

Standard Chartered Bank  
(Hong Kong) Limited

Unaudited Supplementary  
Financial Information

For the year ended  
31 December 2013

**Standard Chartered Bank (Hong Kong) Limited**  
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## Unaudited supplementary financial information

These notes are supplementary to and should be read in conjunction with the 2013 consolidated financial statements. The consolidated financial statements and this unaudited supplementary financial information (“supplementary notes”) taken together comply with the Banking (Disclosure) Rules (“Rules”) under section 60A of the Banking Ordinance.

Capital disclosures as required by section 45 of the Banking (Disclosure) Rules as amended by the Banking (Disclosure) (Amendment) Rules 2013 will be available on our website: [www.sc.com/hk](http://www.sc.com/hk) on or before 30 April 2014.

### 1 Basis of preparation

- (i) The financial information contained in these supplementary notes has been prepared on a consolidated basis. The basis of consolidation for regulatory purposes is different from that for accounting purposes. For regulatory purposes, the Rules require that certain information is prepared on a basis which excludes some of the subsidiaries of the Bank. Further information regarding subsidiaries that are not included in the consolidation for regulatory purposes is set out in note 2(a) of the supplementary notes.
- (ii) The accounting policies applied in preparing these supplementary notes are the same as those applied in preparing the consolidated financial statements for the year ended 31 December 2013 as set out on pages 13 to 27 of the 2013 consolidated financial statements.

### 2 Capital management

#### (a) Basis of consolidation and preparation

The consolidated capital ratios were calculated in accordance with the Banking (Capital) Rules of the Hong Kong Banking Ordinance.

The basis of consolidation for accounting purposes is in accordance with Hong Kong Financial Reporting Standards. The principal subsidiaries of the Bank for accounting purposes are Standard Chartered APR Limited, Standard Chartered Securities (Hong Kong) Limited, Prime Credit Limited and Standard Chartered Leasing Group Limited.

The basis and scope of consolidation for the calculation of capital ratios for regulatory purposes is different from the basis and scope of consolidation for accounting purposes. Directly held subsidiaries not included in the consolidation for regulatory purposes are set out below:

**2 Capital management (continued)****(a) Basis of consolidation and preparation (continued)**

<i>Figures in HK\$m</i>		<i>At 31 December 2013</i>	
<b>Name of company</b>	<b>Principal Activity</b>	<b>Total assets</b>	<b>Total equity</b>
Standard Chartered Securities (Hong Kong) Limited	Equity capital markets, corporate finance and institutional brokerage	1,099	366
SC Learning Limited	Provision of learning solutions in the banking and finance industry	38	(19)
SCOPE International (China) Company Limited	Development and sales of software, data processing and information technology services	377	203
Standard Chartered Investment Services Limited	Investment management	49	37
Standard Chartered Trust (HK) Limited	Trustee services	20	17
Standard Chartered Nominees (Western Samoa) Limited	Nominees Services	–	–
Horsford Nominees Limited	Nominees Services	–	–
Standard Chartered Global Trading Investment Limited	Nominees Services	–	–
		<u>1,583</u>	<u>604</u>

<i>Figures in HK\$m</i>		<i>At 31 December 2012</i>	
<b>Name of company</b>	<b>Principal Activity</b>	<b>Total assets</b>	<b>Total equity</b>
Standard Chartered Securities (Hong Kong) Limited	Equity capital markets, corporate finance and institutional brokerage	920	363
SC Learning Limited	Provision of learning solutions in the banking and finance industry	38	(19)
Standard Chartered Corporate Advisory Company Limited	Consultancy and advisory services	203	(58)
SCOPE International (China) Company Limited	Development and sales of software, data processing and information technology services	288	163
Standard Chartered Investment Services Limited	Investment management	44	34
Standard Chartered Trust (HK) Limited	Trustee services	10	10
Standard Chartered Nominees (Western Samoa) Limited	Nominees Services	–	–
Horsford Nominees Limited	Nominees Services	–	–
Standard Chartered Global Trading Investments Limited	Nominees Services	–	–
		<u>1,503</u>	<u>493</u>

## **2 Capital management (continued)**

### **(a) Basis of consolidation and preparation (continued)**

The Bank uses the advanced internal ratings-based (“IRB”) approach for both the measurement of credit risk capital and the management of credit risk for the majority of its portfolios. The Bank also uses the standardised (credit risk) approach for certain insignificant portfolios exempted from IRB. The Bank adopts the IRB (securitisation) approach to calculate its credit risk for securitisation exposures.

For market risk, the Bank uses an internal models approach for two guaranteed funds and the standardised (market risk) approach for other exposures. In addition, the Bank adopts the standardised (operational risk) approach for operational risk.

The Bank applies the Internal Capital Adequacy Assessment Process (“ICAAP”) to assess its capital demand on a current, planned and stressed basis. The assessment covers the major risks faced by the Bank, in addition to credit, market and operational risks that are covered under the minimum capital requirements. The ICAAP has been approved by the Asset and Liability Committee (“ALCO”) and the Board of Directors (“the Board”).

Further information regarding capital management is set out in note 37(j) on pages 112 to 113 of the 2013 consolidated financial statements.

### **(b) Capital adequacy ratio and capital base**

With the first phase implementation of revised regulatory capital standards as prescribed by the Basel Committee on Banking Supervision, the HKMA has issued the Banking (Capital) (Amendment) Rules 2012 and 2013 which came into effect for authorized institutions in Hong Kong from 1 January 2013 and 30 June 2013 respectively. Starting from 2013, all authorized institutions in Hong Kong have to meet three levels of minimum capital ratios, namely common equity tier 1 (“CET1”), tier 1 and total capital ratios. The definition of regulatory capital under Basel III is different from that under Basel II which was used for 2012. The capital disclosures for 2013 are, therefore, not directly comparable with the disclosures for 2012 prepared under the Basel II basis. Certain comparative figures have not been provided where the current year is the first year of disclosure.

**2 Capital management (continued)****(b) Capital adequacy ratio and capital base (continued)**

	<i>Consolidated 2013 HK\$'M</i>
<b>CET1 capital</b>	
CET1 capital instruments and related share premium	12,574
Retained earnings	34,949
Disclosed reserves	4,149
	<hr/>
CET1 capital before regulatory deductions	51,672
Regulatory deductions to CET1 capital:	
Cash flow hedge reserve	33
Gains and losses due to changes in own credit risk on fair valued liabilities	(2)
Cumulative fair value gains arising from the revaluation of land and buildings	(115)
Regulatory reserve for general banking risks	(6,148)
Goodwill (net of associated deferred tax liability)	(1,254)
Other intangible assets (net of associated deferred tax liability)	(336)
Deferred tax assets net of deferred tax liabilities	(319)
Valuation adjustments	(160)
Significant capital investments in CET1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation	(22)
Regulatory deductions applied to CET1 capital due to insufficient Additional Tier 1 ("AT1") capital	(875)
	<hr/>
<b>CET1 capital after regulatory deductions</b>	<b>42,474</b>
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**2 Capital management (continued)****(b) Capital adequacy ratio and capital base (continued)**

	<i>Consolidated 2013 HK\$'M</i>
<b>AT1 capital</b>	
AT1 capital before regulatory deductions	–
Regulatory deductions to AT1 capital:	
Significant capital investments in capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation	(875)
Regulatory deductions applied to CET1 capital due to insufficient AT1 capital	875
<b>AT1 capital after regulatory deductions</b>	–
<b>Tier 1 capital after regulatory deductions</b>	42,474
<b>Tier 2 capital</b>	
Capital instruments subject to phase out arrangements from Tier 2 capital	10,140
Cumulative fair value gains arising from the revaluation of land and buildings	52
Collective impairment allowances and regulatory reserve for general banking risks	2,031
Tier 2 capital before regulatory deductions	12,223
Regulatory deductions to Tier 2 capital:	
Significant capital investments in capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation	(875)
<b>Tier 2 capital after regulatory deductions</b>	11,348
<b>Total capital base</b>	53,822
<b>CET1 capital ratio</b>	11.3%
<b>Tier 1 capital ratio</b>	11.3%
<b>Total capital ratio</b>	14.4%

**2 Capital management (continued)****(b) Capital adequacy ratio and capital base (continued)**

	<i>Consolidated</i> 2012 HK\$'M
Core capital:	
Paid up ordinary share capital	97
Share premium	12,477
Reserves	21,846
Profit and loss account	4,194
Current year profit	7,294
Dividend paid	(3,100)
Non-controlling interests	22
Deduct:	
Goodwill	(1,254)
Other intangible assets	(282)
Deferred tax assets	(65)
Other deductions	(111)
	<u>36,924</u>
Deductions from core capital	<u>(2,863)</u>
Core capital after deductions	<u><u>34,061</u></u>
Supplementary capital:	
Unrealised gains on available-for-sale equities and debt securities	3
Unrealised gains on debt securities designated at fair value	23
Regulatory reserve	350
Collective impairment allowances	160
Surplus provisions	1,501
Term subordinated debt	11,267
	<u>13,304</u>
Deductions from supplementary capital	<u>(2,863)</u>
Supplementary capital after deductions	<u><u>10,441</u></u>
Total capital base before deductions	50,228
Deductions from total capital base	<u>(5,726)</u>
Total capital base	<u><u>44,502</u></u>
Capital adequacy ratio	<u><u>13.6%</u></u>
Core capital ratio	<u><u>10.4%</u></u>

## 2 Capital management (continued)

### (c) Capital requirements for credit risk

The Bank and its subsidiaries' minimum capital requirement for credit risk is summarised as follows:

	<i>Consolidated capital requirement</i>	
	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
<b>Subject to IRB approach:</b>		
<u>Advanced IRB approach</u>		
Corporate exposures	12,574	11,148
Sovereign exposures	392	285
Bank exposures	2,853	2,233
<u>Retail IRB approach</u>		
Residential mortgages to individuals and property-holding shell companies	1,185	820
Qualifying revolving retail exposures	977	1,048
Small business retail exposures	148	128
Other retail exposures to individuals	2,100	2,138
<u>Specific risk-weight approach</u>		
Other exposures	2,324	2,214
<u>IRB (securitisation) approach</u>		
Securitisation positions	122	126
<b>Total minimum capital requirement for credit risk under IRB approach</b>	<b>22,675</b>	<b>20,140</b>
<b>Subject to standardised (credit risk) approach:</b>		
Sovereign exposures	–	–
Public sector entity exposures	–	–
Multilateral development bank exposures	–	–
Bank exposures	5	7
Securities firm exposures	–	–
Corporate exposures	979	928
Collective investment scheme exposures	–	–
Cash items	–	–
Regulatory retail exposures	77	79
Residential mortgage loans	124	138
Other exposures which are not past due exposures	1,064	228
Past due exposures	47	191
Significant exposures to commercial entities	–	–
<b>Total minimum capital requirement for credit risk under standardised (credit risk) approach</b>	<b>2,296</b>	<b>1,571</b>
<b>Total minimum capital requirement for credit risk</b>	<b>24,971</b>	<b>21,711</b>

### 3 Corporate governance

The Bank is committed to high standards of corporate governance, and has fully complied throughout the year with the guideline on “Corporate Governance of Locally Incorporated Authorised Institutions” under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority (“HKMA”). The Bank has also fully complied with the disclosure requirement in the “Guideline on a Sound Remuneration System” under the Supervisory Policy Manual issued by the HKMA and has set out the relevant disclosures on remuneration on pages 143 to 145 of the 2013 consolidated financial statements.

#### (a) *The Board of Directors (“the Board”)*

The Board is responsible for overseeing the management of the business and affairs of the Bank including the determination and approval of the Bank’s financial objectives and strategic plan. It oversees the Bank’s compliance with statutory and regulatory obligations, its capital and corporate structure and ensures a sound system of internal control and risk management. The Board also reviews performance in light of the Bank’s strategy, objectives, corporate and business plans and budgets and determines appropriate levels for the Bank’s capital and liquidity positions. The Board delegates day-to-day management of the Bank’s risks to a number of committees. Risk profiles and capital related matters are reviewed by the Board on a regular basis.

#### (b) *Executive Committee (“EXCO”)*

The EXCO operates under the direct authority of the Board and meets regularly in relation to the day to day management, operation and control of the business. It also sub-delegates to various committees certain aspects of the conduct of the business as detailed below. The EXCO includes the Chief Executive Officer (“CEO”), the Chief Financial Officer (“CFO”) and the heads of various business functions.

#### (c) *Asset and Liability Committee (“ALCO”)*

The ALCO, appointed by the EXCO, is responsible for the management of capital and the establishment of, and compliance with, policies relating to balance sheet management, including management of the Bank’s liquidity, capital adequacy and structural foreign exchange and interest rate risks. The members of the ALCO include the CEO, the CFO and key business and risk management heads.

#### (d) *Risk Committee (“RC”)*

The RC, through its authority delegated by the EXCO, is responsible for the management of all risks except those for which ALCO and the Pensions Executive Committee (“PEC”) have direct responsibility, including the establishment of, and compliance with, policies relating to credit risk, country cross-border risk, market risk, operational risk, regulatory risk and reputational risk. It also ensures that processes and procedures that are in place for monitoring and controlling risk meet the Group’s internal standards and external regulatory requirements. The Committee meets regularly and comprises the Country Chief Risk Officer (“CCRO”), CEO, CFO, Country Credit Officer (Wholesale Bank), Country Credit Head (Consumer Bank) and representatives from other relevant units. It has appointed various subcommittees to supervise and review specific areas of risk, including the Hong Kong Early Alert Committee (“EAC”), the Group Special Asset Management Committee, the Excess Approval Committee, the Country Operational Risk Committee (“CORC”), the Hong Kong Model Assessment Committee (“HKMAC”), the Hong Kong Reputational Risk Committee (“HKRRC”), the Hong Kong Connected Lending Approval Committee and the Hong Kong Stress Testing Committee (“HKSTC”).

#### (e) *Audit Committee (“AC”)*

The AC meets regularly with internal audit and the external auditors to review and discuss the Bank’s internal financial controls, other internal controls, compliance and risk management systems. The AC also discusses matters raised by the internal and external auditors and ensures that audit recommendations are implemented appropriately. The AC comprises of 5 non-executive directors, the majority of whom are independent.

#### (f) *Group Internal Audit*

Group Internal Audit is an independent function that reports to both the Country Audit Committee and Group Audit Committee. It provides assurance to management and Audit Committees that the key risks associated with the Group’s and the Bank’s businesses and operations have been identified and appropriate controls have been designed to mitigate these key risks and an effective system of controls over these risks is in place and is working as intended.

#### 4 Credit risk exposure management

The Bank has in place a risk management framework, as outlined on pages 75 to 76 of the 2013 consolidated financial statements. As part of risk management, stress testing and scenario analysis are used to assess the financial and management capability of the Bank to continue to operate effectively under extreme but plausible trading conditions. The HKSTC, which is led by the Risk function, has a primary objective to ensure the Bank understands the earnings and capital implications of specific stress scenarios.

In 2013, stress testing focused on specific asset classes, customer segments and the potential impact of macro economic factors. Stress tests have taken into consideration possible future scenarios that would arise as a result of the development of prevailing market conditions.

##### (a) IRB approach to credit risk

The Bank uses the advanced IRB approach for the measurement of credit risk capital and the management of credit risk for the majority of its portfolios. The following exposures are subject to the advanced IRB approach:

- Corporate exposures including exposures to small-and-medium sized corporates and other corporates;
- Sovereign exposures including exposures to governments and foreign public sector entities;
- Bank exposures including exposures to banks and regulated securities firms;

The following exposures are subject to the retail IRB approach:

- Retail exposures including residential mortgages, qualifying revolving retail exposures, small business retail exposures and other retail exposures to individuals;

The following exposures are subject to the specific risk-weight approach:

- Other exposures including notes and coins, premises, plant and equipment and other fixed assets.

Under the IRB approach, the Bank is permitted to use its own internal estimates of probability of default (“PD”), exposure at default (“EAD”) and loss given default (“LGD”) to determine an asset’s risk weighting:

- the PD of an obligor is the likelihood, expressed as a percentage, of a default event in a one-year time horizon.
- EAD is the expected amount of exposure at the time of default.
- LGD is an estimate of the severity of the loss that the Bank is likely to incur in the event that the obligor defaults, expressed as a percentage of the EAD.

The internal estimates of PD, EAD and LGD are supported by sophisticated risk measurement models developed to support the credit decision making process. These models are approved by the RC, on the recommendation of the HKMAC.

Risk-weighted assets (“RWA”) under the IRB approach are determined by regulatory specified formulae dependent on the Bank’s estimates of PD, EAD and LGD. The development, use and governance of models under the IRB approach is covered in more detail in note 6 to the supplementary notes.

#### **4 Credit risk exposure management (continued)**

##### **(b) Standardised approach to credit risk**

The standardised approach to credit risk measures credit risk pursuant to fixed risk weights and is less sophisticated than the IRB approach. The risk weightings applied under the standardised approach are provided by the HKMA and are based on the asset class to which the exposure is assigned.

#### **5 Risk Grade Profile**

##### **(a) Structure of rating systems**

A standard alphanumeric credit risk-grading system is used in both Wholesale and Consumer Banking. The grading is based on the Bank's internal estimate of probability of default over a one year horizon, with customers or portfolios assessed against a range of quantitative and qualitative factors. The numeric grades run from 1 to 14 and some of the grades are further sub-classified. Lower credit grades are indicative of a lower likelihood of default. Credit grades 1 to 12 are assigned to performing customers or accounts, while credit grades 13 and 14 are assigned to non-performing or defaulted customers.

The Bank's credit grades in Wholesale Banking are not intended to replicate external credit grades, and ratings assigned by external rating agencies are not used in determining the Bank's internal credit grades. Nonetheless, as the factors used to grade a borrower may be similar, a borrower rated poorly by an external rating agency is typically assigned a weak internal credit grade.

Credit grades for Consumer Banking accounts are based on a probability of default calculated using IRB models. These models are based on application and behavioural scorecards which make use of credit bureau information as well as the Bank's own data.

IRB models cover a substantial majority of the Bank and its subsidiaries' exposures and are used extensively in assessing risks at customer and portfolio level, setting strategy and optimising the Bank's risk-return decisions.

The Bank makes use of internal risk estimates of PD, LGD and EAD in the areas of:

- Credit Approval and Decision – The level of authority required for the sanctioning of credit requests and the decision made is based on a combination of PD, LGD and EAD of the obligor with reference to the nominal exposure;
- Pricing – In Wholesale Banking, a pre-deal pricing calculator is used which takes into consideration PD, LGD and EAD in the calculation of expected loss and economic capital for the proposed transactions to ensure appropriate return. In Consumer Banking, a standard approach to risk-return assessment is used to assess the risk using PD, LGD and EAD against the expected income for pricing and risk decision;
- Limit Setting – In Wholesale Banking, concentration limits for some portfolios, as well as counterparty limits are determined by PD, LGD and EAD. The limits operate on a sliding scale to ensure that the Bank does not have over-concentration of low credit quality assets. In Consumer Banking, the estimates of PD, LGD and EAD are used in the credit approval documents to define the credit boundaries and risk limits. It is also used in the score cut-off analysis to limit underwriting within the lower quality or unprofitable score bands.
- Provisioning – Portfolio Impairment Provisions ('PIP') are raised as described in note 6(i) to the supplementary notes and are set with reference to expected loss which is based on PD, LGD and EAD amongst other quantitative and qualitative factors; and
- Risk Appetite – PD, LGD and EAD models provide some of the key inputs into the risk-based methodologies used in the assessment of business and market variables which in turn are key components in the approach taken in setting Risk Appetite.

## 5 Risk Grade Profile (continued)

### (b) Risk assessment for exposures under IRB approach

The following tables set out analyses of EAD, LGD, average risk weight and PD by internal credit grading and IRB class or IRB subclass.

	2013						
	Grades 1-5	Grades 6-8	Grades 9-11	Grade 12	Defaulted	Unrated	Total
<b>Total EAD (HK\$ million)</b>							
Advanced IRB approach:							
Corporates	119,094	114,611	31,397	1,277	6,353	–	272,732
Sovereigns	93,367	155	–	–	–	–	93,522
Banks	334,896	7,378	841	–	51	–	343,166
Retail IRB approach:							
Residential mortgages to individuals and property-holding shell companies	162,803	16,068	2,367	82	299	–	181,619
Qualifying revolving retail exposures	51,623	7,040	3,396	562	247	–	62,868
Small business retail exposures	130	1,241	360	6	1	–	1,738
Other retail exposures to individuals	8,442	13,086	5,282	608	77	–	27,495
Specific risk-weight approach:							
Other exposures	–	–	–	–	–	71,460	71,460
IRB (securitisation) approach:							
Securitisation exposures	16,984	–	–	–	–	–	16,984
	<u>787,339</u>	<u>159,579</u>	<u>43,643</u>	<u>2,535</u>	<u>7,028</u>	<u>71,460</u>	<u>1,071,584</u>

	Grades 1-5	Grades 6-8	Grades 9-11	Grade 12	Defaulted	Unrated	Total
<b>Exposure-weighted average LGD (%)</b>							
Corporates	49.46	35.35	28.39	9.25	59.73	–	41.16
Sovereigns	46.33	46.20	–	–	–	–	46.33
Banks	25.18	20.39	25.38	–	26.20	–	25.08
Residential mortgages to individuals and property-holding shell companies	14.16	26.57	33.14	24.90	12.14	–	15.51
Qualifying revolving retail exposures	92.06	92.06	92.06	92.06	76.98	–	92.00
Small business retail exposures	85.78	86.30	86.40	86.40	86.40	–	86.28
Other retail exposures to individuals	92.88	94.37	95.87	94.60	81.26	–	94.17

	Grades 1-5	Grades 6-8	Grades 9-11	Grade 12	Defaulted	Unrated	Total
<b>Exposure-weighted average risk weight (%)</b>							
Corporates	33.74	61.29	80.80	51.56	187.51	–	54.40
Sovereigns	4.83	71.25	–	–	–	–	4.94
Banks	9.17	32.58	76.49	–	327.50	–	9.88
Residential mortgages to individuals and property-holding shell companies	3.85	30.24	99.73	138.87	121.85	–	7.69
Qualifying revolving retail exposures	6.42	33.16	123.11	254.45	104.68	–	18.32
Small business retail exposures	40.18	99.19	124.54	219.80	–	–	100.38
Other retail exposures to individuals	46.28	90.16	144.58	223.50	82.30	–	90.07
Other exposures	–	–	–	–	–	38.28	38.28
Securitisation exposures	8.47	–	–	–	–	–	8.47

## 5 Risk Grade Profile (continued)

### (b) Risk assessment for exposures under IRB approach (continued)

	2013						
	Grades 1-5	Grades 6-8	Grades 9-11	Grade 12	Defaulted	Unrated	Total
<b>Exposure-weighted average PD (%)</b>							
Corporates	0.17	1.16	5.30	27.39	100.00	–	3.63
Sovereigns	0.01	0.89	–	–	–	–	0.02
Banks	0.05	0.86	4.42	–	100.00	–	0.09
Residential mortgages to individuals and property-holding shell companies	0.07	0.88	4.40	24.74	100.00	–	0.37
Qualifying revolving retail exposures	0.12	0.96	6.23	26.48	100.00	–	1.17
Small business retail exposures	0.25	1.58	4.07	31.60	100.00	–	2.16
Other retail exposures to individuals	0.28	0.97	5.77	26.55	100.00	–	2.52
<b>2012</b>							
<b>Total EAD (HK\$ million)</b>							
Advanced IRB approach:							
Corporates	102,531	106,166	28,952	1,110	5,863	–	244,622
Sovereigns	63,096	395	–	–	–	–	63,491
Banks	339,902	4,731	468	–	44	–	345,145
Retail IRB approach:							
Residential mortgages to individuals and property-holding shell companies	152,524	14,586	1,820	62	279	–	169,271
Qualifying revolving retail exposures	47,331	7,812	3,807	673	184	–	59,807
Small business retail exposures	92	1,043	299	6	5	–	1,445
Other retail exposures to individuals	8,072	12,240	6,086	715	44	–	27,157
Specific risk-weight approach:							
Other exposures	–	–	–	–	–	68,999	68,999
IRB (securitisation) approach:							
Securitisation exposures	15,289	–	–	–	–	–	15,289
	<u>728,837</u>	<u>146,973</u>	<u>41,432</u>	<u>2,566</u>	<u>6,419</u>	<u>68,999</u>	<u>995,226</u>
<b>2011</b>							
<b>Exposure-weighted average LGD (%)</b>							
Corporates	49.54	33.55	24.42	71.68	55.49	–	39.87
Sovereigns	46.39	46.20	–	–	–	–	46.39
Banks	27.51	24.40	22.94	–	26.20	–	27.46
Residential mortgages to individuals and property-holding shell companies	12.48	23.29	31.30	15.99	11.56	–	13.61
Qualifying revolving retail exposures	92.06	92.06	92.06	92.06	77.75	–	92.02
Small business retail exposures	86.13	86.22	85.95	86.40	86.40	–	86.16
Other retail exposures to individuals	92.98	94.37	95.90	94.43	82.62	–	94.28

## 5 Risk Grade Profile (continued)

### (b) Risk assessment for exposures under IRB approach (continued)

	2012						Total
	Grades 1-5	Grades 6-8	Grades 9-11	Grade 12	Defaulted	Unrated	
<b>Exposure-weighted average risk weight (%)</b>							
Corporates	34.50	59.69	78.94	223.56	125.90	–	53.74
Sovereigns	4.68	103.66	–	–	–	–	5.30
Banks	7.14	35.51	58.94	–	292.70	–	7.63
Residential mortgages to individuals and property-holding shell companies	2.61	25.15	90.74	88.87	113.58	–	5.71
Qualifying revolving retail exposures	6.42	34.19	124.62	254.41	101.95	–	20.66
Small business retail exposures	40.34	99.01	123.75	217.00	1,080.05	–	104.47
Other retail exposures to individuals	46.14	90.34	144.61	223.31	77.52	–	92.84
Other exposures	–	–	–	–	–	37.85	37.85
Securitisation exposures	9.69	–	–	–	–	–	9.69
	Grades 1-5	Grades 6-8	Grades 9-11	Grade 12	Defaulted	Unrated	Total
<b>Exposure-weighted average PD (%)</b>							
Corporates	0.17	1.16	6.00	24.72	100.00	–	3.79
Sovereigns	0.01	2.03	–	–	–	–	0.03
Banks	0.06	0.94	3.30	–	100.00	–	0.09
Residential mortgages to individuals and property-holding shell companies	0.07	0.83	4.22	25.21	100.00	–	0.36
Qualifying revolving retail exposures	0.12	1.00	6.36	26.08	100.00	–	1.24
Small business retail exposures	0.25	1.58	4.02	31.23	100.00	–	2.48
Other retail exposures to individuals	0.28	0.98	5.75	26.21	100.00	–	2.66

The following table sets out an analysis of the amount of undrawn commitments and EAD for corporate, sovereign and bank exposures:

	2013		2012	
	Undrawn commitments HK\$'M	EAD HK\$'M	Undrawn commitments HK\$'M	EAD HK\$'M
Corporates	66,266	8,523	52,857	8,265
Sovereigns	3,661	529	841	168
Banks	25,587	3,461	17,953	3,034
	<u>95,514</u>	<u>12,513</u>	<u>71,651</u>	<u>11,467</u>

## 5 Risk Grade Profile (continued)

### (b) Risk assessment for exposures under IRB approach (continued)

The following table discloses the amount of exposure in the IRB portfolio that is covered by guarantees.

IRB Exposure Class	EAD covered by guarantees	
	2013	2012
	HK\$'M	HK\$'M
Corporate exposures	17,570	12,823
Sovereign exposures	–	–
Bank exposures	1,867	353
Residential mortgages to individuals and property-holding shell companies	–	–
Qualifying revolving retail exposures	–	–
Small business retail exposures	–	–
Other retail exposures to individuals	–	–
Other exposures	–	–
Securitisation positions	–	–
	19,437	13,176

## 6 Internal ratings-based models

### (a) Model governance

Models are developed by analytics teams within the Consumer Banking and Wholesale Banking risk functions. The model development process is conducted and documented in line with specific criteria setting out the minimum standards for model development. All IRB models are validated periodically by a model validation team reporting to the Group Chief Credit Officer, thereby maintaining independence from the model build processes. Model validation findings are presented to the HKMAC which in turn makes approval recommendations to the RC. These decision-making bodies are comprised of divisional senior management whose role is to challenge model assumptions and performance and agree on appropriate model use for business decision-making. The RC periodically reviews overall model performance.

The model validation process involves a qualitative and quantitative assessment of the model, data, systems and governance. This would typically include an assessment of:

- Model assumptions;
- Validity of the technical approach used;
- Statistical and empirical measures of performance;
- Appropriateness of intended model use;
- Model application and infrastructure;
- Data integrity and history;

## **6 Internal ratings-based models (continued)**

### **(a) Model governance (continued)**

- Model response to changes in internal and external environment: i.e., the extent to which the model provides point in time or through the cycle measures of risk;
- Model monitoring standards and triggers; and
- Levels of conservatism applied.

Statistical testing is used to determine a model's discriminatory power, predicted versus actual performance and stability over time with pre-defined thresholds for passing such tests.

### **(b) PD Model Development**

The Bank employs a variety of techniques to develop its PD models. The appropriate approach is dictated by the availability and appropriateness of both internal and external data. If there is a perceived weakness in the data, for example shorter history or fewer instances of defaults, an appropriate amount of conservatism is applied to predicted default rates.

The general approaches fall into three categories:

Default History Based ("Good-Bad") – where a sufficient number of defaults is available, the Bank deploys a variety of statistical methods to determine the likelihood of default on existing exposures. These methods afford very high discriminatory power by identifying exposure characteristics that have a significant predictive ability. The majority of the Bank's consumer and corporate exposures are rated under such an approach.

Shadow Rating Approach – if it is determined that the Bank's internal data does not provide sufficient default history (so called "low default portfolios"), then the Bank develops models which are designed to be comparable to the ranking of PD rating assigned by established credit assessment institutions, to avail of those agencies having access to large databases of defaults on a variety of credit obligations.

Constrained Expert Judgement – for certain types of exposures there is little or no internal or external default history, and therefore no reliable external ratings. In such rare cases, the Bank develops quantitative frameworks which include the expert opinions of the Bank's credit risk management personnel.

### **(c) LGD Model Development**

The Bank develops LGD models by assessing recoveries, the forced sale value of collateral together with the economic costs in securing these recoveries, and the timing with which such cash flows occur. All such cash flows are then measured at net present value using a suitable discount rate to derive a recovery rate. LGD is therefore the EAD less these estimated recoveries.

Recoveries are estimated based upon empirical experience, which has shown that factors such as customer segment, product and geography have predictive content.

All LGD models are conservatively calibrated to a 'downturn' – with lower collateral values and recoveries on exposures, compared to those estimated over the long run.

## 6 Internal ratings-based models (continued)

### (d) EAD Model Development

An EAD model is developed for uncertain exposure products such as lines of credit, credit cards, overdrafts and other commitments. Based on the Bank's experience (and supplemented by external data), EAD models assess changes to limits and the likely draw-down of committed and uncommitted limits as an exposure approaches default. The factor generated by the model and applied to the undrawn limit is referred to as the credit conversion factor ("CCF").

The Bank has used conservative assumptions in assessing EAD, in keeping with the expected experience in an economic downturn.

### (e) Model Use

In addition to supporting credit decisions, IRB models also support risk-based pricing methodologies and measures used to assess business performance such as Economic Revenue and Economic Profit.

The use of models is governed by a suite of policies:

- use of models is governed by the grading policy and procedure which defines the applicability of that model, details the procedure for use and sets the conditions and approval authority required to override model output;
- the Group Model Risk Policy – IRB Models specifies that models are subject to regular monitoring and review with the underlying Group Model Standards for IRB Credit Risk Models specifying statistical thresholds and other triggers which determine when models need to be redeveloped; and
- the parental support policy, for Wholesale Banking, determines the requirement and extent to which parental support may be utilised to adjust the credit grade of subsidiaries.

### (f) Wholesale Banking Model Results

The following table sets out observed PD, realised LGD and EAD compared to advanced IRB model predictions.

The Bank was incorporated on 1 July 2004. In order to compute the long run actual realisations of LGD and EAD, advanced IRB model development data was used prior to the incorporation date.

	2013				
	PD		LGD		EAD Predicted / Realised
	Observed %	Predicted %	Realised %	Predicted %	
<b>Advanced IRB Exposure Class</b>					
Corporates <sup>1</sup>	0.94	1.51	47.88	40.58	1.01
Sovereigns	0.00	0.02	0.00	46.39	0.00
Banks	0.00	0.08	0.00	27.46	0.00
	2012				
	PD		LGD		EAD Predicted / Realised
	Observed %	Predicted %	Realised %	Predicted %	
<b>Advanced IRB Exposure Class</b>					
Corporates	1.65	1.81	47.78	39.67	1.20
Sovereigns	0.00	0.01	0.00	26.96	0.00
Banks	0.00	0.07	0.00	26.46	0.00

<sup>1</sup> Includes small and medium-sized enterprises managed by Consumer Banking

## **6 Internal ratings-based models (continued)**

### **(f) Wholesale Banking Model Results (continued)**

Wholesale Banking models have been developed from a dataset which runs to over a decade, including default and recovery experience from the 1997 Asian financial crisis. This data has been used to calibrate estimates of PD to the Bank's long run experience. Actual ('point in time') default rates will typically differ from this 'through the cycle' experience as economies move above or below cyclical norms.

Advanced IRB PD estimates are computed as of 1 January 2013 and are compared with default observations through 31 December 2013. The historical loss experience for sovereigns or banks is minimal and in 2013, there were no observed defaults. The observed PD rates for corporate exposures in 2013 remained below AIRB model predictions.

The calculation of realised versus predicted LGD is affected by the fact that it takes a number of years for the workout process to complete. The recovery process on most of the defaults in 2013 is too immature to compute meaningful realised versus predicted outcomes in a manner similar to that for PD and EAD.

The predicted LGD is a downturn LGD based on the model outputs as of 1 January 2013. For the realised LGD, on the other hand, instead of restricting its computation to 2013 defaults only, we have used the long run average realisations from 1995 to 2013, including downturn periods. Therefore, the predicted LGD is not directly comparable to the realised LGD. The predicted LGD estimate takes into account the impact of enhanced risk mitigation techniques (e.g. netting) and proactive Early Alert risk management actions. These have been more prevalent in recent years and are therefore not reflected in the long run average LGD to the same extent as they are in the predicted LGD.

EAD takes into consideration potential drawdown of commitment as a counterparty defaults by estimating the credit conversion factor (CCF, also known as k-factor) of undrawn commitments. The comparison of realised versus predicted EAD is summarized, for assets which defaulted in 2013, as the ratio of the EAD one year before default, to the outstanding at the point of default. The predicted EAD is broadly the same as the realised EAD.

## 6 Internal ratings-based models (continued)

### (g) Consumer Banking Model Results

Consumer Banking models have been developed from datasets which capture eight years of performance data for the majority of portfolios. This history includes “credit bubbles” as well as stress that arose during the SARS outbreak. This experience is therefore reflected in the calibration of the models.

	2013					
	PD		LGD		EAD	
	Actual PD%	Predicted PD%	Actual	Predicted	Actual EAD HK\$'M	Predicted EAD HK\$'M
			Exposure- weighted LGD%	Exposure- weighted LGD%		
<b>Retail IRB Exposure Class</b>						
Residential mortgages	0.05	0.24	0.04	13.19	82	84
Qualifying revolving retail exposures	0.33	0.62	57.62	84.40	248	304
Small business retail exposures	2.00	2.24	80.31	86.40	25	26
Other retail exposures to individuals	2.51	2.62	73.29	93.07	632	732

	2012					
	PD		LGD		EAD	
	Actual PD%	Restated	Actual	Predicted	Actual EAD HK\$'M	Predicted EAD HK\$'M
		Predicted PD%	Exposure- weighted LGD%	Exposure- weighted LGD%		
<b>Retail IRB Exposure Class</b>						
Residential mortgages	0.08	0.30	0.12	18.33	155	157
Qualifying revolving retail exposures	0.35	0.69	56.61	84.60	245	281
Small business retail exposures	1.42	2.25	74.17	86.40	15	17
Other retail exposures to individuals	2.06	2.65	67.93	92.89	460	521

Predicted PD was computed as at 1 January 2013 and compared to the actual default observations during the year to 31 December 2013. The observed default rate for all asset classes is in line with, or lower than, the predicted PD.

The actual LGD is calculated based on recoveries that were realised as of December 2013. This is compared to the predicted LGD of these assets at a given time period. Actual LGDs are lower than the predicted values for all asset classes, primarily due to ‘downturn’ parameter settings used in the models to predict LGD.

For all asset classes, other than QRRE and other retail exposures to individuals, the predicted EAD was close to the actual EAD experienced during 2013. For QRRE and other retail exposures to individuals, the predicted EAD includes regulatory ‘downturn’ requirements that resulted in higher EAD. The actual EAD is also lower due to management actions taken to contain exposure prior to default.

## 6 Internal ratings-based models (continued)

### (h) Analysis of actual losses and estimates

The following table sets out the actual losses in 2013 and 2012 and the regulatory expected loss as at 31 December 2012 and 31 December 2011.

Regulatory expected loss is based on a through-the-cycle methodology using risk parameters and observations over a period of time. It is a conservative and appropriately prudent calculation underpinning regulatory capital requirements, and:

- does not take account of any benefit from management actions to reduce exposures to riskier customers, clients or segments as conditions deteriorate;
- does not take account of any diversification benefit; and
- is calculated in accordance with rules which enforce a certain level of conservatism.

Regulatory expected loss therefore bears little resemblance to impairment as defined for accounting purposes. This is illustrated by the table below which shows expected loss consistently at a multiple of impairment.

The actual loss is the net individual impairment charge recognised in the income statement during the reporting period which has been made in accordance with the Bank's accounting policy as set out in Note 2(k) on pages 21 to 23 of the 2013 consolidated financial statements.

IRB exposure class	Actual loss for the year of		Regulatory expected loss at	
	2013 HK\$'M	2012 HK\$'M	31 December 2012** HK\$'M	31 December 2011** HK\$'M
Corporates	5	585	2,934	2,603
Sovereigns	–	–	8	2
Banks	–	–	70	62
Residential mortgages	(14)	(9)	79	81
Qualifying revolving retail exposures	419	304	639	611
Small business retail exposures	23	17	26	20
Other retail exposures to individuals	539	309	680	554
	<u>972</u>	<u>1,206</u>	<u>4,436</u>	<u>3,933</u>

\*\* The regulatory expected loss is the estimated future loss for the relevant IRB asset classes over the next 12 months

The decrease in actual loss was driven by one single account in 2012.

## 6 Internal ratings-based models (continued)

### (i) *Problem Credit Management and Provisioning*

#### *Consumer Banking*

In Consumer Banking, where there are large numbers of small value loans, a primary indicator of potential impairment is delinquency. A loan is considered delinquent (past due) when the counterparty has failed to make a principal or interest payment when contractually due. However, not all delinquent loans (particularly those in the early stage of delinquency) will be impaired. For delinquency reporting purposes we follow industry standards, measuring delinquency as of 1, 30, 60, 90, 120 and 150 days past due. Accounts that are overdue by more than 30 days are more closely monitored and subject to specific collections processes.

Provisioning within Consumer Banking reflects the fact that the product portfolios (excluding medium-sized enterprises among SME customers and Private Banking customers) consist of a large number of comparatively small exposures. Mortgages are assessed for individual impairment on an account by account basis, but for other products it is impractical to monitor each delinquent loan individually and impairment is therefore assessed collectively.

For the main unsecured products and loans secured by automobiles, the entire outstanding amount is generally written off at 150 days past due. Unsecured consumer finance loans are similarly written off at 90 days past due. For secured loans (other than those secured by automobiles) individual impairment provisions (IIPs) are generally raised at either 150 days (Mortgages) or 90 days (Wealth Management) past due.

The provisions are based on the estimated present values of future cashflows, in particular those resulting from the realisation of security. Following such realisation any remaining loan will be written off. The days past due used to trigger write offs and IIPs are broadly driven by past experience, which shows that once an account reaches the relevant number of days past due, the probability of recovery (other than by realising security where appropriate) is low. For all products there are certain situations where the individual impairment provisioning or write off process is accelerated, such as in cases involving bankruptcy, customer fraud and death. Write off and IIPs are accelerated for all restructured accounts to 90 days past due (unsecured and automobile finance) and 120 days past due (secured) respectively.

The PIP methodology provides for accounts for which an individual impairment provision has not been raised, either individually or collectively. PIP is raised on a portfolio basis for all products, and is set using expected loss rates, based on past experience supplemented by an assessment of specific factors affecting the relevant portfolio. These include an assessment of the impact of economic conditions, regulatory changes and portfolio characteristics such as delinquency trends and early alert trends. The methodology applies a larger provision against accounts that are delinquent but not yet considered impaired.

The procedures for managing problem credits for the Private Bank and the medium-sized enterprises in the SME segment of Consumer Banking are similar to those adopted in Wholesale Banking.

**6 Internal ratings-based models (continued)****(i) Problem Credit Management and Provisioning (continued)***Wholesale Banking*

Loans are classified as impaired and considered non-performing where analysis and review indicates that full payment of either interest or principal is questionable, or as soon as payment of interest or principal is 90 days overdue. Impaired accounts are managed by Group Special Assets Management, ("GSAM") the Bank's specialist recovery unit, which is separate from the main businesses. Where any amount is considered irrecoverable, an individual impairment provision is raised, being the difference between the loan carrying amount and the present value of estimated future cash flows.

The individual circumstances of each customer are taken into account by GSAM when estimating future cash flows. All available sources such as cash flow arising from operations, selling assets or subsidiaries, realising collateral or payments under guarantees are considered. In any decision relating to the raising of provisions, the Bank attempts to balance economic conditions, local knowledge and experience, and the results of independent asset reviews.

Where it is considered that there is no realistic prospect of recovering a portion of an exposure against which an impairment provision has been raised, then that amount will be written off.

As with Consumer Banking, a PIP is held to cover the inherent risk of losses which, although not identified, are known through experience to be present in any loan portfolio. In Wholesale Banking, the PIP is set with reference to historic loss rates, and subjective factors such as the economic environment and the trends in key portfolio indicators. The PIP methodology provides for accounts for which an IIP has not been raised.



## 8 Credit risk mitigation (“CRM”)

Potential credit losses from any given account, customer or portfolio are mitigated using a range of tools such as collateral, netting agreements, credit insurance, credit derivatives and other guarantees. The reliance that can be placed on these mitigants is carefully assessed in light of issues such as legal certainty and enforceability, market value and counterparty risk of the guarantor.

Risk mitigation policies determine the eligibility of collateral types. Collateral types that are eligible for risk mitigation include: cash; residential, commercial and industrial property; fixed assets such as motor vehicles, aircraft, plant and machinery; marketable securities; commodities; bank guarantees; and letters of credit.

Collateral is valued in accordance with the Bank’s risk mitigation policy, which prescribes the frequency of valuation for different collateral types, based on the level of price volatility of each type of collateral and the nature of the underlying product or risk exposure.

### *Wholesale Banking*

The process of managing and recognising credit risk mitigation is governed by policies which set out the eligibility criteria that must be met. The credit risk mitigation policy sets out clear criteria that must be satisfied if the mitigation is to be considered effective:

- Excessive exposure to any particular risk mitigants or counterparties should be avoided. Collateral concentration mitigation standards are maintained at both the portfolio and counterparty level;
- Risk mitigants should not be correlated with the underlying assets such that default would coincide with a lowering of the forced sale value of the collateral;
- Where there is a currency mismatch, haircuts should be applied to protect against currency fluctuations;
- Legal opinions and documentation must be in place; and
- Ongoing review and controls exist where there is a maturity mismatch between the collateral and exposure.

For all CRMs that meet the policy criteria, a clear set of procedures is applied to ensure that the value of the underlying collateral is appropriately recorded and updated regularly.

### *Consumer Banking*

The effective use of collateral is a key tool by which credit risk is mitigated in Consumer Banking. All eligible collateral accepted by Consumer Banking is covered by a product proposal approved by senior credit officers delegated with the relevant authority. New collateral types have to be vetted through a stringent ‘New Business Approval’ process and are approved in accordance with the delegated authorities within Consumer Banking Risk or by the Excess Approval Committee under advice of the Group’s Consumer Banking Risk Committee as appropriate.

In order to be recognised as security and for the loan to be classified as secured, all items pledged must be valued and there must exist an active secondary resale market for the collateral. Documentation must be held to enable Consumer Banking to realise the asset without the cooperation of the asset owner in the event that this is necessary.

Detailed procedures over collateral management must be in place for each business.

## 9 Counterparty credit risk-related exposures

Counterparty credit risk is the risk that the Bank's counterparty in a foreign exchange, interest rate, commodity, equity or credit derivative contract defaults prior to the maturity date of the contract and that the Bank at the time has a claim on the counterparty.

Credit risk arising from all financial derivatives is managed as part of the overall lending limits to banks and corporate customers. Where collateral is deemed a necessary or desirable mitigant to the exposure, the Bank will seek to negotiate Credit Support Annexes ("CSA") with counterparties on a case by case basis. The credit terms of the CSA are specific to each legal document and determined by the credit risk approval unit responsible for the counterparty. The nature of the collateral will be specified in the legal document and will typically be cash or highly liquid securities. The Bank further reduces its credit exposures to counterparties by entering into contractual netting agreements which result in a single amount owed by or to the counterparty through netting the sum of the positive (amounts owed by the counterparty) and negative (amounts owed by the Bank) mark to market ("MTM") values of these transactions. Exposures are however presented on a gross basis in the financial statements as such transactions are not intended to be settled net in the ordinary course of business.

In line with market convention, the Bank negotiates CSA terms for certain counterparties where the thresholds related to each party are dependent on their external credit assessment institutions ("ECAI") long term rating. Such clauses are typically mutual in nature. It is therefore recognised that a downgrade in the Bank's rating could result in counterparties seeking additional collateral calls to cover negative MTM portfolios where thresholds are lowered.

Wrong way risk occurs when an exposure increase is coupled with a decrease in the credit quality of the obligor. For example, as the MTM on a derivative contract increases in favour of the Bank, the counterparty may increasingly be unable to meet its payment, margin call or collateral posting requirements. The Bank employs various policies and procedures to ensure that wrong way risk exposures are recognised upfront and monitored.

The Bank's credit ratings as at the end of December 2013 were AA- (Standard & Poors Ratings Services) ("S & P") and Aa3 (Moody's Investors Service) ("Moody's"). The impact of a 2-notch downgrade has a minimal impact on the Bank's derivative collateral requirements.

The Bank adopts the current exposure method to determine the exposure amount for counterparty credit risk which arises from derivative transactions in the banking and trading books. The credit equivalent amount is calculated as the sum of the current replacement cost and the potential future credit exposure.

For OTC derivative transactions and credit derivative contracts, default risk exposure is the credit equivalent amount. For securities financing transactions, default risk exposure is the principal amount of securities sold or lent, or the money paid or lent, or the securities or money provided as collateral.

The Bank's regulatory capital requirements for counterparty credit risk arising from derivative transactions and securities financing transactions booked in the banking or trading book (referred to as "relevant transactions" in this section), are calculated in accordance with the Banking (Capital) rules. The Bank adopts the advanced IRB approach to calculate the majority of its counterparty credit risk exposures and adopts the standardised (credit risk) approach for certain insignificant portfolios which are exempt from IRB. Following the implementation of the Banking (Capital) (Amendment) Rules 2012 and 2013, the credit risk weighted amounts as at 31 December 2013 have included additional capital requirements for asset value correlation ("AVC") and credit valuation adjustment ("CVA"). The capital requirement for credit risk relating to the relevant transactions is calculated by multiplying the risk-weighted amounts derived from the advanced IRB approach by 8%.

## 9 Counterparty credit risk-related exposures (continued)

### (a) Counterparty credit risk exposures under the IRB approach

The following table summarises the Bank's credit exposure arising from OTC derivative transactions, securities financing transactions and credit derivative contracts.

	<i>Consolidated</i>		
	<i>OTC derivative transactions</i>	<i>Securities financing transactions<sup>(3)</sup></i>	<i>Credit derivative contracts<sup>(1)</sup></i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
<b>2013</b>			
Gross total positive fair value	12,182	–	2
Default risk exposures	26,618	26,385	9
Recognised collateral held			
– Cash	8	576	–
– Equities	–	5,148	–
– Debt securities	–	20,428	–
Default risk exposures net of recognised collateral held	26,610	233	9
Risk weighted amounts <sup>(2)</sup>	<u>9,220</u>	<u>829</u>	<u>2</u>

(1) The outstanding credit derivative contract, amounting to HK\$65 million, was a total return swap. The contract was related to protection bought and was used for the Bank's credit portfolio.

(2) Following the implementation of the Banking (Capital) (Amendment) Rules 2012 and 2013, risk weighted amounts include AVC and CVA.

(3) Securities financing transactions include repo-style transactions and margin lending transactions.

The following table summarises the Bank's credit exposure arising from OTC derivative transactions, repo-style transactions and credit derivative contracts.

	<i>Consolidated</i>		
	<i>OTC derivative transactions</i>	<i>Repo-style transactions</i>	<i>Credit derivative contracts</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
<b>2012</b>			
Gross total positive fair value	7,550	–	–
Credit equivalent amounts/net credit exposures	21,179	3,441	–
Recognised collateral held			
– Cash	47	8	–
– Equities	–	813	–
– Debt securities	–	2,512	–
Credit equivalent amounts/net credit exposures net of recognised collateral held	21,132	920	–
Risk weighted amounts	<u>1,915</u>	<u>123</u>	<u>–</u>

## 9 Counterparty credit risk-related exposures (continued)

### (a) Counterparty credit risk exposures under the IRB approach (continued)

An analysis of the notional amounts, default risk exposures and the risk-weighted amounts for OTC derivative transactions, securities financing transactions and credit derivative contracts by counterparty type under the IRB approach is summarised as follows:

	<i>Consolidated</i>		
	<i>OTC derivative transactions HK\$'M</i>	<i>Securities financing transactions HK\$'M</i>	<i>Credit derivative contracts HK\$'M</i>
<b>2013</b>			
Notional amounts:			
– Corporates	68,892	2,688	–
– Sovereigns	–	–	–
– Banks	1,222,111	23,614	65
– Others	–	–	–
	<u>1,291,003</u>	<u>26,302</u>	<u>65</u>
Default risk exposures:			
– Corporates	1,828	2,688	–
– Sovereigns	–	–	–
– Banks	24,790	23,697	9
– Others	–	–	–
	<u>26,618</u>	<u>26,385</u>	<u>9</u>
Risk-weighted amounts:			
– Corporates	2,511	118	–
– Sovereigns	–	–	–
– Banks	6,671	711	2
– Others	38	–	–
	<u>9,220</u>	<u>829</u>	<u>2</u>

## 9 Counterparty credit risk-related exposures (continued)

### (a) Counterparty credit risk exposures under the IRB approach (continued)

An analysis of the notional amounts, credit equivalent amounts/net credit exposures and the risk-weighted amounts for OTC derivative transactions, repo-style transactions and credit derivative contracts by counterparty type under the IRB approach is summarised as follows:

	<i>Consolidated</i>		
	<i>OTC derivative transactions HK\$'M</i>	<i>Repo-style transactions HK\$'M</i>	<i>Credit derivative contracts HK\$'M</i>
<b>2012</b>			
Notional amounts:			
– Corporates	49,671	–	–
– Sovereigns	–	–	–
– Banks	1,237,591	3,441	–
– Others	–	–	–
	<u>1,287,262</u>	<u>3,441</u>	<u>–</u>
Credit equivalent amounts/net credit exposures:			
– Corporates	977	–	–
– Sovereigns	–	–	–
– Banks	20,202	3,441	–
– Others	–	–	–
	<u>21,179</u>	<u>3,441</u>	<u>–</u>
Risk-weighted amounts:			
– Corporates	703	–	–
– Sovereigns	–	–	–
– Banks	1,212	123	–
– Others	–	–	–
	<u>1,915</u>	<u>123</u>	<u>–</u>

**9 Counterparty credit risk-related exposures (continued)****(b) Counterparty credit risk under the standardised (credit risk) approach**

The following table summaries the Bank's credit exposure arising from OTC derivative transactions.

	<i>Consolidated OTC derivative transactions HK\$'M</i>
<b>2013</b>	
Gross total positive fair value	98
Default risk exposures	253
Recognised collateral held	
– Cash	108
Default risk exposures net of recognised collateral held	145
Risk weighted amounts	<u>119</u>
	<i>Consolidated OTC derivative transactions HK\$'M</i>
<b>2012</b>	
Gross total positive fair value	111
Credit equivalent amounts/net credit exposures	426
Recognised collateral held	
– Cash	120
Credit equivalent amounts/net credit exposures net of recognised collateral held	306
Risk weighted amounts	<u>132</u>

**9 Counterparty credit risk-related exposures (continued)****(b) Counterparty risk under the standardised (credit risk) approach (continued)**

An analysis of the notional amounts, default risk exposures and the risk-weighted amounts for OTC derivatives by counterparty type under the standardised (credit risk) approach is summarised as follows:-

	<i>Consolidated OTC derivative transactions HK\$'M</i>
<b>2013</b>	
Notional amounts:	
– Corporates	2,964
– Banks	895
– Individuals	7,237
	<u>11,096</u>
Default risk exposures	
– Corporates	61
– Banks	33
– Individuals	159
	<u>253</u>
Risk-weighted amounts:	
– Corporates	61
– Banks	7
– Individuals	51
	<u>119</u>

**9 Counterparty credit risk-related exposures (continued)****(b) Counterparty risk under the standardised (credit risk) approach (continued)**

An analysis of the notional amounts, credit equivalent amounts/net credit exposures and the risk-weighted amounts for OTC derivatives by counterparty type under the standardised (credit risk) approach is summarised as follows:–

	<i>Consolidated</i> <i>OTC derivative</i> <i>transactions</i> <i>HK\$'M</i>
<b>2012</b>	
Notional amounts:	
– Corporates	2,206
– Banks	14,864
– Individuals	10,746
	<hr/>
	27,816
	<hr/> <hr/>
Credit equivalent amounts:	
– Corporates	35
– Banks	217
– Individuals	174
	<hr/>
	426
	<hr/> <hr/>
Risk-weighted amounts:	
– Corporates	35
– Banks	43
– Individuals	54
	<hr/>
	132
	<hr/> <hr/>

**(c) Risk exposures to derivative transactions**

	<i>Consolidated</i>		<i>Risk</i> <i>weighted</i> <i>amounts</i> <i>HK\$'M</i>
	<i>Fair value</i> <i>assets</i> <i>HK\$'M</i>	<i>Fair value</i> <i>liabilities</i> <i>HK\$'M</i>	
<b>2013</b>			
<b>Exchange rate contracts</b>			
– Forwards	10,493	10,672	6,787
– Cross currency swaps	615	1,121	1,484
– Options purchased	109	38	46
– Options written	–	61	–
<b>Interest rate contracts</b>			
– Swaps	852	644	835
– Options purchased	4	–	15
– Options written	15	77	–
<b>Other derivatives</b>	<hr/>	<hr/>	<hr/>
	81	236	174
	<hr/>	<hr/>	<hr/>
	12,169	12,849	9,341
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

**9 Counterparty credit risk-related exposures (continued)****(c) Risk exposures to derivative transactions (continued)**

	<i>Consolidated</i>		
	<i>Fair value assets HK\$'M</i>	<i>Fair value liabilities HK\$'M</i>	<i>Risk weighted amounts HK\$'M</i>
<b>2012</b>			
<b>Exchange rate contracts</b>			
– Forwards	6,078	5,987	1,097
– Cross currency swaps	304	561	448
– Options purchased	75	10	52
– Options written	10	95	–
<b>Interest rate contracts</b>			
– Swaps	1,075	1,745	360
– Options purchased	4	–	–
– Options written	–	4	–
<b>Other derivatives</b>	<u>120</u>	<u>73</u>	<u>90</u>
	<u><u>7,666</u></u>	<u><u>8,475</u></u>	<u><u>2,047</u></u>

The fair values and risk weighted amounts shown above do not include embedded derivatives which are not separated out from their host contracts, and therefore may not necessarily represent the amounts at risk.

**10 Asset securitisation**

The Bank adopts the IRB (securitisation) approach to calculate the credit risk for asset securitisations in which it is an investing institution. There was no asset securitisations for which the Bank was an originating institution.

The Bank uses the following external credit assessment institutions to calculate the capital adequacy requirements: S & P, Moody's and Fitch Ratings.

The Bank's securitization exposures are measured in accordance with the accounting policy described in note 2(i) of the 2013 consolidated financial statements.

The securitised assets have appropriate credit and market risk limits in place with exposures being monitored against these limits. There is also a periodic performance analysis of the underlying collateral pools through review of trustee reports, market research and monitoring the changes of their external ratings. In addition, for Wholesale Banking, there is an internal credit model in place to measure any change in the performance of the underlying collateral pools.

**10 Asset securitisation (continued)**

On-balance sheet securitisation exposures booked in banking book:

	2013 HK\$'M	2012 HK\$'M
Residential mortgage loans	8,620	7,903
Diversified payment types	1,887	2,118
Auto loans	2,709	1,791
Credit cards	2,328	1,519
Commercial mortgage loans	564	940
Trade receivables	752	614
Student loans	113	392
Others	10	12
	<u>16,983</u>	<u>15,289</u>

	Consolidated 2013			Exposures deducted from capital	
	Outstanding amounts HK\$'M	Risk- weighted amounts HK\$'M	Minimum capital requirements HK\$'M	CET1 Capital HK\$'M	Tier 2 Capital HK\$'M
Risk weight					
7%	12,706	942	75		
8%	1,491	126	10		
10%	55	6	1		
12%	2,394	305	24		
20%	22	5	1		
35%	229	85	7		
60%	86	55	4		
	<u>16,983</u>	<u>1,524</u>	<u>122</u>	–	–

**10 Asset securitisation (continued)**

	<i>Consolidated 2012</i>			<i>Exposures deducted from capital</i>	
	<i>Outstanding amounts HK\$'M</i>	<i>Risk- weighted amounts HK\$'M</i>	<i>Minimum capital requirements HK\$'M</i>	<i>Core</i>	<i>Supplementary</i>
				<i>Capital HK\$'M</i>	<i>Capital HK\$'M</i>
Risk weight					
7%	10,092	749	60		
8%	1,785	151	12		
10%	841	89	7		
12%	1,330	169	14		
15%	205	33	3		
20%	351	75	6		
35%	549	204	16		
60%	88	56	4		
75%	23	18	1		
100%	25	27	2		
	<u>15,289</u>	<u>1,571</u>	<u>125</u>	<u>–</u>	<u>–</u>

**11 Market risk**

For the calculation of the capital requirement for market risk, the Bank uses an internal models approach for two guaranteed retirement funds and the standardised (market risk) approach for other exposures.

The Bank's minimum capital requirement for market risk is summarised as follows:

	<i>Consolidated capital requirement</i>	
	<i>2013 HK\$'M</i>	<i>2012 HK\$'M</i>
<b>Standardised (market risk) approach:</b>		
Interest rate exposures	1,110	944
Foreign exchange exposures	160	75
Equity exposures	251	227
Commodity exposures	27	30
	<u>1,548</u>	<u>1,276</u>
<b>Internal models approach:</b>		
Guaranteed retirement funds	37	71
	<u>37</u>	<u>71</u>
<b>Total minimum capital requirement for market risk</b>	<u>1,585</u>	<u>1,347</u>

The capital requirement for the Bank's guaranteed retirement funds is calculated based on the potential shortfall between the estimated returns from the funds and the guaranteed returns. The projected returns are estimated using a simulation approach with a 99% confidence level. The model is back-tested against actual results.

## 12 Operational risk

The Bank adopts the standardised (operational risk) approach for assessing capital requirements for operational risk.

Operational risk is the risk of direct or indirect loss due to an event or action resulting from the failure of internal processes, people, and systems, or from external events. The Bank seeks to ensure that key operational risks are managed in a timely and effective manner through a framework of policies, procedures and tools to identify, assess, monitor, control, and report such risks.

The Bank's minimum capital requirement for operational risk is summarised as follows:

	<i>Consolidated capital requirement</i>	
	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Standardised (operational risk) approach	3,443	3,057

CORC is appointed by the RC to review the Bank's operational risk profile with the objective of providing a forum for the management oversight of country and business level operational risk ("OR") trends and issues arising from control lapses/failures, regulatory breaches, policy non-compliance, as well as exceptions and weaknesses identified through the self-assessment processes, risk toolkits, compliance and business reviews, internal and external audits and external developments/changes. CORC will deliberate the root causes of risk issues, the appropriateness of risk ratings, as well as the adequacy and effectiveness of remedial actions.

Further information regarding operational risk governance and management is set out in note 37(g) on pages 110 to 111 of the 2013 consolidated financial statements.

## 13 Equity exposures in the banking book

Investments in equity shares which are intended to be held on a continuing basis, but which do not comprise investments in associates, jointly controlled entities or subsidiaries, are classified as available-for-sale securities and are reported on the balance sheet as "Investment securities". Available-for-sale securities are measured at fair value as described in note 2(i) of the 2013 consolidated financial statements. Included within this category are investments made by the Bank for strategic purposes, which are subject to additional internal procedures and approvals to ensure that the investments are in accordance with the Bank's strategy and to ensure compliance with all relevant regulatory and legal restrictions. In some cases, additional investments may be made later such that the investee becomes an associate, jointly controlled entity or subsidiary, at which point the investment is reclassified in accordance with the Bank's accounting policies.

	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Cumulative realised gains on disposal	2	1
Unrealised gains/(losses) recognised in reserves but not through the income statement	50	(56)

**14 Other annual financial disclosure****(a) Interest rate exposure in the banking book**

As at the balance sheet date, the variation in the Bank's earnings for a 200 basis points interest rate increase, broken down by currency, is shown as follows (in HK\$ million):

	<i>HKD</i>	<i>USD</i>	<i>CNY</i>		
2013	460	857	(390)		
	<u>460</u>	<u>857</u>	<u>(390)</u>		
	<i>HKD</i>	<i>USD</i>	<i>CNY</i>	<i>AUD</i>	<i>EUR</i>
2012	(514)	164	(255)	(122)	370
	<u>(514)</u>	<u>164</u>	<u>(255)</u>	<u>(122)</u>	<u>370</u>

The above analysis is based on the methodology as set out by the HKMA in the completion instructions for the "Return of Interest Rate Risk Exposure" and is compiled on a quarterly basis.

In addition, the analysis is based on the following assumptions:

- (i) there is a parallel shift in the yield curve and in interest rates;
- (ii) positions are assumed to run to maturity and reprice according to the earliest interest repricing date; and
- (iii) no loan prepayment is assumed as the majority of loans are on a floating rate basis.

**(b) Analysis of fee and commission income**

The products constituting not less than 10% of the total amount of fee and commission income are as follows:

	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Trade products	833	910
Global market products	1,807	1,593
Investment services	1,486	1,126
	<u>1,486</u>	<u>1,126</u>

**14 Other annual financial disclosure (continued)****(c) Cross border claims**

Cross border claims are on-balance sheet exposures of counterparties based on the location of those counterparties after taking into account the transfer of risk. For a claim guaranteed by a party situated in a country different from the counterparty, risk will be transferred to the country of the guarantor. For a claim on the branch of a bank or other financial institution, the risk will be transferred to the country where its head office is situated. Claims on individual countries or areas, after risk transfer, amounting to 10% or more of the aggregate cross border claims are shown as follows:

	2013			
	<i>Banks and other financial institutions</i>	<i>Public sector entities</i>	<i>Other</i>	<i>Total</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Asia Pacific excluding Hong Kong				
– Mainland China	144,560	11,335	39,353	195,248
– Others	59,623	1,839	33,455	94,917
	<u>204,183</u>	<u>13,174</u>	<u>72,808</u>	<u>290,165</u>
Western Europe				
– United Kingdom	54,837	–	7,192	62,029
– Others	21,198	–	11,529	32,727
	<u>76,035</u>	<u>–</u>	<u>18,721</u>	<u>94,756</u>
	2012			
	<i>Banks and other financial institutions</i>	<i>Public sector entities</i>	<i>Other</i>	<i>Total</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Asia Pacific excluding Hong Kong				
– Mainland China	128,463	6,189	32,804	167,456
– Others	67,997	10,638	36,713	115,348
	<u>196,460</u>	<u>16,827</u>	<u>69,517</u>	<u>282,804</u>
Western Europe				
– United Kingdom	55,418	–	4,840	60,258
– Others	28,120	114	12,738	40,972
	<u>83,538</u>	<u>114</u>	<u>17,578</u>	<u>101,230</u>

**14 Other annual financial disclosure (continued)****(d) Advances to customers analysed by industry sector**

The analysis of gross advances to customers by industry sector is based on the categories used by the HKMA.

**Consolidated**

	At 31 December 2013 HK\$'M	% of advances covered by collateral or other securities	Restated At 31 December 2012 HK\$'M	Restated % of advances covered by collateral or other securities
Gross advances for use in Hong Kong				
<i>Industrial, commercial and financial</i>				
– Property development	9,971	11%	7,644	14%
– Property investment	42,352	76%	42,176	78%
– Financial concerns	14,968	70%	10,697	70%
– Stockbrokers	6,525	65%	3,774	63%
– Wholesale and retail trade	24,062	39%	19,455	43%
– Manufacturing	23,889	19%	20,982	15%
– Transport and transport equipment	7,903	58%	4,938	32%
– Recreational activities	1,041	14%	617	–
– Information technology	2,549	–	1,854	6%
– Others	15,389	7%	10,328	23%
<i>Individuals</i>				
– Advances for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	674	100%	783	100%
– Advances for the purchase of other residential properties	158,211	100%	143,252	100%
– Credit card advances	19,281	–	20,004	–
– Others	26,123	34%	24,393	33%
Total gross advances for use in Hong Kong	352,938		310,897	
Trade finance	41,093	13%	35,653	13%
Trade bills	2,892	12%	2,857	17%
Gross advances for use outside Hong Kong	57,682	18%	59,672	15%
Gross advances to customers	454,605	55%	409,079	55%

Advances to customers by geographical area are classified according to the location of the counterparties after taking into account the transfer of risk. As at 31 December 2013, approximately 83 per cent (2012: 82 per cent) of the Bank and its subsidiaries' advances to customers were classified under Hong Kong.

Except for Hong Kong, none of the remaining geographical segments represents more than 10% of the Bank and its subsidiaries' gross loans and advances to customers after taking into account the transfer of risk.

**14 Other annual financial disclosure (continued)****(d) Advances to customers analysed by industry sector (continued)****Bank**

	At 31 December 2013 HK\$'M	% of advances covered by collateral or other securities	Restated At 31 December 2012 HK\$'M	Restated % of advances covered by collateral or other securities
Gross advances for use in Hong Kong				
<i>Industrial, commercial and financial</i>				
– Property development	9,971	11%	7,644	14%
– Property investment	42,016	76%	41,792	78%
– Financial concerns	14,968	70%	10,698	70%
– Stockbrokers	6,525	65%	3,774	63%
– Wholesale and retail trade	23,902	39%	19,006	44%
– Manufacturing	23,889	19%	20,982	15%
– Transport and transport equipment	7,903	58%	4,930	32%
– Recreational activities	1,041	14%	617	–
– Information technology	2,549	–	1,854	6%
– Others	15,388	7%	10,328	23%
<i>Individuals</i>				
– Advances for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	674	100%	783	100%
– Advances for the purchase of other residential properties	152,627	100%	137,934	100%
– Credit card advances	18,774	–	19,617	–
– Others	21,485	41%	20,110	40%
Total gross advances for use in Hong Kong	341,712		300,069	
Trade finance	41,093	13%	35,653	13%
Trade bills	2,892	12%	2,857	17%
Gross advances for use outside Hong Kong	55,370	19%	57,750	15%
Gross advances to customers	441,067	56%	396,329	55%

As at 31 December 2013, approximately 78 per cent (2012: 78 per cent) of the Bank's advances to customers were classified under Hong Kong.

Except for Hong Kong, none of the remaining geographical segments represents more than 10% of the Bank's gross loans and advances to customers after taking into account the transfer of risk.

The above balances do not include inter-company loans and advances.

**14 Other annual financial disclosure (continued)****(d) Advances to customers analysed by industry sector (continued)**

The amount of impaired and overdue advances to customers and individually and collectively assessed impairment allowances for industry sectors which constitute not less than 10% of the Bank and its subsidiaries' total advances to customers are as follows:

**Consolidated**

	<i>Impaired advances to customers HK\$'M</i>	<i>Overdue advances to customers HK\$'M</i>	<i>Individually assessed impairment allowances HK\$'M</i>	<i>Collectively assessed impairment allowances HK\$'M</i>	<i>New provision charge HK\$'M</i>
<u>As at 31 December 2013</u>					
Advances for the purchase of other residential properties	120	196	4	3	1
Property investment	75	102	3	17	–
Gross advances for use outside Hong Kong	29	115	19	68	–

As at 31 December 2012 (restated)

Advances for the purchase of other residential properties	115	134	12	4	–
Property investment	5	72	4	10	–
Gross advances for use outside Hong Kong	215	240	112	63	112

**Bank**

	<i>Impaired advances to customers HK\$'M</i>	<i>Overdue advances to customers HK\$'M</i>	<i>Individually assessed impairment allowances HK\$'M</i>	<i>Collectively assessed impairment allowances HK\$'M</i>	<i>New provision charge HK\$'M</i>
<u>As at 31 December 2013</u>					
Advances for the purchase of other residential properties	112	20	3	2	–
Property investment	75	92	3	17	–
Gross advances for use outside Hong Kong	29	78	19	37	–

As at 31 December 2012 (restated)

Advances for the purchase of other residential properties	106	15	12	3	–
Property investment	5	72	4	10	–
Gross advances for use outside Hong Kong	215	215	112	45	112

**14 Other annual financial disclosure (continued)****(e) Overdue and rescheduled assets***(i) Overdue advances to customers***Consolidated**

	2013		2012	
	HK\$'M	% of gross advances	HK\$'M	% of gross advances
Gross advances to customers which have been overdue with respect to either principal or interest for periods of:				
– 6 months or less but over 3 months	190	0.04%	239	0.06%
– 1 year or less but over 6 months	70	0.01%	605	0.15%
– over 1 year	527	0.12%	308	0.08%
	<u>787</u>	<u>0.17%</u>	<u>1,152</u>	<u>0.29%</u>
	2013 HK\$'M		2012 HK\$'M	
Fair value of collateral held against the covered portion of overdue advances to customers	<u>506</u>		<u>381</u>	
Covered portion of overdue advances to customers	352		262	
Uncovered portion of overdue advances to customers	<u>435</u>		<u>890</u>	

**Bank**

	2013		2012	
	HK\$'M	% of gross advances	HK\$'M	% of gross advances
Gross advances to customers which have been overdue with respect to either principal or interest for periods of:				
– 6 months or less but over 3 months	182	0.04%	231	0.06%
– 1 year or less but over 6 months	65	0.02%	597	0.15%
– over 1 year	526	0.12%	308	0.08%
	<u>773</u>	<u>0.18%</u>	<u>1,136</u>	<u>0.29%</u>
	2013 HK\$'M		2012 HK\$'M	
Fair value of collateral held against the covered portion of overdue advances to customers	<u>492</u>		<u>365</u>	
Covered portion of overdue advances to customers	338		246	
Uncovered portion of overdue advances to customers	<u>435</u>		<u>890</u>	

**14 Other annual financial disclosure (continued)****(e) Overdue and rescheduled assets (continued)***(i) Overdue advances to customers (continued)*

The covered portion of overdue advances to customers represents the amount of collateral held against outstanding balances. It does not include any collateral held over and above outstanding exposures.

The collateral held in respect of the overdue advances consists of cash, properties, securities and government guarantee.

**Consolidated**

	2013 HK\$'M	2012 HK\$'M
Individually assessed impairment allowances against overdue advances to customers	312	403

**Bank**

	2013 HK\$'M	2012 HK\$'M
Individually assessed impairment allowances against overdue advances to customers	311	403

*(ii) Overdue advances to banks***Consolidated and Bank**

	2013 HK\$'M	% of advances to banks	2012 HK\$'M	% of advances to banks
Gross advances to banks which have been overdue with respect to either principal or interest for periods of:				
Over 1 year	46	0.04%	44	0.03%

There is no collateral held against overdue advances to banks.

Individually assessed impairment allowances against advances to banks overdue more than 1 year	—	1
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**14 Other annual financial disclosure (continued)****(e) Overdue and rescheduled assets (continued)***(iii) Rescheduled advances to customers***Consolidated**

	2013		2012	
	HK\$'M	% of gross advances	HK\$'M	% of gross advances
Rescheduled advances	1,070	0.24%	348	0.09%

**Bank**

	2013		2012	
	HK\$'M	% of gross advances	HK\$'M	% of gross advances
Rescheduled advances	1,032	0.23%	319	0.08%

Rescheduled advances are those advances, which have been restructured or renegotiated because of a deterioration in the financial position of the borrowers, or the inability of the borrowers to meet the original repayment schedule and for which the revised repayment terms are non-commercial to the Bank. The amount of rescheduled advances to customers excludes those which have been overdue for more than 3 months and reported as overdue advances in note 14(e) (i) above.

There were no rescheduled advances to banks and other financial institutions as at 31 December 2013 and 31 December 2012.

**14 Other annual financial disclosure (continued)****(f) Non-bank Mainland China exposure**

	<i>On-balance sheet exposure HK\$'M</i>	<i>Off-balance sheet exposure HK\$'M</i>	<i>Total HK\$'M</i>	<i>Individually assessed impairment allowances HK\$'M</i>
<u>As at 31 December 2013</u>				
Mainland China entities	46,884	71,935	118,819	19
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	25,667	40,652	66,319	21
Other counterparties where the exposure is considered by the Bank to be non-bank Mainland China exposure	11,841	14,181	26,022	–
<u>As at 31 December 2012</u>				
Mainland China entities	37,075	62,955	100,030	112
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	19,601	34,369	53,970	1
Other counterparties where the exposure is considered by the Bank to be non-bank Mainland China exposure	6,863	2,512	9,375	–

The off-balance sheet exposure represents the amount at risk should the contract be fully drawn upon and the client defaults. As the facilities may expire without being drawn upon, the contractual amounts do not represent expected future cash flows.

**(g) Liquidity ratio**

	<i>Bank</i>	
	<i>2013</i>	<i>2012</i>
	%	%
Average liquidity ratio for the year	33.5%	36.3%

The average liquidity ratio is computed as the simple average of each calendar month's average ratio and is in accordance with the Fourth Schedule to the Hong Kong Banking Ordinance.

**15 Comparative figures**

Certain comparative figures have been restated to conform with the current year's presentation.