中国工商银行（加拿大）
INDUSTRIAL AND COMMERCIAL BANK OF CHINA (CANADA)

# INDUSTRIAL AND COMMERCIAL BANK OF CHINA (CANADA)

# BASEL III PILLAR 3 DISCLOSURES

# AS AT DECEMBER 31, 2017

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## 1. Scope of Application

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

The Bank is licensed to operate as a bank in Canada with full banking powers under the Bank Act as a foreign bank subsidiary. The Bank obtained its letters patent as a Canadian chartered bank under its former name, The Bank of East Asia (Canada), on May 16, 1991 and commenced operations on May 15, 1992. On June 4, 2009, The Bank of East Asia Limited, Hong Kong (the "shareholder bank" or "BEA") reached an agreement with the Industrial and Commercial Bank of China Limited (the "parent bank") regarding the acquisition by the parent bank of 70% of the issued and outstanding common shares of the Bank ("Acquisition"). The Acquisition was completed on January 28, 2010. After obtaining its letters patent to amend the incorporating instrument of the Bank from the Superintendent of Financial Institutions Canada (the "Superintendent" or "OSFI"), on July 2, 2010 the Bank officially changed its name from The Bank of East Asia (Canada) to Industrial and Commercial Bank of China (Canada).

By exercising the option entitled in the shareholders' agreement executed for the Acquisition, on August 26, 2011 the parent bank completed an acquisition of a further 10% of the issued and outstanding common shares of the Bank from BEA. Since then, the parent bank and BEA now own 80% and 20% of the Bank, respectively.

The Bank’s principal office is located at Bay Adelaide Centre, West Tower, Suite 3710, 333 Bay Street, Toronto, Ontario, Canada M5H 2R2.

The following disclosures have been prepared solely for explaining the basis on which the Bank has prepared and disclosed information about capital requirements，the management of certain risks，remuneration of senior management and Leverage Ratio (LR) and for no other purpose. They do not constitute any form of financial statements and must not be relied upon in making any investment or judgment on the Bank or its parent bank and shareholder bank.

## 2. Capital Management

### Qualitative disclosures

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

The Bank actively manages its capital to maintain a strong capital base while providing strong returns to the shareholders and sustaining future development of the business. The Bank's capital management framework provides policies for defining, measuring, monitoring, managing and planning capital to ensure that the quantity and quality of the Bank's capital are adequate, at a minimum to comply with all applicable regulatory requirements. The Bank has developed and implemented its own Internal Capital Adequacy Assessment Process ("ICAAP") as a risk governance process for the purpose of setting internal capital targets and strategies for achieving internal targets that are consistent with the Bank's business plans, risk profile and operating environment. The Bank uses risk adjusted return on capital (RAROC) as performance measure to allocate capital across business streams.

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

In addition, OSFI expects all deposit-taking institution to early attain "all-in" target capital ratios equal to or greater than the 2019 minimum capital ratios plus conservation buffer. These targets are a Common Equity Tier 1 ("CET1") ratio of 7%; a Tier 1 capital ratio of 8.5% and a Total capital ratio of 10.5%. In addition to the CET1, Tier 1 and Total capital ratios, Canadian banks are also required to ensure their compliance of Basel III Leverage Ratio which came into effect on January 1, 2015 to replace the assets to capital multiple, and is required to be publicly disclosed. In August 2014, the Bank received its authorized leverage ratio from OSFI, which has been communicated on a bilateral basis.

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

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

## 2. Capital Management (continued)

### Quantitative disclosures

The following table presents the Bank's regulatory capital and capital ratios as at December 31, 2017. Throughout the year and at year end, the Bank was in compliance with the capital targets established by OSFI.

| (In thousands of CAD dollars) | Basel III 2017 | Basel III 2016 |
|---|---|---|
| Regulatory capital: | | |
| Tier 1 capital: | | |
| Share capital | $ 158,000 | $ 158,000 |
| Retained earnings | 88,544 | 66,111 |
| Accumulated other comprehensive income (losses) | 101 | (14) |
| Common Equity Tier 1 Capital | 246,645 | 224,097 |
| Regulatory adjustments to CET1 | (71) | (104) |
| Total capital | $ 246,574 | $ 223,993 |
| Risk-weighted assets: | | |
| Credit risk | $ 1,684,212 | $1,338,239 |
| Operational risk | 81,838 | 68,313 |
| Total risk-adjusted assets | $ 1,766,050 | $1,406,552 |
| Capital ratios: | | |
| Tier 1 capital | 13.96% | 15.92% |
| Total capital | 13.96% | 15.92% |

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

| (In thousands of CAD dollars) | Risk-weighted assets | Capital requirement |
|---|---|---|
| Total corporate | $ 1,484,823 | $ 118,786 |
| Total retail residential mortgages | 66,504 | 5,320 |
| Total other retail | 30,003 | 2,400 |
| Bank | 86,601 | 6,928 |
| Sovereign | 1,909 | 153 |
| Statements of financial position assets not included in standardized or internal ratings-based approaches | 14,372 | 1,150 |
| Total for credit risk | $ 1,684,212 | $ 134,737 |

## 2. Capital Management (continued)

The minimum capital required for operational risk is calculated under Basic Indicator Approach as at December 31, 2017 is as follows:

| | (In thousands of CAD dollars) |
|---|---|
| Gross income as defined by OSFI over the previous three years: | |
| Year 1 | $ 36,544 |
| Year 2 | 42,914 |
| Year 3 | 51,485 |
| Average of gross income for Year 1-3 | 43,648 |
| Capital charge (15% times average of gross income) | 6,547 |
| Risk-weighted assets for operational risk (12.5 times capital charge) | 81,838 |

## 3. Risk Management Framework

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

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

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

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

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

## 3. Risk Management Framework (continued)

### (a) Credit Risk Management

**Qualitative disclosures**

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

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

- Formulating credit policies within the framework established by the parent bank and in consultation with the business units, covering collateral requirements, credit assessment, risk grading and reporting documentary and legal procedures and compliance with regulatory and statutory requirement.
- Establishing the authorization structure for the approval and renewal of credit facilities. Authorization limits are allocated to the Chief Executive Officer, the Senior Executive Vice President and business unit Lending Officers. Larger facilities require approval by the Executive Committee of the Board, as appropriate.
- Reviewing and assessing credit risk. The Credit Risk Management Department assesses all credit exposures in excess of the authorization limits allocated to the business unit Lending Officers prior to facilities, being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process.
- Limiting concentrations of exposure to counterparties, industries and products.
- Developing and maintaining the Bank's risk gradings in order to categorize exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of 21 grades with institutional/corporate borrowers and 12 grades with personal borrowers reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. The responsibility for approving risk grades lies with the Chief Executive Officer, the Senior Executive Vice President or business unit Lending Officers, as appropriate. Risk grades are subject to regular review.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries and product types. Regular reports are prepared by the Credit Risk Management Department and provided to the Credit Committee and the Board on the credit quality of local portfolios and appropriate corrective action is taken.

## 3. Risk Management Framework (continued)

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

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

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

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

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

Loans with renegotiated terms:
Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank has made concessions that it would not otherwise consider. Once the loan is restructured, it is classified as impaired until there are continuously six months of satisfactory performance after restructuring. There were no loans with term renegotiated in 2017 or 2016.

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

## 3. Risk Management Framework (continued)

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

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

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

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

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

## 3. Risk Management Framework (continued)

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

Collateral Valuation and Management:
The Bank holds collateral against loans and advances to customers in the form of mortgage interests in real property, other registered security over assets, cash collateral and guarantees. Policy is established with respect to the collateral, such as the source and suitability of the collateral. To mitigate the credit risk, the Bank looks at whether the assets of the borrower or guarantor are available to be taken as collateral and whether such collateral is suitable for the purpose.

Estimates of fair value of collateral are based on its value assessed at the time of borrowing, and generally are reviewed annually or when a loan is individually assessed as impaired. Collateral generally is not held in respect of loans and advances to banks. Collateral usually is not held against investment securities and no such collateral was held at December 31, 2017 or 2016.

Main types of Guarantor:
Numbers of non-ICBC group commercial banks have assumed the major credit risk in respect of certain loans of the Bank.

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

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

## 3. Risk Management Framework (continued)

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

**Quantitative disclosures**

The following table indicates the Bank's exposure to credit risk as at December 31, 2017:

(In thousands of CAD dollars)

| | Loans and advances to customers | | Loans and advances to banks | | Investment securities | |
|---|---|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 |
| Assets at amortized cost: | | | | | | |
| Individually impaired: | | | | | | |
| Grade B (sub-standard) - individually impaired | $ – | $ – | $ – | $ – | $ – | $ – |
| Grade B (doubtful) - individually impaired | 1,721 | 1,721 | – | – | – | – |
| Gross amount | 1,721 | 1,721 | – | – | – | – |
| Specific allowance for impairment | (1,721) | (1,721) | – | – | – | – |
| Carrying amount | – | – | – | – | – | – |
| Past due but not impaired: | | | | | | |
| Grade AAA to BBB - low-fair risk | 45,743 | – | – | – | – | – |
| Grade BBB- to BB - watch list | 319 | – | – | – | – | – |
| Carrying amount | 46,062 | – | – | – | – | – |
| Neither past due nor impaired: | | | | | | |
| Grade AAA to BBB - low-fair risk | 1,440,253 | 1,321,140 | 6,772 | 51,140 | 87,490 | 76,956 |
| Grade BBB- to BB - watch list | 1,408 | 1,725 | – | – | – | – |
| Gross amount | 1,441,661 | 1,322,865 | 6,772 | 51,140 | 87,490 | 76,956 |
| Collective allowance for impairment | (4,817) | (4,817) | – | – | – | – |
| Carrying amount | 1,436,844 | 1,318,048 | 6,772 | 51,140 | 87,490 | 76,956 |
| Total carrying amount | $ 1,482,906 | $ 1,318,048 | $ 6,772 | $ 51,140 | $ 87,490 | $ 76,956 |
| Past due but not impaired comprises: | | | | | | |
| 1 - 30 days | $ 46,059 | $ – | $ – | $ – | $ – | $ – |
| 30 - 60 days | 2 | – | – | – | – | – |
| 60 - 90 days | 1 | – | – | – | – | – |
| Carrying amount | $ 46,062 | $ – | $ – | $ – | $ – | $ – |

Past due loans are major in energy industry.

## 3. Risk Management Framework (continued)

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

In addition to the above, the Bank had entered into lending commitments of $691,804 (2016 - $629,468), with counterparties graded from AAA to BBB (low to fair risk). There were no (2016 - nil) lending commitments to counterparties with a grading below BBB.

The Bank has issued financial guarantee contracts in respect of debtors graded low to fair risk and for which the maximum amount payable by the Bank, assuming all guarantees are called on, is $82,941 (2016 - $15,097).

## 3. Risk Management Framework (continued)

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

The following table summarizes the credit risk gross exposure for each portfolio at the reporting date upon the default of an obligor and is calculated based on the definitions and related credit conversion factors provided under the Basel III framework consistent with OSFI reporting. This amount is before any specific allowances and does not reflect the impact of credit mitigation.

| | Drawn(3) | Undrawn commitments(4) | Over-the-counter derivatives(1) | Other off-balance sheet(2) | Total gross exposure(5) |
|---|---|---|---|---|---|
| Residential mortgage | $ 184,237 | $ – | $ – | $ – | $ 184,237 |
| Personal loans | 36,910 | – | – | 75 | 36,985 |
| Retail | 221,147 | – | – | 75 | 221,222 |
| Business: | | | | | |
| Agriculture | 3,874 | – | – | – | 3,874 |
| Capital goods and infrastructure | 9,961 | – | – | 294 | 10,255 |
| Communications | 76,847 | – | – | – | 76,847 |
| Energy | 111,983 | 54,113 | – | 57,433 | 223,529 |
| Financial service (non-bank) | 147,308 | 34,545 | – | 269 | 182,122 |
| Manufacturing | 10,896 | – | – | – | 10,896 |
| Metal and mining | 2,787 | 73,731 | – | 8,370 | 84,888 |
| Real estate | 552,866 | 66,883 | – | 5,359 | 625,108 |
| Resources and basic materials | – | – | – | 1,000 | 1,000 |
| Retail and wholesale | 16,817 | – | – | 3,641 | 20,458 |
| Technology | 659 | – | – | – | 659 |
| Transportation | 180,823 | 18,862 | – | 90 | 199,775 |
| Services | 180,356 | 251 | – | 583 | 181,190 |
| Other | 345 | – | – | – | 345 |
| Sovereign | 28,438 | – | – | – | 28,438 |
| Bank | 220,679 | – | 899 | – | 221,578 |
| Wholesale | 1,544,639 | 248,385 | 899 | 77,039 | 1,870,962 |
| Total exposure | $ 1,765,786 | $ 248,385 | $ 899 | $ 77,114 | $ 2,092,184 |

(1)Represents the credit equivalent amount; see page 17.

(2)Includes credit equivalent amounts for financial guarantee, non-financial guarantee and letters of credit under trade finance.

(3)Includes loan to banks and customers before allowances, accrued interest, deposit with banks and investment securities.

(4)Undrawn commitments represent an estimated credit equivalent amounts after applying credit conversion factors to conditionally and unconditionally cancellable commitments.

(5)Gross credit risk exposure is before allowance for loan losses.

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

## 3. Risk Management Framework (continued)

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

The total exposure that is covered by eligible financial collateral and guarantees as at December 31, 2017 is shown below:

(In thousands of CAD dollars)

| Gross exposure | Covered by: Eligible financial collateral | Guarantees |
|---|---|---|
| Corporate exposure | | |
| Drawn | $ 29,327 | $ 192,895 |
| Other off-balance sheet | 7,574 | 268 |
| Retail | | |
| Drawn: | | |
| Residential Mortgage | 7,962 | – |
| HELOC | 63 | – |
| Retail Others | 433 | – |
| Other off-balance sheet | 75 | – |
| Total | $ 45,434 | $ 193,163 |

## 3. Risk Management Framework (continued)

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

The following table analyzes the Bank's loan portfolio as at December 31, 2017 by the contractual repricing or maturity dates, whichever is earlier. This analysis excludes collective allowance for impairment of $4,817 (2016 - $4,817) and accrued interest on the impaired loan of $271 (2016 – $271).

(In thousands of CAD dollars)

| | | | | | 2017 | 2016 |
|---|---|---|---|---|---|---|
| | Floating | Within 3 months | 3 months to 1 year | 1 to 5 years | Total | Total |
| Canada | $ 689,594 | $ 267,723 | $ 28,197 | $ 36,761 | $ 1,022,275 | $ 800,672 |
| Average effective yield | 4.41% | 3.75% | 3.32% | 3.42% | 4.19% | 3.79% |
| Foreign countries | 187,437 | 252,625 | 25,657 | – | 465,719 | 522,464 |
| Average effective yield | 3.04% | 2.42% | 2.76% | – | 2.72% | 2.26% |
| Total | $ 877,031 | $ 520,348 | $ 53,854 | $ 36,761 | $ 1,487,994 | $ 1,323,136 |
| Average effective yield | 4.12% | 3.13% | 3.09% | 3.42% | 3.76% | 3.22% |

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

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

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

An analysis of impaired loans and advances to customers and the related allowance for impairment as at December 31, 2017 is as follows:

| | | | 2017 | 2016 |
|---|---|---|---|---|
| (In thousands of CAD dollars) | Gross amount | Specific allowance | Carrying amount | Carrying amount |
| Consumer loans | $ – | $ – | $ – | $ – |
| Business loans: | | | | |
| Industrial and commercial | 1,721 | (1,721) | – | – |
| | $ 1,721 | $ (1,721) | $ – | $ – |

Allowances for impairment:

| (In thousands of CAD dollars) | 2017 | 2016 |
|---|---|---|
| Specific allowance for impairment: | | |
| Balance, beginning of year | $ 1,721 | $ 1,724 |
| Impairment loss for the year: | | |
| Charge | 3 | – |
| Reversal | – | (3) |
| Write-offs | (3) | – |
| Balance, end of year | 1,721 | 1,721 |
| Collective allowance for impairment: | | |
| Balance, beginning of year | 4,817 | 4,778 |
| Impairment loss for the year | – | 39 |
| Balance, end of year | 4,817 | 4,817 |
| Total allowances for impairment | $ 6,538 | $ 6,538 |

## 3. Risk Management Framework (continued)

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

An analysis of the Bank's derivative portfolio and related credit exposure as at December 31, 2017 is as follows:

(In thousands of CAD dollars)

| | | | | 2017 | | | | 2016 |
|---|---|---|---|---|---|---|---|---|
| | Notional amount | Current replacement cost | Credit equivalent amount | Risk-weighted balance | Notional amount | Current replacement cost | Credit equivalent amount | Risk-weighted balance |
| Foreign exchange contracts | $ 49,535 | $ 404 | $ 899 | $ 183 | $ 161,972 | $1,093 | $ 2,712 | $ 555 |

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

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

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

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

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

## 3. Risk Management Framework (continued)

### (b) Liquidity Risk Management

**Qualitative disclosures**

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

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

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

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

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

The key measure used by the Bank for managing liquidity risk is the LCR, which is the ratio of total high-quality liquid assets ("HQLA") to a percentage of total net cash outflows over the next 30 calendar days of the Bank. HQLA consist of cash and cash equivalents, short-term interbank placements and highly rated securities issued or guaranteed by governments and central banks. Net cash outflows are considered, as cash outflows of retail and operational deposits, net of cash inflows from secured lending and fully performing exposures.

## 3. Risk Management Framework (continued)

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

**Quantitative disclosures**

In this respect, the Bank endeavours to maintain the LCR at 100% or above at all times. Details of the LCR of the Bank at December 31, 2017 are as follows:

| | (In thousands of CAD dollars) | |
|---|---|---|
| | 2017 | 2016 |
| Total HQLA | $ 74,148 | $ 63,823 |
| Total net cash outflows | 33,244 | 47,457 |
| Liquidity coverage ratio | 223.04% | 134.48% |

## 3. Risk Management Framework (continued)

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

Maturity analysis for financial liabilities as at December 31, 2017:

(In thousands of CAD dollars)

| | Carrying amount | Gross nominal inflow (outflow) | Less than 1 month | 1 to 3 months | 3 months to 1 year | 1 to 5 years |
|---|---|---|---|---|---|---|
| **2017** | | | | | | |
| Non-derivative liabilities: | | | | | | |
| Deposits from banks | $ 513,663 | $ (515,117) | $ (438,033) | $ (52,198) | $ (24,886) | $ – |
| Deposits from customers | 993,842 | (998,419) | (459,269) | (156,525) | (337,713) | (44,912) |
| Issued financial guarantee contracts | – | – | – | – | – | – |
| | $ 1,507,505 | $ (1,513,536) | $ (897,302) | $ (208,723) | $ (362,599) | $ (44,912) |
| Derivative liabilities: | | | | | | |
| Held for risk management purposes | $ 404 | $ – | $ – | $ – | $ – | $ – |
| Outflow | – | (49,535) | (49,535) | – | – | – |
| Inflow | – | 49,535 | 49,535 | – | – | – |
| | $ 404 | $ – | $ – | $ – | $ – | $ – |
| **2016** | | | | | | |
| Non-derivative liabilities: | | | | | | |
| Deposits from banks | $ 352,190 | $ (352,345) | $ (271,344) | $ (24,020) | $ (56,981) | $ – |
| Deposits from customers | 1,072,605 | (1,076,369) | (528,366) | (105,893) | (414,533) | (27,577) |
| Issued financial guarantee contracts | – | – | – | – | – | – |
| | $ 1,424,795 | $ (1,428,714) | $ (799,710) | $ (129,913) | $ (471,514) | $ (27,577) |
| Derivative liabilities: | | | | | | |
| Held for risk management purposes | $ 18 | $ – | $ – | $ – | $ – | $ – |
| Outflow | – | (161,972) | (159,691) | (2,281) | – | – |
| Inflow | – | 161,972 | 159,691 | 2,281 | – | – |
| | $ 18 | $ – | $ – | $ – | $ – | $ – |

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

## 3. Risk Management Framework (continued)

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

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

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

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

## 3. Risk Management Framework (continued)

### (c) Market Risk Management

**Qualitative disclosures**

Market risk is the risk that changes in market prices, such as interest rate, foreign exchange rates and credit spreads will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

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

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

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

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

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

## 3. Risk Management Framework (continued)

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

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

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

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

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

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

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

**Quantitative disclosures**

An analysis of the potential impact of an immediate and sustained 100-basis-point parallel increase or decrease in all yield curves worldwide on net interest income after tax and economic value of the Bank's portfolio, as at December 31, 2017 is as follows:

(In thousands of CAD dollars)

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | 100 basis point parallel increase in rates | 100 basis point parallel decrease in rates | 100 basis point parallel increase in rates | 100 basis point parallel decrease in rates |
| Increase (decrease) in net interest income after tax: | $ 4,147 | $ (4,147) | $ 4,506 | $ (4,506) |
| Increase (decrease) in economy value: | (453) | 453 | (283) | 283 |

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

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

As at December 31, 2017 significant net currency exposures of the Bank are as follows:

(In thousands of CAD dollars)

| | 2017 | 2016 |
|---|---|---|
| Foreign currency transactions: | | |
| Net foreign currency exposure, long (short): | | |
| US$ | $ 1,983 | $ 1,115 |
| Chinese Yuan | (1,156) | (246) |
| HK$ | 427 | 180 |

An analysis of the potential impact of an immediate and sustained 100-basis-point increase or decrease in exchange rates will result in a non-significant change on net interest income after tax and economic value of the Bank's portfolio.

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

**(d) Operational Risk Management**

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks, such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the Bank's operations. The Bank's objective of operational risk management is to identify, assess and monitor operational risk and, in particular, to comply with the relevant regulatory requirements. The Bank manages and mitigates the potential operational risk through a comprehensive supervision framework based on three lines of defense principle and adequate internal controls, which include segregation of duties and appropriate delegation of authority. Business departments/branches, acting as the first line of defense, are responsible for the operational risk management within its own business line and unit; compliance, risk management department and other specialized functional departments, acting as the second line of defense, are responsible for integrating or leading specific operational risk management. The Bank ensures that proper and prudent controls are in place in its information and technology system. During the course of the audit, Internal Audit, acting as the third line of defense, reviews the adequacy and execution of the Bank's policies and operational procedures. Internal Audit Reports, which set out any significant findings and implications accompanied with the recommendations of improvements on policies and operational procedures, in terms of internal controls, are issued to management and presented to the Audit Committee.

The Board reviews and approves the policies for operational risk management. ALRMC is responsible for ongoing operational risk management and is assisted by the Risk Management Department in its day-to-day monitoring activities relating to operational risk. An operational loss data reporting is regularly submitted to the Board.

## 4. Remuneration Policy

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

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

Key management personnel include the senior management, which is composed of the President and Chief Executive Officer, two Senior Executive Vice Presidents, two Executive Vice Presidents, Chief Compliance Officer and Chief Risk Officer of the Bank. The President and Chief Executive Officer is also the executive director of the Bank.

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

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

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

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

Breakdown of the amount of remuneration awards for the year as at December 31, 2017 is follows:

| | (In thousands of CAD dollars) | |
|---|---|---|
| | 2017 | 2016 |
| Cash-based and unrestricted: | | |
| Fixed remuneration | $ 1,775 | $ 1,687 |
| Variable remuneration | 695 | 764 |
| | $ 2,470 | $ 2,451 |

## 5. Leverage Ratio

In connection with the 2014 Basel Committee on Banking Supervision Basel III Leverage Ratio Framework and Disclosure Requirement (the BCBS LR Framework), OSFI requires non-D-SIBs including this Bank to fully implement the disclosures no later than their 2015 year end reporting. The Bank's leverage ratio is disclosed as below.

| | | |
|---|---|---|
| **Industrial and Commercial Bank of China (Canada)** | | |
| **Basel III Leverage Ratio Disclosure** | | |
| as at December 31, 2017 | | |
| (Amounts in thousands of Canadian Dollars, except percentage) | | |
| | **Item** | **Leverage Ratio Framework** |
| On-balance sheet exposures | | |
| 1 | On-balance sheet items (excluding derivatives, SFTs and grandfathered securitization exposures but including collateral) | 1,773,684 |
| 2 | (Asset amounts deducted in determining Basel III "all-in" Tier 1 capital) | -475 |
| 3 | **Total on-balance sheet exposures** (excluding derivatives and SFTs) (sum of lines 1 and 2) | 1,773,209 |
| Derivative exposures | | |
| 4 | Replacement cost associated with all derivative transactions (i.e.net of eligible cash variation margin) | 404 |
| 5 | Add-on amounts for PFE associated with all derivative transactions | 495 |
| 6 | Gross up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework | 0 |
| 7 | (Deductions of receivables assets for cash variation margin provided in derivative transactions) | 0 |
| 8 | (Exempted CCP-leg of client cleared trade exposures) | 0 |
| 9 | Adjusted effective notional amount of written credit derivatives | 0 |
| 10 | (Adjusted effective notional offsets and add-on deductions for written credit derivatives) | 0 |
| 11 | **Total derivative exposures (sum of lines 4 to 10)** | 899 |
| Securities financing transaction exposures | | |
| 12 | Gross SFT assets recognised for accounting purposes (with no recognition of netting), after adjusting for sale accounting transactions | 0 |
| 13 | (Netted amounts of cash payables and cash receivables of gross SFT assets) | 0 |
| 14 | Counterparty credit risk (CCR) exposure for SFTs | 0 |
| 15 | Agent transaction exposures | 0 |
| 16 | **Total securities financing transaction exposures (sum of lines 12 to 15)** | 0 |
| Other off-balance sheet exposures | | |

| | | |
|---|---|---|
| 17 | Off-balance sheet exposure at gross notional amount | 777,702 |
| 18 | (Adjustments for conversion to credit equivalent amounts) | -432,744 |
| 19 | **Off-balance sheet items (sum of line 17 and 18)** | 344,958 |
| | Capital and Total Exposures | |
| 20 | **Tier 1 capital** | 246,574 |
| 21 | **Total Exposures (sum of lines 3, 11.16 and 19)** | 2,119,066 |
| | Leverage Ratios | |
| *22* | **Basel III leverage ratio** | 11.64% |