



**中国工商银行** (加拿大)

INDUSTRIAL AND COMMERCIAL BANK OF CHINA (CANADA)

**INDUSTRIAL AND COMMERCIAL BANK OF CHINA (CANADA)**

**BASEL III PILLAR 3 DISCLOSURES**

**AS AT DECEMBER 31, 2014**

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## 1. Scope of Application

This document addresses the Basel III Pillar 3 disclosure requirements for Industrial and Commercial Bank of China (Canada) (the "Bank").

The Bank is licensed to operate as a bank in Canada with full banking powers under the Bank Act as a foreign bank subsidiary. The Bank obtained its letters patent as a Canadian chartered bank under its former name, The Bank of East Asia (Canada), on May 16, 1991 and commenced operations on May 15, 1992. On June 4, 2009, The Bank of East Asia Limited, Hong Kong (the "shareholder bank" or "BEA") reached an agreement with the Industrial and Commercial Bank of China Limited (the "parent bank") regarding the acquisition by the parent bank of 70% of the issued and outstanding common shares of the Bank ("Acquisition"). Following satisfaction of all the pre-agreed conditions and all the necessary regulatory approvals obtained, the Acquisition was completed on January 28, 2010. After obtaining its letters patent to amend the incorporating instrument of the Bank from the Superintendent of Financial Institutions Canada (the "Superintendent" or "OSFI"), on July 2, 2010 the Bank officially changed its name from The Bank of East Asia (Canada) to Industrial and Commercial Bank of China (Canada). By exercising the option entitled in the shareholders' agreement executed for the Acquisition, on August 26, 2011 the parent bank completed an acquisition of a further 10% of the issued and outstanding common shares of the Bank from BEA. Since then, the parent bank and BEA now own 80% and 20% of the Bank, respectively. The Bank principal office is located at Bay Adelaide Centre, West Tower, Suite 3710, 333 Bay Street, Toronto, Ontario, Canada M5H 2R2.

The following disclosures have been prepared purely for explaining the basis on which the Bank has prepared and disclosed information about capital requirements and the management of certain risks and for no other purpose. They do not constitute any form of financial statements and must not be relied upon in making any investment or judgment on the Bank or its parent bank and shareholder bank BEA. All amounts disclosed herein are in thousands of Canadian dollars unless otherwise noted.

## 2. Capital Management

### Qualitative disclosures

Capital levels for Canadian banks are regulated pursuant to guidelines issued by OSFI, based on standards issued by the Bank for International Settlements. Regulatory capital is allocated to two tiers: Tier 1 (consisting of Common Equity Tier 1 capital and Additional Tier 1 Capital) and Tier 2. Tier 1 capital comprises the more permanent components of capital and the Bank's Tier 1 capital includes common shareholders' equity (common shares issued to the parent bank and shareholder bank) and retained earnings. Currently, the Bank does not account for any amount under Tier 2 capital. Total capital is defined as the total of Tier 1 and Tier 2 capital less deductions as prescribed by OSFI.

The Bank actively manages its capital to maintain a strong capital base while providing strong returns to the shareholders and sustaining future development of the business. The Bank's capital management framework provides policies for defining, measuring, monitoring, managing and planning capital to ensure that the quantity and quality of the Bank's capital are adequate, at a minimum, to comply with all applicable regulatory requirements.

Regulatory capital ratios are calculated by dividing Tier 1 and Total capital by risk-weighted assets. The calculation of risk-weighted assets is determined by OSFI's prescribed rules relating to on- and off-balance sheet exposures and includes an amount for the market risk exposure associated with the Bank's trading portfolios, as well as an amount for operational risk.

In addition, OSFI expects all deposit-taking institution to early attain "all-in" target capital ratios equal to or greater than the 2019 minimum capital ratios plus conservation buffer. These targets are a Common Equity Tier 1 (CET1) ratio of 7%; a Tier 1 Capital ratio of 8.5% and a Total capital ratio of 10.5%. In addition to the CET1, Tier 1 and Total capital ratios, Canadian banks are also required to ensure that their assets to capital multiple, which is calculated by dividing gross-adjusted assets by Total capital, does not exceed a maximum level prescribed by OSFI.

Under Basel III framework, the Bank adopts the Standardized Approach for credit risk and Basic Indicator Approach for operational risk to assess capital adequacy. For market risk, the Bank does not have trading portfolios to meet the qualifying criteria prescribed by OSFI for computing market risk capital requirements.

Under Basel III, collective allowances for credit losses on portfolios subject to the Standardized Approach can be included in Tier 2 capital up to a limit of 1.25% of the risk-weighted assets of those portfolios. The Bank currently does not include this calculation in its Tier 2 capital.

## 2. Capital Management (continued)

### Quantitative disclosures

The following table presents the Bank's regulatory capital and capital ratios. Throughout the year, the Bank was in compliance with the capital targets established by OSFI.

	Basel III	
	2014	2013
Regulatory capital:		
Tier 1 capital:		
Share capital	\$ 108,000	\$ 108,000
Retained earnings	35,727	25,726
Common Equity Tier 1 Capital	143,727	133,726
Regulatory adjustments to CET1	(5)	(13)
<b>Total capital</b>	<b>\$ 143,722</b>	<b>\$ 133,713</b>
Risk-weighted assets:		
Credit risk	\$ 866,652	\$ 790,389
Operational risk	47,488	40,363
<b>Total risk-adjusted assets</b>	<b>\$ 914,140</b>	<b>\$ 830,752</b>
Capital ratios:		
Tier 1 capital	15.72%	16.10%
Total capital	15.72%	16.10%

The Bank's credit risk-weighted assets (after adjustments for credit risk mitigation and with specific risk-weighting factors applied) and capital requirement for credit risk of each portfolio calculated under the Standardized Approach is as follows:

	Risk-weighted assets	Capital requirement
Total corporate	\$ 750,607	\$ 60,049
Total retail residential mortgages	52,443	4,195
Total other retail	29,504	2,360
Bank	22,404	1,792
Balance sheet assets not included in standardized or internal ratings-based approaches	11,694	936
<b>Total for credit risk</b>	<b>\$ 866,652</b>	<b>\$ 69,332</b>

## 2. Capital Management (continued)

The minimum capital required for operational risk is calculated under Basic Indicator Approach as follows:

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Gross income as defined by OSFI over the previous three years:	
Year 1	\$ 20,518
Year 2	25,620
Year 3	29,848
Average of gross income for Year 1-3	25,329
Capital charge (15% times average of gross income)	3,799
Risk-weighted assets for operational risk (12.5 times capital charge)	47,488

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### **3. Risk Management Framework**

The Bank has exposure to the following principal risks from its use of financial instruments: credit risk, liquidity risk, market risk and operational risk.

The Board of Directors (the "Board") has overall responsibility for the establishment and oversight of the Bank's risk management framework. The management of the Bank has established the Asset & Liability Risk Management Committee ("ALRMCO") and Credit Committee, which are authorized by the Board, to be responsible for developing and monitoring the Bank's risk management policies in their specified areas and recommending them to the Board.

The Bank's risk management policies are established to identify and analyze the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations. All of these policies and procedures are reviewed by the Audit Committee of the Board and approved by the Board.

The Audit Committee of the Board is responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by Internal Audit. Internal Audit is an independent function separated from any operational functions in the Bank and reports directly to the Audit Committee and the Group Chief Auditor of the parent bank. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

The Audit Committee and the Board receive reports as required under the Bank's respective risk management policies. The Audit Committee reports regularly to the Board on its activities.

### **3. Risk Management Framework (continued)**

#### **(a) Credit Risk Management**

##### **Qualitative disclosures**

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers and other banks and investment debt securities. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure, such as individual obligor default risk, country and sector risk.

The Bank has established the credit management policies and procedures that comply with the framework established by the parent bank and all of the standards as determined by the governing regulatory bodies in Canada. The Board has delegated responsibility for the management of credit risk to the Credit Committee established by the management of the Bank. A separate Credit Risk Management Department, reporting to the Credit Committee and Chief Risk Officer, is responsible for oversight of the Bank's credit risk, including:

- Formulating credit policies within the framework established by the parent bank and in consultation with the business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures and compliance with regulatory and statutory requirement.
- Establishing the authorization structure for the approval and renewal of credit facilities. Authorization limits are allocated to the Chief Executive Officer, Senior Advisor and business unit Lending Officers. Larger facilities require approval by the Executive Committee of the Board as appropriate.
- Reviewing and assessing credit risk. The Credit Risk Management Department assesses all credit exposures in excess of the authorization limits allocated to the business unit Lending Officers, prior to facilities being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process.
- Limiting concentrations of exposure to counterparties, industries and products.
- Developing and maintaining the Bank's risk gradings in order to categorize exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of twelve grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. The responsibility for approving risk grades lies with the final approving executive or Credit Committee as appropriate. Risk grades are subject to regular review.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries and product types. Regular reports are prepared by the Credit Risk Management Department and provided to the Credit Committee and the Board on the credit quality of local portfolios and appropriate corrective action is taken.



### **3. Risk Management Framework (continued)**

#### **(a) Credit Risk Management (continued)**

Each business unit is required to implement the Bank's credit policies and procedures, with credit approval authorities delegated from the Board. Each business unit is responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolios, including those subject to central approval.

Regular audits of business units and the Credit Risk Management Department processes are undertaken by Internal Audit.

Impaired loans and investment debt securities:

Individually impaired loans and securities are loans and advances and investment debt securities for which the Bank determines that there is objective evidence of impairment and it does not expect to collect all principal and interest due according to the contractual terms of the loan/investment security agreement(s). These loans are graded B in the Bank's internal credit risk grading system.

Past due but not impaired loans and investment debt securities:

Past due but not impaired loans and investment debt securities are those for which contractual interest or principal payments are past due not more than 90 days, but the Bank believes that impairment is not appropriate on the basis of the level of security or collateral available and/or the stage of collection of amounts owed to the Bank.

Loans with renegotiated terms:

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank has made concessions that it would not otherwise consider. Once the loan is restructured, it is classified as impaired until there are continuously six months of satisfactory performance after restructuring.

Allowances for impairment:

The Bank establishes an allowance for impairment losses on assets carried at amortized cost that represents its estimate of incurred losses in its loan and investment debt security portfolio. The main components of this allowance are a specific loss component that relates to individually impaired and individually significant exposures, and a collective loan loss allowance established for groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans that are considered individually insignificant as well as individually significant exposures that were subject to individual assessment for impairment but not found to be individually impaired.

### **3. Risk Management Framework (continued)**

#### **(a) Credit Risk Management (continued)**

##### Write-off policy:

The Bank writes off a loan or an investment debt security balance, and any related allowances for impairment losses, when the Credit Committee of the Bank determines that the loan or security is uncollectible. This determination is made after considering information such as the occurrence of significant changes in the borrower's/issuer's financial position such that the borrower/issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

##### Offsetting:

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank has a legal right to set off the recognized amounts and it intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions.

##### Collateral Valuation and Management:

The Bank holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, cash collateral and guarantees. Policy is established with respect to the collateral, such as the source and suitability of a security which include all formal agreements and undertakings to secure the repayment of a loan. To mitigate the credit risk, the Bank looks at whether the assets of the borrower or guarantor are available to be taken as collateral and whether such collateral is suitable for the purpose.

Estimates of fair value of collateral are based on its value assessed at the time of borrowing, and generally are updated during regular review of loans or when a loan is individually assessed as impaired. Collateral generally is not held over loans and advances to banks. Collateral usually is not held against investment securities, and no such collateral was held at December 31, 2014 or 2013.

##### Main types of Guarantor:

The parent bank and shareholder bank have assumed the credit risk in respect of certain loans of the Bank. In the normal course of its business, the Bank enters into transactions with the parent/shareholder bank on terms similar to those offered to non-related parties.

##### Concentrations of risk:

Concentrations of credit risk exist when changes in geographic, economic or industry factors similarly affect groups of counterparties whose aggregate credit exposure is material in relation to the Bank's total exposures. The Bank monitors concentrations of its portfolio of financial instruments along industry and product sectors.

### **3. Risk Management Framework (continued)**

#### **(a) Credit Risk Management (continued)**

The Bank monitors concentrations of credit risk by sector and by geographic location. The Bank adopts appropriate risk control measures, such as setting limits on exposures to different industries and portfolios. Measures are also implemented to control large exposures to individual customers or corporate groups by setting guidelines and limits for maximum credit exposures.

##### Capital allocation:

The allocation of capital among specific operations, products and/or activities is, to a large extent, driven by optimization of the return achieved on the capital allocated. The amount of capital allocated is based primarily upon the regulatory capital, but in some cases, may be flexed to reflect differing risk profiles, subject to the overall level of capital to support a particular operation, product or activity not falling below the minimum required for regulatory purposes. The process of allocating capital is undertaken independently of those responsible for the operation by Financial Control Department, and is subject to review by the management of the Bank or ALRMCO, as appropriate.

##### Allowances for credit losses:

The specific counterparty component of the total allowances for impairment applies to financial assets evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty's financial situation and the net realizable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Committee.

Collectively assessed impairment allowances cover credit losses inherent in portfolios of loans and advances with similar credit risk characteristics when there is objective evidence to suggest that they contain impaired loans and advances, but the individual items cannot yet be identified. In assessing the need for collective loss allowances, management considers factors, such as credit quality, portfolio size, concentrations and economic factors. In order to estimate the required allowance, assumptions are made to define the way inherent losses are modelled and to determine the required input parameters, based on historical experience and current economic conditions. The accuracy of the allowances depends on the estimates of future cash flows for specific counterparty allowances and the model assumptions and parameters used in determining collective allowances.

### 3. Risk Management Framework (continued)

#### (a) Credit Risk Management (continued)

##### Quantitative disclosures

The following table indicates the Bank's exposure to credit risk:

	Loans and advances to customers		Loans and advances to banks		Investment securities	
	2014	2013	2014	2013	2014	2013
Assets at amortized cost:						
Individually impaired:						
Grade B (sub-standard) - individually impaired	\$ 3,054	\$ 3,053	\$ -	\$ -	\$ -	\$ -
Grade B (doubtful) - individually impaired	1,464	3,067	-	-	-	-
Gross amount	4,518	6,120	-	-	-	-
Specific allowance for impairment	(2,064)	(2,483)	-	-	-	-
Carrying amount	2,454	3,637	-	-	-	-
Past due but not impaired:						
Grade AAA to BBB - low-fair risk	2,804	10,443	-	-	-	-
Grade BBB- to BB - watch list	3,343	5,472	-	-	-	-
Carrying amount	6,147	15,915	-	-	-	-
Neither past due nor impaired:						
Grade AAA to BBB - low-fair risk	928,477	824,526	3,661	569	64,904	34,810
Grade BBB- to BB - watch list	3,550	7,910	-	-	-	-
Gross amount	932,027	832,436	3,661	569	64,904	34,810
Collective allowance for impairment	(4,778)	(4,778)	-	-	-	-
Carrying amount	927,249	827,658	3,661	569	64,904	34,810
<b>Total carrying amount</b>	<b>\$ 935,850</b>	<b>\$ 847,210</b>	<b>\$ 3,661</b>	<b>\$ 569</b>	<b>\$ 64,904</b>	<b>\$ 34,810</b>
Past due but not impaired comprises:						
1 - 30 days	\$ 3,060	\$ 15,274	\$ -	\$ -	\$ -	\$ -
30 - 60 days	3,087	-	-	-	-	-
60 - 90 days	-	641	-	-	-	-
<b>Carrying amount</b>	<b>\$ 6,147</b>	<b>\$ 15,915</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>

### 3. Risk Management Framework (continued)

#### (a) Credit Risk Management (continued)

In addition to the above, the Bank had entered into lending commitments of \$461,950 (2013 - \$250,687) with counterparties graded low to fair risk.

The Bank has issued financial guarantee contracts in respect of debtors graded low to fair risk and for which the maximum amount payable by the Bank, assuming all guarantees are called on, is \$25,758 (2013 - \$25,311).

Set out below is an analysis of the gross and net (of allowances for impairment) amounts of individually impaired loans and advances to customers by risk grade:

	2014		2013	
	Gross	Net	Gross	Net
Grade B (sub-standard) - individually impaired	\$ 3,211	\$ 2,883	\$ 3,053	\$ 2,949
Grade B (doubtful) - individually impaired	1,736	-	3,067	688
	<u>\$ 4,947</u>	<u>\$ 2,883</u>	<u>\$ 6,120</u>	<u>\$ 3,637</u>

\$429 of gross amount in 2014 relates to accrued interest.

There are no individually impaired loans and advances to banks and investment debt securities in 2014 and 2013.

An estimate of the fair value of collateral and other security enhancements held against loans and advances to customers is shown below:

	Loans and advances to customers	
	2014	2013
Against individually impaired:		
Property	\$ 3,200	\$ 4,950
Cash collateral	-	-
Other	-	-
Against past due but not impaired:		
Property	7,706	27,523
Cash collateral	-	110
Other	-	1,755
Against neither past due nor impaired:		
Property	1,331,872	1,078,014
Cash collateral	21,558	30,374
Other	470,705	300,141
	\$ 1,835,041	\$ 1,442,867

### 3. Risk Management Framework (continued)

#### (a) Credit Risk Management (continued)

The following table summarizes the credit risk gross exposure for each portfolio at the reporting date:

	Drawn	Undrawn commitments	Over-the-counter derivatives	Other off-balance sheet <sup>(1)</sup>	Total gross exposure <sup>(2)</sup>
Residential mortgage	\$ 134,399	\$ -	\$ -	\$ -	\$ 134,399
Consumer loans	29,852	-	-	-	29,852
Retail	164,251	-	-	-	164,251
Business:					
Agriculture	-	-	-	-	-
Capital Goods	-	-	-	9,085	9,085
Communications	2,446	-	-	-	2,446
Energy	41,851	-	-	996	42,847
Manufacturing	16,314	-	-	-	16,314
Metal & Mining	251,810	-	-	-	251,810
Real estate	243,051	48,802	-	1,743	293,596
Resources and basic materials	40	-	-	1,000	1,040
Retail and Wholesale	39,396	-	4	1,120	40,520
Technology	-	-	-	-	-
Transportation	144,908	-	-	-	144,908
Services	40,408	28,465	-	70	68,943
Other	844	-	-	-	844
Sovereign	65,059	-	-	-	65,059
Bank	110,995	-	1,027	-	112,022
Wholesale	957,122	77,267	1,031	14,014	1,049,434
<b>Total exposure</b>	<b>\$ 1,121,373</b>	<b>\$ 77,267</b>	<b>\$ 1,031</b>	<b>\$ 14,014</b>	<b>\$ 1,213,685</b>

<sup>(1)</sup> Includes contingent liabilities, such as letters of credit and guarantees.

<sup>(2)</sup> Total exposure represents exposure at default, which is the expected gross exposure upon the default of an obligor. This amount is before any specific allowances and does not reflect the impact of credit risk mitigation.

Based on the location of the Bank entity holding the asset, which has a high correlation with the location of the borrower, the majority of loans and advances are located in Canada and China. Based on the location of the issuer of the security, all investment securities are located in Canada.

### 3. Risk Management Framework (continued)

#### (a) Credit Risk Management (continued)

An analysis of the Bank's loan portfolio, net of unearned income and the allowances for impairment, by category and by location of ultimate risk is as follows:

	2014	2013
Canada:		
Residential mortgages	\$ 109,477	\$ 107,602
Consumer loans	18,517	22,268
Business loans:		
Industrial and commercial	53,549	73,459
Property development and investment	249,589	218,887
	431,132	422,216
Specific allowance for impairment	(2,064)	(2,483)
	429,068	419,733
Foreign countries:		
Residential mortgages	12,952	10,980
Consumer loans	111	102
Business loans:		
Industrial and commercial	467,998	386,663
Property development and investment	30,499	34,510
	511,560	432,255
Specific allowance for impairment	-	-
	511,560	432,255
Collective allowance for impairment	(4,778)	(4,778)
Carrying amount, net of allowances for impairment	\$ 935,850	\$ 847,210

The foreign countries exposures include the total exposures about \$450 millions (2013 - \$360 millions) for China.



### 3. Risk Management Framework (continued)

#### (a) Credit Risk Management (continued)

The following table analyzes the Bank's loan portfolio by the contractual repricing or maturity dates, whichever is earlier. This analysis excludes collective allowance for impairment of \$4,778 (2013 - \$4,778) and loans classified as impaired having a net carrying amount of \$2,454 (2013 - \$3,637) under note 7(c) below.

						2014	2013
	Floating	Within 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total	Total
Canada:	\$ 283,331	\$ 58,789	\$ 44,479	\$ 40,015	\$ -	\$ 426,614	\$ 416,096
Average effective yield	4.48%	3.69%	3.48%	3.65%	-	4.19%	4.14%
Foreign countries:	148,585	276,761	81,834	4,380	-	511,560	432,255
Average effective yield	3.36%	2.92%	2.99%	3.17%	-	3.16%	2.96%
<b>Total</b>	<b>\$ 431,916</b>	<b>\$ 335,550</b>	<b>\$ 126,313</b>	<b>\$ 44,395</b>	<b>\$ -</b>	<b>\$ 938,174</b>	<b>\$ 848,351</b>
Average effective yield	4.19%	3.07%	3.18%	3.61%	-	3.65%	3.53%

Average effective yields are based on book values and contractual interest rates adjusted for the amortization of any deferred income.

### 3. Risk Management Framework (continued)

#### (a) Credit Risk Management (continued)

Investment securities are all classified as HTM where the Bank has the intention and ability to hold the investment until its maturity date.

	2014	2013
HTM investment securities:		
Government bonds	64,904	34,810
	<b>\$ 64,904</b>	<b>\$ 34,810</b>

There were no charges for impairment during 2014 and 2013.

(a) An analysis of the carrying value of securities by remaining term to maturity is as follows:

			2014	2013
	Within 1 year	1 to 5 years	Total	Total
Debt securities	\$ 59,840	\$ 5,064	\$ 64,904	\$ 34,810

The total carrying value of investment securities denominated in Canadian dollars for 2014 and 2013.

(b) An analysis of the average effective yields of securities, by the earlier of contractual repricing or maturity dates, is as follows:

				2014	2013
	Within 3 months	3 months to 1 year	1 to 5 years	Total	Total
Debt securities	\$ 1,997	\$ 57,843	\$5,064	\$ 64,904	\$ 34,810
Average effective yield	1.06%	1.06%	1.07%	1.06%	1.11%

Average effective yields are based on book values and contractual interest rates adjusted for amortization of premiums and discounts. All debt securities held by the Bank pay interest at a fixed rate.

### 3. Risk Management Framework (continued)

#### (a) Credit Risk Management (continued)

An analysis of impaired loans and advances to customers and the related allowance for impairment is as follows:

			2014	2013
	Gross amount	Specific allowance	Carrying amount	Carrying amount
Consumer loans	\$ 3,107	\$ (224)	\$ 2,883	\$ 2,950
Business loans:				
Industrial and commercial	1,840	(1,840)	-	687
	\$ 4,947	\$ (2,064)	\$ 2,883	\$ 3,637

Allowances for impairment:

	2014	2013
Specific allowance for impairment:		
Balance, beginning of year	\$ 2,483	\$ 1,180
Impairment loss for the year:		
Charge	223	1,303
Reversal	(642)	-
Balance, end of year	2,064	2,483
Collective allowance for impairment:		
Balance, beginning of year	4,778	4,778
Impairment loss for the year:		
Charge	-	-
Balance, end of year	4,778	4,778
Total allowances for impairment	\$ 6,842	\$ 7,261

Both the impaired loans and the amounts of specific and general allowances are located in Canada.

### 3. Risk Management Framework (continued)

#### (a) Credit Risk Management (continued)

Risk-weighted assets and capital requirements:

Credit risk:

Regulatory capital requirements for credit risk on portfolios subject to the Standardized Approach are capital equivalent to the "credit risk-weighted assets times 8%". An analysis of the credit risk-weighted assets (after adjustments for credit risk mitigation and with specific risk-weighting factors applied) and capital requirement for credit risk of each portfolio calculated under the Standardized Approach is as follows:

	Risk-weighted assets	Capital requirement
Total corporate	\$ 750,607	\$ 60,049
Total retail residential mortgages	52,443	4,195
Total other retail	29,504	2,360
Bank	22,404	1,792
Statement of financial position assets not included in standardized or internal ratings-based approaches	11,694	936
<b>Total for credit risk</b>	<b>\$ 866,652</b>	<b>\$ 69,332</b>

Under Basel III, collective allowances for credit losses on portfolios subject to the Standardized Approach can be included in Tier 2 capital up to a limit of 1.25% of the risk-weighted assets of those portfolios. The Bank currently does not include this calculation in its Tier 2 capital.

Operational risk:

The minimum capital required for operational risk is calculated under Basic Indicator Approach as follows:

Gross income, as defined by OSFI over the previous three years:	
Year 1	\$ 20,518
Year 2	25,620
Year 3	29,848
Average of gross income for years 1 - 3	25,329
Capital charge (15% times average of gross income)	3,799
Risk-weighted assets for operational risk (12.5 times capital charge)	47,488

**3. Risk Management Framework (continued)**

**(a) Credit Risk Management (continued)**

An analysis of the Bank's derivative portfolio and related credit exposure is as follows:

	2014				2013			
	Notional amount	Current replacement cost	Credit equivalent amount	Risk-weighted balance	Notional amount	Current replacement cost	Credit equivalent amount	Risk-weighted balance
Foreign exchange forward contracts	\$ 94,803	\$ 83	\$ 1,031	\$ 210	\$ 7,126	\$ 16	\$ (87)	\$ 24

All foreign exchange forward contracts mature in less than one year.

Notional amount represents the contractual amounts to which a rate or price is applied to calculate the cash flows to be exchanged.

Current replacement cost represents the estimated replacement cost at current market rates of all contracts that have a positive fair value and does not reflect the actual or expected losses.

Credit equivalent amount represents the current replacement cost plus an amount for future credit exposure associated with the potential for future changes in currency and interest rates. The future credit exposure is calculated using a formula prescribed by OSFI.

Risk-weighted balance represents the regulatory capital required to support the Bank's derivative activities. The credit equivalent amounts are weighted according to the creditworthiness of the counterparty using factors prescribed by OSFI.

### **3. Risk Management Framework (continued)**

#### **(b) Liquidity Risk Management**

##### **Qualitative disclosures**

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset.

The Bank's approach to managing liquidity risk is to ensure, as far as possible, that it always has sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation. The liquidity risk management process ensures that the Bank is able to honour all of its financial commitments as they fall due.

The Bank closely monitors its daily cash flow of assets and liabilities. The Treasury Department receives information from other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business.

All liquidity policies and procedures are subject to review by ALRMCO and approval by the Board. The daily liquidity position is monitored and regular stress testing is conducted under a variety of scenarios covering severe market conditions. Daily reporting that covers the liquidity position of the Bank is reviewed by the Head of Risk Management Department. Exception reports, if any, are submitted to management immediately and remedial action is taken, if required, in the shortest possible time. A summary report, including any exceptions and remedial action taken, is submitted regularly to the Board. ALRMCO meets regularly to oversee compliance with the liquidity requirements.

The Bank relies on deposits from customers and banks as its primary sources of funding. These deposits from banks and a large proportion of the deposits from customers have short maturities of not exceeding one year. The short-term nature of these deposits increases the Bank's liquidity risk, but their renewal rate has maintained at a very stable and high level. The Bank actively manages this risk through maintaining competitive pricing and constant monitoring of market trends.

The key measure used by the Bank for managing liquidity risk is the ratio of net liquid assets to a percentage of the deposits from customers and banks and undrawn commitments. For this purpose, net liquid assets are considered as including cash and cash equivalents, short-term inter-bank placements and investment grade debt securities for which there is an active and liquid market. A similar, but not identical, calculation is used to measure the Bank's compliance with the liquidity limit established by OSFI. The Bank endeavours to maintain a liquidity ratio of at least 1.0 at all times.

**3. Risk Management Framework (continued)**

**(b) Liquidity Risk Management (continued)**

**Quantitative disclosures**

Details of the reported Bank liquidity ratio at the reporting date are as follows:

	2014	2013
At December 31	1.23	1.26

### 3. Risk Management Framework (continued)

#### (b) Liquidity Risk Management (continued)

Maturity analysis for financial liabilities:

	Carrying amount	Gross nominal inflow (outflow)	Less than 1 month	1 to 3 months	3 months to 1 year	1 to 5 years
<b>December 31, 2014</b>						
Non-derivative liabilities:						
Deposits from banks	\$ 368,194	\$ (368,474)	\$ (233,444)	\$ (129,219)	\$ (5,811)	\$ -
Deposits from customers	602,438	(605,276)	(299,421)	(92,563)	(189,785)	(23,507)
Issued financial guarantee contracts	-	-	-	-	-	-
	<u>\$ 970,632</u>	<u>\$ (973,750)</u>	<u>\$ (553,865)</u>	<u>\$ (221,782)</u>	<u>\$ (195,596)</u>	<u>\$ (23,507)</u>
Derivative liabilities:						
Held for risk management purposes	\$ 15	\$ -	\$ -	\$ -	\$ -	\$ -
Outflow	-	94,803	94,444	359	-	-
Inflow	-	(94,803)	(94,444)	(359)	-	-
	<u>\$ 15</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
<b>December 31, 2013</b>						
Non-derivative liabilities:						
Deposits from banks	\$ 361,535	\$ (361,953)	\$ (293,275)	\$ (63,364)	\$ (5,314)	\$ -
Deposits from customers	503,075	(505,662)	(251,310)	(63,946)	(162,390)	(28,016)
Issued financial guarantee contracts	-	-	-	-	-	-
	<u>\$ 864,610</u>	<u>\$ (867,615)</u>	<u>\$ (544,585)</u>	<u>\$ (127,310)</u>	<u>\$ (167,704)</u>	<u>\$ (28,016)</u>
Derivative liabilities:						
Held for risk management purposes	\$ 1	\$ -	\$ -	\$ -	\$ -	\$ -
Outflow	-	(7,125)	(6,624)	(501)	-	-
Inflow	-	7,125	6,624	501	-	-
	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The Bank does not have financial liabilities with contractual maturity longer than five years.



### **3. Risk Management Framework (continued)**

#### **(b) Liquidity Risk Management (continued)**

The previous table shows the undiscounted cash flows of the Bank's non-derivative financial liabilities, including issued financial guarantee contracts, and unrecognized loan commitments on the basis of their earliest possible contractual maturity. For these non-derivative and derivative financial liabilities, the analysis shows their remaining contractual maturities. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called. The Bank's expected cash flows on these instruments vary significantly from this analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance and unrecognized loan commitments are not all expected to be drawn down immediately.

The gross nominal inflow (outflow) disclosed in the previous table represents the contractual undiscounted cash flows relating to derivative financial liabilities held for risk management purposes. The disclosure shows a net amount for derivatives that are net settled, but a gross inflow and outflow amount for derivatives that have simultaneous gross settlement, e.g., forward exchange contracts.

To manage the liquidity risk arising from financial liabilities, the Bank holds a portfolio of liquid assets comprising cash and cash equivalents and investment grade investment securities for which there is an active and liquid market. These assets can be readily sold to meet liquidity requirements. Hence, the Bank believes that it is not necessary to disclose a maturity analysis in respect of these assets to enable users to evaluate the nature and extent of liquidity risk.

### **3. Risk Management Framework (continued)**

#### **(c) Market Risk Management**

##### **Qualitative disclosures**

Market risk is the risk that changes in market prices, such as interest rate, foreign exchange rates and credit spreads (not relating changes in the obligor's/issuer's credit standing) will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

ALRMCO is responsible for the oversight of the Bank's market risk to ensure that overall and individual market risks are within the Bank's risk tolerance. The detailed risk management policies are subject to review by ALRMCO and approval by the Board.

The market risks exposed to the Bank include interest rate risk and foreign exchange risk.

##### **Exposure to interest rate risk - non-trading portfolios**

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments due to changes in market interest rates. Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for repricing bands. The Board authorizes the interest rate gap limits that are sufficient to support the normal operational requirements. ALRMCO is the monitoring body for compliance with these limits and is assisted by the Risk Management Department in its day-to-day monitoring activities. A daily report of the mismatch on asset and liability positions against the respective gap limits is reviewed by the Head of Risk Management Department and regularly submitted to the Board.

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to the interest rate movements. The Bank performs a sensitivity analysis on a monthly basis to assess the effect of a hypothetical interest rate movement across the yield curves on both sides of the balance sheet. Sensitivity limits are set to control the Bank's interest rate risk exposure under both earnings and economic value perspectives. The results of the interest rate sensitivity analysis are reported to ALRMCO and the Board on a regular basis.

### **3. Risk Management Framework (continued)**

#### **(c) Market Risk Management (continued)**

##### **Exposure to foreign exchange risk - non-trading portfolios**

Foreign exchange risk is the risk of loss due to adverse movements and volatilities in spot and forward currency rates. The Bank has exposure to foreign exchange risk on its foreign currency denominated asset and liability positions. The Bank enters into spot and forward foreign exchange contracts on behalf of its customers and for its own account to manage its own currency exposures arising from the assets and liabilities denominated in foreign currencies. The Bank seeks to match closely its foreign currency denominated assets with corresponding liabilities in the same currencies.

All foreign currency positions, including the maximum loss limits on any position held on the day, are managed within limits approved by the Board. ALRMCO is the monitoring body for compliance with these limits and is assisted by the independent Risk Management Department in its day-to-day monitoring activities. A report of the foreign currency positions and profit and loss is reviewed daily by the Head of Risk Management Department and regularly submitted to the Board.

Overall foreign currency positions are managed by the Treasury Department, which will use derivative instruments to hedge the exposure to foreign exchange risk, when necessary.

### 3. Risk Management Framework (continued)

#### (c) Market Risk Management (continued)

##### Quantitative disclosures

An sensitivity analysis of the potential impact of an immediate and sustained 100 basis point parallel increase or decrease in all yield curves worldwide on net interest income after tax and economy value of the Bank's portfolio, assuming no asymmetrical movement in yield curves and a constant financial position, is as follows:

	2014		2013	
	100 basis point parallel increase in rates	100 basis point parallel decrease in rates	100 basis point parallel increase in rates	100 basis point parallel decrease in rates
Increase (decrease) in net interest income after tax: At December 31	\$ 2,845	\$ (2,845)	\$ 1,767	\$ (1,767)
Increase (decrease) in economy value: At December 31	539	(539)	213	(213)

This sensitivity analysis, which is based on a static interest rate risk profile of assets and liabilities at a specific time, is used for risk management purposes only. No loan prepayment is assumed and deposits without fixed maturity dates are assumed to be repriced on next day. Actual changes in the Bank's net interest income and economic value resulting from the changes in interest rates may differ from the results of this sensitivity analysis.

Overall interest rate risk positions are managed by the Treasury Department, which uses investment securities, deposits with banks, deposits from banks and derivative instruments to manage the overall position arising from the Bank's activities.

As at the reporting date, significant net currency exposures of the Bank's equity are as follows:

	2014	2013
Foreign currency transactions: Net foreign currency exposure, long (short):		
US\$	\$ 1,199	\$ 381
Chinese Yuan	(372)	(35)
HK\$	(2)	9

### **3. Risk Management Framework (continued)**

#### **(d) Operational Risk Management**

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and general accepted standards of corporate behaviour. Operational risks arise from all of the Bank's operations. The Bank's objective of operational risk management is to identify, assess and monitor operational risk and, in particular, to comply with the relevant regulatory requirements. The Bank manages and mitigates the potential operational risk through a comprehensive supervision framework and adequate internal controls, which include segregation of duties and appropriate delegation of authority. The Bank always ensures that proper and prudent controls are in place in its information and technology system. During the course of the audit, Internal Audit reviews the adequacy and execution of the Bank's policies and operation procedures. Internal Audit Reports, which set out any significant findings and implications accompanied with the recommendations of improvements on policies and operation procedures, in terms of internal controls, are issued to management and presented to the Audit Committee.

The Board reviews and approves the policies for operational risk management. ALRMCO is responsible for ongoing operational risk management and is assisted by the Bank's operational risk co-ordinator in its day-to-day monitoring activities relating to operational risk. An operational loss data reporting is regularly submitted to the Board.

#### 4. Remuneration Policy

The Bank did not extend credit facilities to key management personnel, including directors, and their immediate relatives and companies controlled by or affiliated with them during the year.

Apart from director fees, the Bank does not provide any other benefits to independent directors.

Key management personnel include the senior management, which is composed of the President & Chief Executive Officer, two Senior Executive Vice Presidents, one Executive Vice President and Chief Compliance Officer of the Bank. Except for Executive Vice President and the Chief Compliance Officer, all the other three senior management members are also executive directors of the Bank.

Remuneration, both fixed and variable, of the President & Chief Executive Officer, Senior Executive Vice Presidents and Executive Vice President is overseen by BOD and parent bank in accordance with its group remuneration policy.

Remuneration of the other senior management members is determined by the President & Chief Executive Officer and overseen by the Human Resources Department of the Bank. Along with all the other staff of the Bank, they are subject to a standardized performance appraisal system to determine their year-end bonus.

There was no change to the remuneration policy as well as process during the year.

The Bank does not provide any non cash-based or deferred remuneration to senior management personnel. The only variable remuneration given to senior management personnel is year-end bonus, which is based on the established performance appraisal system.

Breakdown of the amount of remuneration awards for the year is follows: -

	2014	2013
Cash-based and unrestricted:		
Fixed remuneration	\$ 1,056	\$ 975
Variable remuneration	390	126
	<u>\$ 1,446</u>	<u>\$ 1,101</u>