**HSBC LIFE (INTERNATIONAL) LIMITED**
(Incorporated in Bermuda)

# REPORTS AND FINANCIAL STATEMENTS

# FOR THE YEAR ENDED

# 31 DECEMBER 2017

**HSBC LIFE (INTERNATIONAL) LIMITED**

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**Independent Auditor's Report**
**To the Members of HSBC Life (International) Limited**
(incorporated in Bermuda with limited liability)

## Opinion

*What we have audited*

The financial statements of HSBC Life (International) Limited (the "Company") set out on pages 7 to 79, which comprise:

- the balance sheet as at 31 December 2017;
- the income statement for the year then ended;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

*Our opinion*

In our opinion, the financial statements give a true and fair view of the financial position of the Company as at 31 December 2017, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

## Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the HKICPA. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

*Independence*

We are independent of the Company in accordance with the HKICPA's Code of Ethics for Professional Accountants ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code.

## Other Information

The directors are responsible for the other information. The other information comprises the information included in the directors' report, but does not include the financial statements and our auditor's report thereon.

**Independent Auditor's Report**
**To the Members of HSBC Life (International) Limited (continued)**
(incorporated in Bermuda with limited liability)

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

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

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

**Responsibilities of Directors for the Financial Statements**

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

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

**Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. We report our opinion solely to you, as a body in accordance with Section 90 of the Companies Act 1981 of Bermuda and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

**Independent Auditor's Report**
**To the Members of HSBC Life (International) Limited (continued)**
(incorporated in Bermuda with limited liability)

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

PricewaterhouseCoopers

**PricewaterhouseCoopers**
Certified Public Accountants

Hong Kong, 5 February 2018

**HSBC LIFE (INTERNATIONAL) LIMITED**

**INCOME STATEMENT**
**FOR THE YEAR ENDED 31 DECEMBER 2017**
(Expressed in Hong Kong dollars)

| | Note | 2017 $'millions | 2016 $'millions |
|---|---|---|---|
| **Turnover** | 5 | 44,775 | 41,334 |
| Gross written premiums | | 43,173 | 39,967 |
| Written premiums ceded to reinsurers | | (5,804) | (1,762) |
| **Net written premiums** | 7 | 37,369 | 38,205 |
| Fees and commission income | 8 | 1,855 | 1,482 |
| Net investment income | 9 | 23,447 | 10,455 |
| Other operating income | | 5 | 4 |
| **Net income** | | 62,676 | 50,146 |
| Gross claims and benefits incurred and movement in liabilities to policyholders | | (52,079) | (45,522) |
| Reinsurers' share of claims and benefits incurred and movement in liabilities to policyholders | | 4,562 | 1,266 |
| **Net insurance claims and benefits incurred and movement in liabilities to policyholders** | 11 | (47,517) | (44,256) |
| Movement in investment contract liabilities | 12 | (3,008) | (364) |
| Acquisition costs | 13 | (2,466) | (2,707) |
| Administrative expenses | | (1,686) | (1,587) |
| **Profit from operations before taxation** | 6 | 7,999 | 1,232 |
| Income tax charge | 14 | (1,304) | (176) |
| **Profit after taxation attributable to shareholders of the company for the year** | | 6,695 | 1,056 |

The notes on pages 14 to 79 form part of these financial statements. Details of dividends paid to equity shareholders of the company attributable to the profit for the year are set out in note 15.

**HSBC LIFE (INTERNATIONAL) LIMITED**

**STATEMENT OF COMPREHENSIVE INCOME**
**FOR THE YEAR ENDED 31 DECEMBER 2017**
(Expressed in Hong Kong dollars)

| | Note | 2017<br>$'millions | 2016<br>$'millions |
|---|---|---|---|
| **Profit after taxation for the year** | | 6,695 | 1,056 |
| **Other comprehensive income for the year (after tax and reclassification adjustments)** | | | |
| *Items that are or may be reclassified subsequently to profit or loss* | | | |
| Available-for-sale: | | | |
| - Changes in fair value during the year | 17 | 1,117 | 700 |
| - Amount reclassified from equity upon disposal | 17 | (150) | (421) |
| - Amortisation arising from reclassification of debt securities out of available-for-sale category | 17, 22(i) | (8) | (10) |
| **Total comprehensive income attributable to shareholders of the company for the year** | | 7,654 | 1,325 |

The notes on pages 14 to 79 form part of these financial statements

**HSBC LIFE (INTERNATIONAL) LIMITED**

**BALANCE SHEET**
**AS AT 31 DECEMBER 2017**
(Expressed in Hong Kong dollars)

| | Note | 2017 $'millions | 2016 $'millions |
|---|---|---|---|
| **Assets** | | | |
| Fixed assets | 18 | - | - |
| Intangible assets | 20 | 496 | 314 |
| Investment assets | 22 | 344,042 | 300,264 |
| Insurance receivable | 23 | 2,349 | 2,048 |
| Reinsurers' share of liabilities under insurance contracts issued | 26 | 7,431 | 3,933 |
| Reinsurance receivable | 30 | 44 | 22 |
| Other receivables | | | |
| - Amounts due from fellow subsidiaries | 29 | 243 | 135 |
| - Sundry debtors and prepayments | 24 | 179 | 169 |
| - Amounts due from an intermediate holding company | 29 | - | 146 |
| - Amounts due from immediate holding company | 29 | 188 | 188 |
| Tax recoverable | 21 | - | 815 |
| Cash and cash equivalents | 25 | 2,604 | 1,864 |
| **Total assets** | | 357,576 | 309,898 |
| **Liabilities** | | | |
| Liabilities under insurance contracts issued | 26 | 267,401 | 233,788 |
| Liabilities under investment contracts issued | 27 | 42,538 | 40,193 |
| Deferred tax liabilities | 21 | 280 | 14 |
| Reinsurance payable | 30 | 289 | 315 |
| Insurance payable | 28 | 16,869 | 12,106 |
| Other payables | | | |
| - Amount due to an intermediate holding company | 29 | 574 | 603 |
| - Amounts due to fellow subsidiaries | 29 | 126 | 147 |
| - Amount due to ultimate holding company | 29 | 6 | - |
| Creditors and accruals | 30 | 609 | 736 |
| Current taxation | 21 | 410 | - |
| **Total liabilities** | | 329,102 | 287,902 |
| **Net assets** | | 28,474 | 21,996 |
| **Shareholders' equity** | | | |
| Share capital | 31 | 4,178 | 4,178 |
| Reserves | | 24,296 | 17,818 |
| **Total shareholders' equity** | | 28,474 | 21,996 |

The financial statements on pages 7 to 13 were approved by the Board of Directors on 5 February 2018 and were signed on its behalf.

BL Johns, Chairman

ECL Moncreiffe, Director

The notes on pages 14 to 79 form part of these financial statements.

**HSBC LIFE (INTERNATIONAL) LIMITED**

**STATEMENT OF CHANGES IN EQUITY**
**FOR THE YEAR ENDED 31 DECEMBER 2017**
(Expressed in Hong Kong dollars)

| | | *Attributable to equity shareholders of the company* | | | | | |
|---|---|---|---|---|---|---|---|
| | Note | Share capital $'millions | Share premium $'millions | Fair value reserve on available-for-sale securities $'millions | Share-based payment reserve $'millions | Retained profits $'millions | Total $'millions |
| **Balance at 1 January 2016** | | 4,178 | 89 | 938 | 90 | 16,534 | 21,829 |
| **Changes in equity for 2016** | | | | | | | |
| Profit for the year | | - | - | - | - | 1,056 | 1,056 |
| Other comprehensive income for the year (net of tax) | | - | - | 269 | - | - | 269 |
| Total comprehensive income | | - | - | 269 | - | 1,056 | 1,325 |
| Cost of share-based payment arrangement | | - | - | - | 4 | 1 | 5 |
| Exercise and lapse of share options and vesting of share awards | | - | - | - | (8) | 8 | - |
| Dividends declared in respect of current year | 15 | - | - | - | - | (1,163) | (1,163) |
| **Balance at 31 December 2016** | | 4,178 | 89 | 1,207 | 86 | 16,436 | 21,996 |

The notes on pages 14 to 79 form part of these financial statements.

**HSBC LIFE (INTERNATIONAL) LIMITED**

**STATEMENT OF CHANGES IN EQUITY**
**FOR THE YEAR ENDED 31 DECEMBER 2017**
(Expressed in Hong Kong dollars)

| | | *Attributable to equity shareholders of the company* | | | | | |
|---|---|---|---|---|---|---|---|
| | Note | Share capital $'millions | Share premium $'millions | Fair value reserve on available-for-sale securities $'millions | Share-based payment reserve $'millions | Retained profits $'millions | Total $'millions |
| **Balance at 1 January 2017** | | 4,178 | 89 | 1,207 | 86 | 16,436 | 21,996 |
| **Changes in equity for 2017** | | | | | | | |
| Profit for the year | | - | - | - | - | 6,695 | 6,695 |
| Other comprehensive income for the year (net of tax) | | - | - | 959 | - | - | 959 |
| Total comprehensive income | | - | - | 959 | - | 6,695 | 7,654 |
| Cost of share-based payment arrangement | | - | - | - | (3) | - | (3) |
| Exercise and lapse of share options and vesting of share awards | | - | - | - | (1) | 1 | - |
| Dividends declared in respect of current year | 15 | - | - | - | - | (1,173) | (1,173) |
| **Balance at 31 December 2017** | | 4,178 | 89 | 2,166 | 82 | 21,959 | 28,474 |

The notes on pages 14 to 79 form part of these financial statements.

**HSBC LIFE (INTERNATIONAL) LIMITED**

**STATEMENT OF CASH FLOWS**
**FOR THE YEAR ENDED 31 DECEMBER 2017**
(Expressed in Hong Kong dollars)

| | Note | 2017<br>$'millions | 2016<br>$'millions |
|---|---|---|---|
| **Operating activities** | | | |
| **Profit before taxation** | | 7,999 | 1,232 |
| Adjustments for: | | | |
| - Depreciation and amortisation | 18, 20 | 115 | 71 |
| - Impairment loss on intangible assets | 20 | 1 | 1 |
| - Investment and interest income | | (351) | (340) |
| - Net realised loss on investments | | 2 | 25 |
| - Net exchange (gain) / loss | | (2) | 1 |
| - Share-based payment expenses | | 6 | 2 |
| **Operating profit before changes in working capital** | | 7,770 | 992 |
| Increase in cash balance held in long-term business (Note) | | 607 | 87 |
| (Increase)/Decrease in amount due from long-term business | | (2,111) | 593 |
| (Increase)/Decrease in amounts due from fellow subsidiaries | | (97) | 4 |
| Decrease in sundry debtors and prepayments | | 2 | 32 |
| Increase in amount due from immediate holding company | | - | (91) |
| (Decrease)/Increase in amount due to an intermediate holding company | | (45) | 34 |
| (Decrease)/Increase in amounts due to fellow subsidiaries | | (56) | 22 |
| (Decrease)/Increase in creditors and accruals | | (54) | 40 |
| Increase in amount due to ultimate holding company | | 6 | - |
| **Cash generated from operations carried forward** | | 6,022 | 1,713 |

**HSBC LIFE (INTERNATIONAL) LIMITED**

**STATEMENT OF CASH FLOWS (continued)**
**FOR THE YEAR ENDED 31 DECEMBER 2017**
(Expressed in Hong Kong dollars)

| | Note | 2017 $'millions | 2016 $'millions |
|---|---|---|---|
| **Cash generated from operations brought forward** | | 6,022 | 1,713 |
| Tax paid | | | |
| - Hong Kong Profits Tax paid | | - | (1,183) |
| - Overseas Profits Tax paid | | (1) | - |
| **Net cash generated from operating activities** | | 6,021 | 530 |
| **Investing activities** | | | |
| Payments for purchase of intangible assets | 20 | (298) | (147) |
| Payments for purchase of investments | | (6,969) | (4,603) |
| Proceeds from sales of investments | | 2,832 | 4,829 |
| Investments and interest income received | | 327 | 363 |
| **Net cash (used in) / generated from investing activities** | | (4,108) | 442 |
| **Financing activity** | | | |
| Dividend paid to equity shareholders of the company | | (1,173) | (1,163) |
| **Net cash used in financing activity** | | (1,173) | (1,163) |
| **Net increase / (decrease) in cash and cash equivalents** | | 740 | (191) |
| **Cash and cash equivalents at 1 January** | | 1,864 | 2,055 |
| **Cash and cash equivalents at 31 December** | 25 | 2,604 | 1,864 |

Note: Cash flows arising from long-term business operations are presented as movements in cash balance held in long-term business and amount due from long-term business.

The notes on pages 14 to 79 form part of these financial statements.

## 1 Significant accounting policies

### (a) Statement of compliance

The primary financial information on pages 7 to 13 and notes 1 to 36 thereto has been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs"), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs") and Interpretations issued by Hong Kong Institute of Certified Public Accountants ("HKICPA") and accounting principles generally accepted in Hong Kong. A summary of the significant accounting policies adopted by the company is set out below.

The HKICPA has issued a few new interpretations that are first effective for the current accounting period of the company. Note 2 provides information on any changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the company for the current and prior accounting periods reflected in these financial statements.

The company has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 36).

### (b) Basis of preparation of the financial statements

The financial statements are presented in Hong Kong dollars ("HKD"), and all values are rounded to the nearest million unless otherwise stated. They are prepared under the historical cost convention as modified by the revaluation of certain financial assets and liabilities.

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

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

Judgements made by management in the application of HKFRSs that have significant effect on the financial statements and estimates are discussed in note 3.

### (c) Classification of contracts

Contracts under which the company accepts significant insurance risk from another party ("the policyholder") by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event ("the insured event") adversely affects the policyholder or other beneficiary are classified as insurance contracts. Insurance risk is risk other than financial risk. Financial risk is the risk of a possible future change in one or more of a specified interest rate, security price, commodity price, foreign exchange rate, index of prices of rates, a credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. Insurance contracts may also transfer some financial risk.

Contracts under which the transfers of insurance risk from the policyholders to the company that are not significant are classified as investment contracts.

## 1 Significant accounting policies (continued)

### (c) Classification of contracts (continued)

*Contracts with discretionary participation features*

A significant portion of the company's insurance contracts contain discretionary participation features, which are in the form of non-guaranteed cash dividends payable at the end of each policy year provided premiums due for the year are fully paid. These discretionary participation features are contractual rights held by the policyholders but the amount of payment for each policy year is contractually at the discretion of the company. The company considers the operating result of the company, the market condition and the policyholders' reasonable expectation when determining the amount of cash dividend to be paid.

### (d) Recognition and measurement of contracts

(i) Premium income arising from long-term insurance business

Premium income is accounted for on a receivable basis in respect of non-linked insurance contracts, or in the case of unit-linked insurance contracts, premium income is accounted for when the liability is recognised. Outward reinsurance premiums are accounted for on a payable basis.

(ii) Claims and benefits arising from long-term insurance business

Long-term business claims and benefits reflect the cost of all claims and benefits arising during the year, including policyholder cash dividend payment upon policy anniversary.

(iii) Long-term insurance business provision

The long-term business provision for insurance contracts has been computed in accordance with Cap 41E Insurance (Determination of Long Term Liabilities) Rules. In particular, a prospective modified net premium valuation method has been generally adopted for all major classes of business, with the exception of linked contracts where the provisions are based on the market value of the related assets plus a provision for mortality risk and guarantee risk. Insurance contracts as a whole are subject to a liability adequacy test.

(iv) Reinsurance

Reinsurance contracts under which the company transfers a significant amount of insurance risk to another party ("the reinsurer") are classified as insurance contracts.

Reinsurance premiums are accounted for in the same accounting period as the premiums for the direct insurance contracts to which they relate. Reinsurance recoveries are accounted for in the same period as the related claim is recognised.

The company entered into modified coinsurance agreements to cede the mortality and lapse risks to the reinsurers for protection against extremely adverse scenarios. The reinsurance receivable is not recognised as an asset until it is probable that the receivable will be settled in cash by the reinsurers at contract expiry. The cost of the arrangements is charged to the income statement when incurred.

Further information of the company's reinsurance arrangements is set out in note 4(d).

## 1 Significant accounting policies (continued)

### (d) Recognition and measurement of contracts (continued)

(v) Liabilities and related assets under liability adequacy test

Provisions for insurance contracts are tested for adequacy by discounting current estimates of all expected future cash flows and comparing this amount to the carrying value of the liability. Where a shortfall arises, an additional provision is made and the company recognises the deficiency in the income statement for the year.

(vi) Investment contracts

Investment contracts are recognised as financial liabilities in the balance sheet when the company becomes party to their contractual provisions. Contributions received from policyholders are not recognised in the income statement but are accounted for as deposits.

All investment contracts issued by the company are designated by the company on initial recognition for measurement at fair value through profit or loss. This designation is consistent with the documented risk management and investment strategies of the company.

Changes in the fair value of investment contracts are included in the income statement in the period in which they arise.

(vii) Liability measurement of investment contracts

Liabilities in relation to investment contracts are designated for measurement at fair value through profit or loss and a provision is set for the guarantee feature for those contracts with investment guarantee. Transaction costs and front-end fees in respect of financial liabilities measured at fair value are not included in the initial measurement amount and are recognised as expense where incurred.

(viii) Embedded derivatives in insurance contracts

Features contained within insurance contracts that would be considered derivatives if they were stand-alone instruments have not been separated and measured at fair value if those embedded derivatives are closely related to the host insurance contracts.

The company's exposure to interest rate and market risk under embedded derivatives that are not separated from the host insurance contracts and measured at fair value has been taken into account in estimating interest rate and market risk sensitivity analyses presented in note 23 to the financial statements.

The company has taken advantage of the exemption available in HKFRS 4 not to separate and measure at fair value the policyholder options to surrender insurance contracts for a fixed amount.

## 1 Significant accounting policies (continued)

### (e) Revenue

(i) Premium income

Premium income is accounted for on a receivable basis in respect of non-linked insurance contracts, or in the case of unit-linked insurance contracts, premium income is accounted for when the liability is recognised.

(ii) Interest income and dividend income

Interest income for all financial instruments is recognised using the effective interest rate method, calculated over the asset's expected life. Premiums and/or discounts arising on the purchase of dated investment securities are included in the calculation of their effective interest rates. Dividend income from listed investments is recognised when the share price goes ex-dividend and dividend income from unlisted investments is recognised when the right to receive payment has been irrevocably established. Interest income from bank deposits is accrued on a time-apportioned basis by reference to the principal outstanding and at the rate applicable.

(iii) Fees and commission income

Annual management charges and policy administration charges are recognised when accrued.

Commissions received and receivable which do not require the company to render further services are recognised as revenue by the company on the effective commencement or renewal dates of the related investment and insurance contracts.

### (f) Employee benefits

(i) Short-term employee benefits

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

(ii) Defined contribution plans

Obligations for contributions to defined contribution retirement plans, including contributions payable under the Hong Kong Mandatory Provident Fund Schemes Ordinance, are recognised as an expense in the income statement as incurred.

## 1 Significant accounting policies (continued)

### (f) Employee Benefits (continued)

(iii) Share-based payment transactions

The company's ultimate holding company grants share options to its employees including the company's employees.

The cost of share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted, and is recognised as an expense on a straight-line basis over the vesting period, with a corresponding credit to the "Share-based payment reserve". The vesting period is the period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied.

Fair value is determined by using market price or appropriate valuation models, taking into account the terms and conditions upon which the equity instruments were granted. Vesting conditions include service conditions and performance conditions; any other features of the arrangement are non-vesting conditions. Market performance conditions and non-vesting conditions are taken into account when estimating the fair value of equity instruments at the date of grant, so that an award is treated as vesting irrespective of whether the market performance condition or non-vesting condition is satisfied, provided all other vesting conditions are satisfied.

Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction, so that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. On a cumulative basis, no expense is recognised for equity instruments that do not vest because of a failure to satisfy non-market performance or service conditions.

A cancellation that occurs during the vesting period is treated as an acceleration of vesting and recognised immediately for the amount that would otherwise have been recognised for services over the vesting period.

### (g) Operating lease charges

Where the company has the use of assets held under operating leases, payments made under the leases are charged to income statement in equal instalments over the accounting periods covered by the lease term. Lease incentives received are recognised in the income statement as an integral part of the aggregate net lease payments made. Contingent rentals are charged to the income statement in the accounting period in which they are incurred.

## 1 Significant accounting policies (continued)

### (h) Income tax

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

Current tax is the expected tax payable on the taxable profit for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

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

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

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

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

- in the case of current tax assets and liabilities, the company intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or

- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, the company intends to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

## 1 Significant accounting policies (continued)

### (i) Foreign currency translation

Items included in the financial statements are measured using the currency of the primary economic environment in which the company operates ("the functional currency"). The financial statements are presented in Hong Kong dollars which is also the company's functional currency.

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange at the balance sheet date. Any resulting exchange differences are included in the income statement.

Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the dates the fair value was determined. Any foreign exchange component of a gain or loss on a non-monetary item is recognised either in other comprehensive income or in the income statement depending where the gain or loss on the underlying non-monetary item is recognised.

The results of foreign operations are translated into Hong Kong dollars at the average rates of exchange for the reporting period. Balance sheet items are translated into Hong Kong dollars at the rate of exchange at the balance sheet date. The resulting exchange differences are recognised in other comprehensive income and accumulated separately in equity in the exchange reserve. On liquidation of a foreign operation, exchange differences previously recognised in other comprehensive income are reclassified to the income statement.

### (j) Fixed assets

Fixed assets are stated in the balance sheet at cost less accumulated depreciation and impairment losses.

Subsequent expenditure relating to a fixed asset that has already been recognised is added to the carrying amount of the asset when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing assets, will flow to the company. All other subsequent expenditure is recognised as an expense in the period in which it is incurred.

Depreciation of fixed assets is calculated to write off their cost over their anticipated useful lives, between three to five years, on a straight-line basis.

Gains or losses arising from disposal of a fixed asset are determined as the difference between the estimated net disposal proceeds and the carrying amount of the asset and are recognised in the income statement on the date of retirement or disposal

## 1 Significant accounting policies (continued)

### (k) Intangible assets

Intangible assets represent computer software which is stated at cost less accumulated amortisation and impairment losses.

Amortisation of computer software is charged to the income statement over the estimated useful life of five years, on a straight-line basis.

### (l) Financial instruments

Purchases and sales of financial assets are recognised on the trade date, which is when the company commits to purchase or sell the assets. Financial assets are derecognised when contractual rights to receive cash flows from the investments expire, or where the investments, together with substantially all the risks and rewards of ownership, have been transferred.

Financial instruments are recognised based on the following classifications:

(i) Financial instruments designated at fair value through profit or loss are financial instruments which on initial recognition are designated by the company for measurement at fair value through profit or loss. Derivatives are classified as held for trading and are measured at fair value through profit or loss.

A financial instrument is classified in this category if it meets the certain criteria, and is so designated by management. The company designates financial instruments for measurement at fair value because the designation either:

- Eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or

- Applies to a group of financial assets, financial liabilities or both that is managed and its performance evaluated on a fair value basis, in accordance with the company's Investment Policy and Market and Credit Risk Mandates, and where information about these instruments are provided internally on that basis to the company's key management personnel; or

- Relates to financial instruments containing one or more embedded derivatives which significantly modify the cash flows resulting from the financial instruments, and which would otherwise require separate accounting.

Financial assets and financial liabilities so designated are recognised initially at fair value. After initial recognition, the company measures financial assets and liabilities designated at fair value through profit or loss, at their fair value. Gains and losses from changes in the fair value of such assets and liabilities are recognised in the income statement as they arise.

## 1 Significant accounting policies (continued)

### (l) Financial instruments (continued)

All financial assets that are held by the company to back linked contract liabilities, and a proportion of the assets held to back non-linked contract liabilities are designated by the company on initial recognition for measurement at fair value through profit or loss. In addition, the company has designated all investment contract liabilities for measurement at fair value through profit or loss. The investment strategies of these financial instruments are set by the Investment Committee of the company with performance being evaluated on a fair value basis. The investment strategies are documented and approved by the Investment Committee of the company.

(ii) Held-to-maturity investments are financial assets with fixed or determinable payments and fixed maturities which the company has the positive intention and ability to hold to maturity.

Held-to-maturity investments including the premium and discount on acquisition are measured at amortised cost using the effective interest method, less impairment losses which are determined for each investment individually.

(iii) Investments intended to be held on a continuing basis are classified as available-for-sale securities unless they have been designated at fair value (note 1(l)(i)) or they are classified as held-to-maturity (note 1(l)(ii)).

Available-for-sale investments are initially measured at fair value plus direct and incremental transaction costs. At each balance sheet date the fair value is remeasured, with any resultant gain or loss being recognised in other comprehensive income and accumulated separately in equity in the fair value reserve until the investments are either sold or become impaired. When available-for-sale investments are sold, cumulative gains or losses previously recognised in equity are recognised in the income statement.

When these investments are derecognised or impaired (see note 1(p)), the cumulative gain or loss is reclassified from equity to the income statement.

Available-for-sale financial assets are reclassified to held-to-maturity if there is a change in intention of ability to hold those assets to maturity due to a change in the way those assets are managed. The fair value on reclassification becomes the new amortised cost and the assets are subsequently carried at amortised cost rather than fair value.

(iv) Loans and receivables are non-derivative financial assets with fixed determinable payments that are not quoted in an active market.

Loans and receivables are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest rate method, less any reduction from impairment.

## 1 Significant accounting policies (continued)

### (m) Derivative financial instruments

Derivative financial instruments are recognised initially at fair value on the date a derivative contract is entered into, and are subsequently measured at their fair value with changes in value recognised in the income statement in the period they arise.

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is currently a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

### (n) Share capital

Ordinary shares are classified as equity.

### (o) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash within three months and which are subject to an insignificant risk of change in value.

### (p) Impairment

The carrying amounts of the company's assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, the carrying value is reduced to the estimated recoverable amount by means of a charge to the income statement.

When assessing debt securities and loans and receivables for objective evidence of impairment at the reporting date, the company considers all available evidence, including observable data or information about events specifically relating to the instruments which may result in a shortfall in recovery of future cash flows. These events may include a significant financial difficulty of the issuer/borrower, a breach of contract such as a default, bankruptcy or other financial reorganisation, or the disappearance of an active market for the debt security because of financial difficulties relating to the issuer. These types of specific event and other factors such as information about the issuers'/borrowers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, as well as national and local economic trends and conditions may be considered individually, or in combination, to determine if there is objective evidence of impairment.

For impairment loss on available-for-sale investments, the cumulative loss (measured as the difference between the acquisition cost and the current fair value, less any impairment allowance on that investment previously recognised in the income statement) is removed from equity and recognised in the income statement as "Net investment income".

An impairment loss on assets carried at costs or amortised costs is recognised in the income statement if the recoverable amount of an asset is lower than its carrying amount.

## 1 Significant accounting policies (continued)

### (p) Impairment (continued)

(i) Calculation of recoverable amount

The recoverable amount of the company's investments in held-to-maturity securities and loans and receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate.

(ii) Reversal of impairment loss

An impairment loss in respect of held-to-maturity securities or loans and receivables carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

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

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

### (q) Provisions

A provision is recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation arising from past events and a reliable estimate can be made of the amount of the obligation.

### (r) Repurchase agreements

When securities are sold subject to a commitment to repurchase them at a predetermined price ("repos"), they remain on the balance sheet and a liability is recorded in respect of the consideration received. Repos are measured at amortised cost. The difference between the sale and repurchase price or between the purchase and resale price is treated as interest and recognised as an interest expense over the life of the agreement.

## 1 Significant accounting policies (continued)

### (s) Borrowings

Borrowings are recognised initially at their issue proceeds less transaction costs incurred. Subsequently, borrowings are stated at amortised cost, and any difference between net proceeds and redemption value is recognised in the income statement over the period of the borrowings using the effective interest method. All borrowing costs are expenses as they are incurred.

### (t) Current and non-current assets and liabilities

Financial assets and liabilities that are expected to be recovered or due within one year or less after the reporting date are classified as current assets and liabilities. If not, they are presented as non-current assets and liabilities.

### (u) Related parties

(1) For the purposes of these financial statements, a person, or a close member of that person's family, is related to the company if that person:

(i) has control or joint control over the company;

(ii) has significant influence over the company; or

(iii) is a member of the key management personnel of the company or the company's parent.

(2) An entity is related to the company if any of the following conditions applies:

(i) The entity and the company are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

(ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a company of which the other entity is a member).

(iii) Both entities are joint ventures of the same third party.

(iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.

(v) The entity is a post-employment benefit plan for the benefit of employees of either the company or an entity related to the company.

(vi) The entity is controlled or jointly controlled by a person identified in (1).

(vii) A person identified in (1)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

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

## 2 Changes in accounting policies

The HKICPA has issued a few new interpretations that are first effective for the current accounting period of the company, in which the company has adopted to the extent that they are relevant to the company for the current and prior accounting periods reflected in these financial statements. The company has not applied any new standard or interpretation that is not yet effective for the current accounting period. Of these, the following developments are relevant to the company's financial statements:

***Amendments to HKAS 7, Statement of cash flows***

*The amendment introduces an additional disclosures that will enable users of financial statements to evaluate changes in liabilities arising from financing activities.*

***Amendments to HKAS 12, Income taxes***

*The amendments on the recognition of deferred tax assets for unrealised losses clarify how to account for deferred tax assets related to debt instruments measured at fair value.*

***Amendments to HKFRS 12, Disclosure of interest in other entities***

*The amendment is part of the annual improvements to HKFRSs 2014 – 2016 cycle. The amendment clarifies that disclosure requirements of HKFRS 12 are applicable to interest in entities classified as held for sale, except for summarised financial information (para B17 of HKFRS 12). Previously it was unclear whether all HKFRS 12 requirements were applicable for these interests.*

The adoption of these improvements does not have any impact on these financial statements.

## 3 Accounting estimates and judgements

Critical accounting judgements in applying the company's accounting policies on liabilities under insurance contracts and investment contracts issued are described below:

The company makes estimates of future deaths, and investment returns for long-term insurance contracts with fixed and guaranteed terms. These estimates form the assumptions used to calculate the liabilities arising from these contracts. Estimates are made in order to establish long-term insurance contract liabilities, which are consistent with the requirements of the Insurance Ordinance Chapter 41E.

The company makes estimates of the fair value of investment guarantees provided in the non-linked investment contracts. A best estimate liability plus an allowance for the cost of holding regulatory capital is used to determine the fair value of the guarantee feature of these contracts.

## 4 Insurance and financial risk management

### (a) Risk management objectives, policies and processes for management of insurance risk

The company is exposed to the uncertainty surrounding the timing and severity of insurance claims under the contracts. The company also has exposure to market risk through its insurance and investment activities.

The Company measures the risk profile of its insurance businesses using an economic capital ("EC") approach, where assets and liabilities are measured on a market value basis and a capital requirement is defined to ensure that there is less than a 1 in 200 chance of insolvency over a one year time horizon, given the risks that the businesses are exposed to. The methodology for the economic capital calculation is largely aligned to the pan-European Solvency II insurance capital regulations.

Insurance risks are controlled by high-level policies and procedures set by the ultimate holding company and within the company, taking into account where appropriate local market conditions and regulatory requirements. Formal underwriting, reinsurance and claims handling procedures designed to ensure compliance with regulations are applied, supplemented with stress testing.

As well as exercising underwriting controls, the company uses reinsurance as a means of mitigating exposure to insurance risk. Where the company manages its exposure to insurance risk through the use of third-party reinsurers, the associated revenue and manufacturing profit is ceded to the reinsurers. Although reinsurance provides a means of managing insurance risk, such contracts expose the company to credit risk, the risk of default by the reinsurer.

### (b) Asset/liability management

The company actively manages its assets using an approach that considers asset quality, risk profile, diversification, asset/liability matching, liquidity and target investment return.

The company establishes the investment policy for each major insurance product category according to specific product requirements and local regulatory requirements. The investment policy defines the asset allocation and restrictions with an aim to achieve the target investment return in the long term subject to acceptable risk level. The estimates and assumptions used in determining the approximate amounts and timing of payments to or on behalf of policyholders for insurance liabilities are regularly re-evaluated. Many of these estimates and assumptions are inherently subjective and could impact the company's ability to achieve its asset/liability management goals and objectives.

### (c) Underwriting strategy

The company's underwriting strategy seeks diversity to ensure a balanced portfolio and is based on a large portfolio of similar risks over a number of years and, as such, reduces the variability of the outcome.

## 4 Insurance and financial risk management (continued)

### (d) Reinsurance strategy

The company uses reinsurance to manage risks that are outside of its risk appetite and/or provide financial benefits to the company. Under the terms of the reinsurance agreements, the reinsurers agree to make payments to the company under predefined events. The company however still remains liable to its policyholders with respect to ceded insurance if any reinsurer fails to meet the obligations it assumes.

When selecting a reinsurer the company considers its security by assessing public rating information and by conducting due diligence.

### (e) Nature of risks covered

The following gives details of the company's main products and the ways in which it manages the associated risks.

(i) Long-term insurance contracts - non-linked products

*Product features*

The basic feature of long-term non-linked insurance business is to provide guaranteed death benefit determined at the time of policy issue. For some universal life products, the guaranteed crediting rate is offered within a certain period. For insurance products with a savings element, guaranteed surrender and maturity benefits are usually provided.

Most of the company's non-linked products include discretionary participating features which allow policyholders to participate in the profits of the life fund. These plans offer a discretionary bonus in the form of a cash dividend or terminal bonus payable to the policyholder at the policy anniversary date or certain trigger event respectively.

The principles upon which the distribution of profits among the policyholders is made are:

(1) To recognise the financial condition of the company;

(2) To take into consideration the reasonable expectation of policyholders, fairness among policyholders and a smooth and stable return over long term; and

(3) To balance the interests between the shareholders and policyholders.

## 4 Insurance and financial risk management (continued)

### (e) Nature of risks covered (continued)

(i) Long-term insurance contracts - non-linked products (continued)

*Management of risks*

The company has contractual discretion on the bonuses declared. In practice the company considers policyholders' reasonable expectations when setting bonus levels. It is the company's intention to maintain a smooth and stable dividend scale based on the long-term rate of return. Annual reviews are performed to confirm whether the current dividend scale is supportable taking into account the investment, lapse and surrender, mortality and morbidity, expense and other risks.

Investment risks are managed through matching assets and liabilities. Guaranteed risks are managed through investment in high quality fixed rate bonds. Investment strategies are set which are intended to provide sufficient investment return to satisfy policyholders' reasonable expectations. Mortality risk is managed through reinsurance and underwriting.

(ii) Long-term insurance contracts - unit-linked products

*Product features*

The company writes unit-linked life insurance policies, which provide policyholders with life insurance protection and investment options in a variety of funds. One of the linked products provides guaranteed minimum death benefit and guaranteed minimum accumulation benefit, in addition to life insurance protection. Premiums received are deposited into the chosen funds after deduction of premium fees, if applicable. Other charges for the cost of insurance and administration are deducted from the funds accumulated. Policy surrender or withdrawal may be subject to early encashment charge.

*Management of risks*

Although policyholders bear the market risk on linked products, the company assumes reputational risk for any undue market risk taken by policyholders. Consequently, it is in the company's interest to ensure that the policyholders' exposure to market risk is consistent with any market risk information that the company has communicated to the policyholders.

For the product that provides guaranteed minimum death benefit and guaranteed minimum accumulation benefit, the company cedes the risks through a modified coinsurance agreement to mitigate the exposure to market risk from underwriting the guarantees.

Claims and expenses are reviewed regularly to ensure current charges are sufficient to cover the costs.

## 4 Insurance and financial risk management (continued)

### (e) Nature of risks covered (continued)

(iii) Long-term investment contracts - non-linked return guaranteed products

*Product features*

The company underwrites retirement fund business which gives rise to contracts that are classified as investment contracts. Under each retirement scheme, employers and employees are given a choice of funds to place their contributions. The accumulated fund balance will be payable upon retirement or termination of employment. The company provides capital and minimum investment return guarantees on these funds.

*Management of risks*

Guaranteed risks are managed through investment in high quality fixed rate bonds. Investment strategy is set with the objective of providing return that is sufficient to meet at least the minimum guarantee.

(iv) Long-term investment contracts - unit-linked products

*Product features*

The company underwrites retirement fund business which gives rise to contracts that are classified as investment contracts. Under each retirement scheme, employers and employees are given a choice of funds to place their contributions. The accumulated fund balance will be payable upon retirement or termination of employment.

*Management of risks*

Although scheme members bear the market risk on linked products, the company assumes reputational risk for any undue market risk taken by scheme members. Consequently, it is in the company's interest to ensure that the scheme members' exposure to market risk is consistent with any market risk information that the company has communicated to the scheme members.

## 4 Insurance and financial risk management (continued)

### (f) Concentration of insurance risks

Concentration of risks arises where a particular event, or series of events, impacts heavily upon the company's liabilities.

The company is subject to concentration risks arising from death, accidents, health and other perils relating to common causes, such as earthquakes and other natural disasters that affect lives of the policyholders insured by the company.

To determine the concentration of insurance risks, the reinsurance coverage required and/or the additional amount of capital to be held, the company's economic capital models have been used.

### (g) Financial risk

Transactions in financial instruments may result in the company assuming financial risk. These include market risk, credit risk and liquidity risk. Each of these financial risks is described below, together with a summary of the ways in which the company manages these risks.

The company is also exposed to investment return guarantee risk for certain investment contracts issued to policyholders. The risk is that the yield on the assets held by the company to meet these guarantees may fall short of the guaranteed return. The framework for the management of this risk is to adopt a matching approach whereby assets held are managed to meet the liabilities to policyholders. An additional provision is established where analysis indicates that, over the life of the contracts, the returns from the designated assets may not be adequate to cover the related liabilities.

For the linked insurance product that provides guaranteed minimum death benefit and guaranteed minimum accumulation benefit, the company has purchased reinsurance on modified coinsurance basis to mitigate the exposure to market risk from underwriting the guarantees.

## 4 Insurance and financial risk management (continued)

### (h) Market risk

Market risk can be described as the risk of change in fair value of a financial instrument due to changes in interest rates, equity prices and foreign currency exchange rates.

(i) Interest rate risk

One of the objectives of the investment strategy is to manage the net changes in the value of assets and liabilities arising from interest rate risk movements.

For debt securities backing insurance contract liabilities, the change in asset value due to interest rate change is limited as a majority of the debt securities are held-to-maturity with some portion of debt securities accounted for as available-for-sale and fair value through profit or loss. These held-to-maturity debt securities are managed to match expected liability payments. The company monitors this exposure through periodic reviews of its asset and liability positions. Estimates of cash flows, as well as the impact of interest rate fluctuations relating to the investment portfolio and insurance reserves, are modelled and reviewed regularly.

For participating products, interest rate risk related to non-linked policies can also be mitigated through sharing of the risk with policyholders under the discretionary participation mechanism.

(ii) Equity price risk

The portfolio of marketable equity securities, which the company carries on the balance sheet at fair value, has exposure to price risk. This risk is defined as the potential loss in market value resulting from an adverse change in prices. The risk is mainly mitigated through tactical asset allocation, hedging strategy and sharing the risk with policyholders through the discretionary participation feature. The company's objective is to earn competitive returns by investing in a diversified portfolio of high quality, liquid securities. Portfolio characteristics are analysed regularly and equity price risk is regularly reviewed. The company's investment portfolios are diversified across countries and industries, and concentrations in any one company or industry are limited by parameters established by senior management, as well as by statutory requirements.

(iii) Foreign exchange risk

The assets and liabilities of the company are mainly denominated in two main currencies, United States dollar and Hong Kong dollar. The company adopts a policy of predominately matching the assets with liabilities in the same currency, effectively reducing the foreign currency exchange rate exposure. Limits are set to ensure that the net foreign currency exposure is kept to an acceptable level. The company uses foreign exchange forward contracts and swaps to manage its foreign currency risk.

## 4 Insurance and financial risk management (continued)

### (i) Credit risk

The company's portfolio of debt securities, and to a lesser extent short-term and other investments are subject to credit risk. This risk is defined as the potential loss in market value resulting from adverse changes in a borrower's ability to repay the debt. The company's objective is to earn competitive returns by investing in a diversified portfolio of securities. Management has a credit policy in place. Limits are established to manage credit quality and concentration risk.

The company also has insurance and other receivable amounts subject to credit risk. The most significant of these are reinsurance recoveries. To mitigate the risk of the counterparties not paying the amount due, the company has established business and financial guidelines for reinsurer approval, incorporating ratings by major agencies and considering currently available market information. The company also periodically reviews the financial stability of reinsurers from public and other sources and the settlement trend of amounts due from reinsurers.

### (j) Liquidity risk

The company has to meet daily calls on its cash resources, notably from claims arising on its insurance and investment contracts and early surrender of policies for surrender value. There is therefore a risk that cash will not be available to settle liabilities when due at a reasonable cost. The company manages this risk by monitoring and setting an appropriate level of operating funds to settle these liabilities. Investment portfolios are also structured with regard to the liquidity requirement of each underlying fund, and early surrender penalties and market adjustment clauses are used to defray costs of unexpected cash requirements.

## 5 Turnover

The principal activities of the company are the transaction of life assurance and retirement benefit business.

Turnover represents gross premiums received in respect of long-term unit-linked insurance contracts and gross premiums received and receivable in respect of long term non-linked insurance contracts during the year, net of discounts and returns; and fee income.

## 6 Profit before taxation

Profit before taxation is arrived at

| | Note | 2017 $'millions | 2016 $'millions |
|---|---|---|---|
| ***After crediting:*** | | | |
| Interest income from listed investments | | 3,946 | 3,223 |
| Interest income from unlisted investments | | 4,184 | 4,029 |
| Net gain on disposal of available-for-sale investments | | 180 | 504 |
| Net gain on disposal of held-to-maturity investments | | - | 16 |
| Net income from investment assets designated at fair value through profit or loss | | 15,362 | 3,600 |
| Net exchange gain | | 1,203 | - |
| ***And after charging:*** | | | |
| Depreciation and amortisation | 18, 20 | 115 | 71 |
| Impairment loss on intangible assets | 20 | 1 | 1 |
| Auditors' remuneration | | | |
| - Statutory audit | | 5 | 4 |
| - Audit-related services | | 3 | 1 |
| Rental expenses | | 41 | 44 |
| Personnel expenses | | | |
| - Wages and salaries | | 493 | 459 |
| Pension costs | | | |
| - Contributions to defined contribution plans | | 31 | 28 |
| - Expenses recognised in respect of defined benefit plans | | 11 | 12 |
| Net realised and unrealised loss on trading derivatives | | 1,090 | 118 |
| Share-based payment expenses | | | |
| - Share awards | | 6 | 2 |
| Net exchange loss | | - | 536 |

## 7 Net written premiums

| | Insurance contracts (Non-linked) | | Insurance contracts (Linked) | | Total | |
|---|---|---|---|---|---|---|
| | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions |
| Gross written premiums | 42,815 | 39,076 | 358 | 891 | 43,173 | 39,967 |
| Less: Written premiums ceded to reinsurers | (5,790) | (1,736) | (14) | (26) | (5,804) | (1,762) |
| **Net written premiums** | 37,025 | 37,340 | 344 | 865 | 37,369 | 38,205 |

## 8 Fees and commission income

| | Insurance contracts (Non-linked) | | Insurance contracts (Linked) | | Investment contracts (Non-linked) | | Investment contracts (Linked) | | Service contracts | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions |
| Fee income | - | - | - | - | 106 | 107 | 73 | 69 | 1,423 | 1,191 | 1,602 | 1,367 |
| Reinsurance commission | 241 | 103 | 12 | 12 | - | - | - | - | - | - | 253 | 115 |
| **Total fees and commission income** | 241 | 103 | 12 | 12 | 106 | 107 | 73 | 69 | 1,423 | 1,191 | 1,855 | 1,482 |

## 9 Net investment income

| | 2017 $'millions | 2016 $'millions |
|---|---|---|
| Interest income | | |
| - Held-to-maturity investments | 6,752 | 5,786 |
| - Available-for-sale investments | 941 | 1,048 |
| - Loans and receivables | 437 | 418 |
| Net gain on disposal of available-for-sale investments | 180 | 504 |
| Net gain on disposal of held-to-maturity investments | - | 16 |
| Net income from investment assets designated at fair value through profit or loss (Note 10) | 15,362 | 3,600 |
| Net realised and unrealised loss on trading derivatives | (1,090) | (118) |
| Net exchange gain / (loss) | 1,203 | (536) |
| Investment management fees | (249) | (226) |
| Investment expenses | (58) | (37) |
| Interest expenses | (31) | - |
| **Net investment income** | 23,447 | 10,455 |

## 10 Net income from investment assets designated at fair value through profit or loss

| | 2017 $'millions | 2016 $'millions |
|---|---|---|
| Investment income from listed investments | | |
| - Dividend income | 676 | 589 |
| - Interest income | 205 | 160 |
| Investment income from unlisted investments | | |
| - Dividend income | 278 | 311 |
| - Interest income | 182 | 193 |
| Net realised gain / (loss) | 3,679 | (345) |
| Net unrealised gain | 10,342 | 2,692 |
| **Net income from investment assets designated at fair value through profit or loss** | 15,362 | 3,600 |

## 11 Net insurance claims and benefits incurred and movement in liabilities to policyholders

| | Insurance contracts (Non-linked) | | Insurance contracts (Linked) | | Total | |
|---|---|---|---|---|---|---|
| | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions |
| Death claims and loss adjustment expenses | 577 | 405 | 70 | 68 | 647 | 473 |
| By way of lump sum on maturity | 8,095 | 7,693 | - | - | 8,095 | 7,693 |
| Surrenders | 3,792 | 3,386 | 5,820 | 1,506 | 9,612 | 4,892 |
| Policy dividends | 1,502 | 1,195 | - | - | 1,502 | 1,195 |
| Changes in technical provisions | 31,599 | 30,108 | 624 | 1,161 | 32,223 | 31,269 |
| Gross claims and benefits incurred and movement in liabilities to policyholders | 45,565 | 42,787 | 6,514 | 2,735 | 52,079 | 45,522 |
| Reinsurers' share of claims and benefits incurred and movement in liabilities to policyholders | (5,734) | (1,425) | 1,172 | 159 | (4,562) | (1,266) |
| **Net insurance claims and benefits incurred and movement in liabilities to policyholders** | 39,831 | 41,362 | 7,686 | 2,894 | 47,517 | 44,256 |

## 12 Movement in investment contract liabilities

The company keeps linked investments separate from other investments and invests them separately in accordance with the request of the policyholders.

Benefits of unit-linked investment contract liabilities amounting to $2,352 million (2016: $156 million) are accrued to the contract holders at the fair value of the net gain arising from the underlying linked assets.

Benefits of non-linked investment contract liabilities amounting to $656 million (2016: $208 million) are accrued to the contract holders based on the policy terms.

## 13 Acquisition costs

| | Insurance contracts (Non-linked) | | Insurance contracts (Linked) | | Investment contracts (Non-linked) | | Investment contracts (Linked) | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions |
| Commission expenses paid and payable | 2,374 | 2,621 | 92 | 86 | - | - | - | - | 2,466 | 2,707 |

## 14 Income taxes

### (a) Taxation in the income statement represents:

| | 2017 $'millions | 2016 $'millions |
|---|---|---|
| **Current tax - Hong Kong Profits Tax** | | |
| Provision for the year | 1,220 | 132 |
| Over-provision in respect of prior years | - | (11) |
| | 1,220 | 121 |
| **Current tax - Overseas** | | |
| Withholding tax provision for the year | 6 | 4 |
| | 6 | 4 |
| **Deferred tax** | | |
| Origination and reversal of temporary differences | 78 | 51 |
| Total income tax expense | 1,304 | 176 |

The provision for Hong Kong Profits Tax for 2017 is calculated at 16.5% (2016: 16.5%) of the estimated assessable profits for the year. Taxation for overseas branches, if any, is charged at the appropriate current rates of taxation ruling in the relevant jurisdictions.

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

| | 2017 $'millions | % | 2016 $'millions | % |
|---|---|---|---|---|
| Profit before taxation | 7,999 | | 1,232 | |
| Notional tax on profit before taxation, calculated at the rates applicable to profits in the jurisdictions concerned | 1,320 | 16.5 | 203 | 16.5 |
| Tax effect of non-deductible expenses | 3 | 0.1 | 4 | 0.3 |
| Tax effect of non-taxable income | (25) | (0.4) | (24) | (2.0) |
| Over-provision in prior years | - | - | (11) | (0.9) |
| Overseas withholding tax provision | 6 | 0.1 | 4 | 0.3 |
| | 1,304 | 16.3 | 176 | 14.2 |

## 15 Dividends

Dividends paid to equity shareholders of the company in respect of the year

| | 2017<br>$'millions | 2016<br>$'millions |
|---|---|---|
| Interim dividend declared and paid of $0.281 (2016: $0.278) per ordinary share | 1,173 | 1,163 |

## 16 Directors' remuneration

| | 2017<br>$'000 | 2016<br>$'000 |
|---|---|---|
| Fees | 1,030 | 972 |
| Other emoluments | 2,864 | 6,548 |
| | 3,894 | 7,520 |

Other emoluments disclosed above includes contributions to retirement benefits of $96,000 (2016: $342,000).

The directors' remuneration disclosed above includes amounts in respect of their services to both the company and its immediate holding company. No apportionment has been made as the directors do not believe that it is practicable to apportion the amounts between their services to the company and its immediate holding company.

In addition, certain directors received remuneration from its intermediate holding company or fellow subsidiaries in respect of their services to the company. No apportionment has been made between their services to the company and other group companies.

## 17 Other comprehensive income

### *Tax effects relating to each component of other comprehensive income*

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Before-tax amounts $'millions | Tax (expenses)/ benefits $'millions | Net-of-tax amount $'millions | Before-tax amounts $'millions | Tax (expenses)/ benefits $'millions | Net-of-tax amount $'millions |
| **Items that are or may be reclassified subsequently to profit or loss:** | | | | | | |
| Available-for-sale: | | | | | | |
| - Changes in fair value during the year | 1,338 | (221) | 1,117 | 837 | (137) | 700 |
| - Amount reclassified from equity upon disposal | (180) | 30 | (150) | (504) | 83 | (421) |
| - Amortisation arising from reclassification of debt securities out of available-for-sale category (note 22(i)) | (10) | 2 | (8) | (12) | 2 | (10) |
| Other comprehensive income for the year | 1,148 | (189) | 959 | 321 | (52) | 269 |

## 18 Fixed assets

| | Computer Equipment $'millions | Equipment, fixtures and fittings $'millions | Total $'millions |
|---|---|---|---|
| **Cost:** | | | |
| At 1 January 2017 and 31 December 2017 | 59 | 10 | 69 |
| **Accumulated depreciation and impairment losses:** | | | |
| At 1 January 2017 and 31 December 2017 | 59 | 10 | 69 |
| **Net book value:** | | | |
| At 31 December 2017 | - | - | - |
| **Cost:** | | | |
| At 1 January 2016 and 31 December 2016 | 59 | 10 | 69 |
| **Accumulated depreciation and impairment losses:** | | | |
| At 1 January 2016 and 31 December 2016 | 59 | 10 | 69 |
| **Net book value:** | | | |
| At 31 December 2016 | - | - | - |

## 19 Interests in structured entities

Included in financial assets designated at fair value through profit or loss on the company's balance sheet are certain investments in collective investment schemes (see note 22) that are structured entities. These investment schemes mainly comprise investments in unit trusts, mid-market debt funds, private equity funds, hedge funds and infrastructure funds established by related companies or third parties. These collective investment schemes provide the company with a variety of investment opportunities through managed investment strategies.

Owing to the passive nature of these investments, the maximum exposure to loss from these interests is limited to the associated equity price risk (see note 22(d)) and the capital commitments. The maximum exposure to loss, which represents the maximum loss that the company could be required to report as a result of its involvement with structured entities regardless of the probability of the loss being incurred, is equivalent to the carrying amount of these investments (see note 22) and the outstanding capital commitments to invest in private equity funds (see note 33).

## 20 Intangible assets

| | Software development costs | |
|---|---|---|
| | 2017<br>$'millions | 2016<br>$'millions |
| **Cost:** | | |
| At 1 January | 618 | 471 |
| Additions | 298 | 147 |
| At 31 December | 916 | 618 |
| **Accumulated amortisation and impairment losses:** | | |
| At 1 January | 304 | 232 |
| Charge for the year | 115 | 71 |
| Impairment loss | 1 | 1 |
| At 31 December | 420 | 304 |
| **Net book value:** | | |
| At 31 December | 496 | 314 |

The amortisation charge and impairment loss were included in "administrative expenses" in the income statement.

## 21 Income tax in the balance sheet

### (a) Taxation recognised in other comprehensive income:

| | 2017 $'millions | 2016 $'millions |
|---|---|---|
| Deferred tax expense | 189 | 52 |

### (b) Current taxation in the balance sheet represents:

| | 2017 $'millions | 2016 $'millions |
|---|---|---|
| Provision for Hong Kong Profits Tax for the year | 1,220 | 132 |
| Prior year tax recoverable | (828) | - |
| Provisional Profits Tax paid | - | (960) |
| Provision for overseas withholding tax | 18 | 13 |
| Tax payable / (recoverable) | 410 | (815) |

## 21 Income tax in the balance sheet (continued)

### (c) Deferred tax liabilities recognised:

The components of deferred tax (liabilities)/ assets recognised in the balance sheet and the movements during the year are as follows:

| | Depreciation allowances in excess of related depreciation $'millions | Available-for-sale securities $'millions | Guarantee liability reserve $'millions | Share based payment $'millions | Reinsurance arrangement $'millions | Total $'millions |
|---|---|---|---|---|---|---|
| Deferred tax arising from: | | | | | | |
| At 1 January 2016 | (39) | (186) | (54) | 3 | 365 | 89 |
| Charged to income statement | (13) | - | (3) | (2) | (33) | (51) |
| Recognised in statement of comprehensive income | - | (52) | - | - | - | (52) |
| At 31 December 2016 | (52) | (238) | (57) | 1 | 332 | (14) |
| At 1 January 2017 | (52) | (238) | (57) | 1 | 332 | (14) |
| Charged to income statement | (30) | - | 26 | - | (74) | (78) |
| Recognised in statement of comprehensive income | - | (189) | - | - | - | (189) |
| Other movement | - | - | - | 1 | - | 1 |
| At 31 December 2017 | (82) | (427) | (31) | 2 | 258 | (280) |

Deferred tax assets/liabilities recognised in the balance sheet are expected to be recovered/settled after 12 months.

## 22 Financial instruments

| | 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Available-for-sale $'millions | Trading $'millions | Loans and receivables $'millions | Designated at fair value through profit or loss $'millions | Held-to-maturity $'millions | Total $'millions |
| **Equities** | | | | | | |
| Listed | - | - | - | 25,667 | - | 25,667 |
| **Debt securities - fixed rate** | | | | | | |
| Government bonds | 699 | - | - | 1,002 | 10,529 | 12,230 |
| Listed | 13,302 | - | - | 9,474 | 94,303 | 117,079 |
| Unlisted | 7,115 | - | - | 6,722 | 98,966 | 112,803 |
| | 21,116 | - | - | 17,198 | 203,798 | 242,112 |
| **Debt securities - floating rate** | | | | | | |
| Listed | - | - | - | - | - | - |
| Unlisted | - | - | - | - | - | - |
| | - | - | - | - | - | - |
| **Collective investment schemes** | | | | | | |
| Listed | - | - | - | 22,820 | - | 22,820 |
| Unlisted | - | - | - | 36,357 | - | 36,357 |
| | - | - | - | 59,177 | - | 59,177 |
| **Derivatives** | - | 303 | - | - | - | 303 |
| **Loans and receivables** | - | - | 8,693 | - | - | 8,693 |
| **Amounts due from investment managers** | - | - | 2,493 | - | - | 2,493 |
| **Portfolio cash** | - | - | 5,597 | - | - | 5,597 |
| **Total investment assets** | 21,116 | 303 | 16,783 | 102,042 | 203,798 | 344,042 |

## 22 Financial instruments (continued)

| | 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Available-for-sale $'millions | Trading $'millions | Loans and receivables $'millions | Designated at fair value through profit or loss $'millions | Held-to-maturity $'millions | Total $'millions |
| **Equities** | | | | | | |
| Listed | - | - | - | 20,103 | - | 20,103 |
| **Debt securities - fixed rate** | | | | | | |
| Government bonds | 579 | - | - | 716 | 6,834 | 8,129 |
| Listed | 13,399 | - | - | 5,677 | 71,351 | 90,427 |
| Unlisted | 6,699 | - | - | 7,770 | 94,009 | 108,478 |
| | 20,677 | - | - | 14,163 | 172,194 | 207,034 |
| **Debt securities - floating rate** | | | | | | |
| Listed | - | - | - | 987 | - | 987 |
| Unlisted | - | - | - | 214 | - | 214 |
| | - | - | - | 1,201 | - | 1,201 |
| **Collective investment schemes** | | | | | | |
| Listed | - | - | - | 22,280 | - | 22,280 |
| Unlisted | - | - | - | 31,066 | - | 31,066 |
| | - | - | - | 53,346 | - | 53,346 |
| **Derivatives** | - | 2 | - | - | - | 2 |
| **Loans and receivables** | - | - | 8,892 | - | - | 8,892 |
| **Amounts due from investment managers** | - | - | 2,155 | - | - | 2,155 |
| **Portfolio cash** | - | - | 7,531 | - | - | 7,531 |
| **Total investment assets** | 20,677 | 2 | 18,578 | 88,813 | 172,194 | 300,264 |

## 22 Financial instruments (continued)

The current portion of investment assets was $108,500 million (2016: $95,271 million) and the non-current portion was $235,542 million (2016: $204,993 million).

Derivatives comprising foreign exchange forward contracts, swaps and equity options are measured at fair value at the balance sheet date.

Exposure to credit, interest rate, liquidity, equity price and currency risks arises in the normal course of the company's business. These risks are managed by the company's financial risk management policies and practices disclosed in notes 4(g) to 4(j).

### (a) Credit risk

The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet.

Transactions involving derivative financial instruments are with counterparties with sound credit ratings.

The company's portfolio of fixed income securities, and to a lesser extent short-term and other investments are subject to credit risk. Details of the credit risk management are disclosed in note 4(i).

*Quality classification definitions:*

- Strong: Exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss.
- Medium: Exposures require closer monitoring, with low to moderate default risk.
- Sub-standard: Exposures require varying degrees of special attention and default risk is of greater concern.
- Impaired: Exposures have been assessed, individually or collectively, as impaired.

The company's policy in respect of impairment is set out in note 1(p) to the financial statements.

For debt securities and certain other financial instruments, external ratings have been aligned to the four quality classifications. The ratings of Standard and Poor's are cited, with those of other agencies being treated equivalently. Debt securities with short-term issue ratings are reported against the long-term rating of the issuer of those securities. If major rating agencies have different ratings for the same debt securities, a prudent rating selection is made in line with regulatory requirements.

| Quality classification | S&P rating equivalent |
|---|---|
| Strong | A- and above |
| Medium | BBB+ to B, and unrated |
| Sub-standard | B- and below |
| Impaired | Impaired |

## 22 Financial instruments (continued)

### (a) Credit risk (continued)

The following table presents the analysis of loans and receivables and debt securities supporting liabilities under non-linked insurance and investment contracts and shareholders' funds.

**At 31 December 2017**

| | Neither past due nor impaired | | | | | | |
|---|---|---|---|---|---|---|---|
| | Strong $'millions | Medium $'millions | Sub-standard $'millions | Past due not impaired $'millions | Impaired $'millions | Impairment allowances $'millions | Total $'millions |
| ***Supporting liabilities under non-linked insurance and investment contracts*** | | | | | | | |
| Available-for-sale debt securities | 16,265 | 4,642 | - | - | - | - | 20,907 |
| Debt securities designated at fair value through profit or loss | 13,320 | 561 | - | - | - | - | 13,881 |
| Held-to-maturity debt securities | 168,398 | 17,267 | - | - | - | - | 185,665 |
| Loans and receivables | 6,459 | 2,234 | - | - | - | - | 8,693 |
| ***Supporting shareholders' funds*** | | | | | | | |
| Available-for-sale debt securities | 209 | - | - | - | - | - | 209 |
| Held-to-maturity debt securities | 17,549 | 584 | - | - | - | - | 18,133 |
| **Total** | | | | | | | |
| Available-for-sale debt securities | 16,474 | 4,642 | - | - | - | - | 21,116 |
| Debt securities designated at fair value through profit or loss | 13,320 | 561 | - | - | - | - | 13,881 |
| Held-to-maturity debt securities | 185,947 | 17,851 | - | - | - | - | 203,798 |
| Loans and receivables | 6,459 | 2,234 | - | - | - | - | 8,693 |

Amounts due from investment managers are mainly due from group companies in which the credit quality of ultimate holding company is considered as strong.

## 22 Financial instruments (continued)

### (a) Credit risk (continued)

**At 31 December 2016**

| | Neither past due nor impaired | | | | | | |
|---|---|---|---|---|---|---|---|
| | Strong $'millions | Medium $'millions | Sub-standard $'millions | Past due not impaired $'millions | Impaired $'millions | Impairment allowances $'millions | Total $'millions |
| ***Supporting liabilities under non-linked insurance and investment contracts*** | | | | | | | |
| Available-for-sale debt securities | 16,113 | 4,288 | - | - | - | - | 20,401 |
| Debt securities designated at fair value through profit or loss | 13,510 | 251 | - | - | - | - | 13,761 |
| Held-to-maturity debt securities | 144,007 | 13,152 | - | - | - | - | 157,159 |
| Loans and receivables | 6,491 | 2,401 | - | - | - | - | 8,892 |
| ***Supporting shareholders' funds*** | | | | | | | |
| Available-for-sale debt securities | 276 | - | - | - | - | - | 276 |
| Held-to-maturity debt securities | 14,622 | 413 | - | - | - | - | 15,035 |
| **Total** | | | | | | | |
| Available-for-sale debt securities | 16,389 | 4,288 | - | - | - | - | 20,677 |
| Debt securities designated at fair value through profit or loss | 13,510 | 251 | - | - | - | - | 13,761 |
| Held-to-maturity debt securities | 158,629 | 13,565 | - | - | - | - | 172,194 |
| Loans and receivables | 6,491 | 2,401 | - | - | - | - | 8,892 |

Amounts due from investment managers are mainly due from group companies in which the credit quality of ultimate holding company is considered as strong.

## 22 Financial instruments (continued)

### (b) Interest rate risk

For debt securities backing insurance contract liabilities, the change in asset value due to interest rate change is limited as a majority of the debt securities are held-to-maturity with some portion of debt securities accounted for at available-for-sale and fair value through profit or loss. Details of how the company manages interest rate risk are disclosed in note 4(h)(i).

(i) Financial assets

Movements in interest yield curves as at 31 December 2017 would have the following impact on the profit after taxation for the year and shareholders' equity at that date:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Impact on profit after taxation for the year $'millions | Impact on shareholders' equity $'millions | Impact on profit after taxation for the year $'millions | Impact on shareholders' equity $'millions |
| **Interest rate impact** | | | | |
| + 100 basis points shift in yield curves | | | | |
| - Non AFS | - | - | - | - |
| - AFS | - | (2,016) | - | (1,916) |
| Total | - | (2,016) | - | (1,916) |
| - 100 basis points shift in yield curves | | | | |
| - Non AFS | - | - | - | - |
| - AFS | - | 2,465 | - | 2,329 |
| Total | - | 2,654 | - | 2,329 |

(ii) Liabilities under investment contracts

Certain investment contracts contain capital and minimum return guarantees. The existence of such guarantees limits the ability of liability valuations to be offset by changes in asset values. At 31 December 2017, of the total non-linked investment contracts, an aggregate fund value of $24,891 million (2016: $23,724 million) was subject to contractual capital and investment return guarantees of between 0% and 5% to be met by the company. These guarantees are estimated to have a fair value of $193 million (2016: $324 million) which is reflected in the financial statements as part of the fair value of these financial instrument liabilities. However the determination of fair value is sensitive to future changes in interest rates.

A hypothetical 100 basis points reduction in interest rate is estimated to result in $258 million (2016: $238 million) increase in the value of assets backing investment contract liabilities. This entire amount $258 million (2016: $238 million) would accrue to policyholders' fund value, which will also lead to an increase in the company's investment contract liabilities. In addition, there will be an increase in fair value of capital and minimum return guarantee liabilities which results in a reduction of profit after taxation of $64 million (2016: $71 million). Therefore, the aggregate impact is a reduction of profit after taxation or shareholders' equity of $64 million (2016: $71 million).

## 22 Financial instruments (continued)

### (c) Liquidity risk

(i) In respect of income-earning financial assets and financial liabilities, the following table indicates the contractual maturity profile at the balance sheet date:

| | 2017 | | | | |
|---|---|---|---|---|---|
| | Total $'millions | One year or less $'millions | 1 - 2 years $'millions | 2 - 5 years $'millions | More than 5 years $'millions |
| **Financial assets** | | | | | |
| Debt securities held-to-maturity | 203,798 | 17,753 | 11,643 | 32,143 | 142,259 |
| Debt securities designated at fair value through profit or loss | 17,198 | 3,555 | 3,206 | 7,856 | 2,581 |
| Debt securities available-for-sale | 21,116 | 206 | 497 | 1,217 | 19,196 |
| Reinsurance receivables, insurance receivables and other receivables | 3,003 | 1,983 | - | - | 1,020 |
| Loans and receivables | 8,693 | 294 | 154 | 2,073 | 6,172 |
| Amounts due from investment managers | 2,493 | 2,493 | - | - | - |
| Portfolio cash | 5,597 | 5,597 | - | - | - |
| Cash and cash equivalents | 2,604 | 2,604 | - | - | - |
| | 264,502 | 34,485 | 15,500 | 43,289 | 171,228 |
| **Financial liabilities** | | | | | |
| Reinsurance payable | 289 | 289 | - | - | - |
| Insurance payable | 16,869 | 2,178 | 657 | 2,035 | 11,999 |
| Other payables | 1,315 | 1,315 | - | - | - |
| | 18,473 | 3,782 | 657 | 2,035 | 11,999 |

## 22 Financial instruments (continued)

### (c) Liquidity risk (continued)

(i) In respect of income-earning financial assets and financial liabilities, the following table indicates the contractual maturity profile at the balance sheet date: (continued)

| | 2016 | | | | |
|---|---|---|---|---|---|
| | Total $'millions | One year or less $'millions | 1 - 2 years $'millions | 2 - 5 years $'millions | More than 5 years $'millions |
| **Financial assets** | | | | | |
| Debt securities held-to-maturity | 172,194 | 11,152 | 15,821 | 29,488 | 115,733 |
| Debt securities designated at fair value through profit or loss | 15,364 | 3,213 | 3,709 | 7,879 | 563 |
| Debt securities available-for-sale | 20,677 | 351 | 210 | 914 | 19,202 |
| Reinsurance receivable insurance receivable and other receivables | 2,708 | 1,823 | - | - | 885 |
| Loans and receivables | 8,892 | 239 | 484 | 1,604 | 6,565 |
| Amounts due from investment managers | 2,155 | 2,155 | - | - | - |
| Portfolio cash | 7,531 | 7,531 | - | - | - |
| Cash and cash equivalents | 1,864 | 1,864 | - | - | - |
| | 231,385 | 28,328 | 20,224 | 39,885 | 142,948 |
| **Financial liabilities** | | | | | |
| Reinsurance payable | 315 | 315 | - | - | - |
| Insurance payable | 12,106 | 1,675 | 470 | 1,467 | 8,494 |
| Other payables | 1,486 | 1,486 | - | - | - |
| | 13,907 | 3,476 | 470 | 1,467 | 8,494 |

## 22 Financial instruments (continued)

### (c) Liquidity risk (continued)

(ii) Liabilities under insurance and investment contracts

The following table presents the estimated amounts (on a discounted basis) and timing of cash flows arising from liabilities under insurance and investment contracts. These contracts typically include policyholder surrenders or transfer options at a value equal to, or below, the carrying value of those liabilities. A maturity analysis prepared on the basis of the earliest possible contractual repayment date (assuming that all surrenders and transfer options are exercised) would result in all insurance and investment contracts being presented as falling due within one year or less.

| | 2017 | | | | |
|---|---|---|---|---|---|
| | Total $'millions | One year or less $'millions | 1 - 2 years $'millions | 2 - 5 years $'millions | More than 5 years $'millions |
| Insurance contracts - Non-linked | 229,641 | 2,845 | 1,451 | 2,795 | 222,550 |
| Insurance contracts - Linked | 37,760 | 103 | 7 | 42 | 37,608 |
| Investment contracts - Non-linked | 30,066 | 114 | - | - | 29,952 |
| Investment contracts - Linked | 12,472 | 81 | - | - | 12,391 |
| | 309,939 | 3,143 | 1,458 | 2,837 | 302,501 |

| | 2016 | | | | |
|---|---|---|---|---|---|
| | Total $'millions | One year or less $'millions | 1 - 2 years $'millions | 2 - 5 years $'millions | More than 5 years $'millions |
| Insurance contracts - Non-linked | 196,941 | 3,380 | 2,248 | 2,852 | 188,461 |
| Insurance contracts - Linked | 36,847 | 57 | 8 | 33 | 36,749 |
| Investment contracts - Non-linked | 29,227 | 112 | - | - | 29,115 |
| Investment contracts - Linked | 10,966 | 91 | - | - | 10,875 |
| | 273,981 | 3,640 | 2,256 | 2,885 | 265,200 |

## 22 Financial instruments (continued)

### (d) Equity price risk

The portfolio of equity securities (including collective investment schemes) backing non-linked insurance contracts, which the company carries on the balance sheet at fair value, has exposure to price risk. This risk is defined as the potential loss in market value resulting from an adverse change in prices. Details of how the company manages equity price risk are disclosed in note 4(h)(ii).

At 31 December 2017, the equity securities (including collective investment schemes) backing non-linked insurance contracts were recorded at their fair value of $29,262 million (2016: $24,757 million).

The company utilises equity index options to manage the equity exposure in the investments backing non-linked insurance contracts. The carrying amount of these options was $462 million (2016: $186 million).

The following table illustrates the impact on the aggregated profit after taxation for the year and shareholders' equity of a reasonably possible 10 per cent variance in equity prices from assets backing non-linked insurance contracts:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Impact on profit after taxation for the year $'millions | Impact on shareholders' equity $'millions | Impact on profit after taxation for the year $'millions | Impact on shareholders' equity $'millions |
| 10 per cent increase in equity prices | 2,190 | 2,190 | 1,892 | 1,892 |
| 10 per cent decrease in equity prices | (2,161) | (2,161) | (1,881) | (1,881) |

The impact is estimated taking into account the sharing of risk through the discretionary participation feature.

### (e) Foreign currency risk

At 31 December 2017, approximately 55% (2016: 53%) of the company's invested assets backing non-linked insurance contracts were denominated in foreign currencies and mainly in United States dollars ("USD"). Invested assets denominated in USD comprised approximately 54% (2016: 53%) of the total invested assets at 31 December 2017. USD denominated non-linked insurance and investment contract liabilities are predominately matched with their USD denominated invested assets. Net USD exposure at 31 December 2017 was a long position of $1,410 million (2016: $568 million). As the HKD is pegged to USD, the company considers the impact of movement in exchange rate between USD and HKD to be small.

## 22 Financial instruments (continued)

### (e) Foreign currency risk (continued)

The following table presents the company's financial assets and financial liabilities in main currencies:

| | 2017 | | | |
|---|---|---|---|---|
| | Exposure in USD $'millions | Exposure in HKD $'millions | Exposure in other currencies $'millions | Total $'millions |
| *In millions of HKD equivalent* | | | | |
| **Financial assets** | | | | |
| Loans and receivables | 58 | 8,635 | - | 8,693 |
| Debt securities designated at fair value through profit or loss | 7,021 | 9,759 | 418 | 17,198 |
| Debt securities held-to-maturity | 88,233 | 113,812 | 1,753 | 203,798 |
| Debt securities available-for-sale | 19,314 | 1,014 | 788 | 21,116 |
| Equity securities designated at fair value through profit or loss | 6,955 | 8,526 | 10,186 | 25,667 |
| Derivatives | 75 | 426 | 132 | 633 |
| Collective investment schemes designated at fair value through profit or loss | 50,164 | 7,472 | 1,541 | 59,177 |
| Amounts due from investment managers | 1,250 | 1,195 | 48 | 2,493 |
| Portfolio cash | 1,424 | 3,888 | 285 | 5,597 |
| Cash and cash equivalents | 1,074 | 1,038 | 492 | 2,604 |
| Other assets | 1,144 | 1,809 | 50 | 3,003 |
| | 176,712 | 157,574 | 15,693 | 349,979 |
| **Financial liabilities** | | | | |
| Investment contracts | 1,122 | 41,400 | 16 | 42,538 |
| Other liabilities | 7,105 | 11,298 | 70 | 18,473 |
| Derivatives | - | 293 | 37 | 330 |
| | 8,227 | 52,991 | 123 | 61,341 |

## 22 Financial instruments (continued)

### (e) Foreign currency risk (continued)

The following table presents the company's financial assets and financial liabilities in main currencies: (continued)

| | 2016 | | | |
|---|---|---|---|---|
| | Exposure in USD $'millions | Exposure in HKD $'millions | Exposure in other currencies $'millions | Total $'millions |
| *In millions of HKD equivalent* | | | | |
| **Financial assets** | | | | |
| Loans and receivables | 59 | 8,833 | - | 8,892 |
| Debt securities designated at fair value through profit or loss | 4,249 | 10,748 | 367 | 15,364 |
| Debt securities held-to-maturity | 69,568 | 101,007 | 1,619 | 172,194 |
| Debt securities available-for-sale | 18,994 | 1,096 | 587 | 20,677 |
| Equity securities designated at fair value through profit or loss | 6,017 | 5,834 | 8,252 | 20,103 |
| Derivatives | 17 | 54 | 167 | 238 |
| Collective investment schemes designated at fair value through profit or loss | 45,666 | 6,773 | 907 | 53,346 |
| Amounts due from investment managers | 1,134 | 969 | 52 | 2,155 |
| Portfolio cash | 968 | 6,428 | 135 | 7,531 |
| Cash and cash equivalents | 936 | 548 | 380 | 1,864 |
| Other assets | 937 | 1,779 | (8) | 2,708 |
| | 148,545 | 144,069 | 12,458 | 305,072 |
| **Financial liabilities** | | | | |
| Investment contracts | 1,387 | 38,806 | - | 40,193 |
| Other liabilities | 4,975 | 8,881 | 51 | 13,907 |
| Derivatives | 11 | 222 | 3 | 236 |
| | 6,373 | 47,909 | 54 | 54,336 |

## 22 Financial instruments (continued)

### (f) Recognised assets and liabilities

Changes in the fair value of derivatives are recognised in the income statement. The fair value of derivatives at 31 December 2017 was an asset of $303 million (2016: an asset of $2 million).

### (g) Assumptions used in preparing the sensitivity analysis

In managing interest rate and foreign currency risks, the company aims to reduce the impact of short-term fluctuations on the company's earnings. Over the longer term, however, permanent changes in foreign exchange and interest rates would have an impact on the company's earnings.

In performing the sensitivity analyses for linked business, the company has assumed that all hypothetical changes in the fair value of financial assets backing these policies are attributable to policyholders.

For interest rate risk, the sensitivity analysis is performed by assessing the change in market value of all debt securities designated at fair value through profit or loss, assuming a 100 basis points movement in interest rate on the valuation date. The impact on profit after taxation is taken to be the net retained amount after taking into account the sharing of investment returns with policyholders under the company's distribution strategy.

For foreign currency risk, as the company's exposure is mainly attributable to its USD denominated assets and liabilities, and the HKD is pegged to the USD, a sensitivity analysis is not presented.

In performing the sensitivity analysis, a global uniform 10% equity market movement is assumed, with a corresponding change in the market value of the company's equity holding. This impact is calculated taking into account the sharing of investment returns with policyholders through the discretionary participation feature.

### (h) Fair values

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Financial instruments measured at fair value on a recurring basis include trading assets and liabilities, instruments designated at fair value through profit or loss, derivatives, and financial instruments classified as available-for-sale (including treasury and other eligible bills and debt securities).

## 22 Financial instruments (continued)

### (h) Fair values (continued)

(i) Determination of fair value

Fair values are determined according to the following hierarchy:

a. Level 1 - Quoted market price

Financial instruments with unadjusted quoted prices for identical instruments in active markets that the company can access at the balance sheet date.

b. Level 2 - Valuation technique using observable inputs

Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

c. Level 3 - Valuation technique with significant unobservable inputs

Financial instruments valued using valuation techniques where one or more significant inputs are unobservable.

The best evidence of fair value is a quoted price in an actively traded market. The fair value of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities used. Where a financial instrument has a quoted price in an active market and it is part of a portfolio, the fair value of the portfolio is calculated as the product of the number of units and quoted price.

The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as magnitude and the frequency of trading activity, the availability of prices and the size of bid/offer spreads.

Valuation techniques incorporate assumptions about factors that other market participants would use in their valuations, including interest rate yield curves exchange rates and volatilities. In the event that the market for a financial instrument is not active, a valuation technique is used.

The majority of valuation techniques employ only observable market data. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them the derivation of fair value is more judgemental. 'Unobservable' in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used).

## 22 Financial instruments (continued)

### (h) Fair values (continued)

(i) Determination of fair value (continued)

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments.

a. Securities

The fair values of quoted securities traded in active markets are based on price quotations at the balance sheet date without any deduction for transaction costs.

The fair values of collective investment schemes not traded in active markets are estimated using the net asset value per share as reported by the fund managers of such schemes.

The fair values of debt securities not traded in active markets are estimated by comparing market interest rates when the loans were granted with current market rates offered for similar instruments.

b. Derivatives

Foreign exchange forward contracts, swaps and equity options are either marked to market using market prices or by discounting the contractual forward price and deducting the current spot rate.

c. Loans and receivables

The fair values of loans and receivables are obtained from broker quotes. In the absence of an observable market, the fair value is determined using valuation techniques including discounted cash flow models, which incorporate assumptions regarding an appropriate credit spread for the loan derived from other market instruments issued by the same or comparable entities.

d. Investment contracts

The fair value of investment contracts is the accrued policy fund balance, plus where applicable an allowance for the future cost of guarantee in the non-linked investment contracts. A best estimate liability plus an allowance for the cost of holding regulatory capital is used to determine the fair value of the guarantee features of these contracts.

The best estimate liability is arrived at using a valuation model to project the actual balance and the guaranteed balance based on 1,000 scenarios of stochastically generated investment returns for 30 years. The guarantee cost is derived for each projection year under each scenario, being the present value of any shortfall of the actual balance to meet the guaranteed liability, net of fee income.

The valuation of the allowance for the cost of holding regulatory capital is sensitive to certain assumptions, in particular the cost of capital and the expected yield on assets backing the investment contract liabilities. The cost of capital is computed based on the internal required return of the business. The expected yield on assets is set with reference to the actual experience.

## 22 Financial instruments (continued)

### (h) Fair values (continued)

(ii) Analysis of fair value determination

The following table provides an analysis of the basis for the valuation of financial assets and financial liabilities carried at fair value.

**At December 2017**

| | Fair value measurements categorised into | | | |
|---|---|---|---|---|
| | Level 1 $'millions | Level 2 $'millions | Level 3 $'millions | Total $'millions |
| **Recurring fair value measurement** | | | | |
| *Financial assets* | | | | |
| Designated at fair value through profit or loss | 76,091 | 19,356 | 6,595 | 102,042 |
| Derivatives | - | 633 | - | 633 |
| Available-for-sale | - | 21,116 | - | 21,116 |
| *Financial liabilities* | | | | |
| Designated at fair value through profit or loss | - | 42,538 | - | 42,538 |
| Derivatives | - | 330 | - | 330 |

**At December 2016**

| | Fair value measurements categorised into | | | |
|---|---|---|---|---|
| | Level 1 $'millions | Level 2 $'millions | Level 3 $'millions | Total $'millions |
| **Recurring fair value measurement** | | | | |
| *Financial assets* | | | | |
| Designated at fair value through profit or loss | 62,450 | 23,364 | 2,999 | 88,813 |
| Derivatives | - | 238 | - | 238 |
| Available-for-sale | - | 20,677 | - | 20,677 |
| *Financial liabilities* | | | | |
| Designated at fair value through profit or loss | - | 40,193 | - | 40,193 |
| Derivatives | - | 236 | - | 236 |

Assets designated at fair value through profit or loss using a valuation technique with significant unobservable inputs principally comprised of private equity investments and mid-market debt funds.

## 22 Financial instruments (continued)

### (h) Fair values (continued)

(ii) Analysis of fair value determination (continued)

*Private equity investments*

In the absence of an active market, the fair value is estimated on the basis of an analysis of the investee's financial position and results, risk profile, prospects and other factors, as well as by reference to market valuations for similar entities quoted in an active market, or the price at which similar companies have changed ownership. The exercise of judgement is required because of uncertainties inherent in estimating fair value for private equity investments. Given the bespoke nature of the analysis in respect of each holding, it is not practical to quote a range of key unobservable inputs.

*Mid-Market Debt Funds*

In the absence of an active market, the fair value is derived from the fair value of the underlying loans using valuation techniques with significant unobservable inputs. In valuing the underlying loans, it takes account of a range of factors, including discount rates, market risk premium adjustments to discount rates, cost of capital and probabilities of default and cash flow forecasts. It also considers original transaction price, recent transactions in the same or similar loans and completed third-party transactions in comparable loans and adjust its valuation model as deemed necessary.

(iii) Fair value of financial instruments not carried at fair value

All financial instruments are carried at amounts not materially different from their fair values as at 31 December 2016 and 2017 except for the following financial instruments, for which their carrying amounts and fair value and the level of fair value hierarchy are disclosed below:

| | Carrying amount 2017 $'millions | Fair value 2017 $'millions | Fair value measurements as at 31 December 2017 categorised into Level 1 $'millions | Level 2 $'millions | Level 3 $'millions |
|---|---|---|---|---|---|
| Held-to-maturity debt securities | 203,798 | 210,966 | 4,994 | 205,972 | - |
| Loans and receivables | 8,693 | 8,954 | - | 8,954 | - |

| | Carrying amount 2016 $'millions | Fair value 2016 $'millions | Fair value measurements as at 31 December 2016 categorised into Level 1 $'millions | Level 2 $'millions | Level 3 $'millions |
|---|---|---|---|---|---|
| Held-to-maturity debt securities | 172,194 | 173,184 | 3,366 | 169,818 | - |
| Loans and receivables | 8,892 | 8,904 | - | 8,904 | - |

## 22 Financial instruments (continued)

### (h) Fair values (continued)

(iv) The movement during the year in the Level 3 financial assets and liabilities is as follows:

| | 2017<br>$'millions | 2016<br>$'millions |
|---|---|---|
| **Financial assets** | | |
| *Designated at fair value through profit or loss* | | |
| At 1 January | 2,999 | 1,871 |
| Payments for purchases | 3,688 | 1,532 |
| Net unrealised gains recognised in profit or loss during the year | 775 | 136 |
| Proceeds from distribution | (867) | (540) |
| At 31 December | 6,595 | 2,999 |

The gains/(losses) are recognised in "net investment income" of the income statement.

## 22 Financial instruments (continued)

### (h) Fair values (continued)

(v) Effect of changes in significant unobservable assumptions to reasonably possible alternatives

The following table shows the sensitivity of these fair values to reasonably possible alternative assumptions:

| | | | 2017 | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Reflected in profit or loss | | Reflected in equity | | Reflected in profit or loss | | Reflected in equity | |
| | Valuation techniques | Significant unobservable inputs | Favourable changes $'millions | Unfavourable changes $'millions | Favourable changes $'millions | Unfavourable changes $'millions | Favourable changes $'millions | Unfavourable changes $'millions | Favourable changes $'millions | Unfavourable changes $'millions |
| Financial assets designated at fair value through profit or loss - Private equities and mid-market debt funds | Price – Net asset value | Fund Valuation | 551 | (551) | 551 | (551) | 250 | (250) | 250 | (250) |

Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable parameters using statistical techniques. When parameters are not amendable to statistical analysis, quantification of uncertainty is judgemental.

When the fair value of a financial instrument is affected by more than one unobservable assumptions, the above table reflects the most favourable or most unfavourable change from varying the assumptions individually.

The valuations are assessed on an asset by asset basis using a valuation methodology appropriate to the specific investment, in line with industry guidelines. In many of the methodology, the principal assumption is the valuation multiple to be applied to the main financial indicators including, for example, multiples for comparable listed companies and discounts for marketability.

## 22 Financial instruments (continued)

### (h) Fair values (continued)

(vi) Transfers between Level 1 and Level 2

Transfer between levels of the fair value hierarchy is deemed to occur at the end of the reporting period. There were no transfers between levels during the reporting period.

(vii) Offsetting financial assets and financial liabilities

The following table sets out the carrying amounts of recognised financial instruments that are subject to offsetting:

| | 2017 | | |
|---|---|---|---|
| | Gross Amounts $'millions | Gross amounts set off in the balance sheet $'millions | Net amounts presented in the balance sheet $'millions |
| *Financial assets* | | | |
| Derivatives | 633 | (330) | 303 |
| Reinsurance receivables | 205 | (161) | 44 |
| *Financial liabilities* | | | |
| Derivatives | (330) | 330 | - |
| Reinsurance payables | (450) | 161 | (289) |

| | 2016 | | |
|---|---|---|---|
| | Gross Amounts $'millions | Gross amounts set off in the balance sheet $'millions | Net amounts presented in the balance sheet $'millions |
| *Financial assets* | | | |
| Derivatives | 238 | (236) | 2 |
| Reinsurance receivables | 112 | (90) | 22 |
| *Financial liabilities* | | | |
| Derivatives | (236) | 236 | - |
| Reinsurance payables | (405) | 90 | (315) |

## 22 Financial instruments (continued)

### (i) Reclassification of available for sale debt securities

In 2015, the Company reclassified certain debt securities of HK$4,122 million out of the available-for-sale category into the held-to-maturity category.

## 23 Insurance receivable

| | 2017<br>$'millions | 2016<br>$'millions |
|---|---|---|
| Policy loans | 1,020 | 886 |
| Premium receivables | 1,329 | 1,162 |
| | 2,349 | 2,048 |

The total amount of premium receivables is expected to be recovered within one year. The majority of policy loans are expected to be recovered after more than one year.

## 24 Sundry debtors and prepayments

Sundry debtors and prepayments are expected to be recovered within one year.

## 25 Cash and cash equivalents

| | 2017<br>$'millions | 2016<br>$'millions |
|---|---|---|
| Deposits with banks | 161 | 735 |
| Cash at bank and on hand | 2,443 | 1,129 |
| Cash and cash equivalents in the balance sheet and the statement of cash flow | 2,604 | 1,864 |

## 26 Liabilities under insurance contracts issued and reinsurers' share of liabilities under insurance contracts issued

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Gross $'millions | Reinsurance $'millions | Net $'millions | Gross $'millions | Reinsurance $'millions | Net $'millions |
| **Long-term insurance business** | | | | | | |
| Liabilities to policyholders | | | | | | |
| - Non-linked | 229,641 | 7,321 | 222,320 | 196,941 | 2,641 | 194,300 |
| - Linked | 37,760 | 110 | 37,650 | 36,847 | 1,292 | 35,555 |
| **Total liabilities under insurance contracts issued** | 267,401 | 7,431 | 259,970 | 233,788 | 3,933 | 229,855 |
| Current | 2,948 | 1,434 | 1,514 | 3,437 | 1,641 | 1,796 |
| Non-current | 264,453 | 5,997 | 258,456 | 230,351 | 2,292 | 228,059 |
| | 267,401 | 7,431 | 259,970 | 233,788 | 3,933 | 229,855 |

**(a)** Analysis of movements in liabilities under insurance contracts issued and reinsurers' share of liabilities under insurance contracts issued

### Long-term insurance contracts – non-linked

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Gross $'millions | Reinsurance $'millions | Net $'millions | Gross $'millions | Reinsurance $'millions | Net $'millions |
| Balance at 1 January | 196,941 | 2,641 | 194,300 | 166,776 | 1,317 | 165,459 |
| Claims and benefits paid | (12,382) | (1,108) | (11,274) | (11,469) | (107) | (11,362) |
| Claims and benefits incurred | 44,063 | 5,734 | 38,329 | 41,592 | 1,425 | 40,167 |
| Foreign exchange and other movements | 1,019 | 54 | 965 | 42 | 6 | 36 |
| Balance at 31 December | 229,641 | 7,321 | 222,320 | 196,941 | 2,641 | 194,300 |

### Long-term insurance contracts – linked

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Gross $'millions | Reinsurance $'millions | Net $'millions | Gross $'millions | Reinsurance $'millions | Net $'millions |
| Balance at 1 January | 36,847 | 1,292 | 35,555 | 35,670 | 1,392 | 34,278 |
| Claims and benefits paid | (5,884) | (18) | (5,866) | (1,576) | 50 | (1,626) |
| Claims and benefits incurred | 6,514 | (1,172) | 7,686 | 2,735 | (159) | 2,894 |
| Foreign exchange and other movements | 283 | 8 | 275 | 18 | 9 | 9 |
| Balance at 31 December | 37,760 | 110 | 37,650 | 36,847 | 1,292 | 35,555 |

## 26 Liabilities under insurance contracts issued and reinsurers' share of liabilities under insurance contracts issued (continued)

### (b) Process used to determine assumptions

The process used to determine the assumptions is intended to result in appropriate estimates of future outcome. This is achieved by adopting relatively conservative assumptions which can withstand a reasonable range of fluctuation of actual experience. Annual review of the relevant experience is performed to assess the adequacy of margin between the assumptions adopted and the most likely estimate of future outcome. The assumptions that are considered include the probability of claims and investment returns.

For non-linked life products, the policy reserve is generally calculated on a modified net premium basis. On inception of the contract, the net premium is the level of premium payable over the premium payment period whose discounted value at the outset of the policy would be sufficient to exactly cover the discounted value of the original guaranteed benefits payable until maturity or death if earlier. The net premium is then modified to allow for deferral of acquisition costs. Post-inception, the policy reserve is then calculated by subtracting the present value of future modified net premiums from the present value of the benefits guaranteed at maturity or death up to the balance sheet date. Negative provisions are not allowed. The modified net premium basis makes no allowance for voluntary discontinuance by policyholders as this would generally result in a reduced level of policy reserve. Furthermore the policy reserve includes a provision on future dividend as well as investment fluctuation experience.

For linked life products, the policy reserve is generally determined as the total account balance of all in-force policies with an additional provision for the unexpired insurance risk and guarantee risk. The company has used its own stochastic based valuation model to estimate the value of the guarantees covered under the modified co-insurance treaty on a unit-linked insurance product.

For universal life products, the policy reserve is determined as the present value of account balance to be received by policyholder, plus the present value of death payout on net amount at risk when account value is positive. An additional reserve is provided, when necessary, to ensure the total reserve is sufficient to cover the mortality risk for policies with no-lapse guarantee benefit attached.

The provision of this no-lapse guarantee benefit is determined as the present value of loss on this guarantee only after account balance becomes zero.

(i) Mortality

A base mortality table which is appropriate for each type of contract is selected. A loading is generally added as a provision for adverse deviation. An annual investigation is performed to ascertain the appropriateness with the company's actual experience.

(ii) Morbidity

The morbidity incidence rates, which mainly cover major illness and disability, are generally derived from the reinsurance costs which also form the pricing basis. A loading is generally added as a provision for adverse deviation. An annual investigation is performed to ascertain the appropriateness with the company's actual experience.

## 26 Liabilities under insurance contracts issued and reinsurers' share of liabilities under insurance contracts issued (continued)

### (b) Process used to determine assumptions (continued)

(iii) Discount rates

| Rate of interest | 2017 | 2016 |
|---|---|---|
| *Participating business* | | |
| - Others | 2.50% for HKD policies, 3.25% for other currencies | 2.55% for HKD policies; 3.3% for other currencies |
| - WealthSave (RMB) Protection Plan | 3.0% | 3.0% |
| - WealthSave Insurance Plan | 2.8% | 2.8% |
| - Income Goal Insurance Plan | 2.15% for HKD policies; 2.80% for USD policies | 2.0% for HKD policies; 2.45% for USD policies |
| - Wealth Goal Insurance Plan | 2.45% | Not applicable |
| *Non-participating business* | | |
| - Others | 2.50% for HKD policies; 3.25% for other currencies | 2.55% for HKD policies; 3.3% for other currencies |
| - WealthSave (RMB) Insurance Plan | 2.32% | 2.32% |
| - WealthSave (RMB) Insurance Plan II | 4.09% | 4.09% |
| Jade Global Series | 3.10% | 2.95% |
| Goal Access Universal Life | 3.35% for USD policies | 3.5% for USD policies |
| Other Universal Life products | 3.5% for HKD policies; 4% for other currencies | 3.5% for HKD policies; 4% for other currencies |

Under the modified net premium method, the long-term business liabilities is sensitive to the interest rate used when discounting.

## 26 Liabilities under insurance contracts issued and reinsurers' share of liabilities under insurance contracts issued (continued)

### (b) Process used to determine assumptions (continued)

*Sensitivity to changes in variables*

The company re-runs its valuation models on various bases. An analysis of sensitivity around various scenarios provides insight to the key risks the company exposed to. The table presented below demonstrates the sensitivity of insured liability estimates to particular movements in assumptions used in the estimation process. Certain variables can be expected to impact on life assurance liabilities more than others, and consequently a greater degree of sensitivity to these variables may be expected.

This sensitivity impact on mortality is assessed with the consideration on adjusting future charges subject to the provision of the contract.

*Impact on reported profits to changes in key variables*

| | Change in variable % | *Increase/(decrease) in liability* 2017 $'millions | 2016 $'millions |
|---|---|---|---|
| Base run | | 259,664 | 228,669 |
| Discount rate | +1 | (7,223) | (6,773) |
| Discount rate | -1 | 23,765 | 22,999 |
| Mortality/Morbidity | +10 | 442 | 465 |
| Mortality/Morbidity | -10 | (302) | (318) |

The analysis above has been prepared for a change in variable with all other assumptions remaining constant and ignores changes in values of the related assets.

## 26 Liabilities under insurance contracts issued and reinsurers' share of liabilities under insurance contracts issued (continued)

### (c) The company has reinsurance recoveries subject to credit risk

**At 31 December 2017**

| | *Neither past due nor impaired* | | | | | | |
|---|---|---|---|---|---|---|---|
| | Strong $'millions | Medium $'millions | Sub-standard $'millions | Past due not impaired $'millions | Impaired $'millions | Impairment allowances $'millions | Total $'millions |
| Linked insurance contracts | 6 | 104 | - | - | - | - | 110 |
| Non-linked insurance contracts | 7,321 | - | - | - | - | - | 7,321 |
| Total | 7,327 | 104 | - | - | - | - | 7,431 |

**At 31 December 2016**

| | *Neither past due nor impaired* | | | | | | |
|---|---|---|---|---|---|---|---|
| | Strong $'millions | Medium $'millions | Sub-standard $'millions | Past due not impaired $'millions | Impaired $'millions | Impairment allowances $'millions | Total $'millions |
| Linked insurance contracts | 6 | 1,286 | - | - | - | - | 1,292 |
| Non-linked insurance contracts | 2,641 | - | - | - | - | - | 2,641 |
| Total | 2,647 | 1,286 | - | - | - | - | 3,933 |

For linked insurance products that provide guaranteed minimum death benefits and guaranteed minimum accumulation benefits, the company has purchased reinsurance on modified coinsurance basis with a third party reinsurer. The company has a credit risk exposure in respect of this reinsurer's ability to meet its reinsurance obligation. At 31 December 2017, the exposure to this reinsurer was $104 million (2016: $1,286 million).

In determining recoverability of this reinsurance receivable, the company has assessed the financial position of the reinsurer and its parent company from public information.

## 27 Liabilities under investment contracts issued

| | 2017 $'millions | 2016 $'millions |
|---|---|---|
| Total liabilities under investment contracts issued - fair value | 42,538 | 40,193 |
| Current | 195 | 203 |
| Non-current | 42,343 | 39,990 |
| | 42,538 | 40,193 |

Analysis of movements in liabilities under investment contracts issued

| | Non-linked | | Linked | | Total | |
|---|---|---|---|---|---|---|
| | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions | 2017 $'millions | 2016 $'millions |
| Opening balance at 1 January | 29,226 | 28,938 | 10,967 | 10,996 | 40,193 | 39,934 |
| Benefits paid | (6,007) | (5,050) | (1,302) | (931) | (7,309) | (5,981) |
| Benefits incurred | 6,953 | 5,446 | 2,880 | 971 | 9,833 | 6,417 |
| Fees charges | (106) | (107) | (73) | (69) | (179) | (176) |
| Other movements | - | (1) | - | - | - | (1) |
| Closing balance at 31 December | 30,066 | 29,226 | 12,472 | 10,967 | 42,538 | 40,193 |

## 28 Insurance payable

| | 2017 $'millions | 2016 $'millions |
|---|---|---|
| Advance premiums | 1,549 | 1,261 |
| Policy dividends | 15,320 | 10,845 |
| | 16,869 | 12,106 |
| Current | 2,178 | 1,675 |
| Non-current | 14,691 | 10,431 |
| | 16,869 | 12,106 |

## 29 Amounts due from and to the immediate holding company, an intermediate holding company, ultimate holding company and fellow subsidiaries

The amounts due from and to the immediate holding company, an intermediate holding company, ultimate holding company and fellow subsidiaries are unsecured, interest free and have no fixed terms of repayment.

## 30 Reinsurance receivable/payable, creditors and accruals

Reinsurance receivable/payable, creditors and accruals are expected to be settled within one year.

## 31 Share capital

### (a) Capital management

The primary capital management objectives of the company are to maintain a strong capital base to support the development of its business and to meet regulatory capital requirements at all times. The company recognises the impact on shareholder returns of the level of equity capital employed and seeks to maintain a prudent balance.

Regulatory capital requirements arise from the company's operations in Hong Kong and Macau and require the company to hold assets sufficient to cover liabilities and satisfy the solvency capital rules in the respective jurisdictions. The principal solvency requirements that apply to the company are those set out in the Insurance Ordinance ("IO"). The company has established an internal solvency (assets as a proportion of liabilities) benchmark that exceeds the minimum requirements of the IO and it aims to maintain this level of solvency at all times.

The company manages its own capital within the context of the annual operating plan of its holding company, which determines an appropriate amount and mix of capital required to support planned business growth. As part of this capital management policy, capital generated in excess of planned requirements is returned to shareholders, normally by way of dividends.

The company defines "capital" as including all components of equity plus long term loans from group companies with no fixed terms of repayment, less unaccrued proposed dividends.

The company has complied with all externally imposed capital requirements throughout the current and prior periods.

## 31 Share capital (continued)

### (b) Share capital

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | No. of shares millions | *$'millions* | No. of shares millions | *$'millions* |
| **Authorised:** | | | | |
| At 1 January | 4,178 | 4,178 | 4,178 | 4,178 |
| Shares issued of $1 each | - | - | - | - |
| At 31 December | 4,178 | 4,178 | 4,178 | 4,178 |
| **Issued and fully paid:** | | | | |
| At 1 January | 4,178 | 4,178 | 4,178 | 4,178 |
| Shares issued of $1 each | - | - | - | - |
| At 31 December | 4,178 | 4,178 | 4,178 | 4,178 |

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

## 32 Operating leases

***Leases as lessee***

Non-cancellable operating lease rentals payable are $ Nil (2016: $31,000).

The company previously leased an office premise under operating lease in Mainland China. The lease expired in February 2016 and was not renewed.

Lease payments are usually reviewed annually to reflect market rentals. None of the leases includes contingent rentals.

## 33 Capital commitments

The outstanding capital commitments not provided for in the financial statements as at 31 December 2017 amounting to $6,698 million (2016: $5,723 million).

The capital commitments mainly relate to the commitment to invest in private equity funds which have yet to request these amounts for the purposes of their investments.

## 34 Material related party transactions

During the year, the company entered into transactions with group companies in the ordinary course of its insurance business and investing activity. The company used back office support and IT services of group companies on a cost recovery basis.

### (a) Year end balances with group companies

| | 2017 $'millions | 2016 $'millions |
|---|---|---|
| Amounts due from/(to) | | |
| - Fellow subsidiary companies | 243 | 135 |
| - An intermediate holding company | - | 146 |
| - The immediate holding company | 188 | 188 |
| - An intermediate holding company | (574) | (603) |
| - Fellow subsidiary companies | (126) | (147) |
| - The ultimate holding company | (6) | - |
| Cash and cash equivalents | | |
| - An intermediate holding company | 2,552 | 1,812 |

### (b) Investments include amounts with an intermediate holding company and fellow subsidiary companies as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Intermediate holding company $'millions | Fellow subsidiary companies $'millions | Intermediate holding company $'millions | Fellow subsidiary companies $'millions |
| Debt securities | 887 | - | 846 | - |
| Collective investments schemes | - | 23,763 | - | 17,238 |
| Derivatives | 307 | - | 2 | - |
| Loans and receivables | 973 | - | 1,358 | - |
| Amounts due from investment managers | (109) | 2,602 | - | 2,154 |
| Portfolio cash | 4,034 | 3 | 7,042 | - |
| | 6,092 | 26,368 | 9,248 | 19,392 |

## 34 Material related party transactions (continued)

### (c) Investment income

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Intermediate holding company $'millions | Fellow subsidiary companies $'millions | Intermediate holding company $'millions | Fellow subsidiary companies $'millions |
| Interest income | 48 | - | 48 | - |
| Net income from investment assets designated at fair value through profit or loss | 56 | 1,921 | (36) | 621 |
| Net realised/unrealised loss on trading derivatives | (1,053) | - | (118) | - |
| Interest expense | (31) | - | - | - |
| | (980) | 1,921 | (106) | 621 |

### (d) Sales of services

| | Fellow subsidiary companies | |
|---|---|---|
| | 2017 $'millions | 2016 $'millions |
| Fees and commission income | 26 | 25 |
| Other administration and support services | 86 | 85 |
| | 112 | 110 |

### (e) Purchase of services

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Ultimate holding company $'millions | Intermediate holding company $'millions | Fellow subsidiary companies $'millions | Ultimate holding company $'millions | Intermediate holding company $'millions | Fellow subsidiary companies $'millions |
| Acquisition costs | - | 2,399 | 27 | - | 2,491 | 25 |
| Investment management fees | - | - | 417 | - | - | 361 |
| Other administration and support services | 1 | 831 | 342 | 2 | 586 | 359 |
| | 1 | 3,230 | 786 | 2 | 3,077 | 745 |

## 34 Material related party transactions (continued)

**(f)** Guarantees were given by an intermediate holding company and a fellow subsidiary company on the investment return of some of the company's investment portfolios backing non-linked investment contracts whereby these group companies will reimburse the company with the amount of shortfall should the return of the said portfolios fall below an agreed percentage. The company will pay the excess return to these group companies should the return exceed the agreed percentage. The amount of shortfall receivable from the intermediate holding company during the year was $82 million (2016: $83 million) and the amount of excess to return to the fellow subsidiary company during the year was $0.6 million (2016: a deficit recoverable of $0.1 million) respectively. The amounts outstanding at 31 December are included in note 34(a).

### (g) Key management compensation

| | 2017<br>$'millions | 2016<br>$'millions |
|---|---|---|
| Short-term employee benefits | 34 | 40 |
| Post-employment benefits | 2 | 3 |
| Share-based payments | 2 | 2 |
| Termination benefits | 1 | - |
| Total | 39 | 45 |

Included in the key management compensation above, certain key management staff provided services to the company's immediate holding company. No apportionment has been made as it is not practicable to apportion the amounts between their services to the company and its immediate holding company.

### (h) Share option and share award schemes

The company participates in various share option and share plans operated by HSBC whereby share options or shares of HSBC are granted to employees of the group. As disclosed in note 1(f)(iii), the company recognises an expense in respect of these share options and share awards. The cost borne by the ultimate holding company in respect of share options is treated as a capital contribution and is recorded within "Share-based payment reserves". In respect of share awards, the group recognises a liability to the ultimate holding company over a vesting period. This liability is measured at the fair value of the shares at each reporting date, with changes since the award dates adjusted through the capital contributions account within "Share-based payment reserves". The balances of the capital contribution and the liability as at 31 December 2017 amounted to $82 million and $5 million respectively (2016: $86 million and $14 million respectively).

## 35 Parent and ultimate holding company

At 31 December 2017, the directors consider the parent of the company to be HSBC Insurance (Asia) Limited, a company incorporated in Hong Kong, and the ultimate controlling party of the company to be HSBC Holdings plc, a company incorporated in the United Kingdom. HSBC Holdings plc produces financial statements that are available for public use at www.hsbc.com.

## 36 Possible impact of amendments, new standards and interpretations issued but not yet effective for the year ended 31 December 2017

Certain new accounting standards and interpretations have been published that are not mandatory for the year ended 31 December 2017 and have not been early adopted by the company. The company's assessment of the impact of these new standards and interpretations which may be relevant to the company is set out below:

| | *Effective for accounting periods beginning on or after* |
|---|---|
| *Amendments to HKFRS 2, Share-based payment: Classification and measurement of share-based payment transactions* | 1 January 2018 |
| *Amendments to HKFRS 4, Insurance Contracts: Applying HKFRS 9 Financial Instruments with HKFRS 4 Insurance Contracts* | 1 January 2018 |
| *HKFRS 9, Financial instruments* | 1 January 2018 |
| *HKFRS 15, Revenue from contracts with customers* | 1 January 2018 |
| *IFRIC 22, Foreign Currency Transactions and Advance Consideration: Clarifying the transaction date for determining the exchange rate to be used on recognition of advance consideration in foreign currency* | 1 January 2018 |
| *HKFRS 16, Leases* | 1 January 2019 |
| *IFRIC 23, Uncertainty over Income Tax Treatments: Clarifying how the recognition and measurement requirements of HKAS 12, Income Taxes are applied where there is uncertainty over whether the tax treatment will be accepted by the tax authority* | 1 January 2019 |
| *HKFRS 17 Insurance Contracts* | 1 January 2021 |

## 36 Possible impact of amendments, new standards and interpretations issued but not yet effective for the year ended 31 December 2017 (continued)

The company is in the process of making an assessment of what the impact of the amendments is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the company's financial statements.

As for HKFRS 9, the application of new standard is expected to reduce shareholders' equity by $2,119 million on an after tax basis as at January 1, 2018, arising from:

- A decrease in carrying value of financial assets of $2,389 million (excluding the impact of impairment) and a respective increase in the carrying value of investment contract liabilities of $73 million, resulted from the new rules for classification and measurement of financial assets and liabilities.
- An increase in impairment loss of $74 million driven by the new impairment model that requires the recognition of impairment provisions based on expected credit losses rather than on incurred credit losses as is the case under HKAS 39
- A net release of Deferred Tax Liabilities of $417 million

The standard also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the company's disclosures about its financial instruments.

As for HKFRS 17, a group-wide project will be kicked-off in 2018. Due to the complexity of the standard, it is not possible to quantify the potential effect at this stage.