financial assets and liabilities

(i) 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(e) Fair value of financial assets and liabilities (continued)

(i) Financial assets and liabilities measured at fair value (continued)

- 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 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 reporting period applicable for an instrument with similar terms and conditions.

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

	2018			Total \$'000
	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	
Recurring fair value measurements				
<i>Assets</i>				
Financial assets at fair value through profit and loss	19,192	–	267,832	287,024
Derivative financial assets (note 29)	–	32,787	–	32,787
Investment securities at fair value through other comprehensive income (note 17)	832,923	4,415,526	–	5,248,449
<i>Liabilities</i>				
Trading liabilities	8,159	–	–	8,159
Derivative financial liabilities (note 29)	–	48,430	–	48,430

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(e) Fair value of financial assets and liabilities (continued)

(i) Financial assets and liabilities measured at fair value (continued)

	2017			
	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Recurring fair value measurements				
<i>Assets</i>				
Financial assets at fair value through profit and loss	–	51,230	–	51,230
Derivative financial assets	–	19,535	–	19,535
Investment securities (note 17)	644,793	1,925,058	110,884	2,680,735
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
<i>Liabilities</i>				
Derivative financial liabilities	–	19,294	–	19,294
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

During the years of 2018 and 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 investment 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 financial assets at fair value through profit and loss/available-for-sale investment securities in Level 3 is determined using the most recent transactions. As at 31 December 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 \$10.1 million (2017: \$4.6 million).

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(e) Fair value of financial assets and liabilities (continued)

(i) Financial assets and liabilities measured at fair value (continued)

The movement during the period in the balance of these Level 3 fair value measurements are as follows:

	Wealth management products from banks \$'000	Convertible bonds \$'000	Unlisted issued notes and put option \$'000	Unlisted equity investments \$'000	Total \$'000
At 1 January 2017	–	–	–	–	–
Payment for purchases	110,884	–	–	–	110,884
At 31 December 2017	110,884	–	–	–	110,884
At 1 January 2018	110,884	–	–	–	110,884
Payment for purchases	7,450	364,304	22,769	17,373	411,896
Disposal/redemption for the products	(118,334)	(125,229)	–	(11,385)	(254,948)
At 31 December 2018	–	239,075	22,769	5,988	267,832
Total gains or losses for the period reclassified from other comprehensive income on disposal	–	–	–	–	–
Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period:					
– Other operating income	3,040	–	–	–	3,040
– Interest income	–	9,533	311	–	9,844

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(e) Fair value of financial assets and liabilities (continued)

(i) Financial assets and liabilities measured at fair value (continued)

The fair values of financial instruments in Level 3 as at 31 December 2018 are determined by their respective valuation techniques as follows:

– Wealth management products from banks	Most recent market transactions of market comparable investment
– Convertible bonds	Most recent market transactions of market comparable investments
– Unlisted issued notes	Discounted cashflow analysis
– Unlisted equity investment	Most recent market transactions of market comparable investment

(ii) Financial assets and liabilities not measured at fair value

Financial assets and liabilities that are presented not at their fair value on the Group's consolidated statement of financial position and the Company's statement of financial position mainly represent 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 are measured at amortised cost less impairment. Financial liabilities not presented at their fair value on the Group's consolidated statement of financial position and the Company's statement of financial position mainly represent deposits from banks, deposits from customers and certificates of deposit and other debt securities issued. These financial liabilities are measured at amortised cost.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

5 FINANCIAL RISK MANAGEMENT (CONTINUED)

(e) Fair value of financial assets and liabilities (continued)

(ii) Financial assets and liabilities not measured at fair value (continued)

The Group assessed that the differences between fair values and carrying amounts of those financial assets and liabilities not presented on the Group's and the Company's statement of financial position at their fair values are minimal as most of the Group's and the Company'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:

	Carrying amounts at 31 December 2018 \$'000	Fair value at 31 December 2018 \$'000	Fair value measurements as at 31 December 2018 categorised into		
			Level 1 \$'000	Level 2 \$'000	Level 3 \$'000
Assets					
Investments securities at amortised cost (Note 17)	3,900,069	3,678,159	–	3,678,159	–

(f) Transfers of financial assets

The Group enters into transactions in the normal course of business which transfers recognised financial assets directly to third party. All these transfers resulted in full derecognition of the financial assets concerned as the Group transferred its contractual right to receive cash flows from these financial assets, or retained the rights but assumed an obligation to pass on the cash flows from these financial assets, and transferred substantially all the risks and rewards from financial assets. The risks included credit, interest rate, currency, prepayment and other price risks.

As at 31 December 2018 and 2017, there were no outstanding transferred financial assets in which the Group had a continuing involvement that were derecognised in their entirety.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

6 NET INTEREST INCOME

	2018	2017
	\$'000	\$'000
Interest income		
Interest income calculated using the effective interest method		
– Balances and placements with banks	49,796	160,401
– Loans and advances to customers	721,930	550,674
– Investment securities	344,147	80,595
– Others	10,770	484
Other interest income	10,608	2,242
	<u>1,137,251</u>	<u>794,396</u>
	-----	-----
Interest expense		
Interest expense arising from financial liabilities that are not measured at fair value through profit or loss		
– Deposits from banks	(111,804)	(44,605)
– Deposits from customers	(221,079)	(280,389)
– Certificates of deposit and other debt securities issued	(278,871)	(65,216)
– Others	(7,283)	–
	<u>(619,037)</u>	<u>(390,210)</u>
	-----	-----
Net interest income	<u>518,214</u>	<u>404,186</u>
	=====	=====

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

7 NET FEE AND COMMISSION INCOME

	2018 \$'000	2017 \$'000
Fee and commission income		
– Credit facilities	39,088	33,346
– Trade services	1,222	937
– IPO sponsorship	500	1,500
– Underwriting	–	253
– Corporate advisory	93,440	65,548
– Asset management	11,648	38,098
– Brokerage	323	4,796
– Others	4,474	3,958
	<u>150,695</u>	<u>148,436</u>
Fee and commission expense	<u>(16,022)</u>	<u>(1,148)</u>
Net fee and commission income	<u><u>134,673</u></u>	<u><u>147,288</u></u>

All the fee and commission income of \$150,695,000 (2017: \$148,436,000) and fee and commission expense of \$16,022,000 (2017: \$1,148,000) for the year ended 31 December 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 years ended 31 December 2018 was \$11,648,000 (2017: \$38,098,000).

8 NET INCOME FROM FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

	2018 \$'000	2017 \$'000
Foreign exchange	10,652	107,716
Interest rate and others	(882)	11,720
	<u>9,770</u>	<u>119,436</u>

The foreign exchange gain in 2018 included the translation loss of \$41 million (2017: gain of \$68 million) on those Renminbi (“RMB”) assets funded by the Company’s capital denominated in RMB (which is recorded on these financial statements at historical exchange rate) due to change in exchange rate of RMB against HKD. Excluding this translation gain/loss, trading income from normal foreign exchange activities was \$52 million (2017: \$39 million).

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

9 OPERATING EXPENSES

	Note	2018 \$'000	2017 \$'000
Staff costs			
– Salaries and other benefits		147,629	139,046
– Pension and provident fund costs		5,327	3,816
		<u>152,956</u>	<u>142,862</u>
		-----	-----
Premises and equipment expenses excluding depreciation			
– Rental of premises		21,744	20,352
– Maintenance and office facility expenses		3,283	3,051
– Others		1,519	1,444
		<u>26,546</u>	<u>24,847</u>
		-----	-----
Auditor's remuneration		1,955	1,102
Depreciation of property and equipments	20	7,129	7,709
Amortisation of intangible assets	21	3,160	3,034
Legal and professional fees		5,425	5,445
IT and system expenses		9,126	7,221
Other operating expenses		16,520	11,999
		<u>43,315</u>	<u>36,510</u>
		-----	-----
		<u>222,817</u>	<u>204,219</u>
		=====	=====

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

10 ALLOWANCES FOR CREDIT AND OTHER LOSSES

	Note	2018 HK\$'000	2017 HK\$'000
Cash and balances with banks and central banks	14	205	–
Placements with and advances to banks	15	11	–
Loans and advances to customers	16(b)	140,992	224,628
Investment securities	17	39,246	–
Other assets	22	412	183
Off-balance sheet credit exposures		(4,054)	–
		<u>176,812</u>	<u>224,811</u>
Cash and balances with banks and central bank			
– New allowances		205	–
– Releases		–	–
		<u>205</u>	<u>–</u>
Placements with and advances to banks			
– New allowances		11	–
– Releases		–	–
		<u>11</u>	<u>–</u>
Loans and advances to customers			
– New allowances		209,251	224,628
– Releases		(68,259)	–
		<u>140,992</u>	<u>224,628</u>
Investment securities			
– New allowances		39,246	–
– Releases		–	–
		<u>39,246</u>	<u>–</u>
Other assets			
– New allowances		412	183
– Releases		–	–
		<u>412</u>	<u>183</u>
Off-balance sheet credit exposures			
– New allowances		–	–
– Releases		(4,054)	–
		<u>(4,054)</u>	<u>–</u>

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

11 DIRECTORS' EMOLUMENTS

Directors' emoluments disclosed pursuant to section 383(1) of the Hong Kong Companies Ordinance and Part 2 of the Companies (Disclosure of Information about Benefits of Directors) Regulation are as follows:

	2018 \$'000	2017 \$'000
Fees	1,012	302
Other emoluments	4,148	4,756
Contribution to provident fund	102	231
	<u>5,262</u>	<u>5,289</u>

12 TAXATION

(a) Taxation in the consolidated statement of profit or loss and other comprehensive income represents:

	2018 \$'000	2017 \$'000
Current tax		
Hong Kong Profits Tax		
– Provision for the year	54,638	36,851
– Under/(over)-provision in prior year	2,337	(2,667)
	<u>56,975</u>	<u>34,184</u>
Taxation outside Hong Kong		
– Withholding tax in the People's Republic of China	252	497
– Provision for the year	9,839	1,637
	<u>67,066</u>	<u>36,318</u>
Deferred tax		
Origination and reversal of temporary differences (Note 24(b))	(16,522)	1,335
	<u>50,544</u>	<u>37,653</u>

The provision for Hong Kong Profits Tax for 2018 is calculated at 16.5% (2017: 16.5%) of the estimated assessable profits for the year, taking into account a reduction granted by the Hong Kong SAR Government of 75% of the tax payable for the year of assessment 2017-18. The Company is eligible for the maximum reduction of \$30,000 (2017: a maximum reduction of 20,000 was granted for the year of assessment 2016-17 and was taken into account in calculating the provision for 2017).

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

12 TAXATION (CONTINUED)

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2018 \$'000	2017 \$'000
Profit before taxation	<u>268,673</u>	<u>259,063</u>
Notional tax on profit before taxation, calculated at the tax rate of 16.5%	44,331	42,745
Tax effect of income/expense not subject to taxation	(948)	18
Tax effect of unused current year tax loss not recognised	18	8
Utilisation of tax loss previously not recognised	–	(3,304)
Under/(over)-provision in prior year	2,337	(2,667)
Effect of different tax rates of subsidiaries operating in other jurisdictions	4,493	760
Others	<u>313</u>	<u>93</u>
Actual tax expense	<u>50,544</u>	<u>37,653</u>

13 OTHER COMPREHENSIVE INCOME

(a) Tax effects relating to each component of other comprehensive income

	2018			2017		
	Before tax amount \$'000	Tax expense \$'000	Net-of-tax amount \$'000	Before tax amount \$'000	Tax expense \$'000	Net-of-tax amount \$'000
Foreign currency translation differences for Mainland China subsidiaries	(15,539)	–	(15,539)	3,372	–	3,372
Fair value through other comprehensive income/available-for-sale investment securities: net movement in revaluation reserve	<u>(154,951)</u>	<u>22,282</u>	<u>(132,669)</u>	<u>23,817</u>	<u>(3,921)</u>	<u>19,896</u>
Other comprehensive income	<u>(170,490)</u>	<u>22,282</u>	<u>(148,208)</u>	<u>27,189</u>	<u>(3,921)</u>	<u>23,268</u>

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

13 OTHER COMPREHENSIVE INCOME (CONTINUED)

(b) Components of other comprehensive income

	2018 \$'000	2017 \$'000
Fair value through other comprehensive income/ available-for-sale financial assets:		
Changes in fair value recognised during the year	(153,641)	40,526
Reclassification adjustments for amounts transferred to profit or loss upon disposal	(1,310)	(16,709)
Net deferred tax (debited)/credited to revaluation reserve (Note 24(b))	22,282	(3,921)
	<u> </u>	<u> </u>
Net movement in revaluation reserve during the year recognised in other comprehensive income	<u>(132,669)</u>	<u>19,896</u>

14 CASH AND BALANCES WITH BANKS AND CENTRAL BANK

	2018 \$'000	2017 \$'000
Balances with banks	1,370,609	225,764
Balance with central bank	24,435	199,123
	<u> </u>	<u> </u>
	1,395,044	424,887
Allowance for credit and other losses	(207)	–
	<u> </u>	<u> </u>
Net cash and balances with banks and central bank	<u>1,394,837</u>	<u>424,887</u>

15 PLACEMENTS WITH AND ADVANCES TO BANKS

	2018 \$'000	2017 \$'000
Gross placements with and advances to banks		
– maturing within one month	2,592,888	5,097,766
– maturing between one month and twelve months	–	1,967,728
	<u> </u>	<u> </u>
	2,592,888	7,065,494
Allowance for credit and other losses	(474)	–
	<u> </u>	<u> </u>
Net placements with and advances to banks	<u>2,592,414</u>	<u>7,065,494</u>

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

16 LOANS AND ADVANCES TO CUSTOMERS

(a) Loans and advances to customers

	2018 \$'000	2017 \$'000
Gross loans and advances to customers	15,121,048	15,328,531
Less: Allowance for credit and other losses		
– Stage 1 & 2 ECL	(144,473)	–
– Stage 3 ECL	(146,455)	–
– individually assessed	–	(220,744)
– collectively assessed	–	(44,892)
	<u>14,830,120</u>	<u>15,062,895</u>

(b) Loan impairment allowances against loans and advances to customers

	Stage 3 ECL/ Individually assessed \$'000	Stage 1 & 2 ECL/ Collectively assessed \$'000	Total \$'000
At 1 January 2017	–	(40,590)	(40,590)
Charges (note 10)	(220,326)	(4,302)	(224,628)
Effect of foreign currency movements	(418)	–	(418)
At 31 December 2017	(220,744)	(44,892)	(265,636)
Impact of adopting HKFRS9 on 1 January 2018	–	(40,791)	(40,791)
Adjusted balance on 1 January 2018	(220,744)	(85,683)	(306,427)
Charges (note 10)	(82,202)	(58,790)	(140,992)
Amounts written off	157,103	–	157,103
Effect of foreign currency movements	(612)	–	(612)
At 31 December 2018	<u>(146,455)</u>	<u>(144,473)</u>	<u>(290,928)</u>

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

16 LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

(c) Gross loans and advances to customers by industry sector

	2018		2017	
	\$'000	% of gross advances covered by collaterals	\$'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	214,806	–	416,805	30.9
– property investment	892,120	100.0	893,447	100.0
– financial concerns	3,476,587	56.7	2,780,580	21.6
– wholesale and retail trade	7,399	52.7	170,961	98.0
– manufacturing	–	–	359,576	–
– transport and transport equipment	55,985	–	280,285	2.6
– information technology	544,286	27.2	–	–
– others	204,696	2.6	1,050,396	62.9
	<u>5,395,879</u>	56.0	<u>5,952,050</u>	41.3
Individuals	<u>70,660</u>	–	<u>79,049</u>	–
Total gross loans and advances for use in Hong Kong	<u>5,466,539</u>	55.2	<u>6,031,099</u>	40.8
Trade finance	2,169	–	319,655	3.8
Gross loans and advances for use outside Hong Kong	<u>9,652,340</u>	23.1	<u>8,977,777</u>	37.3
Gross loans and advances to customers	<u><u>15,121,048</u></u>	34.7	<u><u>15,328,531</u></u>	38.0

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

16 LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

(d) 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 \$'000	Impaired loans and advances \$'000	Overdue loans and advances \$'000	Stage 3 ECL/ Individually assessed allowances \$'000	Stage 1 & 2 ECL/ Collectively assessed allowances \$'000
At 31 December 2018					
– Hong Kong	3,498,046	31,320	31,320	(31,320)	(35,725)
– Mainland China	11,390,914	194,771	194,771	(115,135)	(103,994)
– Others	232,088	–	–	–	(4,754)
	<u>15,121,048</u>	<u>226,091</u>	<u>226,091</u>	<u>(146,455)</u>	<u>(144,473)</u>
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)
	<u>15,328,531</u>	<u>274,182</u>	<u>274,182</u>	<u>(220,744)</u>	<u>(44,892)</u>

(e) Gross loans and advances to customers by credit quality

	2018 \$'000	2017 \$'000
Pass	14,797,037	15,054,349
Special mentioned	97,920	–
Substandard	117,450	274,182
Loss	108,641	–
	<u>15,121,048</u>	<u>15,328,531</u>

The above table shows the grading according to the loan classification system as defined by the HKMA.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

17 INVESTMENT SECURITIES

	2018 \$'000	2017 \$'000
Investment securities measured at amortised cost	3,900,069	–
Investment securities at fair value through other comprehensive income	5,248,449	–
Available-for-sale financial assets	–	2,680,735
Held-to-maturity financial assets	–	233,295
	<u>9,148,518</u>	<u>2,914,030</u>
Allowance for credit and other losses	(30,514)	–
	<u>9,118,004</u>	<u>2,914,030</u>
Government bills, notes and bonds	855,608	606,809
Certificate of deposit	1,622,750	120,193
Debt securities	6,639,646	2,076,144
Fund investments	–	110,884
	<u>9,118,004</u>	<u>2,914,030</u>
Issued by:		
– Sovereigns	832,923	644,793
– Public sector entities	22,685	123,332
– Banks	2,321,330	894,709
– Corporates	5,941,066	1,251,196
	<u>9,118,004</u>	<u>2,914,030</u>
Analysed by listing status:		
– Listed in Hong Kong	3,714,118	1,192,968
– Listed outside Hong Kong	2,555,705	783,192
– Unlisted	2,848,181	937,870
	<u>9,118,004</u>	<u>2,914,030</u>

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

18 INTERESTS IN ASSOCIATES

Information of associate that is not individually material:

	2018 \$'000	2017 \$'000
Carrying amount of individually immaterial associates in the consolidated financial statements	<u>228</u>	<u>1,199</u>

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

19 INVESTMENT IN SUBSIDIARIES

	2018 \$'000	2017 \$'000
Unlisted shares, at cost		
At 1 January	780,000	90,000
Additions	–	690,000
At 31 December	<u>780,000</u>	<u>780,000</u>

Particulars of the major operations subsidiaries at 31 December 2018 are as follows:

Name of Companies	Place of incorporation and place of business	Particulars of issued shares held	Proportion of ownership interest			Principal activities
			Group's effective interest	Held by the Company	Held by a subsidiary	
BOSC International Company Limited ("BOSCI")	Hong Kong	78,000,000 shares of HK\$10 each	100%	100%	–	Corporate finance
BOSC International Investment Limited	Hong Kong	1,000,000 shares of HK\$1 each	100%	–	100%	Investment trading
BOSC International (Shenzhen) Company Limited	People's Republic of China	100,000,000 shares of RMB\$1 each	100%	–	100%	Corporate advisory
BOSC International Advisory (Shenzhen) Company Limited	People's Republic of China	10,000,000 shares of RMB\$1 each	100%	–	100%	Corporate advisory
BOSC International (BVI) Limited	British Virgin Islands	1 share of US\$1 each	100%	–	100%	Special purpose entity for financing
BOSC Stable Income Fund SP	Cayman Islands	250,000 shares of US\$100 each	100%	–	100%	Investment fund

The proportion of voting rights in these subsidiaries did not differ from the proportion of ordinary shares held. There was no non-controlling interest in these subsidiaries.

On 6 April 2017, BOSCI issued 69,000,000 shares of HK\$10 each to the Company for supporting its business expansion. After the issuance, the Company's total investment in BOSCI increased to HK\$780 million.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

20 PROPERTY AND EQUIPMENTS

Details of movement of property and equipments are as follows:

	Leasehold improvements \$'000	Furniture, computer and other equipments \$'000	Motor vehicles \$'000	Total \$'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	<u>21,499</u>	<u>20,295</u>	<u>1,007</u>	<u>42,801</u>
At 1 January 2018	21,499	20,295	1,007	42,801
Additions	300	1,927	1,169	3,396
Write-off	–	–	–	–
Exchange adjustments	–	(15)	(3)	(18)
At 31 December 2018	<u>21,799</u>	<u>22,207</u>	<u>2,173</u>	<u>46,179</u>
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	<u>(7,322)</u>	<u>(14,303)</u>	<u>(1,007)</u>	<u>(22,632)</u>
At 1 January 2018	(7,322)	(14,303)	(1,007)	(22,632)
Charge for the year	(3,759)	(3,250)	(120)	(7,129)
Write-off	–	–	–	–
Exchange adjustments	–	18	1	19
At 31 December 2018	<u>(11,081)</u>	<u>(17,535)</u>	<u>(1,126)</u>	<u>(29,742)</u>
Net book value:				
At 31 December 2018	<u>10,718</u>	<u>4,672</u>	<u>1,047</u>	<u>16,437</u>
At 31 December 2017	<u>14,177</u>	<u>5,992</u>	<u>–</u>	<u>20,169</u>

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

21 INTANGIBLE ASSETS

	2018 \$'000	2017 \$'000
Software	4,784	5,789
Club membership	350	350
	<u>5,134</u>	<u>6,139</u>

Details of movement of intangible assets are as follows:

	2018 \$'000	2017 \$'000
Cost:		
At 1 January	16,446	13,758
Additions	2,155	2,897
Write-off	–	(209)
At 31 December	<u>18,601</u>	<u>16,446</u>
Accumulated amortisation:		
At 1 January	(10,307)	(7,482)
Charge for the year	(3,160)	(3,034)
Write-off	–	209
At 31 December	<u>(13,467)</u>	<u>(10,307)</u>
Net book value:		
At 31 December	<u>5,134</u>	<u>6,139</u>

During 2018 and 2017, there was no impairment on intangible assets.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

22 OTHER ASSETS

	2018 \$'000	2017 \$'000
Interest receivables (Note a)	188,107	142,571
Collaterals placed (Note b)	16,130	–
Fees receivable	12,186	3,457
Customer liability under acceptances	6,207	16,852
Prepaid expenses	6,986	5,810
Accounts receivable	18,942	25,738
Others	8,349	7,896
	<u>256,907</u>	<u>202,324</u>

Note a: Included Stage 3 ECL/individual impairment allowance of \$412,000 (2017: \$183,000).

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

23 DEPOSITS FROM CUSTOMERS

	2018 \$'000	2017 \$'000
Deposits from customers		
– Time, call and notice deposits	<u>9,503,353</u>	<u>13,628,287</u>

24 INCOME TAX IN THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(a) Current tax in the consolidated statement of financial position represents:

	2018 \$'000	2017 \$'000
Provision for Hong Kong Profits Tax for the year	54,638	36,851
Provisional Profits Tax paid	<u>(29,213)</u>	<u>(31,537)</u>
	25,425	5,314
Balance of profit tax provision relating to prior year	4,444	–
Provision of overseas tax	<u>10,406</u>	<u>1,513</u>
	<u>40,275</u>	<u>6,827</u>
Representing:		
Current tax payable	42,275	7,955
Current tax recoverable	<u>(2,000)</u>	<u>(1,128)</u>
	<u>40,275</u>	<u>6,827</u>

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

24 INCOME TAX IN THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)

(b) Deferred tax assets and liabilities recognised:

	Depreciation allowances in excess of the related depreciation \$'000	Amortisation of intangible assets \$'000	Impairment allowance \$'000	Others \$'000	Revaluation of investment securities \$'000	Total \$'000
At 1 January 2017	624	976	(6,697)	(2,343)	(5,409)	(12,849)
(Credited)/charged to consolidated statement of profit or loss and other comprehensive income	(231)	(23)	(709)	2,298	–	1,335
Debited to revaluation value reserve	–	–	–	–	3,921	3,921
At 31 December 2017	393	953	(7,406)	(45)	(1,488)	(7,593)
Impact on initial application of HKFRS 9	–	–	(8,451)	–	281	(8,170)
At 1 January 2018	393	953	(15,857)	(45)	(1,207)	(15,763)
Credited to consolidated statement of profit or loss and other comprehensive income	(539)	(166)	(15,273)	(273)	(271)	(16,522)
Credited to revaluation fair value reserve	–	–	–	–	(22,282)	(22,282)
At 31 December 2018	(146)	787	(31,130)	(318)	(23,760)	(54,567)
					2018 \$'000	2017 \$'000
Net deferred tax assets					(54,567)	(8,030)
Net deferred tax liabilities					–	437
					(54,567)	(7,593)

The Group has not recognised deferred tax asset in respect of tax losses of HK\$158,000 (2017: HK\$49,000). The tax losses do not expire under tax legislation.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

25 CERTIFICATES OF DEPOSIT AND OTHER DEBT SECURITIES ISSUED

	2018 \$'000	2017 \$'000
Certificates of deposit issued at amortised cost	5,227,536	2,246,775
Other debt securities issued at amortised cost (Note 32(d))	3,898,728	781,540
	<u>9,126,264</u>	<u>3,028,315</u>

The Group, through one of its subsidiaries, issued bonds with notional amounts of US\$50,000,000 on 14 July 2017 and 21 July 2017 respectively. The bonds are fully subscribed at the price at 100 and bear a coupon rate of 3.3 percent. The bonds were matured in July 2018.

On 18 January 2018, the Group, through one of its subsidiaries, issued bonds with notional amounts of US\$500,000,000. The bonds are fully subscribed of the price at 99.654 and bear a coupon rate of 3.125 percent per annum. The bonds would be matured on 18 January 2021.

26 OTHER LIABILITIES

	2018 \$'000	2017 \$'000
Interest payables	176,972	102,185
Acceptances outstanding	6,207	16,852
Accounts payable	9,149	10,861
Accrued expenses	3,236	3,271
Provision for short-term employee benefits	69,486	58,596
Collateral received	8,949	3,676
Short-term borrowings (Note 32(d))	102,123	–
Others (Note c)	21,086	18,821
	<u>397,208</u>	<u>214,262</u>

Note c: Included allowance for credit and other losses of HK\$3,007,000 (2017: Nil).

27 CAPITAL AND RESERVES

(a) Share capital

	2018		2017	
	No. of shares \$'000	\$'000	No. of shares \$'000	\$'000
Ordinary shares, issued and fully paid:				
At 1 January and 31 December	<u>360,439</u>	<u>4,000,000</u>	<u>360,439</u>	<u>4,000,000</u>

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

27 CAPITAL AND RESERVES (CONTINUED)

(a) Share capital (continued)

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. All ordinary shares rank equally with regards to the Company's residual assets.

(b) Movement in components of equity at Company level

The reconciliation between the opening and closing balances of each component of the Group's consolidated equity is set out in the consolidated statement of changes in equity. Details of the changes in the Company's individual components of equity between the beginning and the end of the year are set out below:

	Note	Share capital \$'000	Retained profits \$'000	Revaluation reserve/ (deficit) \$'000	Regulatory reserve \$'000	Total \$'000
Balance at 1 January 2017		4,000,000	167,679	(27,372)	87,557	4,227,864
Total comprehensive income		–	162,218	17,777	–	179,995
Transfer to regulatory reserve		–	(20,836)	–	20,836	–
Balance at 31 December 2017		4,000,000	309,061	(9,595)	108,393	4,407,859
Impact of adopting HKFRS 9 on 1 January 2018		–	(41,398)	1,053	–	(40,345)
Adjusted balance on 1 January 2018		4,000,000	267,663	(8,542)	108,393	4,367,514
Total comprehensive income		–	159,803	(28,278)	–	131,525
Transfer to regulatory reserve		–	101,655	–	(101,655)	–
Balance at 31 December 2018		4,000,000	529,121	(36,820)	6,738	4,499,039

(c) Dividends

	2018 \$'000	2017 \$'000
Dividend approved or paid during the year	–	–

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

27 CAPITAL AND RESERVES (CONTINUED)

(d) Nature and purpose of reserves

(i) Revaluation reserve

This comprises the cumulative net change in the fair value of investment securities at fair value through other comprehensive income/available-for-sale financial assets until the financial assets are derecognised and is dealt with in accordance with the accounting policies in note 1(f).

(ii) Retained profits

The Group is required to maintain minimum capital adequacy ratio set by the HKMA. The minimum capital requirements could therefore potentially restrict the amount of retained profits available for distribution to the shareholders.

(iii) Regulatory reserve

The regulatory reserve is maintained in accordance with Hong Kong Banking regulations. At 31 December 2018, a regulatory reserve of \$6,738,000 (2017: \$108,393,000) was maintained to satisfy the provisions of the Hong Kong Banking Ordinance for prudential supervision purposes. Movement in this reserve was made directly through retained profits after consultation with the HKMA. The regulatory reserve is non-distributable.

28 MATERIAL RELATED PARTY TRANSACTIONS

During the year, the Group entered into transactions with related parties in the normal course of business including accepting and placement of inter-bank deposits, conducting correspondent banking and foreign exchange transactions. All these related party transactions were priced at the relevant market rates at the time of each transaction.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

28 MATERIAL RELATED PARTY TRANSACTIONS (CONTINUED)

- (a) The amount of material related party transactions during the year and outstanding balances at the reporting date are set out below:

	Immediate holding company	
	2018	2017
	\$'000	\$'000
Consolidated statement of profit or loss and other comprehensive income:		
Interest income	143	2,963
Interest expense	(60,127)	(44,246)
Net fee and commission income	3,189	11,376
Consolidated statement of financial position:		
Amounts due from:		
– Cash and balances with banks and central bank	38,925	19,875
– Other assets	752	599
Amounts due to:		
– Deposits from banks	861,300	2,188,312
– Other debt securities issued	–	781,540
– Other liabilities	4,142	19,001
	<u> </u>	<u> </u>

(b) Directors and key management personnel

During the year, the Group did not provide any credit facilities nor accept any deposits from the directors and key management personnel of the Group and its holding companies as well as their close family members and companies controlled or significantly influenced by them.

Remunerations, for key management personnel, including amounts paid to the Group's directors as disclosed in Note 11, are as follows:

	2018	2017
	\$'000	\$'000
Salaries and other benefits	12,777	10,480
Contribution to provident fund	840	922
Variable bonuses	2,848	4,695
	<u> </u>	<u> </u>

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

29 DERIVATIVE FINANCIAL INSTRUMENTS

Derivatives entered into by the Group include foreign exchange forward and swap contracts. The Group used these derivatives in its own assets and liabilities management and also sold these products to customers as normal banking activities. For these transactions entered into with customers, they were actively managed through offsetting deals with external parties to ensure the Group's net exposures were within acceptable level of risk. No significant proprietary positions were maintained by the Group at 31 December 2018 and 2017.

Credit risk-weighted amount refers to the amount as computed in accordance with the Banking (Capital) Rules and depends on the status of the counterparty and the residual maturity of the transaction. The risk-weight factor for derivatives outstanding at 31 December 2018 ranged from 20% to 100% (2017: 20% to 100%).

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 31 December 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

	2018				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	9,141,672	17,096	42,620	12,127	1,243,705	7,754	19,294	9,775
Interest rate contracts								
– Swap	1,200,720	15,691	5,810	26,022	1,122,126	11,781	–	10,672
	<u>10,342,392</u>	<u>32,787</u>	<u>48,430</u>	<u>38,149</u>	<u>2,365,831</u>	<u>19,535</u>	<u>19,294</u>	<u>20,447</u>

All these derivatives were with residual maturity of one year or less.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

30 CONTINGENT LIABILITIES AND COMMITMENTS

(a) Contingent liabilities and commitment to extend credit

	2018 \$'000	2017 \$'000
Contract amounts		
– Direct credit substitutes	90,942	119,734
– Trade-related contingencies	12,477	4,571
– Transaction-related contingencies	10,860	–
– Other commitments		
– which are unconditionally cancellable	1,775,644	1,551,325
– with an original maturity under one year	–	398,241
– with an original maturity over one year	74,978	160,769
	<u>1,964,901</u>	<u>2,234,640</u>
Credit risk-weighted amounts	<u>39,391</u>	<u>160,144</u>

Contingent liabilities and commitments are credit related instruments. The risk involved in these credit-related instruments is essentially the same as the credit risk involved in extending loan facilities to customers. The contractual amounts represent the amounts at risk should the contract be fully drawn and the customer would be in default. As the facilities may expire without being drawn, the contract amounts do not represent expected future cash flows.

The risk-weight factor for the computation of credit risk-weighted amounts range from 0% to 100%.

(b) Lease commitments

At 31 December 2018, the total future minimum lease payments under non-cancellable operating leases are as follows:

	2018 \$'000	2017 \$'000
Within 1 year	23,512	19,179
After 1 year but within 5 years	43,105	–
	<u>66,617</u>	<u>19,179</u>

The Group leases properties under operating leases. These leases run for an initial period of 3 years, with an option to renew the lease subject to renegotiation of the terms of the lease. None of the leases contains contingent rentals.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

31 LOANS TO DIRECTORS AND ENTITIES CONNECTED WITH DIRECTORS

Loans to directors of the Company and entities connected with directors, disclosed pursuant to section 383(1)(d) of the Hong Kong Companies Ordinance and Part 3 of the Companies (Disclosure of Information about Benefits of Directors) Regulation are as follows:

	2018 \$'000	2017 \$'000
Aggregate amount in respect of principal and interest as at 31 December	—	—
	<u>—</u>	<u>—</u>
The maximum aggregate amount outstanding in respect of principal and interest during the year	—	—
	<u>—</u>	<u>—</u>

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

32 NOTES TO CONSOLIDATED STATEMENT OF CASH FLOWS

(a) Reconciliation of profit before taxation to net cash inflow from operating activities

	Note	2018 \$'000	2017 \$'000
Profit before taxation		268,673	259,063
Adjustments for:			
Interest income	6	(1,137,251)	(794,396)
Interest expense	6	619,037	390,210
Depreciation of property and equipments	9	7,129	7,709
Amortisation of intangible assets	9	3,160	3,034
Impairment charges	10	176,812	224,811
Net income from investment securities		(1,310)	(16,709)
Interest received		753,526	647,248
Interest paid		(399,133)	(343,292)
Operating profit before changes in working capital		290,643	377,678
Change in financial assets at fair value through profit or loss		(176,025)	(51,230)
Change in trading liabilities		8,159	–
Change in balances and placements with and advances to banks with original maturity beyond three months		1,664,035	(1,041,960)
Change in gross loans and advances to customers		95,046	(2,459,734)
Change in other assets		(19,694)	20,058
Change in deposits from customers		(4,124,934)	3,429,135
Change in deposits from banks		557,687	(120,346)
Change in certificates of deposit issued		3,054,761	273,855
Change in other liabilities		14,724	63,084
Elimination of exchange differences and other non cash items		(119,728)	(47,521)
Cash generated from operating activities		1,244,674	443,019
Hong Kong Profits Tax paid		(32,419)	(42,795)
Tax paid outside Hong Kong		(2,260)	(497)
Net cash inflow from operating activities		1,209,995	399,727

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

32 NOTES TO CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)

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

	2018 \$'000	2017 \$'000
Gross cash and balances with banks and central bank (Note 14)	1,395,044	424,887
Less: Balances with banks for segregated accounts	(4,005)	–
Gross placements with banks with original maturity within three months (Note 15)	2,592,888	5,397,454
Investment securities with original maturity within three months	528,972	–
	<u>4,512,899</u>	<u>5,822,341</u>

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

	2018 \$'000	2017 \$'000
Cash and balances with banks and central bank (Note 14)	1,395,044	424,887
Gross placements with and advances to banks (Note 15)	2,592,888	7,065,494
Investment securities (Note 17)	9,148,518	–
Amounts shown in the consolidated statement of financial position	<u>13,136,450</u>	<u>7,490,381</u>
Less: Balances, gross placements with and advances to banks and investment securities with original maturity beyond three months	(8,619,546)	(1,668,040)
Less: Balances with banks for Segregated accounts	(4,005)	–
	<u>4,512,899</u>	<u>5,822,341</u>

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

32 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 (note 25) \$'000	Short-term borrowings (note 26) \$'000	Related interest payables \$'000	Total \$'000
At 1 January 2017	–	–	–	–
Changes from financing cash flow:				
Proceeds from the issuance of other debt securities	781,540	–	–	781,540
Total changes from financing cash flow	781,540	–	–	781,540
Interest expense	–	–	11,961	11,961
Total other changes	–	–	11,961	11,961
At 31 December 2017 and 1 January 2018	781,540	–	11,961	793,501
Changes from financing cash flow:				
Redemption from the issuance of other debt securities	(781,945)	–	–	(781,945)
Proceeds from short-term borrowings	–	102,123	–	102,123
Proceeds from the issuance of other debt securities	3,894,179	–	–	3,894,179
Interest paid	–	–	(85,193)	(85,193)
Total changes from financing cash flow	3,112,234	102,123	(85,193)	3,129,164
Interest expense	5,324	–	123,260	128,584
Exchange difference	(370)	–	(1,796)	(2,166)
Total other changes	4,954	–	121,464	126,418
At 31 December 2018	3,898,728	102,123	48,232	4,049,083

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(EXPRESSED IN HONG KONG DOLLARS)

33 IMMEDIATE AND ULTIMATE HOLDING COMPANY

As at 31 December 2018, the Company's immediate and ultimate holding company was Bank of Shanghai Co., Limited, which is incorporated in the People's Republic of China. Bank of Shanghai Co., Limited produces financial statements available for public access.

34 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31 DECEMBER 2018

Up to the date of issue of the financial statements, the HKICPA has issued a number of amendments, new standards and interpretations which are not yet effective for the year ended 31 December 2018 and which have not been adopted in these financial statements. These include the following which may be relevant to the Group.

	Effective for accounting periods beginning on or after
HKFRS 16, <i>Leases</i>	1 January 2019
HK(IFRIC) 23, <i>Uncertainty over income tax treatments</i>	1 January 2019
Annual Improvements to HKFRSs 2015-2017 Cycle	1 January 2019
Amendments to HKAS 28, <i>Long-term interest in associates and joint ventures</i>	1 January 2019

The Group is in the process of making an assessment of what the impact of these amendments and new standards is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have significant impact on the Group's results of operation and financial position except for HKFRS 16, *Leases*.

HKFRS 16, *Leases* results in lessee accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under HKAS 17 "Leases". Lessees will recognise a "right of use" asset and a corresponding financial liability on the statement of financial position. The asset will be amortised over the length of the lease and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as in HKAS 17.

The Group would apply HKFRS 16 on 1 January 2019 retrospectively, the cumulative effect of initially adopting HKFRS 16 recognised at the date of initial application.

On transition, the estimated impact on the Group's financial statements will be gross-up of \$64 million right-of-use assets and \$64 million lease liabilities.

CORPORATE GOVERNANCE REPORT (UNAUDITED)

The following information is disclosed as part of the accompanying information to the financial statements and does not form part of the audited financial statements

1 CORPORATE GOVERNANCE

The Bank fully complied with, in all material aspects, throughout the year with the module on “Corporate Governance of Locally Incorporated Authorized Institutions” issued by the HKMA.

(a) Corporate Governance Policy

The Bank recognizes the importance of robust corporate governance and high standards of corporate governance and maintains an effective corporate governance framework to ensure effective oversight and strong accountability of the Board and senior management. The established well-structured corporate governance framework directs and provides the business ethical conduct of the Bank, thereby protects and upholds the interests of shareholders as a whole in a sustainable manner.

(b) Governance Framework

The Board is at the core of the Bank’s corporate governance framework and responsible for the leadership and control of the Bank to promote its success and continuing growth. The Board is responsible for providing high-level guidance and effective oversight of the management.

Based on the regulatory requirements, guidelines as well as market practices, the Board has established a number of Board Committees (i.e. Audit Committee, Remuneration and Nomination Committee, Risk and Compliance Committee and Executive Committee), Management Level Committees (i.e. Credit Committee, Asset and Liability Committee, and Operations and Technology Committee), and Anti-Money Laundering Committee to help Executive Committee oversee the daily operations of the Bank.

All these committees have specific terms of reference in order to ensure that the committees will discharge their responsibilities properly and to report back to the Board when appropriate, their recommendations and decisions.

(c) The Board

Generally, the Board is responsible for:

- ensure that the Company’s management is competent by appointing a chief executive (including an alternate chief executive) with integrity, technical competence and experience in the banking business which enables him to administer the Company’s affairs effectively and prudently.
- oversee the appointment of other senior executives and ensure that they are fit and proper to manage and supervise the Company’s key businesses and functions.

CORPORATE GOVERNANCE REPORT (UNAUDITED) (CONTINUED)

1 CORPORATE GOVERNANCE (CONTINUED)

(c) The Board (continued)

- approve and monitor the Company’s business objectives, strategies and financial plan by approving annual budgets and reviewing performance against these budgets; and
- ensure that the Company’s operation is conducted prudently and within the framework of law regulations and the Bank’s policies by, among other things:
 - approving and periodically reviewing the risk management governance and policies of the Company to ensure that they are adequate and consistent with the Company’s operating environment, and that adequate capital is maintained against the risks;
 - ensuring that senior management is implementing the strategies approved by the Board and developing suitable policies and procedures for managing the various types of risk; and
 - regularly reviewing the Company’s financial indicators against performance and the established risk targets.
- ensure that the Company conducts its affairs with a high degree of integrity by, among other things, developing appropriate policies and codes of conduct that safeguard against improper or unlawful activities.

(d) Profiles of Directors

Name	Role in BOSHK	Qualifications	Other Directorships and executive positions held
Mr. JIN Yu	Non-Executive Director, Chairman (resigned as Director and Chairman on 1 February 2019)	Doctorate Degree in Economics, Fudan University	Chairman & Executive Director, Bank of Shanghai Co., Limited Director, Shenlian International Investment Company Director, Shanghai Commercial Bank Limited

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

CORPORATE GOVERNANCE REPORT (UNAUDITED) (CONTINUED)

1 CORPORATE GOVERNANCE (CONTINUED)

(d) Profiles of Directors (continued)

Name	Role in BOSHK	Qualifications	Other Directorships and executive positions held
Mr. HUANG Tao	Non-Executive Director	Master Degree in Business Administration, University of Oxford	Vice President, Bank of Shanghai Co., Limited Director, Shenlian International Investment Company Chairman, BOSC International Company Limited
Ms. ZHANG Xuhong	Executive Director & CEO (appointed as Director & CEO of BOSHK on 12 February 2018)	Master Degree in Business Administration, Shanghai Jiao Tong University	Non-Executive Director, BOSC International Company Limited
Mr. MA Chi Man, Charles	Executive Director & CEO (ceased to be CEO and Director of BOSHK respectively on 12 February 2018 and 7 June 2018)	Graduation Diploma from the Graduate School of Retail Bank Management jointly issued by the Consumer Bankers Association and McIntire School of Commerce, University of Virginia, U.S.A.	Non-Executive Director, BOSC International Company Limited Director, Digital Bright Co. Ltd. Director, Hong Kong Economic Exchange Company Limited

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

CORPORATE GOVERNANCE REPORT (UNAUDITED) (CONTINUED)

1 CORPORATE GOVERNANCE (CONTINUED)

(d) Profiles of Directors (continued)

Name	Role in BOSHK	Qualifications	Other Directorships and executive positions held
Prof. TSIEN James Steed	Independent Non-Executive Director	Honorary Professor, Hong Kong Baptist University	Honorary Director, Hong Kong Baptist University Foundation
		Adjunct Professor, Hang Seng University of Hong Kong	Member, University Council, Hang Seng University of Hong Kong
		Companion, The Chartered Management Institute, UK	
		Honorary Fellow, Hong Kong Baptist University	
		Ordinary Member, The Hong Kong Institute of Bankers	
		Executive Program for International Managers, The Graduate School of Business, Columbia University, New York, U.S.A.	
		Diploma in Business Management (with distinction), Hong Kong Baptist College	

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

CORPORATE GOVERNANCE REPORT (UNAUDITED) (CONTINUED)

1 CORPORATE GOVERNANCE (CONTINUED)

(d) Profiles of Directors (continued)

Name	Role in BOSHK	Qualifications	Other Directorships and executive positions held
Mr. CHENG Kwok Kin, Paul	Independent Non-Executive Director	Fellow member of Institute of Chartered Accountants in England and Wales and Hong Kong Institute of Certified Public Accountants	Independent Non-Executive Director, Kin Yat Holdings Limited Independent Non-Executive Director, Xinyi Solar Holdings Limited
Mr. FONG Wo, Felix	Independent Non-Executive Director	Bachelor of Engineering, Dean's honour (McMaster University, Canada) Juris Doctor (Osgoode Hall Law School, Canada) Member of the law societies of Hong Kong, Ontario and England China-Appointed Attesting Officer in Hong Kong appointed by the Ministry of Justice of China	Independent Non-Executive Director, Greenland Hong Kong Holdings Limited Independent Non-Executive Director, Guangdong Land Holdings Limited Independent Non-Executive Director, Evergreen International Holdings Limited Independent Non-Executive Director, Sheen Tai Holdings Group Company Limited Independent Non-Executive Director, Xinming China Holdings Limited Independent Non-Executive Director, WuXi Biologics (Cayman) Inc.
Ms. LI Xiao Hong	Non-Executive Director (appointed as Director of BOSHK on 11 January 2019)	Doctor of Laws, Jilin University	Consultant, King & Wood Mallesons Board Secretary, Bank of Shanghai Co., Limited Director, BOS International Company Limited

CORPORATE GOVERNANCE REPORT (UNAUDITED) (CONTINUED)

1 CORPORATE GOVERNANCE (CONTINUED)

(e) Specialized Committees' functions and composition

The Board has ultimate and overall responsibility for the corporate governance of the Company.

To assist its performance of the role, the following committees are established:

(i) Audit Committee

The Audit Committee exercises oversight over objectivity, credibility and integrity of the financial reporting and other mandatory professional reporting requirements, and the work of the internal and external auditors. The Committee consists of one non-executive director and three independent non-executive directors, and it is chaired by one of the independent non-executive directors. Four Audit Committee meetings were held during 2018.

(ii) Remuneration and Nomination Committee

The Remuneration and Nomination Committee exercises oversight on the Company's remuneration system and its operation, makes recommendation to the Board on the Company's overall remuneration policy and structure, annual salary adjustment and performance bonus, and determines the remuneration package of key management personnel. For nomination function, it includes identifying individuals suitably qualified to become board members and recommend to the selection of individuals nominated for directorships; making recommendation to the board on appointment or re-appointment of directors and succession planning for directors, in particular the chairman and the chief executive; and performing annual review on the Board's structure, size and composition. The Committee consists of one non-executive director and two independent non-executive directors, and it is chaired by one of the independent non-executive directors. One Remuneration and Nomination Committee meeting were held during 2018.

(iii) Risk and Compliance Committee

The Risk and Compliance Committee assists the Board in monitoring the Company's risk profile and the Company's compliance with internal policies and statutory regulations. The Committee consists of three independent non-executive directors, one non-executive director and one executive director, and it is chaired by one of the independent non-executive directors. Four Risk and Compliance Committee meetings were held during 2018.

(iv) Executive Committee

The Executive Committee assists the Board in conducting and managing the day-to-day business and affairs of the Company. The Committee consists of Chief Executive Officer, Head of Operations and Technology, Head of Corporate and Institutional Banking, Chief Risk Officer, Head of Treasury and Head of Finance, and it is chaired by the Chief Executive Officer. Thirteen Executive Committee meetings were held during 2018.

CORPORATE GOVERNANCE REPORT (UNAUDITED) (CONTINUED)

1 CORPORATE GOVERNANCE (CONTINUED)

(e) Specialized Committees' functions and composition (continued)

(v) Credit Committee

Credit Committee is responsible for credit management. The Committee consists of the Chief Executive Officer, Chief Risk Officer, Head of Corporate and Institutional Banking and senior staff of Credit Risk Division, and it is chaired by the Chief Risk Officer. Twelve Credit Committee meetings were held during 2018.

(vi) Asset & Liability Committee

Asset & Liability Committee is responsible for monitoring liquidity risk and asset and liability management. The Committee consists of the Chief Executive Officer, Head of Treasury, Head of Operations & Technology, Chief Risk Officer, Head of Finance and Head of Corporate and Institutional Banking, and it is chaired by the Head of Treasury. Six Asset & Liability Committee meetings were held during 2018.

(vii) Operations and Technology Committee

Operations and Technology Committee is responsible for formulating operations policies and procedures to ensure on-going operational efficiency, cost effectiveness and proper controls; reviewing standard service charges and fees; monitoring operational risk issues; formulating system and information technology ("IT") policies and practices; ensuring adequate IT control environment; and evaluating cost and effectiveness of IT systems employed by the Company. The Committee consists of the Chief Executive Officer, Chief Risk Officer, Head of Operations and Technology, Head of Finance, Head of Corporate and Institutional Banking, Head of Compliance, Head of Information Technology and Head of Treasury, and it is chaired by the Head of Operations and Technology. Four Operation and Technology Committee meetings were held during 2018.

(viii) Anti-Money Laundering Committee

Anti-Money Laundering Committee is responsible for ensuring sufficient resources to handle AML compliance issues, and reviewing high-risk customers and relevant statistics. The Committee consists of the Chief Executive Officer, Head of Compliance, Chief Risk Officer, and all Alternative Chief Executive Officers, and it is chaired by the Head of Compliance. Four Anti-Money Laundering Committee meetings were held during 2018.

(f) The approach for recruitment and selection of members of the board

Remuneration and Nomination Committee provides oversight of the overall remuneration and nomination matters of the Bank in consistence with its culture, strategy and control environment. Remuneration and Nomination Committee is responsible for identifying individuals suitably qualified to become board members and propose to the board on the selection of individuals nominated for directorship. The appointment of Directors will be considered and approved by the Board based on the nomination of the Remuneration and Nomination Committee. Approval from the HKMA will also be obtained in accordance with the Banking Ordinance.

CORPORATE GOVERNANCE REPORT (UNAUDITED) (CONTINUED)

1 CORPORATE GOVERNANCE (CONTINUED)

(f) The approach for recruitment and selection of members of the board (continued)

In order to promote the Board's efficiency and standards of corporate governance, a number of aspects will be considered to identify suitable and qualified candidates to be a Board member, including but not limited to gender, age, cultural and educational background, ethnicity, geographical location, professional experience, skills and knowledge, etc. At the same time, all Board appointments are made on merit, in the context of the skills and experience the Board as a whole required and the various perspectives of Board diversity elements as mentioned above shall also be adequately considered. All Directors possess appropriate experience, competence and personal and professional integrity to discharge their responsibilities effectively.

2 DISCLOSURE ON REMUNERATION

The Company fully complied with, in all material aspects, the requirements set out in the Supervisory Policy Manual module CG-5, namely "Guideline on a Sound Remuneration System V.2" issued by the HKMA in March 2015.

The Remuneration and Nomination Committee is established with specific terms of reference and its membership consists of 2 independent non-executive directors and a non-executive director. The Remuneration and Nomination Committee meets at least once a year to review and make recommendations to the Board of Directors (the "Board") of the Company on the overall remuneration policy and structure, specific remuneration packages and compensation arrangement relating to the appointment of Senior Management and Key Personnel, and on the formulation of the remuneration policy applicable to all employees of the Company. All remuneration actions and decisions made by the Remuneration and Nomination Committee are reported to the Board for ratification.

The Board and the Remuneration and Nomination Committee provide oversight of the overall remuneration administration of the Company to ensure consistency with its culture, strategy, risk tolerance and control environment. The Remuneration and Nomination Committee reviews the remuneration policy and system periodically or whenever necessary to ensure the Company's effective human resources management.

For the purpose of this disclosure, the Senior Management and Key Personnel mentioned in this section are defined according to the "Guideline on a Sound Remuneration System" issued by the HKMA. Senior Management comprises Chief Executive Officer and Assistant Chief Executive Officers, who are responsible for the oversight of the Companywide strategy and activities or those of the major business lines. Key Personnel including Chief Risk Officer, Head of Operations and Technology, Head of Finance and Head of Treasury, are senior executives whose duties or activities in the course of their employment involve the assumption of material risk or the taking on material exposures on behalf of the Company.

CORPORATE GOVERNANCE REPORT (UNAUDITED) (CONTINUED)

2 DISCLOSURE ON REMUNERATION (CONTINUED)

Design and Structure of the Remuneration Process

The remuneration system of the Company is designed to motivate employee behaviour that supports the Company's overall business goals and objectives, long-term financial soundness and effective risk management. It aims to create long-term value for the Company and to align the remuneration of employees with the Company's profitability and time horizon of risks.

The remuneration package comprises fixed salary and variable remuneration. The objective is to ensure the package is competitive in the market so as to attract, retain and motivate the right talents. The proportion of variable remuneration shall vary according to the staff's roles and responsibilities, as well as performance.

Fixed remuneration refers to base salary, fixed allowances and year-end guaranteed pay (if applicable). Variable remuneration, mainly cash bonus payment, is awarded based on the overall performance of the Company, the relevant business unit and the individual staff member, taking into consideration of the full range of current and potential short-term and longer-term risks connected with the activities of staff which may affect the performance of the Company.

Performance Management and Consideration of Relevant Risks in the Remuneration Process

Performance of individual staff member is assessed against a number of pre-defined and measurable performance goals. The goals are determined according to the job responsibilities and areas of contribution covering both financial and non-financial factors. Financial factors include quantitative measures such as profit, revenue, business turnover or volume. Non-financial factors include criteria such as strict adherence to the code of conduct, internal control policies, compliance requirement and risk management standard. The non-financial factors constitute a significant part of an employee's overall performance measurement. The size and allocation of variable remuneration take into account the full range of current and potential risks associated with the functions and activities conducted by the relevant employee.

BANK OF SHANGHAI (HONG KONG) LIMITED
YEAR ENDED 31 DECEMBER 2018

CORPORATE GOVERNANCE REPORT (UNAUDITED) (CONTINUED)

2 DISCLOSURE ON REMUNERATION (CONTINUED)

The overall and balanced quality of staff performance is therefore measured and determined not only by financial achievements but also non-financial indicators which form an integral part of the performance management system.

Remuneration Awarded to Senior Management and Key Personnel

	2018	2017
Number of Senior Management	<u>3</u>	<u>3</u>
	2018	2017
	\$'000	\$'000
Fixed remuneration (see Note below)		
– Cash	5,651	6,480
Variable remuneration		
– Cash	<u>825</u>	<u>3,350</u>
	2018	2017
Number of Key Personnel	<u>5</u>	<u>3</u>
	2018	2017
	\$'000	\$'000
Fixed remuneration (see Note below)		
– Cash	6,954	4,650
Variable remuneration		
– Cash	<u>2,023</u>	<u>1,345</u>

Note: The fixed remuneration included employer's contribution to provident fund.

One Senior Management/Key Personnel was awarded special bonus in 2018. No Senior Management and Key Personnel were awarded guaranteed bonus, deferred variable remuneration or severance payment in 2017 and 2018.