

Standard Chartered Bank
(Hong Kong) Limited

Directors' Report and
Consolidated Financial
Statements

For the year ended
31 December 2013

Standard Chartered Bank (Hong Kong) Limited
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Report of the directors

The directors have pleasure in submitting their annual report together with the audited financial statements for the year ended 31 December 2013.

Principal place of business

Standard Chartered Bank (Hong Kong) Limited (the "Bank") is a bank incorporated and domiciled in Hong Kong and has its registered office at 32/F., 4 – 4A Des Voeux Road Central, Hong Kong.

Principal activities

The Bank is a licensed bank registered under the Hong Kong Banking Ordinance. The Bank's principal activities are the provision of banking and related financial services. The principal activities and other particulars of the Bank's principal subsidiaries are set out in note 19 to the financial statements.

Financial statements

The profit of the Bank and its subsidiaries for the year ended 31 December 2013 and the state of the Bank's and its subsidiaries' affairs as at that date are set out in the financial statements on pages 5 to 142.

During the year ended 31 December 2013, the directors had declared and paid an ordinary dividend of HK\$1.60125 (2012: HK\$1.6005) per each "A" and "B" ordinary share totalling HK\$3,102 million (2012: HK\$3,100 million).

Details of the movements in reserves are set out in the consolidated statement of changes in equity.

Charitable donations

Charitable donations made by the Bank and its subsidiaries during the year amounted to HK\$8 million (2012: HK\$8 million).

Fixed assets

Details of the movements in fixed assets are set out in note 21 to the financial statements.

Share capital

There were no movements in the Bank's share capital during the year.

Directors

The directors during the year and up to the date of this report are:

Executive directors

Benjamin Hung Pi Cheng

Ling Fou Tsong

Report of the directors (continued)

Non-executive directors

Katherine Tsang King Suen, Chairperson

Jaspal Singh Bindra

Julian Fong Loong Choon

Tan Siew Boi (re-designated as a non-executive director on 29 May 2013)

Gavin Rodney Opperman (appointed on 18 October 2013)

Janardhan Parthasarathi Cadambi (resigned on 1 July 2013)

Norman Lyle*

Chan Wing Kin*

Ma Xuezheng* (resigned on 29 June 2013)

Fong Ching* (appointed on 29 May 2013)

Stephen Robert Eno* (appointed on 25 July 2013)

** Independent non-executive directors*

There being no provision in the Bank's Articles of Association for the retirement of directors by rotation, all the present directors continue in office for the ensuing year.

Directors' service contracts

The maximum term of appointment of independent non-executive directors is 2 years. Their remuneration is determined by the shareholders at the annual general meeting.

Directors' interests in Share Option Schemes

Certain directors of the Bank have been granted options under various share option schemes of Standard Chartered PLC, the ultimate holding company of the Bank. During the year, Jaspal Singh Bindra, Katherine Tsang King Suen, Benjamin Hung Pi Cheng, Julian Fong Loong Choon, Gavin Rodney Opperman, Ling Fou Tsong, Tan Siew Boi and Janardhan Parthasarathi Cadambi were granted options under these schemes.

Directors' rights to acquire shares

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

Directors' interests in contracts

No contract of significance to which the Bank, its holding companies, subsidiaries or fellow subsidiaries was a party and in which a director of the Bank had a material interest, subsisted at the end of the year or at any time during the year.

Report of the directors (continued)

Auditor

The financial statements have been audited by KPMG who will retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as the auditor of the Bank is to be proposed at the forthcoming annual general meeting.

On behalf of the Board

Katherine Tsang King Suen
Chairperson

Hong Kong, 5 March 2014

Independent auditor's report to the shareholders of Standard Chartered Bank (Hong Kong) Limited

(Incorporated in Hong Kong SAR with limited liability)

We have audited the consolidated financial statements of Standard Chartered Bank (Hong Kong) Limited (the "Bank") and its subsidiaries (together "the Bank and its subsidiaries") set out on pages 5 to 142, which comprise the consolidated and the bank balance sheets as at 31 December 2013, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated and the bank statements of changes in equity and the consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the financial statements

The directors of the Bank are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board and with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. This report is made solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the consolidated financial statements that give a true and fair view 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Bank and of the Bank and its subsidiaries as at 31 December 2013 and of the Bank and its subsidiaries' profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

KPMG

Certified Public Accountants

8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

5 March 2014

Consolidated income statement
For the year ended 31 December 2013
(Expressed in millions of Hong Kong dollars)

	Note	2013 HK\$'M	Restated (note) 2012 HK\$'M
Interest income	4(a)	18,514	18,349
Interest expense	4(b)	(5,274)	(6,047)
Net interest income		<u>13,240</u>	<u>12,302</u>
Fee and commission income		8,112	7,480
Fee and commission expense		(634)	(701)
Net fee and commission income	4(c)	7,478	6,779
Net trading income	4(d)	3,529	3,079
Net gains from financial instruments designated at fair value through profit or loss	4(e)	124	188
Net gains from disposal of available-for-sale securities	5	17	149
Other operating income	4(f)	2,385	1,163
		<u>13,533</u>	<u>11,358</u>
Total operating income		26,773	23,660
Staff costs		(6,624)	(6,785)
Premises and equipment		(2,420)	(1,862)
Others		(4,539)	(4,398)
Operating expenses	4(g)	(13,583)	(13,045)
Operating profit before impairment		13,190	10,615
Impairment charges on advances to banks and customers	6(a)	(1,019)	(789)
Other impairment charges	6(b)	(3)	(1,043)
Operating profit after impairment		12,168	8,783
Share of profit of associates		1,188	893
Profit before taxation		13,356	9,676
Taxation	7(a)	(1,981)	(1,507)
Profit after taxation		<u>11,375</u>	<u>8,169</u>
Attributable to:			
Equity shareholders of the Bank		11,368	8,152
Non-controlling interests		7	17
Profit after taxation		<u>11,375</u>	<u>8,169</u>

(note) Amounts have been restated as explained in note 45.

The notes on pages 13 to 142 form part of these financial statements.

Consolidated statement of comprehensive income**For the year ended 31 December 2013***(Expressed in millions of Hong Kong dollars)*

	2013 HK\$'M	<i>Restated</i> <i>(note)</i> 2012 HK\$'M
Profit after taxation	11,375	8,169
Other comprehensive income:		
<u>Items that will not be reclassified to the income statement:</u>		
Defined benefit plans:		
– Remeasurement of net defined benefit liability	267	31
– Related tax effect	(44)	(5)
<u>Items that may be reclassified subsequently to the income statement:</u>		
Available-for-sale securities:		
– Changes in fair value recognised during the year	(315)	1,115
– Changes in fair value transferred to the income statement on disposal	(17)	(149)
– Transfer to the income statement on fair value hedged items attributable to hedged risk	266	213
– Related tax effect	16	(207)
Cash flow hedges:		
– Changes in fair value recognised during the year	(105)	94
– Transfer to the income statement on termination of hedging derivatives	(11)	(16)
– Related tax effect	19	(13)
Surplus on revaluation of buildings and leasehold land held for own use	–	2
Exchange difference	62	121
	<hr/>	<hr/>
Other comprehensive income for the year, net of tax	138	1,186
	<hr/>	<hr/>
Total comprehensive income for the year	11,513	9,355
	<hr/> <hr/>	<hr/> <hr/>
Attributable to:		
Shareholders of the Bank	11,506	9,338
Non-controlling interests	7	17
	<hr/>	<hr/>
	11,513	9,355
	<hr/> <hr/>	<hr/> <hr/>

(note) Amounts have been restated as explained in note 45.

The notes on pages 13 to 142 form part of these financial statements.

Consolidated balance sheet as at 31 December 2013*(Expressed in millions of Hong Kong dollars)*

	Note	2013 HK\$'M	Restated (note) 2012 HK\$'M
Assets			
Cash and balances with banks, central banks and other financial institutions	10	26,885	20,492
Placements with banks and other financial institutions	11(a)	125,868	143,579
Hong Kong SAR Government certificates of indebtedness	12	34,581	32,481
Trading assets	13	38,861	28,414
Financial assets designated at fair value	14	2,154	3,216
Investment securities	17	199,181	174,379
Advances to customers	15(a)	453,558	408,018
Amounts due from immediate holding company	18	53,689	58,731
Amounts due from fellow subsidiaries	18	35,180	20,591
Interest in associates	20	8,331	7,101
Fixed assets	21	28,573	23,705
Goodwill and intangible assets	22	1,933	1,821
Current tax assets		7	13
Deferred tax assets	27	275	88
Other assets	23	15,156	17,001
		1,024,232	939,630
Liabilities			
Hong Kong SAR currency notes in circulation	12	34,581	32,481
Deposits and balances of banks and other financial institutions		16,213	12,281
Deposits from customers	24	817,428	756,589
Trading liabilities	28	23,547	23,068
Financial liabilities designated at fair value	26	5,723	3,612
Debt securities in issue	25	15,336	10,006
Amounts due to immediate holding company	18	19,013	19,606
Amounts due to fellow subsidiaries	18	3,852	5,085
Current tax liabilities		786	629
Deferred tax liabilities	27	112	43
Other liabilities	29	22,047	18,184
Subordinated liabilities	31	10,548	11,267
		969,186	892,851
Equity			
Share capital	32	97	97
Reserves	33	54,949	46,660
Shareholders' equity		55,046	46,757
Non-controlling interests		–	22
		55,046	46,779
		1,024,232	939,630

Approved and authorised for issue by the Board of Directors on 5 March 2014.

Tsang King Suen Katherine
Chairperson

Hung Pi Cheng Benjamin
Director

Ling Fou Tsong
Director

Wang Wei Min
Company Secretary

(note) Amounts have been restated as explained in note 45.

The notes on pages 13 to 142 form part of these financial statements.

Balance sheet as at 31 December 2013*(Expressed in millions of Hong Kong dollars)*

	Note	2013 HK\$'M	2012 HK\$'M
Assets			
Cash and balances with banks, central banks and other financial institutions	10	26,697	20,331
Placements with banks and other financial institutions	11(a)	125,857	143,571
Hong Kong SAR Government certificates of indebtedness	12	34,581	32,481
Trading assets	13	38,861	28,410
Financial assets designated at fair value	14	2,154	3,216
Investment securities	17	199,181	174,312
Advances to customers	15(a)	440,186	395,386
Amounts due from immediate holding company	18	52,495	57,746
Amounts due from fellow subsidiaries	18	34,906	20,460
Amounts due from subsidiaries of the Bank	18	37,407	33,693
Investments in subsidiaries of the Bank	19	1,222	1,100
Interest in associates	20	4,127	4,059
Fixed assets	21	2,903	2,830
Goodwill and intangible assets	22	1,130	1,011
Deferred tax assets	27	227	38
Other assets	23	13,155	14,406
		<u>1,015,089</u>	<u>933,050</u>
Liabilities			
Hong Kong SAR currency notes in circulation	12	34,581	32,481
Deposits and balances of banks and other financial institutions		15,008	11,356
Deposits from customers	24	816,300	755,487
Trading liabilities	28	23,547	23,065
Financial liabilities designated at fair value	26	5,723	3,612
Debt securities in issue	25	15,336	10,006
Amounts due to immediate holding company	18	18,443	19,124
Amounts due to fellow subsidiaries	18	3,762	5,008
Amounts due to subsidiaries of the Bank	18	1,936	2,017
Current tax liabilities		740	596
Other liabilities	29	20,793	17,205
Subordinated liabilities	31	10,548	11,267
		<u>966,717</u>	<u>891,224</u>
Equity			
Share capital	32	97	97
Reserves	33	48,275	41,729
		<u>48,372</u>	<u>41,826</u>
Shareholders' equity		<u>48,372</u>	<u>41,826</u>
		<u>1,015,089</u>	<u>933,050</u>

Approved and authorised for issue by the Board of Directors on 5 March 2014.

Tsang King Suen Katherine
Chairperson

Hung Pi Cheng Benjamin
Director

Ling Fou Tsong
Director

Wang Wei Min
Company Secretary

The notes on pages 13 to 142 form part of these financial statements.

Consolidated statement of changes in equity**For the year ended 31 December 2013***(Expressed in millions of Hong Kong dollars)*

	Attributable to equity shareholders of the Bank													
	Share capital	Share premium	Capital redemption reserve	Cash flow hedge reserve	Available-for-sale investment reserve	Revaluation reserve	Pension reserve	Exchange reserve	Property revaluation reserve	Retained profits	Share option equity reserve	Total	Non-controlling interests	Total
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
At 1 January 2012,														
as previously stated	97	12,477	3,804	(1)	(870)	146	(459)	249	-	24,696	304	40,443	58	40,501
Reclassification	-	-	-	-	-	-	459	-	-	(459)	-	-	-	-
As restated	97	12,477	3,804	(1)	(870)	146	-	249	-	24,237	304	40,443	58	40,501
Total comprehensive income (restated)	-	-	-	65	972	-	-	121	2	8,178	-	9,338	17	9,355
Dividend paid	-	-	-	-	-	-	-	-	-	(3,100)	-	(3,100)	(53)	(3,153)
Movement in respect of share-based compensation plans	-	-	-	-	-	-	-	-	-	-	76	76	-	76
At 31 December 2012	97	12,477	3,804	64	102	146	-	370	2	29,315	380	46,757	22	46,779
At 1 January 2013,														
as previously stated	97	12,477	3,804	64	102	146	(510)	370	2	29,817	380	46,749	22	46,771
Reclassification	-	-	-	-	-	-	510	-	-	(510)	-	-	-	-
Effect of adoption of HKFRS 11/IFRS 11	-	-	-	-	-	-	-	-	-	8	-	8	-	8
As restated	97	12,477	3,804	64	102	146	-	370	2	29,315	380	46,757	22	46,779
Total comprehensive income	-	-	-	(97)	(50)	-	-	62	-	11,591	-	11,506	7	11,513
Dividend paid	-	-	-	-	-	-	-	-	-	(3,102)	-	(3,102)	-	(3,102)
Movement in respect of share-based compensation plans	-	-	-	-	-	-	-	-	-	-	(115)	(115)	-	(115)
Disposal of a subsidiary	-	-	-	-	-	-	-	-	-	-	-	-	(29)	(29)
At 31 December 2013	97	12,477	3,804	(33)	52	146	-	432	2	37,804	265	55,046	-	55,046

The notes on pages 13 to 142 form part of these financial statements.

Statement of changes in equity
For the year ended 31 December 2013
(Expressed in millions of Hong Kong dollars)

	Share capital HK\$'M	Share premium HK\$'M	Capital redemption reserve HK\$'M	Cash flow hedge reserve HK\$'M	Available- for-sale investment reserve HK\$'M	Pension reserve HK\$'M	Retained profits HK\$'M	Share option equity reserve HK\$'M	Total HK\$'M
At 1 January 2012, as previously stated	97	12,477	3,804	(1)	(872)	(459)	21,818	257	37,121
Reclassification	-	-	-	-	-	459	(459)	-	-
As restated	97	12,477	3,804	(1)	(872)	-	21,359	257	37,121
Total comprehensive income (restated)	-	-	-	65	983	-	6,711	-	7,759
Dividend paid	-	-	-	-	-	-	(3,100)	-	(3,100)
Movement in respect of share-based compensation plans	-	-	-	-	-	-	-	46	46
At 31 December 2012	<u>97</u>	<u>12,477</u>	<u>3,804</u>	<u>64</u>	<u>111</u>	<u>-</u>	<u>24,970</u>	<u>303</u>	<u>41,826</u>
At 1 January 2013, as previously stated	97	12,477	3,804	64	111	(510)	25,480	303	41,826
Reclassification	-	-	-	-	-	510	(510)	-	-
As restated	97	12,477	3,804	64	111	-	24,970	303	41,826
Total comprehensive income	-	-	-	(97)	4	-	9,866	-	9,773
Dividend paid	-	-	-	-	-	-	(3,102)	-	(3,102)
Movement in respect of share-based compensation plans	-	-	-	-	-	-	-	(125)	(125)
At 31 December 2013	<u>97</u>	<u>12,477</u>	<u>3,804</u>	<u>(33)</u>	<u>115</u>	<u>-</u>	<u>31,734</u>	<u>178</u>	<u>48,372</u>

During the year ended 31 December 2013, the directors had declared and paid an ordinary dividend of HK\$1.60125 (2012: HK\$1.6005) per each 'A' and 'B' ordinary share totalling HK\$3,102 million (2012: HK\$3,100 million).

The notes on pages 13 to 142 form part of these financial statements.

Consolidated cash flow statement
For the year ended 31 December 2013
(Expressed in millions of Hong Kong dollars)

	<i>Note</i>	<i>2013</i> <i>HK\$'M</i>	<i>Restated</i> <i>(note)</i> <i>2012</i> <i>HK\$'M</i>
Operating activities			
Profit before taxation		13,356	9,676
Adjustments for:			
Impairment charges on advances to banks and customers		1,019	789
Advances written off net of recoveries		(1,013)	(845)
Unwinding of discount on loan impairment charges		(21)	(19)
Other impairment charges		3	1,043
Depreciation		1,251	753
Amortisation of intangible assets		141	85
Gains on disposal of fixed assets		(43)	–
Net (gains)/losses on revaluation of investment properties		(127)	26
Share of profit of associates		(1,188)	(893)
Interest expense on subordinated liabilities		342	355
Expense in respect of the defined benefit plan		111	109
Fair value gains transferred from reserves on cash flow hedges		(11)	(16)
Exchange translation on subordinated liabilities		(165)	149
		<u>13,655</u>	<u>11,212</u>
(Increase)/decrease in operating assets:			
Placements with banks and other financial institutions with original maturity beyond three months		23,787	(14,097)
Trading assets		(7,239)	(5,296)
Financial assets designated at fair value		1,062	1,059
Investment securities		(16,088)	(28,176)
Gross advances to customers		(45,532)	(18,232)
Amounts due from immediate holding company and fellow subsidiaries		(10,916)	(2,032)
Other assets		1,320	(5,775)
Increase/(decrease) in operating liabilities:			
Deposits and balances of banks and other financial institutions		4,066	(3,524)
Deposits from customers		60,850	83,638
Debt securities in issue		5,330	(3,259)
Financial liabilities designated at fair value		2,111	125
Amounts due to immediate holding company and fellow subsidiaries		2,673	2,024
Trading liabilities		479	(1,569)
Other liabilities		3,245	(2,475)
		<u>38,803</u>	<u>13,623</u>
Cash generated from operations		38,803	13,623
Income tax paid		(1,954)	(1,756)
		<u>36,849</u>	<u>11,867</u>
Net cash generated from operating activities		36,849	11,867

Consolidated cash flow statement (continued)**For the year ended 31 December 2013***(Expressed in millions of Hong Kong dollars)*

	<i>Note</i>	<i>2013</i> <i>HK\$'M</i>	<i>Restated</i> <i>(note)</i> <i>2012</i> <i>HK\$'M</i>
Investing activities			
Dividend received from associates		35	104
Payment for purchase of an associate		–	(54)
Payment for additional investment in an associate		(68)	–
Proceeds from disposal of a subsidiary		–	158
Payment for purchase of fixed assets		(6,998)	(14,029)
Payment for purchase of intangible assets		(253)	(165)
Proceeds from disposal of fixed assets		1,049	14
		<hr/>	<hr/>
Net cash used in investing activities		(6,235)	(13,972)
		<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
Financing activities			
Payment for redemption of subordinated liabilities		–	(2,335)
Interest paid on subordinated liabilities		(331)	(345)
Dividend paid to shareholders of the Bank		(3,102)	(3,100)
Dividend paid to non-controlling interests		–	(53)
		<hr/>	<hr/>
Net cash used in financing activities		(3,433)	(5,833)
		<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
Net increase/(decrease) in cash and cash equivalents		27,181	(7,938)
Cash and cash equivalents at 1 January		141,146	148,525
Effect of foreign exchange		480	559
		<hr/>	<hr/>
Cash and cash equivalents at 31 December	34	168,807	141,146
		<hr style="border-top: 3px double black;"/>	<hr style="border-top: 3px double black;"/>
Cash flows from operating activities include:			
Interest received		18,369	17,318
Interest paid		5,107	5,179
Dividends received		24	25
		<hr style="border-top: 3px double black;"/>	<hr style="border-top: 3px double black;"/>

(note) Amounts have been restated as explained in note 45.

The notes on pages 13 to 142 form part of these financial statements.

Notes to the financial statements

(Expressed in millions of Hong Kong dollars)

1 Principal activities

The principal activities of Standard Chartered Bank (Hong Kong) Limited (the “Bank”) and its subsidiaries (together referred to as the “Bank and its subsidiaries”) are the provision of banking and related financial services.

2 Significant accounting policies

(a) Statement of compliance

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (“HKFRSs”), which collective term includes all applicable Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (“HKASs”) and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. As HKFRSs are consistent with International Financial Reporting Standards (“IFRSs”), which collective term includes all applicable individual International Financial Reporting Standards, International Accounting Standards (“IAS”) and Interpretations issued by the International Accounting Standards Board (“IASB”), these financial statements also comply with IFRSs.

(b) Basis of preparation of the financial statements

(i) Basis of Preparation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries made up to 31 December 2013.

The consolidated and the Bank’s financial statements have been prepared under the historical cost convention, as modified by the revaluation of investment properties, available-for-sale assets, and financial assets and liabilities (including derivatives) at fair value through profit or loss.

The preparation of financial statements in conformity with adopted HKFRS/IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank and its subsidiaries’ accounting policies. Actual results may differ from these estimates. The significant judgements made by management in applying the accounting policies and key sources of uncertainty were the same as those applied to the consolidated financial statements as at and for the year ended 31 December 2012.

The accounting policies set out below have been applied consistently across the Bank and its subsidiaries and to all periods presented in these financial statements.

(ii) Consolidated Financial Statements

During the year, the Bank had subordinated debts in issue. These subordinated debts were issued under a note issuance programme which is listed on the Stock Exchange of Hong Kong. Consequently, the Bank is required to produce consolidated financial statements in accordance with HKAS 27/IAS 27 “Consolidated and Separate Financial Statements”.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(c) Subsidiaries and non-controlling interests**

Subsidiaries are all entities which the Bank and its subsidiaries control. The Bank and its subsidiaries control an entity when they are exposed to, or have rights to, variable returns from their involvement with the entity and have the ability to affect those returns through their power over the investee. Subsidiaries are fully consolidated from the date on which the Bank and its subsidiaries effectively obtain control. They are de-consolidated from the date that control ceases, and where any interest in the subsidiary remains, this is remeasured to its fair value and the change in carrying amount is recognised in the income statement. Details of the Bank's principal subsidiaries are given in note 19.

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

Non-controlling interests represent the portion of the net assets of subsidiaries attributable to interests that are not owned by the Bank, whether directly or indirectly through subsidiaries, and in respect of which the Bank and its subsidiaries have not agreed any additional terms with the holders of those interests which would result in the Bank and its subsidiaries as a whole having a contractual obligation in respect of those interests that meet the definition of a financial liability. Non-controlling interests are presented in the consolidated balance sheet within equity, separately from equity attributable to the equity shareholders of the Bank. Non-controlling interests are presented on the face of the consolidated income statement and the consolidated statement of comprehensive income as an allocation of the total profit or loss and total comprehensive income for the year between non-controlling interests and the equity shareholders of the Bank.

Where losses applicable to the non-controlling interest exceed its interest in the equity of a subsidiary, the excess, and any further losses applicable to the non-controlling interest, are charged against the Bank and its subsidiaries' interest except to the extent that the non-controlling interest has a binding obligation to, and is able to, make additional investment to cover the losses. If the subsidiary subsequently reports profits, the Bank and its subsidiaries' are allocated all such profits until the non-controlling interest's share of losses previously absorbed by the Bank and its subsidiaries have been recovered.

In the Bank's balance sheet, investments in subsidiaries are stated at cost less impairment losses, if any.

(d) Associates and joint arrangements

Associates are entities in respect of which the Bank has significant influence, but not control, over the financial and operating policies and procedures, generally accompanying a shareholding of between 20 percent and 50 percent of the voting rights.

Joint arrangements are where two or more parties either have rights to the assets, and obligations of the joint arrangement (joint operations) or have rights to the net assets of the joint arrangement (joint venture). The Bank and its subsidiaries evaluate the contractual terms of joint arrangements to determine whether a joint arrangement is a joint operation or a joint venture. At 31 December 2013, the Bank and its subsidiaries have an insignificant contractual interest in a joint venture but do not have any contractual interest in joint operations. Details of the Bank and its subsidiaries' interest in associates are provided in note 20.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(d) Associates and joint arrangements (continued)

Investments in associates and joint ventures are accounted for using the equity method of accounting in the consolidated financial statements and are initially recognised at cost. The Bank and its subsidiaries' investment in associates and joint ventures includes goodwill identified on acquisition and accumulated impairment loss.

The Bank and its subsidiaries' share of its associates' and joint ventures' post-acquisition profits or losses are recognised in the income statement, and the share of post-acquisition movements in other comprehensive income are recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment in the consolidated balance sheet. When the Bank and its subsidiaries' share of losses in an associate or a joint venture is equal to or exceeds its interest in the associate and joint venture, including any other unsecured receivables, the Bank and its subsidiaries do not recognise further losses, unless they have incurred obligations or made payments on behalf of the associate and joint venture.

Unrealised gains and losses on transactions between the Bank and its associates and joint ventures are eliminated to the extent of the Bank and its subsidiaries' interest in the associates and joint ventures.

In the Bank's balance sheet, investment in associates and joint ventures are stated at cost less impairment losses and dividends from pre-acquisition profits received prior to 1 January 2009, if any.

(e) Intangible assets

(i) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Bank and its subsidiaries' share of the net identifiable assets and contingent liabilities of the acquired subsidiary/associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in "Goodwill and intangible assets". Goodwill on acquisitions of associates is included in "Interest in associates".

Goodwill included in "Goodwill and intangible assets" is tested annually for impairment and carried at cost less any accumulated impairment losses. Detailed calculations are performed based on discounting expected pre-tax cash flows of the relevant cash generating units and discounting these at an appropriate discount rate, the determination of which requires the exercise of judgement. Goodwill is allocated to cash generating units for the purpose of impairment testing. Cash generating units represent the lowest level within the Bank and its subsidiaries at which the goodwill is monitored for internal management purposes. Note 22 sets out the major cash-generating units to which goodwill has been allocated.

(ii) Acquired intangibles

At the date of acquisition of a subsidiary or associate, intangible assets which are deemed separable and that arise from contractual or other legal rights are capitalised and included within the net identifiable assets acquired. These intangible assets are initially measured at fair value, which reflects market expectations of the probability that the future economic benefits embodied in the asset will flow to the entity, and are amortised on the basis of their expected useful lives (4 to 16 years). At each balance sheet date, these assets are assessed for indicators of impairment. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, the asset is written down immediately.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(e) Intangible assets (continued)****(iii) Computer software**

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Costs associated with the development of software are capitalised where it is probable that it will generate future economic benefits in excess of its cost. Computer software costs are amortised on the basis of expected useful life (3 to 5 years). Costs associated with maintaining software are recognised as an expense as incurred. At each balance sheet date, these assets are assessed for indicators of impairment. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, the asset is written down immediately.

(f) Investment properties

Investment properties are land and buildings which are owned either to earn rental income or for long term investments or for both. Investment properties are stated in the balance sheet at fair value. Any gains or losses arising from a change in fair value or from the disposal of an investment property is recognised in the income statement.

(g) Other property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and impairment, if any. Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Depreciation on fixed assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

- Buildings, leasehold land and leasehold improvements, are depreciated over the shorter of their estimated useful lives, being 50 years from the date of completion, and the unexpired terms of the lease.
- Equipment and motor vehicles, are depreciated over 3 to 15 years.
- Aircraft and vessels, are depreciated over 25 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. At each balance sheet date, these assets are assessed for indicators of impairment. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, the asset is written down immediately.

Gains and losses on disposals are included in the income statement.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(h) Leases**

Where the Bank and its subsidiaries are the lessees

The leases entered into by the Bank and its subsidiaries are primarily operating leases. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the leases.

Where the Bank and its subsidiaries are the lessors

When assets are leased to customers under finance leases, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method (before tax), which reflects a constant periodic rate of return ignoring tax cash flows.

Assets leased to customers under operating leases are included within Fixed assets and depreciated over their estimated useful lives. Rental income on these leased assets is recognised in the income statement on a straight-line basis unless another systematic basis is more representative.

(i) Financial assets and liabilities (excluding derivatives)

Financial assets are classified into the following categories: financial assets held at fair value through profit or loss, loans and receivables, and available-for-sale financial assets. Financial liabilities are classified as either held at fair value through profit or loss, or at amortised cost. Management determines the classification of the financial assets and liabilities on initial recognition or, where appropriate, at the time of reclassification.

(i) Financial assets and liabilities held at fair value through profit or loss

This category has two sub-categories: financial assets and liabilities held for trading, and those designated at fair value through profit or loss at inception. A financial asset or liability is classified as trading if acquired principally for the purpose of selling or repurchasing in the short term or is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking.

Financial assets and liabilities may be designated at fair value through profit or loss when:

- the designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities on a different basis, or
- a group of financial assets and/or liabilities is managed and its performance evaluated on a fair value basis, or
- assets or liabilities include embedded derivatives and such derivatives are not recognised separately.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(i) Financial assets and liabilities (excluding derivatives) (continued)****(ii) Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and it is expected that substantially all of the initial investment will be recovered, other than because of credit deterioration.

(iii) Available-for-sale assets

Available-for-sale assets are those non-derivative financial assets intended to be held for an indefinite period of time, which may be sold in response to liquidity requirements or changes in interest rates, exchange rates, commodity prices or equity prices.

(iv) Financial liabilities held at amortised cost

Financial liabilities, which include borrowings, not classified as held at fair value through profit or loss are classified as amortised cost instruments.

Initial recognition

Purchases and sales of financial assets and liabilities held at fair value through profit or loss or which are available-for-sale are initially recognised using trade date accounting (the date on which the Bank and its subsidiaries commit to purchase or sell the asset). Loans and receivables are recognised when cash is advanced to the borrowers. Other financial assets and financial liabilities are initially recognised on value date at fair value plus directly attributable transaction costs.

Subsequent measurement

Financial assets and liabilities held at fair value through profit or loss are subsequently carried at fair value, with gains and losses arising from changes in fair value taken directly to the income statement.

Available-for-sale financial assets are subsequently carried at fair value, with gains and losses arising from changes in fair value taken to a separate component of equity until the asset is sold, or is impaired, when the cumulative gain or loss is transferred to the income statement.

Loans and receivables are subsequently carried at amortised cost using the effective interest method.

Financial liabilities other than those held at fair value through profit or loss are subsequently stated at amortised cost, with any difference between proceeds net of directly attributable transaction costs and the redemption value recognised in the income statement over the period of the borrowings using the effective interest method.

In addition to these instruments, the carrying value of a financial instrument carried at amortised cost that is the hedged item in a qualifying fair value hedge relationship is adjusted by the fair value gain or loss attributable to the hedged risk.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial assets and liabilities (excluding derivatives) (continued)

Fair value of financial assets and liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal market or in the absence of a principal market the most advantageous market to which the Bank and its subsidiaries have access at that date. The fair value of a liability reflects its non-performance risk.

The fair values of quoted financial assets or financial liabilities in active markets are based on current prices. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. If the market for a financial asset or financial liability is not active, and for unlisted securities, the Bank and its subsidiaries establish fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Reclassifications

Reclassifications of financial assets, other than as disclosed below, or of financial liabilities between measurement categories are not permitted following their initial recognition.

Held for trading non-derivative financial assets can only be transferred out of the held at fair value through profit or loss category in the following circumstances: (i) to the available-for-sale category, where, in rare circumstances, they are no longer held for the purpose of selling or repurchasing in the near term; or (ii) to the loans and receivables category, where they are no longer held for the purpose of selling or repurchasing in the near term and they would have met the definition of a loan and receivable on initial recognition and the Bank and its subsidiaries have the intent and ability to hold the assets for the foreseeable future or until maturity.

Financial assets can only be transferred out of the available-for-sale category to the loans and receivables category, where they would have met the definition of a loan and receivable on initial recognition and the Bank and its subsidiaries have the intent and ability to hold the assets for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. For financial assets reclassified out of the available-for-sale category into loans and receivables, any gain or loss on those assets recognised in shareholders' equity prior to the date of reclassification is amortised to the income statement over the remaining life of the financial asset, using the effective interest method.

Renegotiated loans

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

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank and its subsidiaries have transferred substantially all risks and rewards of ownership.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(i) Financial assets and liabilities (excluding derivatives) (continued)**

Financial liabilities are derecognised when they are extinguished, i.e. when the obligation is discharged, cancelled or expires. If the Bank and its subsidiaries purchase their own debt, it is removed from the balance sheet, and the difference between the carrying amount of the liability and the consideration paid is included in 'Other operating income'.

(j) Derivative financial instruments and hedge accounting

Derivatives are financial instruments that derive their value in response to changes in interest rates, financial instrument prices, commodity prices, foreign exchange rates, credit risk and indices. Derivatives are categorised as trading unless they are designated as hedging instruments.

Derivative contracts are initially recognised at fair value on the date on which they are entered into and are subsequently re-measured at their fair value. Fair values are obtained from market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and option pricing models, as appropriate. All derivatives are carried as assets when their fair values are positive and as liabilities when their fair values are negative.

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Bank and its subsidiaries designate certain derivatives as either: (1) hedges of the fair value of recognised assets or liabilities, or commitments (fair value hedge); or, (2) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (cash flow hedge). Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

The Bank and its subsidiaries document, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Bank and its subsidiaries also document the assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

(i) Fair value hedge

Changes in the fair value of derivatives that are designated and that qualify as fair value hedging instruments are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to the income statement over the period to maturity or derecognition.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(j) Derivative financial instruments and hedge accounting (continued)****(ii) Cash flow hedge**

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedging instruments are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Derivatives that do not qualify for hedge accounting

Certain derivative transactions do not qualify for hedge accounting. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

(k) Impairment of financial assets

The Bank and its subsidiaries assess at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The following factors are considered in assessing objective evidence of impairment:

- whether the counterparty is in default of principal or interest payments;
- a counterparty files for bankruptcy protection (or the local equivalent) where this would avoid or delay repayment of its obligation;
- the Bank and its subsidiaries file to have the counterparty declared bankrupt or file a similar order in respect of a credit obligation;
- the Bank and its subsidiaries consent to a restructuring of the obligation, resulting in a diminished financial obligation, demonstrated by a material forgiveness of debt or postponement of scheduled payments;
- the Bank and its subsidiaries sell a credit obligation at a material credit-related economic loss; or

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment of financial assets (continued)

- there is observable data indicating that there is a measurable decrease in the estimated future cash flows of a group of financial assets, although the decrease cannot yet be identified with specific individual financial assets.

Assets carried at amortised cost

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

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Bank and its subsidiaries may measure impairment on the basis of an instrument's fair value using observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are based on the probability of default inherent within the portfolio of impaired loans or receivables and the historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

To the extent a loan is irrecoverable, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(k) Impairment of financial assets (continued)***Available-for-sale assets*

A significant or prolonged decline in the fair value of an equity security below its cost is considered, amongst other factors in determining whether the equity security is impaired. Where objective evidence of impairment exists for available-for-sale financial assets, the cumulative loss (measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the income statement) is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

(l) Offsetting financial transactions

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

(m) Fiduciary activities

The Bank and its subsidiaries commonly act as trustee and in other fiduciary capacities that result in the holding or placing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions. The assets and income arising thereon are excluded from these financial statements, as they are not assets and income of the Bank and its subsidiaries.

(n) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including: cash and balances with banks, central banks and other financial institutions, trading assets, placements with banks and other financial institutions, and amounts due from immediate holding company and fellow subsidiaries.

(o) Revenue recognition**(i) Interest income and expense**

Interest income and expense on available-for-sale assets, financial assets or liabilities held at amortised cost and financial assets and liabilities held at fair value through profit or loss excluding derivatives is recognised in the income statement using the effective interest rate method.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank and its subsidiaries estimate cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all amounts paid or received between parties to the contract that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(o) Revenue recognition (continued)

(i) Interest income and expense (continued)

Where the estimates of cash flows have been revised, the carrying amount of the financial asset or liability is adjusted to reflect the actual and revised cash flows, discounted at the instrument's original effective interest rate. The adjustment is recognised as interest income or expense in the period in which the revision is made.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised at the original effective interest rate of the financial asset applied to the impaired carrying amount.

(ii) Fees and commissions

Fees and commissions are generally recognised on an accrual basis when the service has been provided or significant act performed. Loan syndication fees are recognised as revenue when the syndication has been completed and the Bank and its subsidiaries have retained no part of the loan package for itself or have retained a part at the same effective interest rate as for the other participants. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportioned basis.

(iii) Other income from financial assets and liabilities

Gains and losses arising from changes in the fair value of financial assets and liabilities held at fair value through profit or loss, as well as any interest receivable or payable, are included in the income statement in the period in which they arise.

Gains and losses arising from changes in the fair value of available-for-sale financial assets other than foreign exchange gains and losses from monetary items, are recognised directly in equity, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement.

Dividends on equity instruments are recognised in the income statement when the Bank and its subsidiaries' right to receive payment is established.

(p) Income tax

Income tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise. The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the balance sheet date and that are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(p) Income tax (continued)**

Current and deferred tax relating to items which are charged or credited directly to equity, are credited or charged directly to equity and are subsequently recognised in the income statement together with the current or deferred gain or loss.

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 Bank and its subsidiaries have a 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 Bank or its subsidiaries intend either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities for which a legal right of set off exists.

(q) Provisions

Provisions for restructuring costs and legal claims are recognised when the Bank and its subsidiaries have a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

(r) Employee benefits**(i) Short term employee benefits**

Salaries, annual bonuses, and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees.

(ii) Retirement benefit obligations

The Bank and its subsidiaries operate a number of defined contribution and defined benefit plans.

For defined contribution plans, the Bank and its subsidiaries pay contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis, and such amounts are charged to operating expenses. The Bank and its subsidiaries have no further payment obligations once the contributions have been paid.

For funded defined benefit plans, the net liability recognised in the balance sheet represents the present value of the defined benefit obligations at the balance sheet date less the fair value of plan assets. The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligations is determined by discounting the estimated future cash outflows using an interest rate equal to the yield on government bonds that are denominated in the currency in which the benefits will be paid, and that have a term to maturity approximating to the term of the related pension liability.

Actuarial gains and losses that arise are recognised in shareholders' equity and presented in the consolidated statement of other comprehensive income in the period they arise. Past service costs are recognised immediately to the extent that benefits are vested and are otherwise recognised over the average period until benefits are vested on a straight-line basis. Current service costs and any past service costs, together with the net interest expense on the net defined benefit liability, are charged to operating expenses.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(r) Employee benefits (continued)***(ii) Retirement benefit obligations (continued)*

The Bank determines the net interest expense on the net defined benefit liability for the year by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then net defined benefit liability, taking into account any changes in the net defined benefit liability during the year as a result of contributions and benefit payment.

(iii) Share-based compensation

The Group operates equity-settled share-based compensation plans in which the Bank and its subsidiaries' employees participate. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. For deferred share awards granted as part of an annual performance award, the expense is recognised over the period from the start of the performance period to the vesting date. For all other awards the expense is recognised over the period from the start of the date of grant to the vesting date.

For equity-settled awards, the total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and growth targets). The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments is estimated using an appropriate valuation technique, such as a binomial option pricing model.

Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. At each balance sheet date, the Bank and its subsidiaries revise its estimates of the number of options that are expected to vest. It recognises the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity over the remaining vesting period. Forfeitures prior to vesting attributable to factors other than the failure to satisfy a non-market vesting condition are treated as a cancellation and the remaining unamortised charge is debited to the income statement at the time of cancellation.

(s) Translation of foreign currencies

Foreign currency transactions are translated into Hong Kong dollars using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognised in the income statement.

Non-monetary assets and liabilities are translated at historical exchange rates if held at historical cost or year-end exchange rates if held at fair value, and the resulting foreign exchange gains and losses are recognised in either the income statement or shareholders' equity depending on the treatment of the gain or loss on the asset or liability.

The results and financial position of all foreign operations that have a functional currency different from the Bank's presentation currency are accounted for as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the balance sheet date.
- income and expenses for each income statement are translated at average exchange rates or at rates on the date of the transaction where exchange rates fluctuate significantly; and

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(s) Translation of foreign currencies (continued)

- all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to other comprehensive income. When a foreign operation is sold, the exchange differences are recognised in the income statement as part of the gain or loss on disposal.

(t) Related parties

For the purposes of these financial statements, parties are considered to be related to the Bank and its subsidiaries if the Bank and its subsidiaries have the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Bank and its subsidiaries and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include (i) associates and joint ventures of the Group, (ii) entities which are under the significant influence of related parties of the Bank where those parties are individuals, and (iii) post-employment benefit plans which are for the benefit of employees of the Bank or of any entity that is a related party of the Bank.

(u) Segment reporting

Operating segments, and the amounts of each segment item reported in the financial statements, are identified from the financial information provided regularly to the Bank and its subsidiaries' most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Bank and its subsidiaries' various lines of business and geographical locations.

(v) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') remain on the balance sheet; the counterparty liability is included in 'Deposits and balances of banks and other financial institutions' and 'Deposits from customers', as appropriate. Securities purchased under agreements to re-sell ('reverse repos') are not recognised on the balance sheet and the consideration paid is recorded in 'Advances to customers' or 'Placements with banks and other financial institutions' as appropriate. The difference between the sale and repurchase price is treated as interest and recognised over the life of the agreement.

Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income.

3 Changes in accounting policies

New HKFRSs/IFRSs and amendments to HKFRSs/IFRSs

The HKICPA/IASB has issued a number of new HKFRSs/IFRSs and amendments to HKFRSs/IFRSs that are first effective for the current accounting period commencing 1 January 2013.

The Bank and its subsidiaries adopted the following new accounting standards and amendments to existing accounting standards from 1 January 2013.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

3 Changes in accounting policies (continued)

New HKFRSs/IFRSs and amendments to HKFRSs/IFRSs (continued)

The revised HKAS 19/IAS 19 *Employee benefits* introduces changes in the recognition, presentation and disclosure of defined benefit plans. The most significant impact on the Bank as a result of these revisions comes in the form of the rate used to discount the plan assets. Where this rate was previously based on the expected return on each class of pension assets, plan assets are now measured based on a rate equal to the yield on government bonds, which aligns to the rate at which the defined benefit obligation is discounted. The revised HKAS 19/IAS 19 has been applied retrospectively with comparative amounts restated (see note 45).

HKFRS 10/IFRS 10 Consolidated financial statements replaces the current guidance on consolidation in *HKAS 27/IAS 27 Consolidated and Separate Financial Statements and HK(SIC)12/SIC-12 Special purpose entities*. It introduces a single model of assessing control whereby an investor controls an investee when it has the power, exposure to variable returns and the ability to use its power to influence the returns of the investee. *HKFRS 10/IFRS 10* also includes specific guidance on de facto control, protective rights and the determination of whether a decision maker is acting as principal or agent, all of which influence the assessment of control. *HKFRS 10/IFRS 10* has been applied retrospectively and has not had a material impact on the Bank and its subsidiaries.

HKFRS 11/IFRS 11 Joint arrangements replaces *HKAS 31/IAS 31 Interest in joint ventures*. It requires all joint ventures to be equity accounted thereby removing the option in *HKAS 31/IAS 31* for proportionate consolidation. As a result, the Bank's joint venture investment which was previously proportionately consolidated is now accounted for using the equity method under *HKFRS 11/IFRS 11*. *HKFRS 11/IFRS 11* has been applied retrospectively with comparative amounts restated (see note 45).

HKFRS 12/IFRS 12 Disclosures of interests in other entities prescribes additional disclosures around significant judgements and assumptions made in determining whether an entity controls another entity or has joint control or significant influence over another entity. Relevant disclosures are presented in note 20. *HKFRS 12 / IFRS 12* is required to be applied prospectively.

HKFRS 13/IFRS 13 Fair value measurement consolidates the guidance on how to measure fair value, which was spread across various HKFRSs/IFRSs, into one comprehensive standard. It introduces the use of an exit price, as well as extensive disclosure requirements, particularly the inclusion of non-financial instruments into the fair value hierarchy disclosures. The most significant impact of applying *HKFRS 13/IFRS 13* is the mandatory requirement for the fair value of derivative liabilities and other liabilities held at fair value through profit or loss to take into account an adjustment for an entity's own credit risk. In addition, there is enhanced disclosure of valuation techniques and details on significant unobservable inputs for level 3 financial instruments. The adjustment for own credit risk is recognised in the income statement, and the approach for determining these fair values, along with the enhanced disclosures, are set out in note 38. *HKFRS 13/IFRS 13* is required to be applied prospectively.

Amendments to *HKAS 1/IAS 1 Presentation of financial statements* change the grouping of items presented within Other Comprehensive Income ("OCI") such that the potential impact that OCI items may have on future profit or loss can be more easily identified. Amendments to *HKAS 1/IAS 1* have been applied retrospectively.

Amendments to *HKFRS 7/IFRS 7 Financial Instruments: Disclosure* require the disclosure of the effect or potential effect of netting financial assets and financial liabilities on an entity's financial position. This includes financial instruments transacted under enforceable master netting arrangements or other similar agreements. The relevant disclosures relating to netting benefits are presented in note 38(d). Amendments to *HKFRS 7 / IFRS 7* are required to be applied retrospectively.

None of the other amendments had a material impact on the Bank and its subsidiaries' financial statements.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***4 Operating profit**

The operating profit for the year is stated after taking into account the following:

	2013 HK\$'M	<i>Restated</i> 2012 HK\$'M
(a) Interest income		
Interest income on listed securities	421	497
Interest income on unlisted securities	2,024	2,240
Other interest income	16,069	15,612
	<u>18,514</u>	<u>18,349</u>
Amount shown in the income statement	18,514	18,349
Less: interest income arising from trading assets	(373)	(265)
Less: interest income on financial assets designated at fair value	(67)	(109)
	<u>18,074</u>	<u>17,975</u>
Total interest income on financial assets that are not measured at fair value through profit or loss	<u>18,074</u>	<u>17,975</u>

Other interest income includes interest income on unwinding of discounts on loan impairment charges of HK\$21 million (note 16) (2012: HK\$19 million), and fair value gains of HK\$11 million transferred from reserves on cash flow hedges (2012: HK\$16 million).

	2013 HK\$'M	<i>Restated</i> 2012 HK\$'M
(b) Interest expense		
Interest expense on customer deposits, deposits of banks, certificates of deposit issued, debt securities issued, trading liabilities and financial liabilities designated at fair value	4,932	5,692
Interest expense on subordinated liabilities	342	355
	<u>5,274</u>	<u>6,047</u>
Amount shown in the income statement	5,274	6,047
Less: interest expense arising from trading liabilities	(110)	(130)
Less: interest expense arising from financial liabilities designated at fair value	(33)	(38)
	<u>5,131</u>	<u>5,879</u>
Total interest expense on financial liabilities that are not measured at fair value through profit or loss	<u>5,131</u>	<u>5,879</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***4 Operating profit (continued)**

	2013 HK\$'M	Restated 2012 HK\$'M
(c) Net fee and commission income		
Net fee and commission income (other than amounts included in determining the effective interest rate) arising from financial assets or financial liabilities that are not held for trading or designated at fair value		
– fee and commission income	3,496	3,199
– fee and commission expense	169	173
	<u>3,496</u>	<u>3,199</u>
Net fee and commission income from trust and other fiduciary activities where the Bank and its subsidiaries hold or invest assets on behalf of its customers		
– fee and commission income	494	441
– fee and commission expense	120	117
	<u>494</u>	<u>441</u>
	2013 HK\$'M	2012 HK\$'M
(d) Net trading income		
Gains less losses from dealing in foreign currencies	2,527	2,209
Gains less losses from trading securities	(68)	49
Gains less losses from other dealing activities	1,070	821
	<u>2,527</u>	<u>2,209</u>
Amount shown in the income statement	3,529	3,079
Add: interest income arising from trading assets	373	265
Less: interest expense arising from trading liabilities	(110)	(130)
	<u>3,792</u>	<u>3,214</u>
Net income from trading instruments	<u>3,792</u>	<u>3,214</u>
	2013 HK\$'M	Restated 2012 HK\$'M
(e) Net gains from financial instruments designated at fair value		
Net gains as shown in the income statement	124	188
Add: interest income arising from financial assets designated at fair value	67	109
Less: interest expense arising from financial liabilities designated at fair value	(33)	(38)
	<u>158</u>	<u>259</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***4 Operating profit (continued)**

	2013 HK\$'M	Restated 2012 HK\$'M
(f) Other operating income		
Rental income from operating lease assets	2,089	1,070
Dividend income from listed available-for-sale securities	1	1
Dividend income from unlisted available-for-sale securities	23	24
Gains on disposal of fixed assets	43	–
Net gains/(losses) on disposal of financial instruments measured at amortised cost	17	(17)
Net gains/(losses) on revaluation of investment properties (note 21)	127	(26)
Others	85	111
	<u>2,385</u>	<u>1,163</u>

	2013 HK\$'M	Restated 2012 HK\$'M
(g) Operating expenses		
Staff costs		
– contributions to defined contribution plans	208	188
– expense in respect of the defined benefits plan (note 30(c))	111	109
– equity-settled share-based payment expenses	269	457
– salaries and other staff costs	6,036	6,031
Depreciation (note 21)	1,251	753
Premises and equipment expense, excluding depreciation		
– rental of premises	839	713
– others	330	396
Amortisation		
– other intangible assets (note 22)	141	85
Auditor's remuneration	17	17
Others	4,381	4,296
	<u>13,583</u>	<u>13,045</u>

5 Net gains from disposal of available-for-sale securities

	2013 HK\$'M	2012 HK\$'M
Net gains transferred from reserves	<u>17</u>	<u>149</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***6 Impairment charges**

	<i>2013</i> <i>HK\$'M</i>	<i>2012</i> <i>HK\$'M</i>
(a) Impairment charges on advances to banks and customers		
Individual impairment provisions (note 16)		
– additions	1,292	1,196
– releases	(131)	(76)
– recoveries	(240)	(344)
	<u>921</u>	<u>776</u>
Portfolio impairment charges (note 16)	<u>98</u>	<u>13</u>
	<u>1,019</u>	<u>789</u>
(b) Other impairment charges		
Charges for an interest in an associate	–	465
Charges for risk participation transactions	–	583
Charges/(releases) relating to investment securities classified as:		
– available-for-sale – equity shares	15	–
– loans and receivables – debt securities	(12)	(5)
	<u>3</u>	<u>1,043</u>

7 Taxation in the consolidated income statement**(a) Taxation in the consolidated income statement represents:**

	<i>2013</i> <i>HK\$'M</i>	<i>Restated</i> <i>2012</i> <i>HK\$'M</i>
<i>Current tax</i>		
Hong Kong profits tax	1,881	1,465
Overseas taxation	31	46
Under/(over)-provision in respect of prior years	205	(46)
	<u>2,117</u>	<u>1,465</u>
<i>Deferred tax (note 27)</i>		
Origination/reversal of temporary differences	75	49
Over-provision in respect of prior years	(211)	(7)
	<u>(136)</u>	<u>42</u>
	<u>1,981</u>	<u>1,507</u>

The provision for Hong Kong profits tax for 2013 is calculated at 16.5% (2012: 16.5%) of the estimated assessable profits for the year. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***7 Taxation in the consolidated income statement (continued)****(b) Reconciliation between tax expenses and accounting profit at applicable tax rates:**

	2013 HK\$'M	<i>Restated</i> 2012 HK\$'M
Profit before taxation	13,356	9,676
Notional tax on profit before taxation, calculated at Hong Kong profits tax rate of 16.5%	2,204	1,596
Tax effect of non-deductible expenses	130	165
Tax effect of non-taxable revenue	(334)	(211)
Over-provision in prior years	(6)	(53)
Tax effect of different tax rates of subsidiaries operating in other jurisdictions	(5)	8
Others	(8)	2
Actual tax expense	1,981	1,507

8 Directors' remuneration

Directors' remuneration disclosed pursuant to section 161 of the Hong Kong Companies Ordinance is as follows:

	2013 HK\$'M	<i>Bank</i> 2012 HK\$'M
Fees	1	1
Salaries and other emoluments	88	115
	89	116

9 Segmental reporting

The Bank and its subsidiaries manage its businesses using two main business segments:

- Consumer Banking which provides financial services to customers including lending and deposit taking activities, credit card facilities and investment services; and
- Wholesale Banking which provides financial services to corporations and institutions, including lending and deposit taking activities, structured finance products, syndicated loans, cash management, investment advice, distributing fixed income and equity investments, brokerage services, interbank and capital market activities and proprietary trading.

In addition, certain items which do not fall within the two main business segments, including unallocated central costs are reported in "Other Banking". Financial information is presented internally to the Bank's senior management using these three business segments.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***9 Segmental reporting (continued)**

The Bank and its subsidiaries comprise only one geographical segment as over 90% of the business is based in Hong Kong. Geographical segment is classified by the location of the principal operations of the subsidiary or, in the case of the Bank, the location of the branch responsible for reporting the results or advancing the funds.

(a) Segment results, assets and liabilities

Revenue and expenses are allocated to the reportable segments with reference to income generated by those segments and the expenses incurred by those segments or which otherwise arise from the depreciation or amortisation of assets attributable to those segments.

	Consumer banking		Wholesale banking		Other banking		Inter-segment eliminations		Consolidated Total	
	2013 HK\$'M	2012 HK\$'M	2013 HK\$'M	2012 Restated HK\$'M	2013 HK\$'M	2012 HK\$'M	2013 HK\$'M	2012 HK\$'M	2013 HK\$'M	2012 Restated HK\$'M
<i>Operating income</i>										
- Net interest income	7,397	6,685	6,365	6,673	(131)	(619)			13,631	12,739
- Other operating income	4,534	4,175	10,136	8,405	19	(6)			14,689	12,574
	11,931	10,860	16,501	15,078	(112)	(625)			28,320	25,313
Operating expenses (note)	(6,209)	(5,951)	(6,892)	(6,234)	49	29			(13,052)	(12,156)
Operating profit before impairment	5,722	4,909	9,609	8,844	(63)	(596)			15,268	13,157
Impairment (charges)/releases	(1,081)	(739)	4	(168)	-	-			(1,077)	(907)
Profit before taxation	4,641	4,170	9,613	8,676	(63)	(596)			14,191	12,250
Total assets	274,635	253,230	820,881	702,535	101,201	92,329	(52,647)	(46,660)	1,144,070	1,001,434
Segment liabilities	411,595	367,457	617,447	563,543	113,489	69,237	(52,647)	(46,660)	1,089,884	953,577

(note): Operating expenses in Wholesale banking includes depreciation charges of HK\$1,005 million (2012: HK\$514 million) for commercial aircraft and vessels leased to customers under operating leases.

(b) Reconciliation of reportable segment revenues, profit before taxation, assets and liabilities**Revenue**

	Consolidated	
	2013 HK\$'M	2012 Restated HK\$'M
Reportable segment revenue	28,320	25,313
Income relating to Financial Market products	(1,434)	(1,521)
Cost of free funds	175	208
Others	(288)	(340)
Total operating income	26,773	23,660

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***9 Segmental reporting (continued)****(b) Reconciliation of reportable segment revenues, profit before taxation, assets and liabilities (continued)**

	<i>Consolidated</i>	
	<i>2013</i>	<i>Restated 2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Profit before taxation		
Reportable segment profit before taxation	14,191	12,250
Income relating to Financial Market products	(1,434)	(1,521)
Cost of free funds	175	208
Reallocations of impairment releases/(charges)	42	(947)
Others	382	(314)
	<u>13,356</u>	<u>9,676</u>

	<i>Consolidated</i>	
	<i>2013</i>	<i>Restated 2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Assets		
Reportable segment assets	1,144,070	1,001,434
Assets of group companies not included in consolidated total assets	(3,153)	(2,221)
Others	(116,685)	(59,583)
	<u>1,024,232</u>	<u>939,630</u>

	<i>Consolidated</i>	
	<i>2013</i>	<i>Restated 2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Liabilities		
Reportable segment liabilities	1,089,884	953,577
Liabilities of group companies not included in consolidated total liabilities	(2,521)	(1,928)
Others	(118,177)	(58,798)
	<u>969,186</u>	<u>892,851</u>

Income and profit before taxation recognised in the consolidated financial statements represent an arm's length compensation for the services provided and risks borne. For internal management reporting purposes, income and profit before taxation are allocated on a global perspective. In addition, for internal management reporting purposes, a charge is allocated to reportable segments for the use of interest-free funds.

Reportable segment assets and liabilities include assets and liabilities which are not booked on the Bank and its subsidiaries' balance sheets but which contribute to the reportable segment's income and profit before taxation.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***10 Cash and balances with banks, central banks and other financial institutions**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Cash in hand	1,819	1,833	1,798	1,821
Balances with central banks	14,231	12,600	14,231	12,600
Balances with banks and other financial institutions	10,835	6,059	10,668	5,910
	<u>26,885</u>	<u>20,492</u>	<u>26,697</u>	<u>20,331</u>

11 Placements with banks and other financial institutions**(a) Placements with banks and other financial institutions**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013</i>	<i>Restated 2012</i>	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross placements with banks and other financial institutions				
– maturing within one month	63,688	47,204	63,679	47,197
– maturing between one month to one year	60,600	95,154	60,598	95,153
– maturing between one year to five years	1,580	1,222	1,580	1,222
	<u>125,868</u>	<u>143,580</u>	<u>125,857</u>	<u>143,572</u>
Less: impairment charges individually assessed (note 16(b))	<u>–</u>	<u>(1)</u>	<u>–</u>	<u>(1)</u>
	<u>125,868</u>	<u>143,579</u>	<u>125,857</u>	<u>143,571</u>

(b) Impaired placements with banks and other financial institutions

	<i>Consolidated and Bank</i>	
	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross impaired advances to banks	46	44
Impairment charges – individually assessed	<u>–</u>	<u>(1)</u>
	<u>46</u>	<u>43</u>
Gross impaired advances to banks as a % of gross advances to banks	<u>0.04%</u>	<u>0.03%</u>

There is no collateral held against impaired advances to banks.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***12 Hong Kong SAR Government certificates of indebtedness and currency notes in circulation**

The Hong Kong Special Administrative Region currency notes in circulation are secured by the deposit of funds in respect of which the Government of Hong Kong Special Administrative Region certificates of indebtedness are held.

13 Trading assets

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Trading securities	33,985	27,651	33,985	27,651
Advances to customers	3,983	186	3,983	186
Positive fair values of trading derivatives	893	577	893	573
	<u>38,861</u>	<u>28,414</u>	<u>38,861</u>	<u>28,410</u>
			<i>Consolidated and Bank</i>	
			<i>2013</i>	<i>2012</i>
			<i>HK\$'M</i>	<i>HK\$'M</i>
Trading securities:				
Treasury bills			13,230	8,702
Certificates of deposit held			1,769	1,079
Debt securities			17,882	17,369
Equity securities			1,104	501
			<u>33,985</u>	<u>27,651</u>
Issued by:				
Central governments and central banks			25,376	24,270
Public sector entities			10	16
Banks and other financial institutions			2,485	1,446
Corporate entities			6,114	1,919
			<u>33,985</u>	<u>27,651</u>
By place of listing:				
Listed in Hong Kong			11,118	14,563
Listed outside Hong Kong			6,582	3,591
			<u>17,700</u>	<u>18,154</u>
Unlisted			16,285	9,497
			<u>33,985</u>	<u>27,651</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***14 Financial assets designated at fair value**

	<i>Consolidated and Bank</i>	
	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Debt securities	2,154	3,216
Issued by:		
Corporate entities	2,154	3,216
By place of listing:		
Listed outside Hong Kong	1,389	2,268
Unlisted	765	948
	2,154	3,216

The above financial assets designated at fair value represent certain debt securities with embedded derivatives that are not separately recognised.

15 Advances to customers**(a) Advances to customers****Consolidated**

	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross advances to customers	451,713	406,222
Trade bills	2,892	2,857
	454,605	409,079
Less : Impairment charges		
– individually assessed (note 16(a))	(382)	(494)
– collectively assessed (note 16(a))	(665)	(567)
	453,558	408,018

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***15 Advances to customers (continued)****(a) Advances to customers (continued)****Bank**

	<i>2013</i> <i>HK\$'M</i>	<i>2012</i> <i>HK\$'M</i>
Gross advances to customers	438,175	393,472
Trade bills	2,892	2,857
	<u>441,067</u>	<u>396,329</u>
Less : Impairment charges		
– individually assessed (note 16(a))	(373)	(489)
– collectively assessed (note 16(a))	(508)	(454)
	<u>440,186</u>	<u>395,386</u>

(b) Impaired advances to customers**Consolidated**

	<i>2013</i> <i>HK\$'M</i>	<i>2012</i> <i>HK\$'M</i>
Gross impaired advances to customers	1,935	1,352
Impairment charges – individually assessed	(382)	(494)
	<u>1,553</u>	<u>858</u>
Gross impaired advances to customers as a % of gross advances to customers	<u>0.43%</u>	<u>0.33%</u>
Fair value of collateral held against the covered portion of impaired advances to customers	<u>1,150</u>	<u>749</u>
Covered portion of impaired advances to customers	567	307
Uncovered portion of impaired advances to customers	<u>1,368</u>	<u>1,045</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***15 Advances to customers (continued)****(b) Impaired advances to customers (continued)****Bank**

	<i>2013</i> <i>HK\$'M</i>	<i>2012</i> <i>HK\$'M</i>
Gross impaired advances to customers	1,842	1,325
Impairment charges – individually assessed	(373)	(489)
	<u>1,469</u>	<u>836</u>
Gross impaired advances to customers as a % of gross advances to customers	<u>0.42%</u>	<u>0.33%</u>
Fair value of collateral held against the covered portion of impaired advances to customers	<u>1,131</u>	<u>729</u>
Covered portion of impaired advances to customers	559	298
Uncovered portion of impaired advances to customers	<u>1,283</u>	<u>1,027</u>

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

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***15 Advances to customers (continued)****(c) Net investment in finance leases**

Advances to customers include the net investment in equipment leased to customers under finance leases. The total minimum lease payments receivable under finance leases and their present values at the year end, are as follows:

Consolidated

	2013			2012		
	<i>Present value of the minimum lease payments receivable</i>	<i>Interest income relating to future periods</i>	<i>Total minimum lease payments</i>	<i>Present value of the minimum lease payments receivable</i>	<i>Interest income relating to future periods</i>	<i>Total minimum lease payments</i>
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Within 1 year	5	–	5	7	–	7
After 1 year but within 5 years	–	–	–	–	–	–
After 5 years	–	–	–	–	–	–
	<u>5</u>	<u>–</u>	<u>5</u>	<u>7</u>	<u>–</u>	<u>7</u>
Impairment charges:						
– individually assessed	<u>–</u>			<u>–</u>		
Net investment in finance leases	<u>5</u>			<u>7</u>		

Bank

The Bank has no net investment in finance lease (2012: Nil).

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***16 Movement in impairment charges on advances to banks and customers****(a) Advances to customers****Consolidated**

	2013		
	<i>Individually assessed HK\$'M</i>	<i>Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2013	494	567	1,061
Amounts written off	(1,253)	–	(1,253)
Recoveries of advances written off in previous years	240	–	240
Net charge to the income statement (note 6(a))	921	98	1,019
Unwind of discount on loan impairment charges (note 4(a))	(20)	–	(20)
	<u>382</u>	<u>665</u>	<u>1,047</u>
At 31 December 2013 (note 15(a))			
	2012		
	<i>Individually assessed HK\$'M</i>	<i>Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2012	580	554	1,134
Amounts written off	(1,189)	–	(1,189)
Recoveries of advances written off in previous years	344	–	344
Net charge to the income statement (note 6(a))	776	13	789
Unwind of discount on loan impairment charges (note 4(a))	(17)	–	(17)
	<u>494</u>	<u>567</u>	<u>1,061</u>
At 31 December 2012 (note 15(a))			

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***16 Movement in impairment charges on advances to banks and customers (continued)****(a) Advances to customers (continued)****Bank**

	2013		Total HK\$'M
	Individually assessed HK\$'M	Collectively assessed HK\$'M	
At 1 January 2013	489	454	943
Amounts written off	(849)	–	(849)
Recoveries of advances written off in previous years	198	–	198
Net charge to the income statement	554	54	608
Unwind of discount on loan impairment charges	(19)	–	(19)
	<u>373</u>	<u>508</u>	<u>881</u>
At 31 December 2013 (note 15(a))	<u>373</u>	<u>508</u>	<u>881</u>

	2012		Total HK\$'M
	Individually assessed HK\$'M	Collectively assessed HK\$'M	
At 1 January 2012	578	444	1,022
Amounts written off	(889)	–	(889)
Recoveries of advances written off in previous years	294	–	294
Net charge to the income statement	523	10	533
Unwind of discount on loan impairment charges	(17)	–	(17)
	<u>489</u>	<u>454</u>	<u>943</u>
At 31 December 2012 (note 15(a))	<u>489</u>	<u>454</u>	<u>943</u>

(b) Placements with banks and other financial institutions**Consolidated and Bank**

	Individually assessed	
	2013 HK\$'M	2012 HK\$'M
At 1 January	1	3
Charge to the income statement (note 6(a))	–	–
Unwind of discount on loan impairment charges (note 4(a))	(1)	(2)
	<u>–</u>	<u>1</u>
At 31 December (note 11(a))	<u>–</u>	<u>1</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***17 Investment securities**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Available-for-sale securities				
Treasury bills	66,152	33,507	66,152	33,507
Certificates of deposit held	34,737	31,756	34,737	31,756
Debt securities	91,640	99,706	91,640	99,706
Equity shares	450	526	450	526
Less: impairment charges	(15)	(6)	(15)	(6)
	<u>192,964</u>	<u>165,489</u>	<u>192,964</u>	<u>165,489</u>
Loans and receivables – Debt securities	6,217	8,916	6,217	8,849
Less: impairment charges	–	(26)	–	(26)
	<u>6,217</u>	<u>8,890</u>	<u>6,217</u>	<u>8,823</u>
	<u>199,181</u>	<u>174,379</u>	<u>199,181</u>	<u>174,312</u>
Issued by:				
Available-for-sale securities				
Central governments and central banks	87,007	56,040	87,007	56,040
Public sector entities	2,639	3,162	2,639	3,162
Banks and other financial institutions	84,446	88,744	84,446	88,744
Corporate entities	18,872	17,543	18,872	17,543
	<u>192,964</u>	<u>165,489</u>	<u>192,964</u>	<u>165,489</u>
Loans and receivables – Debt securities				
Corporate entities	6,217	8,890	6,217	8,823
	<u>6,217</u>	<u>8,890</u>	<u>6,217</u>	<u>8,823</u>
	<u>199,181</u>	<u>174,379</u>	<u>199,181</u>	<u>174,312</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***17 Investment securities (continued)**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
By place of listing:				
Available-for-sale securities				
Listed in Hong Kong	12,859	4,581	12,859	4,581
Listed outside Hong Kong	64,334	66,327	64,334	66,327
	<u>77,193</u>	<u>70,908</u>	<u>77,193</u>	<u>70,908</u>
Unlisted	115,771	94,581	115,771	94,581
	<u>192,964</u>	<u>165,489</u>	<u>192,964</u>	<u>165,489</u>
Loans and receivables – Debt securities				
Listed outside Hong Kong	1,520	1,519	1,520	1,519
Unlisted	4,697	7,371	4,697	7,304
	<u>6,217</u>	<u>8,890</u>	<u>6,217</u>	<u>8,823</u>
	<u>199,181</u>	<u>174,379</u>	<u>199,181</u>	<u>174,312</u>

18 Amounts due from/to immediate holding company, fellow subsidiaries and subsidiaries of the Bank

During the year, the Bank and its subsidiaries entered into transactions with related parties in the ordinary course of its banking business including lending, acceptance and placement of inter-bank deposits, correspondent banking transactions, banking operation/outsourcing activities and off-balance sheet transactions.

The Bank has entered into various risk participation transactions with related companies. For funded risk participation transactions, the Bank undertakes to deposit an amount equal to the participating balances with the related companies. When there is a default, under the undertaking clause of the agreement, the Bank is obligated to honor the risk participation by transferring such deposits to the related companies.

During the year, none of these deposits (2012: HK\$583 million) were transferred to the related companies. As at 31 December 2013, the amount due from group companies shown on the balance sheet is stated net of HK\$1,570 million (2012: HK\$1,585 million) in respect of such obligations.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***18 Amounts due from/to immediate holding company, fellow subsidiaries and subsidiaries of the Bank (continued)****Consolidated**

The amounts of material transactions during the year are set out below:

	<i>Immediate holding company</i>		<i>Fellow subsidiaries</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Operating income	322	560	649	214
Operating expenses	1,562	1,583	520	569

The amounts due from/to immediate holding company and fellow subsidiaries stated on the consolidated balance sheet included the following:

	<i>2013</i>		<i>2012</i>	
	<i>Immediate holding company</i>	<i>Fellow subsidiaries</i>	<i>Immediate holding company</i>	<i>Fellow subsidiaries</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Amounts due from:				
Cash and balances with banks and other financial institutions	3,639	4,770	2,156	4,271
Placements with banks and other financial institutions	37,100	29,287	45,952	14,585
Trading assets				
– Positive fair values of trading derivatives	10,515	43	6,097	81
Financial assets designated at fair value				
– Listed debt securities	–	–	–	98
Investment securities				
– Listed available-for-sale debt securities	–	498	–	1,305
Other assets				
– Positive fair values of hedging derivatives	718	–	911	–
– Others	1,717	582	3,615	251
	53,689	35,180	58,731	20,591

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***18 Amounts due from/to immediate holding company, fellow subsidiaries and subsidiaries of the Bank (continued)****Consolidated (continued)**

	2013		2012	
	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M	<i>Immediate holding company</i> HK\$'M	<i>Restated Fellow subsidiaries</i> HK\$'M
Amounts due to:				
Deposits and balances of banks and other financial institutions	4,201	1,935	9,681	2,995
Deposits from customers	–	63	–	5
Trading liabilities:				
– Negative fair values of trading derivatives	10,631	44	5,642	76
Financial liabilities designated at fair value:				
– Structured bank and customer deposits	–	–	186	–
Debt securities in issue	–	1,216	–	1,144
Other liabilities				
– Negative fair values of hedging derivatives	948	96	1,654	264
– Others	3,233	498	2,443	601
	<u>19,013</u>	<u>3,852</u>	<u>19,606</u>	<u>5,085</u>

The contractual amounts of contingent liabilities and commitments to the immediate holding company and fellow subsidiaries are set out below:

	2013		2012	
	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M
Financial guarantees and other credit related contingent liabilities	2,832	230	3,529	5
Loan commitments and other credit related commitments	–	33,850	1,550	50,402

Bank

The amounts of material transactions during the year are set out below:

	<i>Immediate holding company</i>		<i>Fellow subsidiaries</i>		<i>Subsidiaries of the Bank</i>	
	2013 HK\$'M	2012 HK\$'M	2013 HK\$'M	2012 HK\$'M	2013 HK\$'M	2012 HK\$'M
Operating income	<u>381</u>	<u>551</u>	<u>618</u>	<u>223</u>	<u>1,934</u>	<u>1,217</u>
Operating expenses	<u>1,562</u>	<u>1,583</u>	<u>520</u>	<u>569</u>	<u>60</u>	<u>24</u>

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

18 Amounts due from/to immediate holding company, fellow subsidiaries and subsidiaries of the Bank (continued)**Bank (continued)**

The amounts due from/to immediate holding company, fellow subsidiaries and subsidiaries of the Bank stated on the balance sheet included the following:

	2013			2012		
	Immediate holding company HK\$'M	Fellow subsidiaries HK\$'M	Subsidiaries of the Bank HK\$'M	Immediate holding company HK\$'M	Fellow subsidiaries HK\$'M	Restated Subsidiaries of the Bank HK\$'M
Amounts due from:						
Cash and balances with banks and other financial institutions	2,684	4,603	–	1,255	4,195	–
Placements with banks and other financial institutions	36,945	29,282	8,662	45,952	14,584	7,998
Trading assets						
– Positive fair values of trading derivatives	10,511	43	–	6,093	81	–
Financial assets designated at fair value						
– Listed debt securities	–	–	–	–	98	–
Investment securities						
– Listed available-for-sale debt securities	–	498	–	–	1,305	–
Advances to customers	–	–	26,948	–	–	23,168
Other assets						
– Positive fair values of hedging derivatives	718	–	–	911	–	–
– Others	1,637	480	1,797	3,535	197	2,527
	<u>52,495</u>	<u>34,906</u>	<u>37,407</u>	<u>57,746</u>	<u>20,460</u>	<u>33,693</u>
Amounts due to:						
Deposits and balances of banks and other financial institutions	4,201	1,935	127	9,681	2,995	160
Deposits from customers	–	63	722	–	5	733
Trading liabilities:						
– Negative fair values of trading derivatives	10,631	44	–	5,642	76	–
Financial liabilities designated at fair value:						
– Structured bank and customer deposits	–	–	–	186	–	–
Debt securities in issue	–	1,216	–	–	1,144	–
Other liabilities						
– Negative fair values of hedging derivatives	948	96	–	1,654	264	–
– Others	2,663	408	1,087	1,961	524	1,124
	<u>18,443</u>	<u>3,762</u>	<u>1,936</u>	<u>19,124</u>	<u>5,008</u>	<u>2,017</u>

The contractual amounts of contingent liabilities and commitments to the immediate holding company, fellow subsidiaries and subsidiaries of the Bank are set out below:

	2013			2012		
	Immediate holding company HK\$'M	Fellow subsidiaries HK\$'M	Subsidiaries of the Bank HK\$'M	Immediate holding company HK\$'M	Fellow subsidiaries HK\$'M	Subsidiaries of the Bank HK\$'M
Financial guarantees and other credit related contingent liabilities	2,832	230	8	3,529	5	83
Loan commitments and other credit related commitments	–	33,850	16,670	1,550	50,402	14,748

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***19 Investments in subsidiaries of the Bank**

	<i>Bank</i>	
	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Unlisted shares, at cost less impairment charges, if any	1,222	1,100

The following list contains only the particulars of subsidiaries which principally affected the results, assets or liabilities of the Bank and its subsidiaries.

<i>Name of company</i>	<i>Place of incorporation</i>	<i>Particulars of issued and paid up capital</i>	<i>Proportion of ownership interest held by the Bank</i>	<i>Principal activity</i>
Standard Chartered APR Limited	United Kingdom	21,971,715 ordinary shares of US\$1 each	100%	Investment holdings
Standard Chartered Securities (Hong Kong) Limited	Hong Kong	1,000,000 ordinary shares of HK\$10 each	100%	Equity capital markets, corporate finance and institutional brokerage
Prime Credit Limited ("PCL")	Hong Kong	400,000 ordinary shares of HK\$100 each	100%	Provision of banking and related financial services
Standard Chartered Leasing Group Limited	Hong Kong	30,000 ordinary shares of US\$1 each	100%	Provision of leasing services

20 Interest in associates***Consolidated***

	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Share of net assets	7,079	5,849
Goodwill	1,717	1,717
Less: Impairment losses	(465)	(465)
	<u>8,331</u>	<u>7,101</u>

Bank

	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Unlisted investments, at cost less impairment losses, if any	3,290	3,222
Listed investment, at cost less impairment losses, if any	837	837
	<u>4,127</u>	<u>4,059</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***20 Interest in associates (continued)**

The following list contains only the particulars of material associates:

<i>Name of associate</i>	<i>Place of establishment and operation</i>	<i>Particulars of issued and paid up capital</i>	<i>Proportion of ownership interest</i>	<i>Principal activity</i>
Asia Commercial Joint Stock Bank ("ACB")	Vietnam	937,696,506 ordinary shares of VND10,000 each	15%	Provision of banking and related financial services (Note 1)
China Bohai Bank Company Limited ("Bohai")	The People's Republic of China	13,855,000,000 ordinary shares of RMB1 each	19.99%	Provision of banking and related financial services (Note 2)

Note 1: ACB is a strategic partner for the Group, providing investment opportunities and access to the Vietnam market.

Note 2: Bohai is a strategic partner for the Group to develop its China business.

Shareholdings in associated companies include a listed investment of HK\$1,998 million (2012: HK\$2,016 million). At the balance sheet date, the investment based on quoted market prices was valued at HK\$807 million (2012: HK\$862 million). Impairment testing on the investment has been carried out using a value-in-use methodology and this demonstrates that there is no additional impairment charge required in 2013 (2012: HK\$465 million).

The Bank and its subsidiaries' investment in ACB and Bohai are less than 20% but both companies are considered to be associates because of the significant influence the Bank is able to exercise over the management of these companies and their financial and operating policies. Significant influence is evidenced largely through the interchange of management personnel and the provision of expertise.

In respect of the year ended 31 December 2013, the share of the results of ACB was included in these financial statements based on accounts drawn up to 30 September 2013, but taking into account any events or transactions in the subsequent period from 1 October 2013 to 31 December 2013 that would materially affect the results. Bohai's result was included in the financial statements based on accounts drawn up to 30 November 2013. The Bank and its subsidiaries have taken advantage of the provision contained in HKAS 28/IAS 28 "Investments in Associates" whereby it is permitted to include the attributable share of associates' results based on accounts drawn up to a non-coterminous period and where the difference is not greater than three months.

All of the above associates are accounted for using the equity method in the consolidated financial statements.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***20 Interest in associates (continued)****Summary of financial information of the material associates and reconciliation to the carrying amounts in the consolidated financial statements**

	2013		2012	
	ACB HK\$'M	Bohai HK\$'M	ACB HK\$'M	Bohai HK\$'M
Gross amounts of the associates				
Assets	58,990	686,025	79,619	534,417
Liabilities	54,280	655,018	74,789	509,269
Net assets	4,710	31,007	4,830	25,148
Revenue	6,370	15,411	9,677	11,112
Profit after taxation	300	5,677	908	3,778
Other comprehensive loss	–	(271)	–	(58)
Total comprehensive income	300	5,406	908	3,720
Dividends received from the associate	35	–	104	–
Gross amount of net assets of the associate	4,710	31,007	4,830	25,148
Effective interest of the Bank and its subsidiaries	15%	19.99%	15%	19.99%
Share of net assets of the associate by the Bank and its subsidiaries	707	6,198	725	5,027
Fair value adjustment on acquisition	39	–	39	–
Goodwill	1,717	–	1,717	–
Less: Impairment	(465)	–	(465)	–
Carrying amount in the consolidated financial statements	1,998	6,198	2,016	5,027

Associates that are not individually material

	2013 HK\$'M	2012 HK\$'M
Carrying amount in the consolidated financial statements	135	58
Profit after taxation and total comprehensive income	8	1

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

20 Interest in associates (continued)**Reconciliation to the Bank and its subsidiaries' total interest in associates:**

	2013 HK\$'M	2012 HK\$'M
Carrying amount of material associates		
- ACB	1,998	2,016
- Bohai	6,198	5,027
Carrying amount of other associates	135	58
	<u>8,331</u>	<u>7,101</u>
Interest in associates in the consolidated financial statements	<u>8,331</u>	<u>7,101</u>

21 Fixed assets**Consolidated**

	2013					
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Operating lease assets HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost or valuation:						
At 1 January 2013, as previously stated	2,946	513	21,202	24,661	552	25,213
Effect of adoption of HKFRS 11/IFRS 11	-	-	-	-	(41)	(41)
As restated	2,946	513	21,202	24,661	511	25,172
Additions	100	115	6,783	6,998	-	6,998
Disposals and write-offs	(29)	(163)	(1,101)	(1,293)	-	(1,293)
Reclassifications	(40)	40	-	-	-	-
Fair value adjustments (note 4(f))	-	-	-	-	127	127
At 31 December 2013	<u>2,977</u>	<u>505</u>	<u>26,884</u>	<u>30,366</u>	<u>638</u>	<u>31,004</u>
Representing:						
Cost	2,977	505	26,884	30,366	-	30,366
Valuation	-	-	-	-	638	638
	<u>2,977</u>	<u>505</u>	<u>26,884</u>	<u>30,366</u>	<u>638</u>	<u>31,004</u>
Accumulated depreciation:						
At 1 January 2013	591	269	607	1,467	-	1,467
Charge for the year (note 4(g))	114	132	1,005	1,251	-	1,251
Attributable to assets sold or written off	(29)	(163)	(95)	(287)	-	(287)
At 31 December 2013	<u>676</u>	<u>238</u>	<u>1,517</u>	<u>2,431</u>	<u>-</u>	<u>2,431</u>
Net book value:						
At 31 December 2013	<u>2,301</u>	<u>267</u>	<u>25,367</u>	<u>27,935</u>	<u>638</u>	<u>28,573</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***21 Fixed assets (continued)****Consolidated (continued)**

	2012 Restated					
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Operating lease assets HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost or valuation:						
At 1 January 2012, as previously stated	2,958	488	7,359	10,805	586	11,391
Effect of adoption of HKFRS 11/IFRS 11	–	–	–	–	(55)	(55)
As restated	2,958	488	7,359	10,805	531	11,336
Additions	119	67	13,843	14,029	–	14,029
Disposals and write-offs	(54)	(115)	–	(169)	–	(169)
Surplus on revaluation credited to property revaluation reserve	2	–	–	2	–	2
Reclassifications	(79)	73	–	(6)	6	–
Fair value adjustments (note 4(f))	–	–	–	–	(26)	(26)
At 31 December 2012	2,946	513	21,202	24,661	511	25,172
Representing:						
Cost	2,946	513	21,202	24,661	–	24,661
Valuation	–	–	–	–	511	511
	2,946	513	21,202	24,661	511	25,172
Accumulated depreciation:						
At 1 January 2012	535	241	93	869	–	869
Charge for the year (note 4(g))	96	143	514	753	–	753
Attributable to assets sold or written off	(40)	(115)	–	(155)	–	(155)
At 31 December 2012	591	269	607	1,467	–	1,467
Net book value:						
At 31 December 2012	2,355	244	20,595	23,194	511	23,705

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***21 Fixed assets (continued)****Bank**

	2013				
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost or valuation:					
At 1 January 2013	2,699	465	3,164	503	3,667
Additions	95	82	177	–	177
Disposals and write-offs	(29)	(159)	(188)	–	(188)
Reclassifications	(39)	39	–	–	–
Fair value adjustments	–	–	–	125	125
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
At 31 December 2013	2,726	427	3,153	628	3,781
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Representing:					
Cost	2,726	427	3,153	–	3,153
Valuation	–	–	–	628	628
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	2,726	427	3,153	628	3,781
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Accumulated depreciation:					
At 1 January 2013	579	258	837	–	837
Charge for the year	109	120	229	–	229
Attributable to assets sold or written off	(29)	(159)	(188)	–	(188)
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
At 31 December 2013	659	219	878	–	878
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Net book value:					
At 31 December 2013	2,067	208	2,275	628	2,903
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***21 Fixed assets (continued)****Bank (continued)**

	2012				
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost or valuation:					
At 1 January 2012	2,694	456	3,150	531	3,681
Additions	116	48	164	–	164
Disposals and write-offs	(40)	(110)	(150)	–	(150)
Reclassifications	(71)	71	–	–	–
Fair value adjustments	–	–	–	(28)	(28)
	<u>2,699</u>	<u>465</u>	<u>3,164</u>	<u>503</u>	<u>3,667</u>
At 31 December 2012	2,699	465	3,164	503	3,667
Representing:					
Cost	2,699	465	3,164	–	3,164
Valuation	–	–	–	503	503
	<u>2,699</u>	<u>465</u>	<u>3,164</u>	<u>503</u>	<u>3,667</u>
Accumulated depreciation:					
At 1 January 2012	527	235	762	–	762
Charge for the year	91	133	224	–	224
Attributable to assets sold or written off	(39)	(110)	(149)	–	(149)
	<u>579</u>	<u>258</u>	<u>837</u>	<u>–</u>	<u>837</u>
At 31 December 2012	579	258	837	–	837
Net book value:					
At 31 December 2012	<u>2,120</u>	<u>207</u>	<u>2,327</u>	<u>503</u>	<u>2,830</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***21 Fixed assets (continued)****(a) Buildings and leasehold land held for own use**

	Consolidated		Bank	
	2013 HK\$'M	2012 HK\$'M	2013 HK\$'M	2012 HK\$'M
Leasehold in Hong Kong, at cost				
– long-term leases	35	33	–	–
– medium-term leases	1,982	2,044	1,970	2,032
– short-term leases	97	88	97	88
	<u>2,114</u>	<u>2,165</u>	<u>2,067</u>	<u>2,120</u>
Freehold outside Hong Kong, at cost	<u>187</u>	<u>190</u>	<u>–</u>	<u>–</u>
	<u>2,301</u>	<u>2,355</u>	<u>2,067</u>	<u>2,120</u>

(b) Investment properties

	Consolidated		Bank	
	2013 HK\$'M	Restated 2012 HK\$'M	2013 HK\$'M	2012 HK\$'M
Leasehold in Hong Kong, at fair value				
– medium-term lease	10	8	–	–
Freehold outside Hong Kong, at fair value	<u>628</u>	<u>503</u>	<u>628</u>	<u>503</u>
	<u>638</u>	<u>511</u>	<u>628</u>	<u>503</u>

The investment property outside Hong Kong was revalued as at 31 December 2013 on an open market value basis. The valuation was carried out by an independent firm, CBRE Limited, which has among its staff, members of the Royal Institute of Chartered Surveyors with recent experience in the location and category of the property being valued.

The fair value of the investment property is primarily determined using comparable recent market transactions on arm's length terms.

These fair values are categorised as level 2 valuations using observable inputs.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***21 Fixed assets (continued)****(c) Operating lease assets:**

Assets leased to customers under operating leases consist of commercial aircraft and vessels. At 31 December, the total future minimum lease receivables under operating leases are as follows:

	<i>Consolidated</i>	
	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Within 1 year	2,606	2,057
After 1 year but within 5 years	7,661	5,906
After 5 years	12,031	9,992
	<u>22,298</u>	<u>17,955</u>

22 Goodwill and intangible assets***Consolidated***

	<i>2013</i>		
	<i>Capitalised software and other intangible assets</i>	<i>Goodwill</i>	<i>Total</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Cost:			
At 1 January 2013	481	1,507	1,988
Additions	253	–	253
Disposals and write-offs	(32)	–	(32)
	<u>702</u>	<u>1,507</u>	<u>2,209</u>
At 31 December 2013	<u>702</u>	<u>1,507</u>	<u>2,209</u>
Accumulated amortisation:			
At 1 January 2013	167	–	167
Charge for the year (note 4(g))	141	–	141
Attributable to intangible assets sold or written off	(32)	–	(32)
	<u>276</u>	<u>–</u>	<u>276</u>
At 31 December 2013	<u>276</u>	<u>–</u>	<u>276</u>
Carrying amount:			
At 31 December 2013	<u>426</u>	<u>1,507</u>	<u>1,933</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***22 Goodwill and intangible assets (continued)**

	2012		
	<i>Capitalised software and other intangible assets</i> HK\$'M	<i>Goodwill</i> HK\$'M	<i>Total</i> HK\$'M
Cost:			
At 1 January 2012	381	1,507	1,888
Additions	165	–	165
Disposals and write-offs	(65)	–	(65)
	<hr/>	<hr/>	<hr/>
At 31 December 2012	481	1,507	1,988
	<hr/>	<hr/>	<hr/>
Accumulated amortisation:			
At 1 January 2012	147	–	147
Charge for the year (note 4(g))	85	–	85
Attributable to intangible assets sold or written off	(65)	–	(65)
	<hr/>	<hr/>	<hr/>
At 31 December 2012	167	–	167
	<hr/>	<hr/>	<hr/>
Carrying amount:			
At 31 December 2012	314	1,507	1,821
	<hr/>	<hr/>	<hr/>
Bank			
	2013		
	<i>Capitalised software and other intangible assets</i> HK\$'M	<i>Goodwill</i> HK\$'M	<i>Total</i> HK\$'M
Cost:			
At 1 January 2013	398	729	1,127
Additions	253	–	253
Disposals and write-offs	(32)	–	(32)
	<hr/>	<hr/>	<hr/>
At 31 December 2013	619	729	1,348
	<hr/>	<hr/>	<hr/>
Accumulated amortisation:			
At 1 January 2013	116	–	116
Charge for the year	134	–	134
Attributable to intangible assets sold or written off	(32)	–	(32)
	<hr/>	<hr/>	<hr/>
At 31 December 2013	218	–	218
	<hr/>	<hr/>	<hr/>
Carrying amount:			
At 31 December 2013	401	729	1,130
	<hr/>	<hr/>	<hr/>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***22 Goodwill and intangible assets (continued)**

	2012		
	<i>Capitalised software and other intangible assets HK\$'M</i>	<i>Goodwill HK\$'M</i>	<i>Total HK\$'M</i>
Cost:			
At 1 January 2012	298	729	1,027
Additions	165	–	165
Disposals and write-offs	(65)	–	(65)
	<hr/>	<hr/>	<hr/>
At 31 December 2012	398	729	1,127
	<hr/>	<hr/>	<hr/>
Accumulated amortisation:			
At 1 January 2012	106	–	106
Charge for the year	75	–	75
Attributable to intangible assets sold or written off	(65)	–	(65)
	<hr/>	<hr/>	<hr/>
At 31 December 2012	116	–	116
	<hr/>	<hr/>	<hr/>
Carrying amount:			
At 31 December 2012	282	729	1,011
	<hr/>	<hr/>	<hr/>

Impairment tests for cash-generating units containing goodwill

Goodwill is allocated to the Bank and its subsidiaries' cash-generating units ("CGUs") as follows:

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013 HK\$'M</i>	<i>2012 HK\$'M</i>	<i>2013 HK\$'M</i>	<i>2012 HK\$'M</i>
Lending	611	611	611	611
Private Banking	118	118	118	118
Standard Chartered Securities (Hong Kong) Limited	253	253	–	–
Prime Credit Limited	525	525	–	–
	<hr/>	<hr/>	<hr/>	<hr/>
	1,507	1,507	729	729
	<hr/>	<hr/>	<hr/>	<hr/>

The recoverable amounts of the CGUs are determined based on value in use calculations. The key assumptions and approach to determining value in use calculations, as set out below, are solely estimates for the purpose of assessing impairment on acquired goodwill. These calculations use cash flow projections over a 20-year period based on budgets and forecasts approved by management. These budgets and forecasts cover periods of one year, except for Standard Chartered Securities (Hong Kong) Limited, where budgets and forecasts cover periods up to five years. These budgets and forecasts are extrapolated forward using steady growth rates of 4.4 per cent (2012: 4.2 per cent).

In assessing impairment of goodwill, the Bank and its subsidiaries assumed growth at a steady rate in line with long-term forecast GDP growth. A discount rate of 15.2 per cent (2012: 11.8 per cent) was used.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***23 Other assets**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Prepayments and accrued income	2,795	3,012	2,738	2,921
Sundry debtors	2,327	3,190	2,104	2,965
Acceptances and endorsements	5,591	4,839	5,591	4,839
Unsettled trades and others	4,443	5,960	2,722	3,681
	<u>15,156</u>	<u>17,001</u>	<u>13,155</u>	<u>14,406</u>

24 Deposits from customers

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Current accounts	113,756	101,131	113,756	101,131
Savings accounts	393,863	373,620	393,863	373,620
Time, call and notice deposits	273,209	257,669	272,081	256,567
Deposits and balances of central banks	36,600	24,169	36,600	24,169
	<u>817,428</u>	<u>756,589</u>	<u>816,300</u>	<u>755,487</u>

25 Debt securities in issue

	<i>Consolidated and Bank</i>	
	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Certificates of deposit, measured at amortised cost	<u>15,336</u>	<u>10,006</u>

26 Financial liabilities designated at fair value

	<i>Consolidated and Bank</i>	
	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Structured bank and customer deposits	3,897	3,574
Debt securities issued	<u>1,826</u>	<u>38</u>
	<u>5,723</u>	<u>3,612</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***26 Financial liabilities designated at fair value (continued)**

The Bank designates certain financial liabilities at fair value where either the liabilities:

- have fixed rates of interest and interest rate swaps or other interest related derivatives have been transacted with the intention of significantly reducing interest rate risk; or
- are exposed to equity price risk, foreign currency risk or credit risk and derivatives have been transacted with the intention of significantly reducing exposure to market changes;

At 31 December 2013, the contractual amount payable at maturity of these financial liabilities exceeded the carrying amount by HK\$60 million (2012: HK\$30 million). Of this, a gain of HK\$2 million (2012: Nil) relates to changes in credit risk. The cumulative fair value movement relating to changes in credit risk was a gain of HK\$2 million (2012: Nil).

27 Taxation in the balance sheet***Deferred tax assets and liabilities:***

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

Consolidated

	<i>Depreciation allowances in excess of related depreciation HK\$'M</i>	<i>Impairment losses on financial assets HK\$'M</i>	<i>Available- for-sale securities HK\$'M</i>	<i>Others HK\$'M</i>	<i>Total HK\$'M</i>
<i>2013</i>					
<i>Deferred tax arising from:</i>					
At 1 January 2013	221	(101)	40	(205)	(45)
Charge/(release) to income statement (note 7(a))	231	(16)	–	(351)	(136)
(Release)/charge to reserves	–	–	(16)	25	9
Disposal of a subsidiary	–	7	–	2	9
	<u>452</u>	<u>(110)</u>	<u>24</u>	<u>(529)</u>	<u>(163)</u>
<i>2012 Restated</i>					
At 1 January 2012, as previously stated	53	(103)	(167)	(97)	(314)
Effect of adoption of HKFRS 11/IFRS 11	–	–	–	2	2
	<u>53</u>	<u>(103)</u>	<u>(167)</u>	<u>(95)</u>	<u>(312)</u>
Charge/(release) to income statement (note 7(a))	168	2	–	(128)	42
Charge to reserves	–	–	207	18	225
	<u>221</u>	<u>(101)</u>	<u>40</u>	<u>(205)</u>	<u>(45)</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***27 Taxation in the balance sheet (continued)*****Deferred tax assets and liabilities (continued):***

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

Bank

	<i>Depreciation allowances in excess of related depreciation HK\$'M</i>	<i>Impairment losses on financial assets HK\$'M</i>	<i>Available- for-sale securities HK\$'M</i>	<i>Others HK\$'M</i>	<i>Total HK\$'M</i>
<i>2013</i>					
<i>Deferred tax arising from:</i>					
At 1 January 2013	29	(75)	40	(32)	(38)
Charge/(release) to income statement	29	(9)	–	(218)	(198)
(Release)/charge to reserves	–	–	(16)	25	9
	<u>58</u>	<u>(84)</u>	<u>24</u>	<u>(225)</u>	<u>(227)</u>
<i>2012 Restated</i>					
At 1 January 2012	12	(74)	(167)	(46)	(275)
Charge/(release) to income statement	17	(1)	–	(4)	12
Charge to reserves	–	–	207	18	225
	<u>29</u>	<u>(75)</u>	<u>40</u>	<u>(32)</u>	<u>(38)</u>
<i>Consolidated</i>					
<i>Restated</i>					
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>	
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	
<i>Analysed by:</i>					
Net deferred tax asset recognised on the balance sheet	(275)	(88)	(227)	(38)	
Net deferred tax liability recognised on the balance sheet	112	43	–	–	
	<u>(163)</u>	<u>(45)</u>	<u>(227)</u>	<u>(38)</u>	

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***28 Trading liabilities**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Short positions in securities	22,417	22,229	22,417	22,229
Negative fair values of trading derivatives	1,130	839	1,130	836
	<u>23,547</u>	<u>23,068</u>	<u>23,547</u>	<u>23,065</u>

29 Other liabilities

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013</i>	<i>Restated 2012</i>	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Accruals and deferred income	4,525	5,009	4,121	4,603
Provision for liabilities and charges	129	230	62	230
Acceptances and endorsements	5,591	4,839	5,591	4,839
Unsettled trades and others	11,802	8,106	11,019	7,533
	<u>22,047</u>	<u>18,184</u>	<u>20,793</u>	<u>17,205</u>

30 Employee retirement benefits

The Bank makes contributions to a defined benefit retirement scheme, namely Standard Chartered Bank Hong Kong Retirement Scheme (“the Scheme”), which provides lump sum benefits based on a multiple of a member’s final salary and years of service upon the member’s retirement, death, disability or leaving service. The Scheme is closed to new employees.

The Scheme was established under a trust arrangement. It is registered under the Occupational Retirement Schemes Ordinance (“ORSO”). The Bank is the sole employer participating in the Scheme.

The Bank has an unconditional right to the Scheme’s surplus and the Scheme has no minimum funding requirements.

The key responsibilities of the Scheme’s trustees are to ensure that the Scheme is administered in accordance with the trust deed and to act on behalf of all members impartially, prudently and in good faith.

The Scheme exposes the Bank to interest rate risk, investment risk and salary risk.

The Bank’s contributions are determined with reference to the funding valuation carried out by the Scheme’s actuary in accordance with the ORSO requirements. The last funding valuation of the Scheme was carried out as at 31 December 2011.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***30 Employee retirement benefits (continued)****(a) The amounts recognised in the consolidated balance sheet are as follows:**

	2013 HK\$'M	2012 HK\$'M
Fair value of plan assets	2,203	2,069
Present value of wholly or partly funded obligations	(2,225)	(2,309)
	<u> </u>	<u> </u>
Net liability recognised in the balance sheet (included in "Other liabilities")	<u> (22)</u>	<u> (240)</u>

(b) Movements in the fair value of plan assets and the present value of the defined benefit obligations:

	2013		
	Assets HK\$'M	Obligations HK\$'M	Total HK\$'M
At 1 January 2013	2,069	(2,309)	(240)
Contributions	62	–	62
Benefits paid	(152)	152	–
Current service cost	–	(109)	(109)
Interest income/(cost)	14	(15)	(1)
Administrative expenses	(1)	–	(1)
Return on plan assets, excluding interest income	211	–	211
Actuarial loss – from experience	–	(60)	(60)
Actuarial loss – from demographic assumptions	–	–	–
Actuarial gain – from financial assumptions	–	116	116
	<u> </u>	<u> </u>	<u> </u>
At 31 December 2013	<u> 2,203</u>	<u> (2,225)</u>	<u> (22)</u>
	2012 Restated		
	Assets HK\$'M	Obligations HK\$'M	Total HK\$'M
At 1 January 2012	1,906	(2,129)	(223)
Contributions	61	–	61
Benefits paid	(132)	132	–
Current service cost	–	(105)	(105)
Interest income/(cost)	27	(30)	(3)
Administrative expenses	(1)	–	(1)
Return on plan assets, excluding interest income	208	–	208
Actuarial loss – from experience	–	(57)	(57)
Actuarial loss – from demographic assumptions	–	(5)	(5)
Actuarial loss – from financial assumptions	–	(115)	(115)
	<u> </u>	<u> </u>	<u> </u>
At 31 December 2012	<u> 2,069</u>	<u> (2,309)</u>	<u> (240)</u>

The weighted average duration of the defined benefit obligation as at 31 December 2013 is 6 years (2012: 6 years).

The Bank expects to contribute approximately HK\$61 million to the Scheme in 2014.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***30 Employee retirement benefits (continued)****(c) The expense recognised in the consolidated income statement for the year is as follows:**

	2013 HK\$'M	Restated 2012 HK\$'M
Current service cost	109	105
Net interest cost	1	3
Administrative expenses	1	1
	<u>111</u>	<u>109</u>

(d) The principal actuarial assumptions used in the valuation and sensitivity analysis are as follows:

	2013 HK\$'M	2012 HK\$'M
Discount rate	2.00%	0.70%
Future salary increases	4.00%	3.50%

These assumptions are likely to change in the future and thus will affect the value placed on the defined benefit obligations. Changes at the reporting date to one of the relevant actuarial assumptions, holding other assumptions constant, would have affected the defined benefit obligation by the amounts shown below:

- if the discount rate increased by 25 basis points the obligation would reduce by approximately HK\$32 million.
- if the rate of growth of salaries was higher by 25 basis points the obligation would increase by approximately HK\$31 million.

The above sensitivity analysis is based on the assumption that changes in actuarial assumptions are not correlated and therefore it does not take into account the correlations between the actuarial assumptions.

(e) The major categories of assets as a percentage of total assets are as follows:

	2013 HK\$'M	2012 HK\$'M
Equities	62%	52%
Bonds	31%	45%
Cash	7%	3%
	<u>100%</u>	<u>100%</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***30 Employee retirement benefits (continued)****(e) The major categories of assets as a percentage of total assets are as follows: (continued)**

As at 31 December 2013, the Scheme did not invest in the Bank's own financial instruments and properties (2012: Nil). The Scheme has a benchmark asset allocation of 60% in equities and 40% in bonds and cash (2012: 50% in equities and 50% in bonds and cash). The long term strategic asset allocations of the Scheme are set and reviewed from time to time by the trustees taking into account the Scheme's membership, liability profile, liquidity requirements, and the risk appetite of the Bank.

31 Subordinated liabilities

	<i>Consolidated and Bank</i>	
	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
US\$750 million 5.875% Fixed Rate Notes 2020 ⁽¹⁾	6,120	6,565
SGD750 million 4.15% Fixed Rate Notes 2021 ⁽²⁾	4,428	4,702
	<u>10,548</u>	<u>11,267</u>

All subordinated liabilities are unsecured and subordinated to the claims of other creditors.

- ⁽¹⁾ Interest rate at 5.875 per cent per annum, payable semi-annually, to the maturity date on 24 June 2020.
- ⁽²⁾ Interest rate at 4.15 per cent per annum, payable semi-annually, to the maturity date on 27 October 2021.

32 Share capital

	<i>2013 and 2012</i>	
	<i>No. of shares in millions</i>	<i>HK\$'M</i>
Authorised:		
'A' ordinary shares of HK\$0.05 each	780	39
'B' ordinary shares of HK\$0.05 each	1,231	62
	<u>2,011</u>	<u>101</u>
Preference shares of HK\$1.00 each	3,800	3,800
	<u>5,811</u>	<u>3,901</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***32 Share capital (continued)**

	<i>2013 and 2012</i>	
	<i>No. of shares in millions</i>	<i>HK\$'M</i>
<i>Issued and fully paid:</i>		
'A' ordinary shares of HK\$0.05 each	706	35
'B' ordinary shares of HK\$0.05 each	1,231	62
	<hr/>	<hr/>
Preference shares of HK\$1.00 each	1,937	97
	<hr/>	<hr/>
	–	–
	<hr/>	<hr/>
	1,937	97
	<hr/> <hr/>	<hr/> <hr/>

The preference shares bear a non-cumulative preferential dividend at a rate of 8.25% per annum on their nominal amount and rank in priority to the 'A' ordinary shares and the 'B' ordinary shares with respect to the payment of dividends and any return of capital. The 'B' ordinary shares rank in priority to the 'A' ordinary shares with respect to any return of capital.

33 Reserves***Nature and purpose of reserves*****(i) Share premium**

The application of the share premium account is governed by Section 48B of the Hong Kong Companies Ordinance.

(ii) Capital redemption reserve

The capital redemption reserve represents the repurchase of the Bank's own shares.

(iii) Available-for-sale investment reserve

The available-for-sale investment reserve comprises the cumulative net change in the fair value of available-for-sale securities held at the balance sheet date and is dealt with in accordance with the accounting policy in note 2(i).

(iv) Cash flow hedge reserve

The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair value of hedging instruments used in cash flow hedges pending subsequent recognition of the hedged cash flow in accordance with the accounting policy adopted for cash flow hedges in note 2(j).

(v) Exchange reserve

The exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations. The reserve is dealt with in accordance with the accounting policy set out in note 2(s).

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***33 Reserves (continued)*****Nature and purpose of reserves (continued)*****(vi) Revaluation reserve**

The revaluation reserve comprises the share of the change in fair value of an associate's identifiable net assets prior to the Bank and its subsidiaries obtaining significant influence in a step-acquisition.

(vii) Share option equity reserve

The Group operates equity-settled share-based compensation plans in which the Bank and its subsidiaries' employees participate. The fair value of the employee services received in exchange for the grant of the share awards is recognised as an expense with the corresponding amount credited to the share option equity reserve.

(viii) Property revaluation reserve

The property revaluation reserve represents the revaluation surplus arising upon the reclassification of a property previously included in "Buildings and leasehold land held for own use" to "investment properties".

The HKMA requires the Bank and its subsidiaries to maintain a minimum level of impairment allowances which is in excess of the impairment allowances required under Hong Kong Financial Reporting Standards. Of the retained earnings as at 31 December 2013, an amount of HK\$6,148 million (2012: HK\$5,561 million) has been reserved for this purpose.

34 Cash and cash equivalents

	<i>2013</i>	<i>Restated</i>
	<i>HK\$'M</i>	<i>2012</i>
		<i>HK\$'M</i>
(a) <i>Components of cash and cash equivalents in the cash flow statement</i>		
Cash and balances with banks, central banks and other financial institutions	26,885	20,492
Trading assets with original maturity within three months	5,807	2,599
Placements with banks and other financial institutions with original maturity within three months	66,343	60,268
Investment securities with original maturity within three months	20,720	10,609
Amounts due from immediate holding company and fellow subsidiaries with original maturity within three months	51,068	53,067
Less: Overdrafts included in "deposits and balances of banks and other financial institutions"	(19)	(153)
Less: Overdrafts included in "amounts due to immediate holding company"	(1,997)	(5,736)
	<u>168,807</u>	<u>141,146</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Cash and cash equivalents (continued)**

	2013 HK\$'M	<i>Restated</i> 2012 HK\$'M
(b) Reconciliation with the consolidated balance sheet		
Cash and balances with banks, central banks, and other financial institutions	26,885	20,492
Trading assets	38,861	28,414
Placements with banks and other financial institutions	125,868	143,579
Investment securities	199,181	174,379
Amounts due from immediate holding company and fellow subsidiaries	88,869	79,322
Overdrafts included in "deposits and balances of banks and other financial institutions"	(19)	(153)
Overdrafts included in "amounts due to immediate holding company"	(1,997)	(5,736)
	<hr/>	<hr/>
Amounts shown in the balance sheet	477,648	440,297
Less: amounts with an original maturity of beyond three months	(308,841)	(299,151)
	<hr/>	<hr/>
Cash and cash equivalents in the consolidated cash flow statement	<u>168,807</u>	<u>141,146</u>

35 Derivative financial instruments

The use of derivatives for trading and their sale to customers as risk management products is an integral part of the Bank's business activities. These instruments are also used to manage the Bank's own exposures to market risk as part of its asset and liability management process. The principal derivative instruments used by the Bank are foreign exchange related and interest rate related contracts, which are primarily over-the-counter derivatives. Most of the Bank's derivative positions have been entered into to meet customer demand and to hedge these and other trading positions. For accounting purposes, derivatives are classified as either held for trading or held for hedging.

(a) Notional amounts of derivatives

The notional amounts of these instruments indicate the volume of transactions outstanding and do not represent amounts at risk.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Derivative financial instruments (continued)****(a) Notional amounts of derivatives (continued)**

The following is a summary of the notional amounts of each significant type of derivative entered into by the Bank and its subsidiaries:

Consolidated

	2013			
	Qualifying for hedge accounting HK\$'M	Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$'M	Others, including held for trading HK\$'M	Total HK\$'M
Exchange rate contracts				
Forwards	5,069	–	1,216,036	1,221,105
Cross currency swaps	15,259	200	32,109	47,568
Options purchased	–	52	6,436	6,488
Options written	–	246	6,878	7,124
Interest rate contracts				
Swaps	68,293	3,161	25,469	96,923
Options purchased	–	470	235	705
Options written	–	582	152	734
Other derivatives	–	1,078	2,556	3,634
	<u>88,621</u>	<u>5,789</u>	<u>1,289,871</u>	<u>1,384,281</u>
2012				
Exchange rate contracts				
Forwards	–	99	1,192,815	1,192,914
Cross currency swaps	36,264	1,214	32,176	69,654
Options purchased	–	69	13,210	13,279
Options written	–	1,927	13,231	15,158
Interest rate contracts				
Swaps	103,927	108	28,587	132,622
Options purchased	–	–	436	436
Options written	–	217	43	260
Other derivatives	–	–	2,442	2,442
	<u>140,191</u>	<u>3,634</u>	<u>1,282,940</u>	<u>1,426,765</u>

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Derivative financial instruments (continued)**(a) Notional amounts of derivatives (continued)****Bank**

	2013			Total HK\$'M
	Qualifying for hedge accounting HK\$'M	Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$'M	Others, including held for trading HK\$'M	
Exchange rate contracts				
Forwards	5,069	–	1,216,036	1,221,105
Cross currency swaps	15,259	200	32,109	47,568
Options purchased	–	52	6,436	6,488
Options written	–	246	6,878	7,124
Interest rate contracts				
Swaps	68,293	3,161	24,657	96,111
Options purchased	–	470	235	705
Options written	–	582	152	734
Other derivatives	–	1,078	2,556	3,634
	<u>88,621</u>	<u>5,789</u>	<u>1,289,059</u>	<u>1,383,469</u>
2012				
Exchange rate contracts				
Forwards	–	99	1,192,815	1,192,914
Cross currency swaps	36,264	1,214	32,176	69,654
Options purchased	–	69	13,210	13,279
Options written	–	1,927	13,231	15,158
Interest rate contracts				
Swaps	103,927	108	27,482	131,517
Options purchased	–	–	436	436
Options written	–	217	43	260
Other derivatives	–	–	2,270	2,270
	<u>140,191</u>	<u>3,634</u>	<u>1,281,663</u>	<u>1,425,488</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Derivative financial instruments (continued)****(b) Fair values and credit risk weighted amounts of derivatives****Consolidated**

	2013			2012		
	<i>Fair value assets</i>	<i>Fair value liabilities</i>	<i>Credit risk weighted amount</i>	<i>Fair value assets</i>	<i>Fair value liabilities</i>	<i>Credit risk weighted amount</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Exchange rate contracts	11,217	11,892	8,317	6,467	6,653	1,597
Interest rate contracts	871	721	850	1,079	1,749	360
Other derivatives	81	236	174	120	73	90
	<u>12,169</u>	<u>12,849</u>	<u>9,341</u>	<u>7,666</u>	<u>8,475</u>	<u>2,047</u>

Bank

	2013			2012		
	<i>Fair value assets</i>	<i>Fair value liabilities</i>	<i>Credit risk weighted amount</i>	<i>Fair value assets</i>	<i>Fair value liabilities</i>	<i>Credit risk weighted amount</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Exchange rate contracts	11,217	11,892	8,317	6,467	6,653	1,597
Interest rate contracts	867	721	833	1,075	1,749	357
Other derivatives	81	236	110	116	70	34
	<u>12,165</u>	<u>12,849</u>	<u>9,260</u>	<u>7,658</u>	<u>8,472</u>	<u>1,988</u>

Credit risk weighted amount refers to the amount as computed in accordance with the Banking (Capital) Rules of the Hong Kong Banking Ordinance. The amount calculated is dependent upon the status of the counterparty and maturity characteristics of each type of contract.

Following the implementation of the Banking (Capital) (Amendment) Rules 2012 and 2013 from 1 January 2013 and 30 June 2013 respectively, the credit risk weighted amounts as at 31 December 2013 have included additional capital requirements for asset value correlation and credit valuation adjustment.

The fair values and credit risk weighted amounts do not take into account any bilateral netting arrangements entered into during the year and accordingly these amounts are shown on a gross basis.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***(c) Fair value of derivative financial instruments designated as hedging instruments**

The following is a summary of the fair values of derivatives held for hedging purposes by product type entered into by the Bank and its subsidiaries as at 31 December 2013:

Consolidated and Bank

	2013	
	Assets <i>(Included in Amounts due from immediate holding company and fellow subsidiaries)</i> HK\$'M	Liabilities <i>(Included in Amounts due to immediate holding company and fellow subsidiaries)</i> HK\$'M
Exchange rate contracts	6	544
Interest rate contracts	712	500
	718	1,044
	718	1,044
	2012	
	Assets <i>(Included in Other assets and Amounts due from immediate holding company and fellow subsidiaries)</i> HK\$'M	Liabilities <i>(Included in Amounts due to immediate holding company and fellow subsidiaries)</i> HK\$'M
Exchange rate contracts	16	355
Interest rate contracts	895	1,563
	911	1,918
	911	1,918

Fair value hedges

The fair value hedges principally consist of interest rate swaps and cross currency swaps. The interest rate swaps are used to protect against changes in the fair value of certain fixed rate assets and liabilities due to movements in market interest rates. The cross currency swaps are used to manage foreign exchange exposures. At 31 December 2013, the net positive fair value of derivatives held as fair value hedges was HK\$42 million (2012: negative HK\$705 million) comprising assets of HK\$681 million (2012: HK\$827 million) and liabilities of HK\$639 million (2012: HK\$1,532 million). The gains on the hedging instruments for the year were HK\$691 million (2012: losses of HK\$330 million). The losses on the hedged item attributable to the hedged risk were HK\$644 million (2012: gains of HK\$330 million).

Cash flow hedges

The cash flow hedges principally consist of interest rate swaps and cross currency swaps that are used to hedge against the variability in cash flows of certain floating rate assets and liabilities. At 31 December 2013, the net negative fair value of derivatives held as cash flow hedges was HK\$368 million (2012: negative HK\$302 million) comprising assets of HK\$37 million (2012: HK\$84 million) and liabilities of HK\$405 million (2012: HK\$386 million). The derivatives will mature within 5 years (2012: within 5 years) from the balance sheet date. During the year, there was no ineffectiveness recognised in the income statement that arose from cash flow hedges (2012: HK\$Nil).

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***36 Contingent liabilities and commitments****(a) The following is a summary of the contractual amounts of each significant contingent liability and commitment:**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013</i>	<i>Restated 2012</i>	<i>2013</i>	<i>Restated 2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Direct credit substitutes	6,885	7,963	6,885	7,963
Transaction-related contingencies	9,316	10,786	9,320	10,790
Trade-related contingencies	23,735	23,009	23,740	23,088
Forward asset purchases	279	140	279	140
Forward forward deposits placed	388	–	388	–
Other commitments: which are not unconditionally cancellable:				
with original maturity of not more than one year	10,307	8,649	9,614	7,741
with original maturity of more than one year	24,294	18,425	24,295	17,639
which are unconditionally cancellable	394,614	382,628	410,480	396,644
	<u>469,818</u>	<u>451,600</u>	<u>485,001</u>	<u>464,005</u>
Credit risk weighted amount	<u>33,270</u>	<u>34,779</u>	<u>33,254</u>	<u>34,597</u>

Contingent liabilities and commitments are credit-related instruments, which include letters of credit, guarantees and commitments to extend credit. The risk involved is similar to the credit risk involved in extending loan facilities to customers. These transactions are, therefore, subject to the same credit application, portfolio maintenance and collateral requirements as for customers applying for loans. The contractual amounts represent the amounts at risk should the contract be fully drawn upon and the client defaults. As the facilities may expire without being drawn upon, the contracted amounts do not represent expected future cash flows.

(b) Capital commitments

Capital commitments outstanding at 31 December in respect of fixed asset purchases not provided for in the financial statements were as follows:

	<i>Consolidated and Bank</i>	
	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Contracted for	71	63
Authorised but not contracted for	2	61
	<u>73</u>	<u>124</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***36 Contingent liabilities and commitments (continued)****(c) Lease commitments**

The Bank and its subsidiaries lease a number of properties under operating leases. The leases typically run for an initial period of two to ten years, with an option to renew the lease when all terms are renegotiated. At 31 December, total future minimum lease payments under non-cancellable operating leases are payable as follows:

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Within 1 year	871	759	847	737
After 1 year but within 5 years	1,888	1,531	1,878	1,519
After 5 years	1,341	1,094	1,341	1,094
	<u>4,100</u>	<u>3,384</u>	<u>4,066</u>	<u>3,350</u>

During the year, HK\$861 million (2012: HK\$744 million) was recognised as an expense in the income statement in respect of operating leases. The Bank and its subsidiaries lease various premises and equipment under non-cancellable operating lease agreements.

(d) Contingencies

The Bank and its subsidiaries are named in and are defending a number of legal actions arising from its banking activities. Management of the Bank believes that the resolution of these actions and proceedings will not be material to the financial position of the Bank and its subsidiaries.

37 Risk management

The management of risk lies at the heart of the Bank's business. One of the principal risks the Bank incurs arises from extending credit to customers through its trading and lending operations. Beyond credit risk, the Bank is also exposed to a range of other risk types such as cross-border country, market, liquidity, operational, pensions, reputational and other risks that are inherent to the Bank's strategy, product range and business coverage.

Risk management framework

Effective risk management is fundamental to being able to generate profits consistently and sustainably – and is thus a central part of the financial and operational management of the Bank.

Through its risk management framework the Bank manages enterprise-wide risks, with the objective of maximising risk-adjusted returns while remaining within its risk appetite.

As part of this framework, the Bank uses a set of principles that describe the risk management culture the Bank wishes to sustain:

- Balancing risk and return: risk is taken in support of the requirements of the Bank's stakeholders, in line with the Bank's strategy and within its risk appetite;

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

Risk management framework (continued)

- Responsibility: it is the responsibility of all employees to ensure that risk-taking is disciplined and focused. The Bank takes account of its social responsibilities, and its commitment to customers in taking risk to produce a return;
- Accountability: risk is taken only within agreed authorities and where there is appropriate infrastructure and resource. All risk-taking must be transparent, controlled and reported;
- Anticipation: the Bank seeks to anticipate future risks and ensure awareness of all known risks; and
- Competitive advantage: the Bank seeks competitive advantage through efficient and effective risk management and control.

Risk governance

Ultimate responsibility for setting our risk appetite and for the effective management of risk rests with the Board.

Acting within an authority delegated by the Board via the Executive Committee, the Bank's Risk Committee ("RC") is responsible for the management of all risks other than those delegated to the Asset and Liability Committee ("ALCO") and the Pensions Risk Committee ("PRC"). The RC is responsible for the establishment of, and compliance with policies relating to credit risk, country cross-border risk, market risk, operational risk and reputational risk. The RC also defines the overall risk management framework.

The ALCO is responsible for the management of capital and the establishment of, and compliance with, policies relating to balance sheet management, including management of our liquidity, capital adequacy and structural foreign exchange and interest rate risk. The PRC is responsible for the management of Pensions Risk.

The role of the Board's Audit Committee is to have oversight and review of financial, audit and internal control issues.

The committee governance structure ensures that risk-taking authority and risk management policies are cascaded down from the Board through to the appropriate functional, divisional and country-level committees. Information regarding material risk issues and compliance with policies and standards is communicated to the business and functional committees.

Roles and responsibilities for risk management are defined under a 'three lines of defence' model. Each line of defence describes a specific set of responsibilities for risk management and control.

- First line of defence: all employees are required to ensure the effective management of risks within the scope of their direct organisational responsibilities. Business, function and geographic governance heads are accountable for risk management in their respective businesses and functions, and for countries where they have governance responsibilities.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

Risk governance (continued)

- Second line of defence: this comprises the Risk Control Owners, supported by their respective control functions. Risk Control Owners are responsible for ensuring that the risks within the scope of their responsibilities remain within appetite. The scope of a Risk Control Owner's responsibilities is defined by a given Risk Type and the risk management processes that relate to that Risk Type. These responsibilities cut across the Bank and are not constrained by functional and business boundaries. The major risk types are described individually in the following sections.
- Third line of defence: the independent assurance provided by the Group Internal Audit ("GIA") function. Its role is defined and overseen by the Audit Committee.
 - The findings from GIA's audits are reported to all relevant management and governance bodies, accountable line managers, relevant oversight function or committee and committees of the Board.
 - GIA provides independent assurance of the effectiveness of management's control of its own business activities (the first line) and of the processes maintained by the Risk Control Functions (the second line). As a result, GIA provides assurance that the overall system of control effectiveness is working as required within the Risk Management Framework.

The Risk function

The Country Chief Risk Officer ("CCRO") directly manages a Risk function that is separate from and independent of the origination, trading and sales functions of the businesses. The CCRO chairs the RC.

The role of the Risk function is:

- To maintain the Risk Management Framework, ensuring it remains appropriate to the Bank's activities, is effectively communicated and implemented across the Bank and for administering related governance and reporting processes.
- To uphold the overall integrity of the Bank's risk/return decisions, and in particular for ensuring that risks are properly assessed, that risk/return decisions are made transparently on the basis of this proper assessment, and are controlled in accordance with the Bank's standards.
- To exercise direct Risk Control Ownership for Credit, Market, Country Cross-Border, Short-term Liquidity and Operational risk types.

Risk appetite

We manage our risks to build a sustainable franchise in the interests of all our stakeholders. Risk appetite is an expression of the amount of risk we are willing to take in pursuit of our strategic objectives, reflecting our capacity to sustain losses and continue to meet our obligations arising from a range of different stress trading conditions.

We define our risk appetite in terms of both volatility of earnings and the maintenance of adequate regulatory capital requirements under stress scenarios. We also define a risk appetite with respect to liquidity risk, operational risk and reputational risk.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

Risk appetite (continued)

Our quantitative risk profile is assessed through a bottom-up analytical approach covering all of our major businesses and products. It is also assessed against a range of exposure concentration thresholds. The Bank's risk appetite statement is approved by the Board and forms the basis for establishing the risk parameters within which the businesses must operate, including policies, concentration limits and business mix.

The Bank will not compromise adherence to its risk appetite in order to pursue revenue growth or higher returns.

The RC and ALCO are responsible for ensuring that our risk profile is managed in compliance with the risk appetite set by the Board.

(a) **Credit risk**

Credit risk is the potential for loss due to the failure of a counterparty to meet its obligations to pay in accordance with agreed terms. Credit exposures may arise from both the banking and trading books.

Credit risk is managed through a framework that sets out policies and procedures covering the measurement and management of credit risk. There is a clear segregation of duties between transaction originators in the businesses and the approvers in the Risk function. All credit exposure limits are approved within a defined credit approval authority framework.

Group-wide credit policies and standards are considered and approved by the Group Risk Committee ("GRC"), which also oversees the delegation of credit approval and loan impairment provisioning authorities.

The RC approves policies and standards based on those approved by GRC, risk limits and risk exposure delegated approval authority frameworks. When approving risk policies and standards, the RC takes into account the requirements of the Hong Kong Banking Ordinance and the guidelines issued by the HKMA with respect to large exposures and provisioning requirements.

Credit rating and measurement

Risk measurement plays a central role, along with judgement and experience, in informing risk-taking and portfolio management decisions. It is a primary area for sustained investment and senior management attention.

Since 1 January 2008, the Bank has used the Advanced Internal Ratings-Based (AIRB) approach under the Basel II regulatory framework to calculate credit risk capital.

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(a) Credit risk (continued)**

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

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

AIRB risk measurement models are approved by the RC, on the recommendation of the Group Model Assessment Committee ('MAC') and the Bank's MAC. The Bank's MAC supports the RC in ensuring risk identification and measurement capabilities are objective and consistent, so that risk control and risk origination decisions are properly informed. Prior to review by the MAC, all AIRB models are validated in detail by a model validation team, which is separate from the teams which develop and maintain the models. Models undergo a detailed annual review. Reviews are also triggered if the performance of a model deteriorates materially against predetermined thresholds during the ongoing model performance monitoring process.

Credit Approval

The Bank has been locally incorporated since 1 July 2004. Since then, the approval process reflects that strategic decisions are being made in accordance with individual managers' delegated authorities and the terms of reference of the appropriate committees. It is recognised that, as a major part of the Group, all significant risk decisions emanating from Hong Kong will have an impact to the Group, be it regulatory, concentration, strategic, etc. It is therefore recognised that it is essential for the Group to consider such transactions to ensure that these Group issues are included as part of the decision making process. Delegated authorities approved by the RC are delegated to the key risk managers to ensure that all risk decisions are made within the Bank. Where proposals fall outside of the individual's authorities, the advice and guidance of the Group is sought. In such cases, the relevant Group authority, whether an individual or a committee, will review the proposal from a Group perspective and give their recommendation. On receipt of such recommendation, the Bank's Excess Approval Committee ("EAC"), being a sub-committee of the RC, will meet to consider such advice and reach a suitable decision. All the credit applications approved by the EAC will be reported at each RC meeting for noting.

Credit concentration risk

Credit concentration risk is managed within concentration caps set by counterparty or groups of connected counterparties, by country and industry in Wholesale Banking; and tracked by product in Consumer Banking (and also by industry for the small and medium-sized enterprise business ("SME")). Additional targets are set and monitored for concentrations by credit rating.

Credit concentrations are monitored by the RC and concentration limits that are material to the Bank are reviewed and approved at least annually by the RC.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(a) Credit risk (continued)***Credit monitoring*

The Bank and its subsidiaries regularly monitor credit exposures, portfolio performance, and external trends that may impact risk management outcomes.

Internal risk management reports are presented to risk committees, containing information on key environmental, political and economic trends across major portfolios and countries; portfolio delinquency and loan impairment performance; as well as AIRB portfolio metrics including credit grade migration.

The Bank's Wholesale Banking Credit Issues Forum (which is a sub-committee of the Risk Committee) meets regularly to assess the impact of external events and trends on the Wholesale Banking credit risk portfolio and to define and implement the Bank's response in terms of appropriate changes to portfolio shape, portfolio and underwriting standards, risk policy and procedures.

Client accounts are placed on Early Alert when they display signs of actual or potential weakness. For example where there is a decline in the client's position within the industry, a financial deterioration, a breach of covenants, non-performance of an obligation, or there are issues relating to ownership or management.

Such accounts and portfolios are subjected to a dedicated process overseen by an Early Alert Committee. Client account plans and credit grades are re-evaluated and remedial actions are agreed and monitored. Remedial actions include, but are not limited to, exposure reduction, security enhancement, exiting the account or immediate movement of the account into the control of Group Special Assets Management ("GSAM"), the Bank's specialist recovery unit.

The Consumer Banking Credit Governance Committee ("CGC") is a sub-committee of the RC. The CGC meet regularly to assess relevant credit matters. This includes market developments with direct credit concerns, credit policy changes, prominent or emerging credit concerns and mitigating actions.

In Consumer Banking, portfolio delinquency trends are monitored continuously at a detailed level. Individual customer behaviour is also tracked and is considered for lending decisions. Accounts that are past due are subject to a collections process, managed independently by the Risk function. Charged-off accounts are managed by a specialist recovery team.

The SME business is managed within Consumer Banking in two distinct customer sub-segments: small businesses and medium enterprises, differentiated by the annual turnover of the counterparty. The credit processes are further refined based on exposure at risk. Larger exposures are managed through the Discretionary Lending approach, in line with Wholesale Banking procedures, and smaller exposures are managed through Programmed Lending, in line with Consumer Banking procedures. Discretionary Lending and Private Banking past due accounts are managed by GSAM.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(a) Credit risk (continued)***Credit mitigation*

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

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

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

In Wholesale Banking, the effectiveness of credit mitigation is ensured by policies which govern eligibility criteria such as monitoring of concentration of collateral, correlation of the collateral to underlying assets, adjustments for currency fluctuations for collateral. For all credit risk mitigation that meets the policy criteria, a clear set of procedures are applied to ensure that the value of the underlying collateral is appropriately recorded and updated regularly.

In Consumer Banking, effective use of collateral is a key tool by which credit risk is mitigated. All eligible collateral accepted by Consumer Banking is covered by a product proposal approved by senior credit officers delegated with the relevant authority. New collateral types have to be vetted through a stringent 'New Business Approval' process and are approved in accordance with the delegated authorities within Consumer Banking Risk or by the EAC under advice of the Bank's Consumer Banking RC as appropriate. In order to be recognised as security and for the loan to be classified as secured, all items pledged must be valued and an active secondary resale market must exist for the collateral. Documentation must be held to enable Consumer Banking to realize the asset without the cooperation of the asset owner in the event that this is necessary.

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

Traded Products

Credit risk from traded products is managed within the overall credit risk appetite for corporates and financial institutions.

The credit risk exposure from traded products is derived from the positive mark-to-market value of the underlying instruments, and an additional component to cater for potential market movements.

For derivative contracts, the Bank limits its exposure to credit losses in the event of default by entering into master netting agreements with certain counterparties. As required by HKAS 32/IAS 32, exposures are presented on a gross basis in the financial statements as such transactions are not intended to be settled net in the ordinary course of business.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(a) Credit risk (continued)***Traded Products (continued)*

In addition, the Bank enters into Credit Support Annexes (“CSA”) with counterparties where collateral is deemed a necessary or desirable mitigant to the exposure. Under a variation margin process, additional collateral is called from the counterparty if total uncollateralised mark-to-market exposure exceeds the threshold and minimum transfer amount specified in the CSA. With certain counterparties, the CSA is reciprocal and requires the Bank to post collateral if the overall mark-to-market value of positions is in the counterparty’s favour and exceeds an agreed threshold.

Securities

Within Wholesale Banking, the Group’s Underwriting Committee (“UC”) (as approved by the Bank’s Board) approves the portfolio limits and parameters for the underwriting and purchase of all pre-defined securities assets to be held for sale. The UC is established under the authority of the Board and under advice of the Group. Wholesale Banking operates within set limits, which include country, single issuer, holding period and credit grade limits.

Day to day credit risk management activities for traded securities are carried out by Traded Credit Risk Management whose activities include oversight and approval within the levels delegated by the UC. Issuer credit risk, including settlement and pre-settlement risk, is controlled by Wholesale Banking Risk, while price risk is controlled by Market Risk.

The UC approves individual proposals to underwrite new corporate security issues for clients. Where an underwritten security is held for a period longer than the target sell-down period, the final decision on whether to sell the position rests within the Risk function.

Maximum exposure to credit risk

The maximum exposures to credit risk of on-balance sheet financial instruments, before taking account of any collateral or other credit enhancements is the carrying amount reported on the balance sheet. For off-balance sheet instruments, the maximum exposure to credit risk excludes loan commitments which are unconditionally cancellable is the contractual nominal amounts as set out below:

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Financial guarantees and other credit related contingent liabilities	39,936	41,758	39,945	41,841
Loan commitments and other credit related commitments	35,268	27,214	34,576	25,520
	<u>75,204</u>	<u>68,972</u>	<u>74,521</u>	<u>67,361</u>

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(a) Credit risk (continued)**

Collateral

Collateral is held to mitigate credit risk exposures and risk mitigation policies determine the eligibility of collateral types.

For certain types of lending – typically mortgages and asset financing – the right to take charge over physical assets is significant in terms of determining appropriate pricing and recoverability in the event of default.

Collateral is valued in accordance with our risk mitigation policy, which prescribes the frequency of valuation for different collateral types, based on the level of price volatility of each type of collateral and the nature of the underlying product or risk exposure. Where appropriate, collateral values are adjusted to reflect current market conditions, probability of recovery and the period of time to realise the collateral in the event of possession. The collateral values reported below reflect this conservative basis and are also adjusted for the effects of over-collateralisation.

(i) Loans and advances

The requirement for collateral is not a substitute for the ability to pay, however, which is the primary consideration for any lending decisions. In determining the financial effect of collateral held against loans neither past due nor impaired, we have assessed the significance of the collateral held in relation to the type of lending.

Loans neither past due nor impaired

At 31 December 2013, the Bank and its subsidiaries have HK\$187,473 million (2012: HK\$173,846 million) of mortgage loans in Consumer Banking that are neither past due nor impaired. These are generally fully secured exposures (2012: fully secured).

In Wholesale Banking, the Bank and its subsidiaries have HK\$188,442 million (2012: HK\$159,310 million) of corporate exposures that are neither past due nor impaired. Based on the fair value of the collateral held, 23% (2012: 20%) of these exposures are secured by tangible collateral.

The Bank and its subsidiaries also undertake collateralised lending and borrowing (reverse repos and repos) arrangements, and the collateral held against these types of loans are set out in note 39 to the financial statements.

Non-tangible collateral – such as guarantees and letters of credit – may also be held against corporate exposures although the financial effect of this type of collateral is less significant in terms of recoveries. It is not practicable to quantify the effect of this collateral as the value of the collateral is conditional on circumstances at the time of default and other credit related factors.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(a) Credit risk (continued)***Loans past due or impaired*

The fair value of collateral held against past due or impaired loans is detailed in the table below as at 31 December:

Consolidated

	2013		2012	
	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M
Estimated fair value of collateral (Note):				
Held against impaired advances	567	–	307	–
Held against past due but not impaired advances	2,361	–	6,407	–

Bank

	2013		2012	
	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M
Estimated fair value of collateral (Note):				
Held against impaired advances	559	–	298	–
Held against past due but not impaired advances	2,180	–	6,297	–

(Note) The fair value of the collateral held represents fair value, after taking into account the effects of over-collateralisation where it is not available for offset against other loans.

Repossessed Collateral

As at 31 December, the amount of assets obtained by taking possession of collateral held as security were as follows:

	Consolidated		Bank	
	2013 HK\$'M	2012 HK\$'M	2013 HK\$'M	2012 HK\$'M
Property, plant and equipment	110	32	93	26

Loan collateral acquired from borrowers due to restructuring or their inability to repay, continues to be recorded as “Advances to customers” in the balance sheet at the lower of fair value (less costs to sell) and the carrying amount of the loan (net of any impairment allowances), until the collateral is realised.

Repossessed collateral obtained are intended to be realised in an orderly fashion to repay the impaired loans and are not held for the own use of the Bank and its subsidiaries.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(a) Credit risk (continued)***(ii) Off-balance sheet exposures*

For certain types of exposures such as letters of credit and guarantees, the Bank and its subsidiaries obtain collateral such as cash depending on internal credit risk assessments. However, for trade finance products such as letters of credit, the Bank and its subsidiaries will normally hold legal title to the underlying assets should a default take place.

Credit quality*(i) Analysis of the loan portfolio***Consolidated**

	2013		2012	
	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M	<i>Advances to customers</i> HK\$'M	<i>Restated Advances to banks</i> HK\$'M
Loans and advances				
– neither past due nor impaired	449,135	125,787	398,645	143,523
– past due but not impaired	3,535	35	9,082	13
– impaired, net of individually assessed impairment charges	1,553	46	858	43
Less: collectively assessed impairment charges	(665)	–	(567)	–
	<u>453,558</u>	<u>125,868</u>	<u>408,018</u>	<u>143,579</u>

Bank

	2013		2012	
	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M
Loans and advances				
– neither past due nor impaired	436,026	125,776	386,169	143,515
– past due but not impaired	3,199	35	8,835	13
– impaired, net of individually assessed impairment charges	1,469	46	836	43
Less: collectively assessed impairment charges	(508)	–	(454)	–
	<u>440,186</u>	<u>125,857</u>	<u>395,386</u>	<u>143,571</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(a) Credit risk (continued)***(i) Analysis of the loan portfolio (continued)*

The following tables set out an analysis of the internal credit gradings for advances which are not past due and for which no individual impairment provision has been raised. The credit gradings set out in the tables below are based on a probability of default measure as set out on page 78.

Consolidated

	2013		2012	
	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M	<i>Advances to customers</i> HK\$'M	<i>Restated Advances to banks</i> HK\$'M
Credit grades:				
1 to 5	265,953	124,397	238,341	142,447
6 to 8	136,836	1,239	115,727	953
9 to 11	43,624	151	43,194	123
12	2,722	–	1,383	–
	<u>449,135</u>	<u>125,787</u>	<u>398,645</u>	<u>143,523</u>

Bank

	2013		2012	
	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M
Credit grades:				
1 to 5	264,551	124,386	233,993	142,439
6 to 8	131,812	1,239	112,022	953
9 to 11	37,491	151	38,976	123
12	2,172	–	1,178	–
	<u>436,026</u>	<u>125,776</u>	<u>386,169</u>	<u>143,515</u>

The following tables set out the ageing of advances which are past due and for which no individual impairment provision has been raised. A loan is considered to be past due when the counterparty has failed to make a principal or interest payment when contractually due. Past due does not necessarily mean that the counterparty is impaired.

Consolidated

	2013		2012	
	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M
Past due				
– up to 30 days	3,109	35	7,903	13
– 31-60 days	233	–	200	–
– 61-90 days	99	–	844	–
– 91-120 days	57	–	45	–
– 121-150 days	37	–	90	–
	<u>3,535</u>	<u>35</u>	<u>9,082</u>	<u>13</u>

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(a) Credit risk (continued)***(i) Analysis of the loan portfolio (continued)***Bank**

	2013		2012	
	Advances to customers HK\$'M	Advances to banks HK\$'M	Advances to customers HK\$'M	Advances to banks HK\$'M
Past due				
– up to 30 days	2,852	35	7,705	13
– 31-60 days	190	–	174	–
– 61-90 days	63	–	821	–
– 91-120 days	57	–	45	–
– 121-150 days	37	–	90	–
	<u>3,199</u>	<u>35</u>	<u>8,835</u>	<u>13</u>

*(ii) Analysis of debt securities (including certificates of deposit), equity shares and treasury bills***Consolidated**

	2013			
	Treasury bills HK\$'M	Debt securities HK\$'M	Equity shares HK\$'M	Total HK\$'M
Impaired securities	–	–	33	33
Impairment provisions	–	–	(15)	(15)
Net impaired securities	–	–	18	18
Securities neither past due nor impaired	<u>79,382</u>	<u>154,897</u>	<u>1,521</u>	<u>235,800</u>

	2012			
	Treasury bills HK\$'M	Debt securities HK\$'M	Equity shares HK\$'M	Total HK\$'M
Impaired securities	–	26	6	32
Impairment provisions	–	(26)	(6)	(32)
Net impaired securities	–	–	–	–
Securities neither past due nor impaired	<u>42,209</u>	<u>163,419</u>	<u>1,021</u>	<u>206,649</u>

Bank

	2013			
	Treasury bills HK\$'M	Debt securities HK\$'M	Equity shares HK\$'M	Total HK\$'M
Impaired securities	–	–	33	33
Impairment provisions	–	–	(15)	(15)
Net impaired securities	–	–	18	18
Securities neither past due nor impaired	<u>79,382</u>	<u>154,897</u>	<u>1,521</u>	<u>235,800</u>

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(a) Credit risk (continued)**

- (ii) Analysis of debt securities (including certificates of deposit), equity shares and treasury bills (continued)

Bank (continued)

	2012			
	<i>Treasury bills</i>	<i>Debt securities</i>	<i>Equity shares</i>	<i>Total</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Impaired securities	–	26	6	32
Impairment provisions	–	(26)	(6)	(32)
Net impaired securities	–	–	–	–
Securities neither past due nor impaired	42,209	163,352	1,021	206,582

The following table analyses debt securities (including certificates of deposit) and treasury bills which are neither past due nor impaired by external credit rating. The standard credit ratings used by the Bank are those used by Standard & Poors or their equivalent. Debt securities held which have a short-term rating are reported against the long-term rating of the issuer.

Consolidated

	2013		2012	
	<i>Treasury bills</i>	<i>Debt securities</i>	<i>Treasury bills</i>	<i>Debt securities</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
AAA	–	27,106	–	19,122
AA - to AA +	79,382	61,380	42,209	72,764
A - to A +	–	59,374	–	65,339
Lower than A-	–	3,508	–	1,487
Unrated	–	3,529	–	4,707
	79,382	154,897	42,209	163,419

Bank

	2013		2012	
	<i>Treasury bills</i>	<i>Debt securities</i>	<i>Treasury bills</i>	<i>Debt securities</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
AAA	–	27,106	–	19,122
AA - to AA +	79,382	61,380	42,209	72,764
A - to A +	–	59,374	–	65,339
Lower than A-	–	3,508	–	1,487
Unrated	–	3,529	–	4,640
	79,382	154,897	42,209	163,352

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(b) Country cross-border risk

Country cross-border risk is the risk that the Bank will be unable to obtain payment from its customers or third parties on their contractual obligations as a result of certain actions taken by foreign governments, chiefly relating to convertibility and transferability of foreign currency.

The RC is responsible for approving country cross-border risk limits.

Cross-border assets comprise loans and advances, interest-bearing deposits with other banks, trade and other bills, acceptances, amounts receivable under finance leases, derivatives, certificates of deposit and other negotiable paper, investment securities and formal commitments where the counterparty is resident in a country other than where the assets are recorded. Cross-border assets also include exposures to local residents denominated in currencies other than the local currency. Cross-border exposure also includes the value of commodity, aircraft and shipping assets owned by the Bank that are held in a given country.

(c) Market risk management

Market risk

The Bank recognises market risk as the potential loss of earnings or economic value due to adverse changes in financial market rates or prices. The Bank's exposure to market risk arises principally from customer-driven transactions. The objective of the Bank's market risk policies and processes is to obtain the best balance of risk and return whilst meeting customers' requirements.

The Bank transacts in the money market, foreign exchange markets, equity markets, commodity markets and capital markets giving rise to market risk exposures. Financial instruments transacted include debt and other securities and derivatives. Derivatives are contracts with characteristics and value derived from underlying financial instruments, interest and exchange rates or indices. They include futures, forwards, swaps, and options transactions in the foreign exchange and interest rate markets. The Bank enters into derivative contracts in the normal course of business to meet customer demand and for hedging purposes. Derivative contracts entered into by the Bank are primarily over-the-counter derivatives which the mark-to-market values are readily determinable by reference to independent prices and valuation quotes.

The Bank has established a market risk management framework and policies, including limits setting, monitoring and reporting and control procedures, which are reviewed regularly by the RC. Market risk limits are proposed by the business within the terms of agreed policy and reviewed by the Market Risk department. The RC approves the limits and the Market Risk department monitors exposure against these limits and approves temporary limits within the delegated authorities. Additional limits are placed on specific instruments and position concentrations where appropriate. Sensitivity measures are used in addition to using value-at-risk ("VaR") as risk management tools. For example, interest rate sensitivity is measured in terms of exposure to a one basis point increase in yields.

Value at Risk

VaR, in general, is a quantitative measure of market risk that applies recent historical market conditions to estimate the potential future loss in market value that will not be exceeded in a set time period at a set statistical confidence level. VaR provides a consistent measure that can be applied across trading businesses and products over time and can be set against actual daily trading profit and loss outcome.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(c) Market risk management (continued)****Value at Risk (continued)**

VaR is calculated for expected movements over a minimum of one business day and to a confidence level of 97.5 per cent. This confidence level suggests that potential daily losses, in excess of the VaR measure, are likely to be experienced six times per year.

The Bank applies two VaR methodologies, historic simulation and Monte Carlo simulation, with a historical observation period of one year. Historic simulation is applied for general market risk factors. This approach involves the revaluation of all existing positions to reflect the effect of historically observed changes in market risk factors on the valuation of the current portfolio. Monte Carlo simulation is applied for credit spread VaR of the banking book. This approach is similar to historic simulation but with considerably more input risk factor observations. These are generated by random sampling techniques, but the results retain the essential variability and correlations of historically observed risk factor changes.

Stress Testing

Losses beyond the confidence interval are not captured by a VaR calculation, which therefore gives no indication of the size of unexpected losses in these situations.

VaR and other risk measures are complemented by weekly stress testing of market risk exposures to highlight potential risk that may arise from extreme market events that are rare but plausible. Stress testing is an integral part of the market risk management framework and considers both historical market events and forward looking scenarios. A consistent stress testing methodology is applied to trading and non-trading books. The stress testing methodology assumes that scope for management action would be limited during a stress event, reflecting the decrease in liquidity that often occurs.

Stress scenarios are regularly updated to reflect changes in risk profile and economic events. The RC reviews stress test results on a regular basis. Ad hoc scenarios are also prepared reflecting specific market conditions and for particular concentrations of risk that arise within the business.

Trading and Non-trading (VaR at 97.5%, 1 day)*

<i>Value at risk:</i>	2013				2012 Restated			
	<i>Average</i> <i>HK\$'M</i>	<i>High</i> <i>HK\$'M</i>	<i>Low</i> <i>HK\$'M</i>	<i>Actual**</i> <i>HK\$'M</i>	<i>Average</i> <i>HK\$'M</i>	<i>High</i> <i>HK\$'M</i>	<i>Low</i> <i>HK\$'M</i>	<i>Actual**</i> <i>HK\$'M</i>
Interest rate risk ^	51.2	65.9	40.3	40.3	60.3	86.4	38.8	60.7
Foreign exchange risk	9.1	22.1	2.9	17.9	8.3	17.7	3.2	11.2
Commodity risk	0.8	2.0	0.2	1.3	0.1	0.4	0.0	0.2
Total ^^	52.6	71.7	39.5	47.7	62.1	87.1	41.2	64.8

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(c) Market risk management (continued)**Trading (VaR at 97.5%, 1 day)*

Value at risk:	2013				2012 Restated			
	Average	High	Low	Actual**	Average	High	Low	Actual**
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Interest rate risk	15.2	29.9	9.9	11.0	17.6	26.7	12.3	16.4
Foreign exchange risk	9.1	22.1	2.9	17.9	8.3	17.7	3.2	11.2
Commodity risk	0.8	2.0	0.2	1.3	0.1	0.4	0.0	0.2
Total ^^	20.1	47.8	11.4	21.3	20.5	31.0	12.8	26.0

Non-trading (VaR at 97.5%, 1 day)*

Value at risk:	2013				2012 Restated			
	Average	High	Low	Actual**	Average	High	Low	Actual**
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Interest rate risk ^	47.2	62.7	37.2	37.8	60.3	79.1	41.1	54.0

Average daily income earned from market risk related activities*** are as follows:

	2013	Restated
	HK\$'M	2012
		HK\$'M
Trading		
Interest rate risk	5.8	5.3
Foreign exchange risk	10.9	10.2
Commodity risk	2.6	1.7
Total	19.3	17.2
Non-Trading		
Interest rate risk	4.7	6.5

* VaR includes both onshore and offshore portfolios, where for globally co-managed books, VaR is scaled according to the respective global income allocation to the Bank.

** Actual one day VaR at period end date.

*** Includes profits from offshore portfolios.

^ Interest rate risk VaR includes credit spread risk arising from securities held for trading or available-for-sale.

^^ The total VaR shown in the tables above is not a sum of the component risks due to offsets between them. Total included trading book equity risk that is insignificant.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(d) Foreign exchange risk**

The foreign exchange positions of the Bank and its subsidiaries arise from foreign exchange trading and commercial banking operations. Foreign exchange trading exposures are principally derived from customer driven transactions. The Market Risk department approves foreign exchange limits within delegated authorities and monitors exposures against these limits. The net option position is calculated on the basis of the delta-weighted positions of all foreign exchange option contracts.

Foreign exchange risk on the non-trading book portfolios is minimised by match funding assets and liabilities in the same currency.

The Bank and its subsidiaries had the following non-structural foreign currency positions which exceeded 10% of the net non-structural position in all foreign currencies:

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013</i>	<i>2012</i>	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
US dollars exposure				
Spot assets	354,480	320,683	354,480	320,680
Spot liabilities	(299,956)	(279,069)	(299,956)	(279,069)
Forward purchases	598,709	608,542	598,709	608,542
Forward sales	(650,692)	(644,729)	(650,692)	(644,729)
Net option position	—	—	—	—
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net long non-structural position	<u>2,541</u>	<u>5,427</u>	<u>2,541</u>	<u>5,424</u>
			<i>Consolidated and Bank</i>	
			<i>2013</i>	<i>2012</i>
			<i>HK\$'M</i>	<i>HK\$'M</i>
Chinese renminbi exposure				
Spot assets			118,819	98,441
Spot liabilities			(117,545)	(86,732)
Forward purchases			451,310	382,433
Forward sales			(453,433)	(393,558)
Net option position			—	—
			<u> </u>	<u> </u>
Net (short)/long non-structural position			<u>(849)</u>	<u>584</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(d) Foreign exchange risk (continued)**

	<i>Consolidated and Bank</i>	
	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
New Taiwan dollars exposure		
Spot assets	3,934	2,911
Spot liabilities	(220)	(1,115)
Forward purchases	544	1,004
Forward sales	(3,444)	(2,947)
Net option position	—	—
	<u>814</u>	<u>(147)</u>
Net long/(short) non-structural position	<u>814</u>	<u>(147)</u>

The Bank and its subsidiaries had the following structural foreign currency positions which exceeded 10% of the net structural position in all foreign currencies:

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2013</i>	<i>Restated</i>	<i>2013</i>	<i>Restated</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Chinese Renminbi	6,335	5,085	6,335	5,085
Vietnamese Dong	746	764	310	317
US dollars	1,001	611	1,001	611
	<u>8,082</u>	<u>6,460</u>	<u>7,646</u>	<u>6,013</u>

(e) Interest rate risk

The Bank's interest rate exposures comprise trading exposures and non-trading structural interest rate exposures. Structural interest rate risk generally arises from the differing re-pricing characteristics of commercial banking assets and liabilities.

Interest rate risk from the non-trading book portfolios is transferred to Financial Markets. Financial Markets manages these risks with oversight by the Asset and Liability Committee ("ALCO") and within limits approved by the Market Risk department. VaR and stress tests are applied to non-trading book interest rate exposures in the same way as for the trading book.

The Bank has established principles, policies and techniques for managing interest rate risk. Interest rate risk management is governed by the ALCO.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(f) Liquidity risk

Liquidity risk is the risk that the Bank either does not have sufficient financial resources available to meet all its obligations and commitments as they fall due, or can only access these financial resources at excessive cost.

It is the Bank's policy to maintain adequate liquidity at all times and hence to be in a position to meet obligations as they fall due. The Bank manages liquidity risk both on a short-term and structural basis. In the short-term, the focus is on ensuring that the cash flow demands can be met where required. In the medium-term, the focus is on ensuring the balance sheet remains structurally sound and aligned to the Bank's strategy.

Policies and procedures

The Bank's policy is to manage liquidity without presumption of Group support. ALCO is responsible for ensuring that the Bank is able to meet all of its obligations to make payments as they fall due, and operates within regulatory and internal limits.

The Bank's liquidity risk management framework requires limits to be set for prudent liquidity management. There are limits on:

- The local and foreign currency cash flow gaps
- The level of external wholesale borrowing to ensure that the size of this funding is proportionate to the local market and operations
- The level of lending and borrowing within the Group
- Commitments, both on and off balance sheet, to ensure there are sufficient funds available in the event of drawdown on these commitments
- The advances to deposits ratio to ensure that commercial advances are funded by stable sources and that customer lending is funded by customer deposits
- The amount of assets that may be funded from other currencies

Financial Markets is responsible for the day-to-day management of all the liquidity risk in the Bank, executing liquidity directives and operating within the liquidity policy and approved limits. All limits are reviewed at least annually, and more frequently if required, to ensure that they remain relevant given market conditions and business strategy. Compliance with limits is monitored independently on a regular basis. Limit excesses are escalated and approved under a delegated authority structure and reviewed by ALCO.

The Bank has significant levels of marketable securities, including government securities that can be realised, repurchased or used as collateral in the event of liquidity stress. The Bank prescribes three liquidity stress scenarios that assume accelerated withdrawal of deposits over a period of time. Under such scenarios, the Bank ensures that cash inflows exceed outflows. The Bank also has a liquidity crisis management plan, which lays out trigger points and actions in the event of a liquidity crisis to ensure that there is an effective response by senior management in case of such an event.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)**

Customer deposits, made up of current and savings accounts and other deposits, form a significant part of the Bank's overall funding. The customer deposits are widely diversified by type and maturity and represent a stable source of funds. The ALCO monitors trends in the balance sheet and ensures that any concerns that might impact the stability of these deposits are addressed effectively. The ALCO also reviews balance sheet plans to ensure that asset growth plans are matched by growth in this stable funding base. Moreover, professional markets are accessed for the purposes of providing additional funding, maintaining a presence in local money markets and optimising asset and liability maturities.

Liquidity metrics

The Bank monitors key liquidity metrics on a regular basis. The key metrics are:

(1) Advances to deposits ratio

This is defined as the ratio of total loans and advances to customers relative to total customer deposits. A low advances to deposits ratio demonstrates that customer deposits exceed customer loans resulting from emphasis placed on generating a high level of stable funding from customers.

	<i>Consolidated</i>	
	2013	2012
	HK\$'M	HK\$'M
Advances to customers	453,558	408,018
Deposits from customers	817,428	756,589
Advances to deposits ratio	<u>55%</u>	<u>54%</u>

(2) Liquidity Coverage Ratio ("LCR")

The Bank monitors the LCR in line with the Bank of International Settlements and Hong Kong Monetary Authority's guidelines. The Bank already meets the Basel III coverage requirements for the LCR, ahead of the 1 January 2015 implementation date.

(3) Other liquidity metrics

A range of short-term and structural liquidity metrics are monitored to ensure a robust liquidity strategy in line with the Bank's overall risk appetite. The contractual medium term funding ratio is intended to highlight reliance on the ability of the Bank to rollover short term liabilities to fund medium term assets based on the Bank's contractual obligations. The behavioural medium term funding ratio is intended to highlight whether the Bank's business / product mix and balance sheet structure in a business-as-usual environment is sustainable over time. The Maximum Cumulative Outflow report allows the Bank to manage any mismatches in the maturity of cash inflows and outflows. Intraday liquidity risk, wholesale borrowing capacity and outflows due to off-balance sheet commitments are also monitored.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(f) Liquidity risk (continued)****Liquidity management – stress scenarios**

The Bank conducts a range of liquidity related stress analyses, both for internal and regulatory purposes. Internally, three stress tests are run routinely: an acute 8-day name specific stress, a 30-day market wide stress and a 30-day combined name specific and market wide stress.

The 8-day stress is specifically designed to determine a minimum quantity of marketable securities that must be held at all times. This stress is computed daily, and the minimum marketable securities requirement is observed daily. This is intended to ensure that, in the unlikely event of an acute loss of confidence in the Bank, there is sufficient time to take corrective action. No support from Group is presumed.

The Bank is also exposed to the risk of market-wide disruption. It is therefore appropriate to test resilience to unexpected local market disruption, for example loss of interbank money markets. The 30-day marketwide and the 30-day combined name specific and marketwide stress scenarios are constructed to examine cashflow needs and assess the resilience of the Bank in such severe but plausible stress events.

Total derivative exposure is less than 5% of the Bank's balance sheet.

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(f) Liquidity risk (continued)****(i) Contractual maturity**

The following maturity profile is based on the remaining period to the contractual maturity date as at the balance sheet date, on a discounted basis. The disclosure does not imply that the assets will be held to maturity or that the liabilities will be withdrawn on maturity.

Consolidated

	2013							Undated	Total
	Repayable	Due	Due	Due	Due	Due			
	on demand	within	between	between	between	after			
HK\$'M	1 month	1 month to	3 months to	1 year to	5 years	5 years	HK\$'M	HK\$'M	
	HK\$'M	HK\$'M	3 months	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Assets									
Cash and balances with banks, central banks and other financial institutions	26,885	-	-	-	-	-	-	-	26,885
Placements with banks and other financial institutions	35	63,653	32,309	28,291	1,580	-	-	-	125,868
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	34,581	-	34,581
Trading assets	-	6,312	5,965	9,371	12,589	3,520	1,104	-	38,861
Financial assets designated at fair value	-	-	-	9	77	2,068	-	-	2,154
Advances to customers	11,242	85,066	35,627	59,526	121,406	141,738	(1,047)	-	453,558
Investment securities	270	35,807	37,026	56,237	60,164	9,242	435	-	199,181
Amounts due from group companies	8,515	35,369	15,387	14,103	15,657	1,408	(1,570)	-	88,869
Others	313	2,525	10,767	1,245	419	125	38,881	-	54,275
Total Assets	47,260	228,732	137,081	168,782	211,892	158,101	72,384	-	1,024,232
Liabilities									
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	34,581	-	34,581
Deposits and balances of banks and other financial institutions	13,898	261	183	-	1,871	-	-	-	16,213
Deposits from customers	515,633	137,102	89,238	73,111	2,320	24	-	-	817,428
Trading liabilities	-	22,597	214	420	100	-	216	-	23,547
Financial liabilities designated at fair value	-	750	262	2,097	1,324	1,290	-	-	5,723
Debt securities in issue	-	3,732	10,058	1,546	-	-	-	-	15,336
Amounts due to group companies	4,475	2,676	7,451	5,699	2,132	432	-	-	22,865
Subordinated liabilities	-	-	-	-	-	10,548	-	-	10,548
Others	6,317	7,440	6,980	1,585	51	510	62	-	22,945
Total Liabilities	540,323	174,558	114,386	84,458	7,798	12,804	34,859	-	969,186

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)****(i) Contractual maturity (continued)****Consolidated (continued)**

	Repayable on demand	2013					Undated	Total
		Due within 1 month	Due between 1 month to 3 months	Due between 3 months to 1 year	Due between 1 year to 5 years	Due after 5 years		
Of which:								
Certificates of deposit held								
- included in Trading assets	-	44	-	1,369	259	97	-	1,769
- included in Investment securities as available-for-sale securities	-	9,442	12,402	11,932	961	-	-	34,737
	-	9,486	12,402	13,301	1,220	97	-	36,506
Treasury bills								
- included in Trading assets	-	5,852	3,330	4,048	-	-	-	13,230
- included in Investment securities as available-for-sale securities	-	22,325	22,046	21,781	-	-	-	66,152
	-	28,177	25,376	25,829	-	-	-	79,382
Debt securities								
- included in Trading assets	-	230	2,480	3,237	8,681	3,254	-	17,882
- included in Financial assets designated at fair value	-	-	-	9	77	2,068	-	2,154
- included in Investment securities classified as:								
- available-for-sale securities	-	4,040	2,093	22,233	54,032	9,242	-	91,640
- loans and receivables	270	-	485	291	5,171	-	-	6,217
- included in Amounts due from fellow subsidiaries classified as:								
- available-for-sale securities	-	-	-	-	-	498	-	498
	270	4,270	5,058	25,770	67,961	15,062	-	118,391

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)**

(i) Contractual maturity (continued)

Consolidated (continued)

	Repayable on demand HK\$'M	Due within 1 month HK\$'M	2012 Restated			Due after 5 years HK\$'M	Undated HK\$'M	Total HK\$'M
			Due between 1 month to 3 months HK\$'M	Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M			
Assets								
Cash and balances with banks, central banks and other financial institutions	20,492	-	-	-	-	-	-	20,492
Placements with banks and other financial institutions	535	46,669	47,572	47,582	1,222	-	(1)	143,579
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	32,481	32,481
Trading assets	-	1,513	4,173	9,273	8,851	4,103	501	28,414
Financial assets designated at fair value	-	-	-	-	110	3,106	-	3,216
Advances to customers	16,228	62,269	30,857	56,102	113,699	129,924	(1,061)	408,018
Investment securities	67	18,306	32,919	56,861	59,158	6,548	520	174,379
Amounts due from group companies	14,986	35,131	10,090	12,635	5,602	2,463	(1,585)	79,322
Others	350	4,515	10,796	733	554	86	32,695	49,729
Total Assets	52,658	168,403	136,407	183,186	189,196	146,230	63,550	939,630
Liabilities								
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	32,481	32,481
Deposits and balances of banks and other financial institutions	10,798	494	217	772	-	-	-	12,281
Deposits from customers	487,710	97,913	87,138	81,955	1,831	42	-	756,589
Trading liabilities	-	21,601	110	447	50	86	774	23,068
Financial liabilities designated at fair value	-	818	924	1,372	468	30	-	3,612
Debt securities in issue	-	320	3,586	6,100	-	-	-	10,006
Amounts due to group companies	10,031	3,253	4,825	3,322	1,218	2,042	-	24,691
Subordinated liabilities	-	-	-	-	-	11,267	-	11,267
Others	6,395	5,025	5,528	1,289	48	244	327	18,856
Total Liabilities	514,934	129,424	102,328	95,257	3,615	13,711	33,582	892,851

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)****(i) Contractual maturity (continued)****Consolidated (continued)**

	Repayable on demand	2012					Undated	Total
		Due within 1 month	Due between 1 month to 3 months	Due between 3 months to 1 year	Due between 1 year to 5 years	Due after 5 years		
Of which:								
Certificates of deposit held								
- included in Trading assets	-	4	452	590	33	-	-	1,079
- included in Investment securities as available-for-sale securities	-	6,603	11,663	10,634	2,856	-	-	31,756
	-	6,607	12,115	11,224	2,889	-	-	32,835
Treasury bills								
- included in Trading assets	-	1,341	3,348	3,988	25	-	-	8,702
- included in Investment securities as available-for-sale securities	-	4,994	15,007	13,506	-	-	-	33,507
	-	6,335	18,355	17,494	25	-	-	42,209
Debt securities								
- included in Trading assets	-	-	291	4,278	8,725	4,075	-	17,369
- included in Financial assets designated at fair value	-	-	-	-	110	3,106	-	3,216
- included in Investment securities classified as:								
- available-for-sale securities	-	6,116	6,249	28,611	52,182	6,548	-	99,706
- loans and receivables	67	593	-	4,110	4,120	-	-	8,890
- included in Amounts due from fellow subsidiaries classified as:								
- available-for-sale securities	-	-	-	-	-	1,305	-	1,305
- financial assets designated at fair value	-	-	-	-	-	98	-	98
	67	6,709	6,540	36,999	65,137	15,132	-	130,584

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)****(i) Contractual maturity (continued)****Bank**

	Repayable on demand HK\$'M	2013					Undated HK\$'M	Total HK\$'M
		Due within 1 month HK\$'M	Due between 1 month to 3 months HK\$'M	Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M		
Assets								
Cash and balances with banks, central banks and other financial institutions	26,697	-	-	-	-	-	-	26,697
Placements with banks and other financial institutions	35	63,644	32,309	28,289	1,580	-	-	125,857
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	34,581	34,581
Trading assets	-	6,312	5,965	9,371	12,589	3,520	1,104	38,861
Financial assets designated at fair value	-	-	-	9	77	2,068	-	2,154
Advances to customers	11,149	84,547	34,835	56,161	116,924	137,451	(881)	440,186
Investment securities	270	35,807	37,026	56,237	60,164	9,242	435	199,181
Amounts due from group companies	7,405	36,238	17,860	17,603	29,256	18,016	(1,570)	124,808
Others	309	1,585	10,514	747	227	-	9,382	22,764
Total Assets	45,865	228,133	138,509	168,417	220,817	170,297	43,051	1,015,089
Liabilities								
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	34,581	34,581
Deposits and balances of banks and other financial institutions	13,898	191	8	-	911	-	-	15,008
Deposits from customers	515,632	136,708	88,770	72,856	2,310	24	-	816,300
Trading liabilities	-	22,597	214	420	100	-	216	23,547
Financial liabilities designated at fair value	-	750	262	2,097	1,324	1,290	-	5,723
Debt securities in issue	-	3,732	10,058	1,546	-	-	-	15,336
Amounts due to group companies	5,162	2,835	7,998	5,666	2,048	432	-	24,141
Subordinated liabilities	-	-	-	-	-	10,548	-	10,548
Others	6,317	7,188	6,727	1,279	-	-	22	21,533
Total Liabilities	541,009	174,001	114,037	83,864	6,693	12,294	34,819	966,717

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)****(i) Contractual maturity (continued)****Bank (continued)**

	Repayable on demand	2013					Undated	Total
		Due within 1 month	Due between 1 month to 3 months	Due between 3 months to 1 year	Due between 1 year to 5 years	Due after 5 years		
Of which:								
Certificates of deposit held								
- included in Trading assets	-	44	-	1,369	259	97	-	1,769
- included in Investment securities as available-for-sale securities	-	9,442	12,402	11,932	961	-	-	34,737
	-	9,486	12,402	13,301	1,220	97	-	36,506
Treasury bills								
- included in Trading assets	-	5,852	3,330	4,048	-	-	-	13,230
- included in Investment securities as available-for-sale securities	-	22,325	22,046	21,781	-	-	-	66,152
	-	28,177	25,376	25,829	-	-	-	79,382
Debt securities								
- included in Trading assets	-	230	2,480	3,237	8,681	3,254	-	17,882
- included in Financial assets designated at fair value	-	-	-	9	77	2,068	-	2,154
- included in Investment securities classified as:								
- available-for-sale securities	-	4,040	2,093	22,233	54,032	9,242	-	91,640
- loans and receivables	270	-	485	291	5,171	-	-	6,217
- included in Amounts due from fellow subsidiaries classified as:								
- available-for-sale securities	-	-	-	-	-	498	-	498
	270	4,270	5,058	25,770	67,961	15,062	-	118,391

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)****(i) Contractual maturity (continued)****Bank (continued)**

	Repayable on demand HK\$'M	2012					Undated HK\$'M	Total HK\$'M
		Due within 1 month HK\$'M	Due between 1 month to 3 months HK\$'M	Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M		
Assets								
Cash and balances with banks, central banks and other financial institutions	20,331	-	-	-	-	-	-	20,331
Placements with banks and other financial institutions	537	46,660	47,572	47,581	1,222	-	(1)	143,571
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	32,481	32,481
Trading assets	-	1,510	4,172	9,273	8,851	4,103	501	28,410
Financial assets designated at fair value	-	-	-	-	110	3,106	-	3,216
Advances to customers	16,148	61,801	29,937	52,964	109,656	125,823	(943)	395,386
Investment securities	-	18,306	32,919	56,861	59,158	6,548	520	174,312
Amounts due from group companies	14,388	36,383	12,929	16,978	18,500	14,306	(1,585)	111,899
Others	337	4,096	9,364	540	38	-	9,069	23,444
Total Assets	51,741	168,756	136,893	184,197	197,535	153,886	40,042	933,050
Liabilities								
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	32,481	32,481
Deposits and balances of banks and other financial institutions	10,798	444	62	52	-	-	-	11,356
Deposits from customers	487,709	97,610	86,704	81,596	1,826	42	-	755,487
Trading liabilities	-	21,599	109	447	50	86	774	23,065
Financial liabilities designated at fair value	-	818	924	1,372	468	30	-	3,612
Debt securities in issue	-	320	3,586	6,100	-	-	-	10,006
Amounts due to group companies	10,754	3,414	5,715	3,081	1,143	2,042	-	26,149
Subordinated liabilities	-	-	-	-	-	11,267	-	11,267
Others	6,395	4,939	5,222	1,010	-	-	235	17,801
Total Liabilities	515,656	129,144	102,322	93,658	3,487	13,467	33,490	891,224

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)****(i) Contractual maturity (continued)****Bank (continued)**

	Repayable on demand	2012					Undated	Total
		Due within 1 month	Due between 1 month to 3 months	Due between 3 months to 1 year	Due between 1 year to 5 years	Due after 5 years		
Of which:								
Certificates of deposit held								
- included in Trading assets	-	4	452	590	33	-	-	1,079
- included in Investment securities as available-for-sale securities	-	6,603	11,663	10,634	2,856	-	-	31,756
	-	6,607	12,115	11,224	2,889	-	-	32,835
Treasury bills								
- included in Trading assets	-	1,341	3,348	3,988	25	-	-	8,702
- included in Investment securities as available-for-sale securities	-	4,994	15,007	13,506	-	-	-	33,507
	-	6,335	18,355	17,494	25	-	-	42,209
Debt securities								
- included in Trading assets	-	-	291	4,278	8,725	4,075	-	17,369
- included in Financial assets designated at fair value	-	-	-	-	110	3,106	-	3,216
- included in Investment securities classified as:								
- available-for-sale securities	-	6,116	6,249	28,611	52,182	6,548	-	99,706
- loans and receivables	-	593	-	4,110	4,120	-	-	8,823
- included in Amounts due from fellow subsidiaries classified as:								
- available-for-sale securities	-	-	-	-	-	1,305	-	1,305
- financial assets designated at fair value	-	-	-	-	-	98	-	98
	-	6,709	6,540	36,999	65,137	15,132	-	130,517

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)**

(ii) Behavioural maturity of financial liabilities on a discounted basis

The cash flows presented in note 37(f)(i) reflect the cash flows which will be contractually payable over the residual maturity of the instruments. In practice, however, liability instruments behave differently from their contractual terms and typically, short term customer accounts extend to a longer period than their contractual maturity. The Bank and its subsidiaries' expectation of when such liabilities are likely to become payable is provided in the table below. No information has been presented for financial liabilities which will become payable on their contractual due dates.

Consolidated

	2013				Total HK\$'M
	Within 3 months HK\$'M	Between 3 months and 1 year HK\$'M	Between 1 year and 5 years HK\$'M	After 5 years HK\$'M	
Deposits and balances of banks and other financial institutions	14,338	–	1,875	–	16,213
Deposits from customers	164,659	91,907	560,862	–	817,428
Total	178,997	91,907	562,737	–	833,641

	2012				Total HK\$'M
	Within 3 months HK\$'M	Between 3 months and 1 year HK\$'M	Between 1 year and 5 years HK\$'M	After 5 years HK\$'M	
Deposits and balances of banks and other financial institutions	11,509	772	–	–	12,281
Deposits from customers	135,216	112,815	508,558	–	756,589
Total	146,725	113,587	508,558	–	768,870

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)****(ii) Behavioural maturity of financial liabilities on a discounted basis (continued)****Bank**

	2013				Total HK\$'M
	<i>Within 3 months HK\$'M</i>	<i>Between 3 months and 1 year HK\$'M</i>	<i>Between 1 year and 5 years HK\$'M</i>	<i>After 5 years HK\$'M</i>	
Deposits and balances of banks and other financial institutions	14,093	–	915	–	15,008
Deposits from customers	163,796	91,652	560,852	–	816,300
Total	177,889	91,652	561,767	–	831,308

	2012				Total HK\$'M
	<i>Within 3 months HK\$'M</i>	<i>Between 3 months and 1 year HK\$'M</i>	<i>Between 1 year and 5 years HK\$'M</i>	<i>After 5 years HK\$'M</i>	
Deposits and balances of banks and other financial institutions	11,304	52	–	–	11,356
Deposits from customers	134,479	112,456	508,552	–	755,487
Total	145,783	112,508	508,552	–	766,843

(iii) Financial liabilities excluding derivative financial instruments on an undiscounted basis

The following tables show the cash flows by remaining contractual maturity on an undiscounted basis for the Bank's financial liabilities. The financial liability balances in the tables will not agree to the balances reported in the balance sheets as the tables incorporate all contractual cash flows, on an undiscounted basis, relating to both principal and interest payments. The cash flows presented in the tables reflect the cash flows which will be contractually payable over the residual maturity of the instruments. In practice, however, the liability instruments behave differently from their contractual terms and typically, for short term customer accounts, extend to a longer period than their contractual maturity.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)**

(iii) Financial liabilities excluding derivative financial instruments on an undiscounted basis (continued)

Consolidated

	2013						Total HK\$'M
	Repayable on demand HK\$'M	Due within 3 months HK\$'M	Due	Due	Due	Undated HK\$'M	
			between 3 months to 1 year HK\$'M	between 1 year to 5 years HK\$'M	after 5 years HK\$'M		
Deposits and balances of banks and other financial institutions	13,899	446	–	1,894	–	–	16,239
Deposits from customers	515,633	227,087	73,967	2,410	24	–	819,121
Trading liabilities	–	22,239	–	–	–	216	22,455
Financial liabilities designated at fair value	–	1,024	2,119	1,354	1,354	–	5,851
Debt securities in issue	–	13,801	1,549	–	–	–	15,350
Amounts due to group companies	4,475	10,126	5,706	2,158	432	–	22,897
Subordinated liabilities	–	–	530	2,126	11,489	–	14,145
Others	5,853	13,893	1,398	–	510	34,603	56,257
	<u>539,860</u>	<u>288,616</u>	<u>85,269</u>	<u>9,942</u>	<u>13,809</u>	<u>34,819</u>	<u>972,315</u>
2012 Restated							
	Repayable on demand HK\$'M	Due within 3 months HK\$'M	Due	Due	Due	Undated HK\$'M	Total HK\$'M
			between 3 months to 1 year HK\$'M	between 1 year to 5 years HK\$'M	after 5 years HK\$'M		
Deposits and balances of banks and other financial institutions	10,798	715	772	–	–	–	12,285
Deposits from customers	487,710	185,600	83,138	2,005	84	–	758,537
Trading liabilities	–	20,818	–	–	–	774	21,592
Financial liabilities designated at fair value	–	1,777	1,390	497	28	–	3,692
Debt securities in issue	–	3,918	6,161	–	–	–	10,079
Amounts due to group companies	10,031	8,078	3,323	1,238	2,042	–	24,712
Subordinated liabilities	–	–	536	2,153	12,217	–	14,906
Others	5,744	9,750	1,094	11	244	33,095	49,938
	<u>514,283</u>	<u>230,656</u>	<u>96,414</u>	<u>5,904</u>	<u>14,615</u>	<u>33,869</u>	<u>895,741</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)**

(iii) Financial liabilities excluding derivative financial instruments on an undiscounted basis (continued)

Bank

	Repayable on demand HK\$'M	Due within 3 months HK\$'M	2013			Undated HK\$'M	Total HK\$'M
			Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M		
Deposits and balances of banks and other financial institutions	13,899	199	–	934	–	–	15,032
Deposits from customers	515,632	226,223	73,710	2,399	24	–	817,988
Trading liabilities	–	22,239	–	–	–	216	22,455
Financial liabilities designated at fair value	–	1,024	2,119	1,354	1,354	–	5,851
Debt securities in issue	–	13,801	1,549	–	–	–	15,350
Amounts due to group companies	5,162	10,833	5,674	2,074	432	–	24,175
Subordinated liabilities	–	–	530	2,126	11,489	–	14,145
Others	5,853	13,326	1,238	–	–	34,603	55,020
	<u>540,546</u>	<u>287,645</u>	<u>84,820</u>	<u>8,887</u>	<u>13,299</u>	<u>34,819</u>	<u>970,016</u>
	Repayable on demand HK\$'M	Due within 3 months HK\$'M	2012			Undated HK\$'M	Total HK\$'M
			Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M		
Deposits and balances of banks and other financial institutions	10,798	509	52	–	–	–	11,359
Deposits from customers	487,709	184,861	82,777	2,000	84	–	757,431
Trading liabilities	–	20,818	–	–	–	774	21,592
Financial liabilities designated at fair value	–	1,777	1,390	497	28	–	3,692
Debt securities in issue	–	3,918	6,161	–	–	–	10,079
Amounts due to group companies	10,754	9,132	3,081	1,165	2,042	–	26,174
Subordinated liabilities	–	–	536	2,153	12,217	–	14,906
Others	5,735	9,636	968	–	–	32,716	49,055
	<u>514,996</u>	<u>230,651</u>	<u>94,965</u>	<u>5,815</u>	<u>14,371</u>	<u>33,490</u>	<u>894,288</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity risk (continued)**

(iv) Derivative financial instruments on an undiscounted basis

The following tables show the maturity of derivative financial instruments including those net settled derivative contracts in a net liability position, together with the pay leg of gross settled contracts regardless of whether the overall contract is in an asset or liability position. The receiving leg is not shown in this table and as a result the derivative amounts in this table are inflated by their exclusion.

Consolidated

	<i>Due within 3 months HK\$'M</i>	<i>Due between 3 months to 1 year HK\$'M</i>	<i>Due between 1 year to 5 years HK\$'M</i>	<i>Due after 5 years HK\$'M</i>	<i>Total HK\$'M</i>
	2013				
Derivative financial instruments	711,796	523,144	37,937	3,941	1,276,818
	2012				
Derivative financial instruments	731,255	532,200	26,824	6,061	1,296,340

Bank

	<i>Due within 3 months HK\$'M</i>	<i>Due between 3 months to 1 year HK\$'M</i>	<i>Due between 1 year to 5 years HK\$'M</i>	<i>Due after 5 years HK\$'M</i>	<i>Total HK\$'M</i>
	2013				
Derivative financial instruments	711,796	523,144	37,935	3,939	1,276,814
	2012				
Derivative financial instruments	731,170	532,200	26,824	6,061	1,296,255

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(g) Operational risk

Operational risk is the potential for loss arising from the failure of people, process or technology or the impact of external events. We seek to minimize our exposure to operational risk, subject to cost trade-offs. Operational risk exposures are managed through a consistent set of management processes that drive risk identification, assessment, control and monitoring.

Operational risks can arise from all business lines and from all activities carried out by the Bank. We seek to systematically identify and manage operational risk by segmenting all the Bank's activities into manageable units. Each of these has an owner who is responsible for identifying and managing all the risks that arise from those activities as an integral part of their first line responsibilities. Products and services offered to clients and customers in all our markets are also assessed and authorised in accordance with product governance procedures.

Although operational risk exposures can take many varied forms, we seek to manage them in accordance with standards that drive systematic risk identification, assessment, control and monitoring. These standards are challenged and reviewed regularly to ensure their ongoing effectiveness. To support the systematic identification of material operational risk exposures associated with a given process, we classify them into the following types:

Operational Risk Subtypes

Processing failures	Potential for loss due to failure of an established process or a process design weakness
External Rules & Regulations	Potential for actual or opportunity loss due to failure to comply with laws or regulations, or as a result of changes in laws or regulations or in their interpretation or application
Liability	Potential for loss or sanction due to a legal claim against any part of the Group or individuals within the Group
Legal enforceability	Potential for loss due to failure to protect legally the Group's interests or from difficulty in enforcing the Group's rights
Damage to assets	Potential for loss or damage to physical assets and other property from natural disaster and other events
Safety and security	Potential for loss or damage to health or safety of staff, customers or third parties arising from internal failures or the effects of external events
Internal crime or dishonesty	Potential for loss due to action by staff that is intended to defraud, misappropriate property or to circumvent the law or company policy
External crime	Potential for loss due to criminal acts by external parties such as fraud, theft and other criminal activity
Model	Potential for loss due to a significant discrepancy between the output of risk measurement models and actual experience

The RC oversees the management of operational risks across the Bank, supported by business and functional level committees. This formal structure of governance provides the Board with confidence that operational risks are being proactively identified and effectively managed.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(g) Operational risk (continued)**

The RC is responsible for setting and maintaining standards for operational risk management and measurement. In addition, specialist operational risk control owners have responsibility for the management of operational risk arising from the following Bank-wide activities: legal processes, people management, technology management, vendor management, property management, security management, accounting and financial control, tax management, corporate authorities and structure and regulatory compliance. Each risk control owner is responsible for identifying risks that are material to the Bank and for maintaining an effective control environment, which includes defining appropriate policies and procedures for approval by authorized risk committees.

The Country Operational Risk Committee (“CORC”) is a sub-committee of the RC and is responsible for the supervision and management of operational risks across the Bank. CORC is also responsible for ensuring adequate and appropriate policies and procedures, and resources are in place for identification, assessment, monitoring, control and reporting of operational risks.

Compliance with operational risk policies and procedures is the responsibility of all managers within the Bank. Wholesale Bank and Consumer Bank have independent Operational Risk teams reporting to the Risk Function to ensure operational risk is effectively managed. These units are responsible for approving operational controls, ensuring compliance with policies and procedures in the business, monitoring material operational risk exposures, and providing guidance to the respective business areas on operational risk management.

(h) Reputational risk

Reputational risk is the potential for damage to the Bank’s franchise, resulting in loss of earnings or adverse impact on market capitalisation as a result of stakeholders taking a negative view of the Bank or its actions.

Reputational risk could arise from the failure by the Bank to effectively mitigate the risks in its businesses including one or more of country, credit, liquidity, market, regulatory, legal or other operational risk. It may also arise from a failure to comply with environmental and social standards. Damage to the Bank’s reputation could cause existing clients to reduce or cease to do business with the Bank and prospective clients to be reluctant to do business with the Bank. A failure to manage reputational risk effectively could materially affect the Bank’s business, results of operations and prospects. All employees are responsible for day to day identification and management of reputational risk.

The RC and its sub-committee, the Responsibility and Reputational Risk Committee, provides Bank-wide oversight on reputational risk, sets policy and monitors material risks. The Head of Corporate Affairs is the overall risk control owner for reputational risk. The Executive Committee (“EXCO”) provide additional oversight of reputational risk on behalf of the Board.

The Head of Corporate Affairs as risk control owner is responsible for the protection of the Bank’s reputation with the support of the country management team. The Head of Corporate Affairs and Chief Executive Officer must actively:

- Promote awareness and application of the Bank’s policies and procedures regarding reputational risk.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(h) Reputational risk (continued)**

- Encourage businesses and functions to take account of the Bank's reputation in all decision-making, including dealings with customers and suppliers.
- Implement effective in-country reporting systems to ensure they are aware of all potential issues in tandem with respective business committees.
- Promote effective, proactive stakeholder management through ongoing engagement.

(i) Pension risk

Pension risk is the potential for loss due to having to meet an actuarially assessed shortfall in the Bank's pension scheme. Pension risk exposure is not concerned with the financial performance of the Bank's pension scheme but is focused upon the risk to the Bank's financial position arising from the need to meet pension scheme funding obligations. The risk assessment is focused on our obligations towards the Bank's pension scheme, ensuring that our funding obligation is comfortably within our financial capacity. Pension risk is monitored on a quarterly basis taking account of the actual variations in asset values and updated expectations regarding the progression of the pension fund assets and liabilities.

The PRC is the body responsible for governance of pension risk and it receives its authority from EXCO.

(j) Capital management

The HKMA sets and monitors capital requirements for the Bank and certain subsidiaries specified by the HKMA. In implementing current capital requirements, the HKMA requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. The Bank calculates its capital adequacy ratios in accordance with the Banking (Capital) Rules of the Hong Kong Banking Ordinance.

In addition to meeting the regulatory requirements, the Bank's primary objectives when managing capital are to safeguard the Bank and its subsidiaries' ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, by pricing products and services commensurately with the level of risk and by securing access to finance at a reasonable cost. The Bank actively and regularly reviews and manages its capital structure to maintain a balance between the higher shareholder returns that might otherwise be possible with greater gearing and the advantages and security afforded by a sound capital position, and makes adjustments to the capital structure in light of changes in economic conditions.

The process of allocating capital to specific operations and activities is undertaken by ALCO and is reviewed regularly by the Board.

Consistent with industry practice, the Bank monitors its capital structure on the basis of the capital adequacy ratio and there have been no material changes in the Bank's policy on the management of capital during the year.

The Bank and its subsidiaries have complied with all externally imposed capital requirements throughout the years ended 31 December 2013 and 2012.

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(j) Capital management (continued)

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

With the first phase implementation of revised regulatory capital standards as prescribed by the Basel Committee on Banking Supervision, the HKMA has issued the Banking (Capital) (Amendment) Rules 2012 and 2013 which came into effect for authorized institutions in Hong Kong from 1 January 2013 and 30 June 2013 respectively. Starting from 2013, all authorized institutions in Hong Kong have to meet three levels of minimum capital ratios, namely common equity tier 1, tier 1 and total capital ratios.

The Bank's consolidated capital as at 31 December 2013 consists of tier 1 capital after deduction of HK\$42,474 million and tier 2 capital after deductions of HK\$11,348 million. Tier 2 capital includes subordinated debt and collective impairment allowances for impaired assets.

The Bank's consolidated capital as at 31 December 2012 consists of core capital after deduction of HK\$34,061 million and supplementary capital after deductions of HK\$10,441 million. Supplementary capital includes subordinated debt and collective impairment allowances for impaired assets.

38 Financial instruments

(a) Valuation of financial instruments carried at fair value

Valuation of financial assets and liabilities held at fair value are subject to a review independent of the business by Valuation Control. For those financial assets and liabilities whose fair value is determined by reference to externally quoted prices or market observable pricing inputs to valuation models, an assessment is made against external market data and consensus services. Financial instruments held at fair value in the balance sheet have been classified into a valuation hierarchy that reflects the significance of the inputs used in the fair value measurements.

Valuation methodologies

The valuation hierarchy, and the types of instruments classified into each level within that hierarchy, is set out below:

	Level 1	Level 2	Level 3
Fair value determined using:	Unadjusted quoted price in an active market for identical assets and liabilities	Valuation models with directly or indirectly market observable inputs (note 1)	Valuation models using significant non-market observable inputs (see note 38 (a) (i))
Types of financial assets	Actively traded government, agency and other securities Listed equities Quoted derivative instruments	Asset backed securities Corporate and other government bonds and loans Over-the-counter derivatives	Asset backed securities in illiquid markets Corporate bonds and loans in illiquid markets Unlisted equities
Types of financial liabilities	Short positions in actively traded government and agency securities Short positions in listed equities Quoted derivative instruments	Structured bank and customer deposits Debt securities issued Over-the-counter derivatives	Structured bank and customer deposits Over-the-counter derivatives with unobservable inputs

(Note 1) These valuation models included discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. These models incorporate assumptions and inputs that other market participants would use in their valuations, such as discount rates, default rates, credit spreads and option volatilities. These inputs need to be directly or indirectly observable in order to be classified as level 2.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)**

The tables below show the classification of financial instruments held at fair value into the valuation hierarchy set out above as at 31 December:

Consolidated

	2013			Total HK\$'M
	Level 1 HK\$'M	Level 2 HK\$'M	Level 3 HK\$'M	
Trading assets				
– Trading securities	25,777	8,208	–	33,985
– Advances to customers	–	3,983	–	3,983
– Positive fair values of trading derivatives	1	892	–	893
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	1	10,513	1	10,515
– Positive fair values of hedging derivatives	–	718	–	718
Amounts due from fellow subsidiaries				
– Listed available-for-sale debt securities	–	–	498	498
– Positive fair values of trading derivatives	–	43	–	43
Financial assets designated at fair value	–	2,071	83	2,154
Available-for-sale securities				
– Treasury bills	66,152	–	–	66,152
– Certificates of deposit held	–	34,737	–	34,737
– Debt securities	27,914	63,089	637	91,640
– Equity shares, net of impairment	82	–	353	435
Total assets measured at fair value	119,927	124,254	1,572	245,753
Trading liabilities				
– Short positions in securities	22,417	–	–	22,417
– Negative fair values of trading derivatives	–	1,130	–	1,130
Financial liabilities designated at fair value				
– Structured bank and customer deposits	–	3,832	65	3,897
– Debt securities issued	–	1,826	–	1,826
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	2	10,617	12	10,631
– Negative fair values of hedging derivatives	–	948	–	948
Amounts due to fellow subsidiaries				
– Negative fair values of trading derivatives	–	44	–	44
– Negative fair values of hedging derivatives	–	96	–	96
Total liabilities measured at fair value	22,419	18,493	77	40,989

There were no significant transfers between level 1 and level 2 instruments in 2013.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****Consolidated (continued)**

	2012			Total HK\$'M
	Level 1 HK\$'M	Level 2 HK\$'M	Level 3 HK\$'M	
Trading assets				
– Trading securities	24,871	2,780	–	27,651
– Advances to customers	–	186	–	186
– Positive fair values of trading derivatives	2	567	8	577
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	3	6,093	1	6,097
– Positive fair values of hedging derivatives	–	911	–	911
Amounts due from fellow subsidiaries				
– Listed available-for-sale debt securities	–	–	1,305	1,305
– Debt securities designated at fair value	–	–	98	98
– Positive fair values of trading derivatives	–	81	–	81
Financial assets designated at fair value				
– Debt securities	–	2,668	548	3,216
Available-for-sale securities				
– Treasury bills	33,507	–	–	33,507
– Certificates of deposit held	–	31,756	–	31,756
– Debt securities	28,692	71,014	–	99,706
– Equity shares, net of impairment	90	–	430	520
Total assets measured at fair value	87,165	116,056	2,390	205,611
Trading liabilities				
– Short positions in securities	22,229	–	–	22,229
– Negative fair values of trading derivatives	–	838	1	839
Financial liabilities designated at fair value				
– Structured bank and customer deposits	–	3,574	–	3,574
– Debt securities issued	–	38	–	38
Amounts due to immediate holding company				
– Structured deposits designated at fair value	–	186	–	186
– Negative fair values of trading derivatives	2	5,632	8	5,642
– Negative fair values of hedging derivatives	–	1,654	–	1,654
Amounts due to fellow subsidiaries				
– Negative fair values of trading derivatives	–	76	–	76
– Negative fair values of hedging derivatives	–	264	–	264
Total liabilities measured at fair value	22,231	12,262	9	34,502

There were no significant transfers between level 1 and level 2 instruments in 2012.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****Bank**

	2013			
	Level 1 HK\$'M	Level 2 HK\$'M	Level 3 HK\$'M	Total HK\$'M
Trading assets				
– Trading securities	25,777	8,208	–	33,985
– Advances to customers	–	3,983	–	3,983
– Positive fair values of trading derivatives	1	892	–	893
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	1	10,509	1	10,511
– Positive fair values of hedging derivatives	–	718	–	718
Amounts due from fellow subsidiaries				
– Listed available-for-sale debt securities	–	–	498	498
– Positive fair values of trading derivatives	–	43	–	43
Financial assets designated at fair value				
– Debt securities	–	2,071	83	2,154
Available-for-sale securities				
– Treasury bills	66,152	–	–	66,152
– Certificates of deposit held	–	34,737	–	34,737
– Debt securities	27,914	63,089	637	91,640
– Equity shares, net of impairment	82	–	353	435
Total assets measured at fair value	119,927	124,250	1,572	245,749
Trading liabilities				
– Short positions in securities	22,417	–	–	22,417
– Negative fair values of trading derivatives	–	1,130	–	1,130
Financial liabilities designated at fair value				
– Structured bank and customer deposits	–	3,832	65	3,897
– Debt securities issued	–	1,826	–	1,826
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	2	10,617	12	10,631
– Negative fair values of hedging derivatives	–	948	–	948
Amounts due to fellow subsidiaries				
– Negative fair values of trading derivatives	–	44	–	44
– Negative fair values of hedging derivatives	–	96	–	96
Total liabilities measured at fair value	22,419	18,493	77	40,989

There were no significant transfers between level 1 and level 2 instruments in 2013.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****Bank (continued)**

	2012			Total HK\$'M
	Level 1 HK\$'M	Level 2 HK\$'M	Level 3 HK\$'M	
Trading assets				
– Trading securities	24,871	2,780	–	27,651
– Advances to customers	–	186	–	186
– Positive fair values of trading derivatives	2	563	8	573
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	3	6,089	1	6,093
– Positive fair values of hedging derivatives	–	911	–	911
Amounts due from fellow subsidiaries				
– Listed available-for-sale debt securities	–	–	1,305	1,305
– Debt securities designated at fair value	–	–	98	98
– Positive fair values of trading derivatives	–	81	–	81
Financial assets designated at fair value				
– Debt securities	–	2,668	548	3,216
Available-for-sale securities				
– Treasury bills	33,507	–	–	33,507
– Certificates of deposit held	–	31,756	–	31,756
– Debt securities	28,692	71,014	–	99,706
– Equity shares, net of impairment	90	–	430	520
Total assets measured at fair value	87,165	116,048	2,390	205,603
Trading liabilities				
– Short positions in securities	22,229	–	–	22,229
– Negative fair values of trading derivatives	–	835	1	836
Financial liabilities designated at fair value				
– Structured bank and customer deposits	–	3,574	–	3,574
– Debt securities issued	–	38	–	38
Amounts due to immediate holding company				
– Structured deposits designated at fair value	–	186	–	186
– Negative fair values of trading derivatives	2	5,632	8	5,642
– Negative fair values of hedging derivatives	–	1,654	–	1,654
Amounts due to fellow subsidiaries				
– Negative fair values of trading derivatives	–	76	–	76
– Negative fair values of hedging derivatives	–	264	–	264
Total liabilities measured at fair value	22,231	12,259	9	34,499

There were no significant transfers between level 1 and level 2 instruments in 2012.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****(i) Valuation of financial instruments with significant unobservable inputs (continued)**

	<i>Financial liabilities designated at fair value</i>	<i>Amounts due to immediate holding company</i>	<i>Derivatives financial instruments</i>	<i>Total level 3 liabilities</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Financial liabilities				
At 1 January 2013	–	8	1	9
Total losses/(gains) recognised in the income statement				
– Net trading income	–	4	(1)	3
– Net losses from financial instruments designated at fair value through profit or loss	2	–	–	2
Issuances	47	–	–	47
Transferred into level 3 (Note 2)	16	–	–	16
	<u>65</u>	<u>12</u>	<u>–</u>	<u>77</u>
At 31 December 2013				
Total losses recognised in the income statement relating to liabilities held at 31 December 2013				
– Net trading income	–	4	–	4
– Net losses from financial instruments designated at fair value through profit or loss	2	–	–	2

(Note 1) Amounts due from fellow subsidiaries included debt securities which are available for sale and designated at fair value.

(Note 2) Transfers into/(out of) level 3 during the year relate to financial instruments where the valuation parameters became unobservable/(observable) during the year.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****(i) Valuation of financial instruments with significant unobservable inputs (continued)**

	2012					
	<i>Financial assets designated at fair value</i>	<i>Amounts due from immediate holding company</i>	<i>Amounts due from fellow subsidiaries (Note 1)</i>	<i>Available-for-sale securities</i>	<i>Derivatives financial instruments</i>	<i>Total level 3 assets</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Financial assets						
At 1 January 2012	1,616	–	2,340	318	–	4,274
Total gains recognised in the income statement						
– Net trading income	–	1	–	–	8	9
– Net gains from financial instruments designated at fair value through profit or loss	76	–	5	–	–	81
– Net gains from disposal of available-for-sale securities	–	–	30	–	–	30
Total gains recognised in the available-for-sale investment reserve	–	–	8	30	–	38
Purchases	–	–	–	217	–	217
Sales	–	–	–	(31)	–	(31)
Settlements	(700)	–	(980)	(104)	–	(1,784)
Transferred into level 3 (Note 2)	113	–	–	–	–	113
Transferred out of level 3 (Note 2)	(557)	–	–	–	–	(557)
At 31 December 2012	<u>548</u>	<u>1</u>	<u>1,403</u>	<u>430</u>	<u>8</u>	<u>2,390</u>
Total gains/(losses) recognised in the income statement relating to assets held at 31 December 2012						
– Net trading income	–	1	–	–	8	9
– Net gains/(losses) from financial instruments designated at fair value through profit or loss	<u>5</u>	<u>–</u>	<u>(1)</u>	<u>–</u>	<u>–</u>	<u>4</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****(i) Valuation of financial instruments with significant unobservable inputs (continued)**

	<i>Amounts due to immediate holding company HK\$'M</i>	<i>Derivatives financial instruments HK\$'M</i>	<i>Total level 3 liabilities HK\$'M</i>
Financial liabilities			
At 1 January 2012	–	–	–
Total losses recognised in the income statement			
– Net trading income	8	1	9
	<u>8</u>	<u>1</u>	<u>9</u>
At 31 December 2012	8	1	9
	<u>8</u>	<u>1</u>	<u>9</u>
Total losses recognised in the income statement relating to liabilities held at 31 December 2012			
– Net trading income	8	1	9
	<u>8</u>	<u>1</u>	<u>9</u>

(Note 1) Amounts due from fellow subsidiaries included debt securities which are available for sale and designated at fair value.

(Note 2) Transfers into/(out of) level 3 during the year relate to financial instruments where the valuation parameters became unobservable/(observable) during the year.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

(i) Valuation of financial instruments with significant unobservable inputs (continued)

The following table presents the key valuation techniques used to measure the fair value of level 3 financial instruments which are held at fair value, the significant unobservable inputs and the range of values for those inputs and the weighted average of those inputs.

Type of instruments	Principal valuation technique	Significant unobservable inputs	Range (Note 1)	Weighted average (Note 2)
Debt securities	Discounted cash flows	Yield	1.49% to 4.01%	2.2%
Structured bank and customer deposits	Internal pricing model	Equity-equity correlation	45%	45%
		Equity-foreign exchange correlation	44% to 65%	N/A
Derivative financial Instruments	Internal pricing model	Equity-equity correlation	45%	45%
		Equity-foreign exchange correlation	44% to 65%	N/A

(Note 1) The ranges of values shown represent the highest and lowest levels used in the valuation of the level 3 financial instruments as at 31 December 2013. The ranges of values used are reflective of the underlying characteristics of these level 3 financial instruments based on the market conditions at the balance sheet date. However, these ranges of values may not represent the uncertainty in fair value measurements of these level 3 financial instruments.

(Note 2) Weighted average for non-derivative financial instruments have been calculated by weighting inputs by the relative fair value. Weighted average for derivatives has been provided by weighting inputs by the risk relevant to that variable. N/A has been entered for the cases where weighted average is not a meaningful indicator.

(Note 3) Level 3 equity shares, which are mainly measured using unadjusted net asset value, are excluded.

The following section describes the significant unobservable inputs identified in the above valuation technique table.

Yield

Yield is the interest rate that is used to discount the future cash flows in a discounted cash flow model. An increase in the yield, in isolation, would result in a decrease in a fair value measurement.

Correlation

Correlation is the measure of how movement in one variable influences the movement in another variable. In derivative products, where the payoff is subject to the value of more than one underlying, the correlation between two variables is used as an input in determining the value of the product. Examples include correlation between two stocks, a stock and an index, an index and another index etc. Correlation can be high or low as well as positive or negative. Positive high correlation between two variables means that an increase in one variable is expected to cause a similar increase in other variable.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)**

(ii) Sensitivities in respect of the fair values of level 3 assets and liabilities

Consolidated and Bank

	2013					
	<i>Held at fair value through profit or loss</i>			<i>Available-for-sale securities</i>		
	<i>Net exposure</i>	<i>Favourable changes</i>	<i>Unfavourable changes</i>	<i>Net exposure</i>	<i>Favourable changes</i>	<i>Unfavourable changes</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Amounts due from immediate holding company	1	1	1	–	–	–
Amounts due from fellow subsidiaries	–	–	–	498	498	497
Debt securities	83	83	83	637	640	635
Equity securities	–	–	–	353	389	318
Amounts due to immediate holding company	(12)	(12)	(12)	–	–	–
Structured bank and customer deposits	(65)	(58)	(71)	–	–	–
	<u>7</u>	<u>14</u>	<u>1</u>	<u>1,488</u>	<u>1,527</u>	<u>1,450</u>

	2012					
	<i>Held at fair value through profit or loss</i>			<i>Available-for-sale securities</i>		
	<i>Net exposure</i>	<i>Favourable changes</i>	<i>Unfavourable changes</i>	<i>Net exposure</i>	<i>Favourable changes</i>	<i>Unfavourable changes</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Amounts due from immediate holding company	1	1	1	–	–	–
Amounts due from fellow subsidiaries	98	98	98	1,305	1,310	1,300
Debt securities	548	554	542	–	–	–
Equity securities	–	–	–	430	473	387
Derivative financial instruments	7	7	7	–	–	–
Amounts due to immediate holding company	(8)	(8)	(8)	–	–	–
	<u>646</u>	<u>652</u>	<u>640</u>	<u>1,735</u>	<u>1,783</u>	<u>1,687</u>

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

Where the fair value of financial instruments are measured using valuation techniques that incorporate one or more significant inputs which are based on unobservable market data, we apply a 10 per cent increase or decrease on the values of these unobservable parameter inputs, to generate a range of reasonably possible alternative valuations in accordance with the requirements of HKFRS 7/IFRS 7. The percentage shift is determined by statistical analyses performed on a set of reference prices, which included certain equity indices, credit indices and volatility indices, based on the composition of our level 3 financial instruments. 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. This level 3 sensitivity analysis assumes a one way market move and does not consider offsets for hedges.

As of 31 December 2013, these reasonably possible alternatives could have increased the fair values of financial instruments held at fair value through profit or loss by HK\$7 million (2012: HK\$6 million) or decreased the fair values by HK\$6 million (2012: HK\$6 million); and increased the fair values of available-for-sale securities by HK\$39 million (2012: HK\$48 million) or decreased them by HK\$38 million (2012: HK\$48 million).

(b) Valuation of financial instruments carried at amortised cost

All financial instruments are stated at fair value or amounts not materially different from their fair value as at 31 December 2013 and 2012, except for subordinated liabilities.

The following table summarises the carrying amounts and fair values (including the valuation hierarchy) of subordinated liabilities. The values in the table below are stated as at 31 December and may be different from the actual amounts that will be received on the settlement or maturity of the subordinated liabilities.

	2013		2012	
	Carrying amount HK\$'M	Fair value Level 1 HK\$'M	Carrying amount HK\$'M	Fair value Level 1 HK\$'M
Subordinated liabilities	10,548	11,154	11,267	11,643

The following sets out the Bank's basis of establishing the fair value of its financial assets and liabilities which are not carried at fair value. The basis for establishing the fair value of financial assets and liabilities held at fair value and of derivatives is set out in note 2(i) and note 2(j), respectively.

Cash and balances with banks, central banks and other financial institutions

The fair value of cash and balances with banks, central banks and other financial institutions is their carrying amounts.

Placements with banks and other financial institutions

The fair value of floating rate placements and overnight deposits is their carrying amounts. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using the prevailing money market rates for debts with a similar credit risk and remaining maturity.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(b) Valuation of financial instruments carried at amortised cost (continued)****Advances to customers**

Advances are net of provisions for impairment. The estimated fair value of advances represents the discounted amount of future cash flows expected to be received, including assumptions relating to prepayment rates and, where appropriate, credit spreads. Expected cash flows are discounted at current market rates to determine fair value.

Deposits and balances of banks, other financial institutions and customers

The estimated fair value of deposits with no stated maturity is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on discounted cash flows using the prevailing market rates for debts with a similar credit risk and remaining maturity.

Debt securities in issue and subordinated liabilities

The aggregate fair values are calculated based on quoted market prices. For those securities where quoted market prices are not available, a discounted cash flow model is used based on a current market yield curve appropriate for the remaining term to maturity.

(c) Transfers of financial assets

The Bank enters into collateralised repurchase agreements (repos). These transactions typically entitle the Bank and its counterparties to have recourse to assets similar to those provided as collateral in the event of a default. Assets pledged in respect of repos continue to be recognised on the balance sheet as the Bank retains substantially the associated risk and rewards of these assets. The associated liability is included in "Amounts due to immediate holding company".

The table below sets out the financial assets provided by the Bank as collateral for repos:

	<i>Consolidated and Bank</i>	
	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Collateral pledged against repos		
On balance sheet		
Cash	4	52
Investment securities	–	795
Off balance sheet		
Repledged collateral received	541	–
	<u>545</u>	<u>847</u>
Balance sheet liabilities - repos		
Amount due to Group companies	548	813
	<u>548</u>	<u>813</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(d) Offsetting financial assets and financial liabilities**

The following tables present details of financial instruments subject to offsetting, enforceable master netting arrangements and similar agreements.

Consolidated

	2013				
	<i>Gross amounts of recognised financial assets</i>	<i>Gross amounts of recognised financial liabilities offset in the balance sheet</i>	<i>Net amounts of financial assets presented in the balance sheet</i>	<i>Related amounts not offset in the balance sheet</i>	<i>Net amount</i>
<i>Assets</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Positive fair values of derivative financial instruments	12,169	–	12,169	(11,366)	803
Reverse repos, securities borrowing and similar agreements	20,851	–	20,851	(20,664)	187
	<u>33,020</u>	<u>–</u>	<u>33,020</u>	<u>(32,030)</u>	<u>990</u>
<i>Liabilities</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Negative fair values of derivative financial instruments	12,849	–	12,849	(11,366)	1,483
Repos and similar agreements	548	–	548	(545)	3
	<u>13,397</u>	<u>–</u>	<u>13,397</u>	<u>(11,911)</u>	<u>1,486</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(d) Offsetting financial assets and financial liabilities (continued)**

	2012				
	<i>Gross amounts of recognised financial assets</i>	<i>Gross amounts of recognised financial liabilities offset in the balance sheet</i>	<i>Net amounts of financial assets presented in the balance sheet</i>	<i>Related amounts not offset in the balance sheet</i>	<i>Net amount</i>
<i>Assets</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Positive fair values of derivative financial instruments	7,666	–	7,666	(7,105)	561
Reverse repos, securities borrowing and similar agreements	3,434	–	3,434	(3,154)	280
	<u>11,100</u>	<u>–</u>	<u>11,100</u>	<u>(10,259)</u>	<u>841</u>
<i>Liabilities</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Negative fair values of derivative financial instruments	8,475	–	8,475	(7,105)	1,370
Repos and similar agreements	813	–	813	(813)	–
	<u>9,288</u>	<u>–</u>	<u>9,288</u>	<u>(7,918)</u>	<u>1,370</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(d) Offsetting financial assets and financial liabilities (continued)****Bank**

	2013				
	<i>Gross amounts of recognised financial assets</i>	<i>Gross amounts of recognised financial liabilities offset in the balance sheet</i>	<i>Net amounts of financial assets presented in the balance sheet</i>	<i>Related amounts not offset in the balance sheet</i>	<i>Net amount</i>
<i>Assets</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Positive fair values of derivative financial instruments	12,165	–	12,165	(11,366)	799
Reverse repos, securities borrowing and similar agreements	20,851	–	20,851	(20,664)	187
	<u>33,016</u>	<u>–</u>	<u>33,016</u>	<u>(32,030)</u>	<u>986</u>
<i>Liabilities</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Negative fair values of derivative financial instruments	12,849	–	12,849	(11,366)	1,483
Repos and similar agreements	548	–	548	(545)	3
	<u>13,397</u>	<u>–</u>	<u>13,397</u>	<u>(11,911)</u>	<u>1,486</u>

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Financial instruments (continued)****(d) Offsetting financial assets and financial liabilities (continued)**

Assets	Gross amounts of recognised financial assets HK\$'M	Gross amounts of recognised financial liabilities offset in the balance sheet HK\$'M	2012		Net amount HK\$'M
			Net amounts of financial assets presented in the balance sheet HK\$'M	Related amounts not offset in the balance sheet HK\$'M	
Positive fair values of derivative financial instruments	7,658	–	7,658	(7,105)	553
Reverse repos, securities borrowing and similar agreements	3,434	–	3,434	(3,154)	280
	<u>11,092</u>	<u>–</u>	<u>11,092</u>	<u>(10,259)</u>	<u>833</u>
Liabilities	Gross amounts of recognised financial liabilities HK\$'M	Gross amounts of recognised financial assets offset in the balance sheet HK\$'M	Net amounts of financial liabilities presented in the balance sheet HK\$'M	Related amounts not offset in the balance sheet HK\$'M	Net amount HK\$'M
Negative fair values of derivative financial instruments	8,472	–	8,472	(7,105)	1,367
Repos and similar agreements	813	–	813	(813)	–
	<u>9,285</u>	<u>–</u>	<u>9,285</u>	<u>(7,918)</u>	<u>1,367</u>

The Bank and its subsidiaries are able to offset assets and liabilities which do not meet the HKAS32/IAS 32 netting criteria (see note 2(l)). Such arrangements include master netting arrangements for derivatives and global master repurchase agreements for repos and reverse repos. These agreements generally allow that all outstanding transactions with a particular counterparty can be offset but only in the event of default or other pre-determined events, therefore the related financial assets and financial liabilities are not offset in the balance sheet.

Under repos and reverse repos, the Bank and its subsidiaries would pledge (legally sell) and obtain (legally purchase) financial collateral which are mainly highly liquid assets which can be sold in the event of a default.

The related amounts not offset in the balance sheet which are disclosed in the table above include financial instruments covered by master netting arrangements and financial collateral pledged and obtained, but exclude the effect of over collateralisation.

39 Assets pledged as security for liabilities

The Bank maintains pledged cash and securities accounts to secure any borrowings or other obligations resulting from the Bank's use of clearing systems and to cover short positions. As at 31 December 2013, the Bank had securities amounting to HK\$22,417 million (2012: HK\$22,229 million) to cover the short positions.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***39 Assets pledged as security for liabilities (continued)**

Reverse repos and securities borrowing transactions

The Bank also undertakes reverse repos and securities borrowing transactions as set out in the table below:

	<i>Consolidated and Bank</i>	
	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Balance sheet assets - reverse repos and securities borrowing		
Placements with banks and other financial institutions	10,790	2,362
Advances to customers	3,083	1,072
Amounts due from Group companies	6,978	–
	<u>20,851</u>	<u>3,434</u>

Under reverse repos and securities borrowing arrangements, the Bank obtains securities on terms that permit it to repledge or resell the securities to others. The amount of securities which the Bank is able to repledge or resell are as follows:

	<i>Consolidated and Bank</i>	
	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Securities and collateral that can be repledged or sold (at fair value)	20,719	3,333
Thereof repledged/transferred to others under repos (at fair value)	541	–
	<u>20,719</u>	<u>3,333</u>

These transactions are conducted under terms that are usual and customary to standard lending and stock borrowing activities.

40 Material related party transactions

In addition to the transactions and balances disclosed elsewhere in these financial statements, the Bank and its subsidiaries entered into the following material related party transactions. The transactions of the Bank are materially the same as those appearing in the consolidated financial statements in 2013 and 2012.

(a) Key management personnel remuneration

Remuneration for key management personnel of the Bank, including amounts paid to the directors as disclosed in note 8 is as follows:

	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Short-term employee benefits	120	129
Post-employment benefits	7	12
Equity compensation benefits	32	48
	<u>159</u>	<u>189</u>

Total remuneration is included in staff costs (see note 4(g)).

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(b) Credit facilities and loans to key management personnel**

During the year, the Bank provided credit facilities to key management personnel of the Bank and their close family members and companies controlled or significantly influenced by them. The credit facilities were provided in the ordinary course of business and on substantially the same terms as for comparable transactions with persons of a similar standing or, where applicable, with other employees.

	<i>2013</i> <i>HK\$'M</i>	<i>2012</i> <i>HK\$'M</i>
Loan balances:		
At 1 January	124	441
	<u> </u>	<u> </u>
At 31 December	105	124
	<u> </u>	<u> </u>
Average balance during the year	109	454
	<u> </u>	<u> </u>
Income earned	1	4
	<u> </u>	<u> </u>

(c) Share based payments

The Group operates a number of share based payment schemes for its directors and employees.

2011 Standard Chartered Share Plan (the 2011 Plan)

Approved by shareholders in May 2011, this is the Group's main share plan. The 2011 Plan is designed to deliver performance shares, deferred awards (share or cash) and restricted shares, giving the Group sufficient flexibility to meet the challenges of the changing regulatory and competitive environment. Discretionary share awards are a key part of both executive directors' and senior management's variable compensation and their significance as a proportion of potential total remuneration is one of the strongest indicators of the Group's commitment to pay for sustainable performance and aligning reward with the risk horizon. Performance and restricted share awards will generally be in the form of nil price options to acquire shares in SC PLC.

Performance shares

Awards of performance shares vest after a three-year period and are subject to a combination of three performance measures, Total Shareholder Return (TSR), Earnings per share (EPS) and Return on Risk Weighted Assets (RoRWA). The three performance measures are equally weighted with one third of the award depending on each measure, assessed independently. Performance share awards for executive directors are currently subject to an annual limit of 400 per cent of base salary in face value terms and are delivered as nil cost options.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Material related party transactions (continued)**(c) Share based payments (continued)****Deferred share awards/Restricted shares**

Deferred awards are used to deliver the deferred portion of annual performance awards. These awards are subject to a three year deferral period, vesting equally one third on each of the first, second and third anniversaries. These awards are not subject to an annual limit to ensure that regulatory requirements relating to deferral levels can be met. Deferred awards will not be subject to any further performance criteria, although the Group's claw-back policy will apply.

Restricted share awards which are made outside of the annual performance process, as buy-out or retention mechanisms, are provided as restricted shares under the 2011 Plan. These awards vest in equal instalments on the second and the third anniversaries of the award date. In a few circumstances, some awards vest over a four-year period in equal tranches. Restricted share awards are not subject to an annual limit and do not have any performance conditions.

1997/2006 Restricted Share Scheme (2006 RSS)/ 2007 Supplementary Restricted Share Scheme (2007 SRSS)

The Group's previous plans for delivering restricted shares were the 2006 RSS and 2007 SRSS, both of which are now replaced by the 2011 Plan. There are still unvested and vested awards outstanding under these plans which were previously used to deliver the deferred portion of annual performance awards and as an incentive to motivate and retain high performing employees. Awards will generally be in the form of nil cost options and do not have any performance conditions. Generally deferred restricted share awards vest equally over three years and for non-deferred awards half vests two years after the date of grant and the balance after three years. No further awards will be granted under the 2006 RSS and 2007 SRSS.

2000 Executive Share Option Scheme (2000 ESOS)

The 2000 ESOS is designed to be internationally competitive and focus executive directors and their senior management teams on delivering long-term performance. An EPS performance criterion must be met before options can be exercised.

Executive share options to purchase ordinary shares in the ultimate holding company are exercisable after the third, but before the tenth anniversary of the date of grant. The exercise price per share is the share price at the date of grant and options can only be exercised if a performance condition is satisfied. No further awards may be granted to the employees of the Bank and its subsidiaries under the 2000 ESOS.

2001 Performance Share Plan (2001 PSP)

The Group's previous plan for delivering performance shares was the PSP. Although the PSP was replaced in 2011, there are still outstanding vested and unvested awards under the plan.

Under the PSP, half the award is dependent upon TSR performance and the balance is subject to a target of defined EPS growth. Both measures use the same three-year period and are assessed independently. No further awards can be granted under the plan.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)****All Employee Sharesave Schemes (2004 International Sharesave, 2004 UK Sharesave and 2013 Sharesave)**

Under the Sharesave schemes, employees have the choice of opening a three-year or five-year savings contract. Within a period of six months after the third or fifth anniversary, as appropriate, employees may purchase ordinary shares in the ultimate holding company. The price at which they may purchase shares is at a discount of up to 20 per cent on the share price at the date of invitation. There are no performance conditions attached to options granted under the Sharesave schemes. No further award can be granted under 2004 Sharesave plans.

A new sharesave scheme, the Standard Chartered 2013 Sharesave Plan was approved by Shareholders in May 2013 and it will replace the 2004 Sharesave plans.

2011 Standard Chartered Share Plan (the 2011 plan)**Performance Shares**

Valuation

The fair value is based on the market value less an adjustment to take into account the expected dividends over the vesting period and the relevant performance condition applying to that portion of the award. The fair value of the TSR component is derived by discounting a third of the award that is subject to the TSR condition by the loss of expected dividends over the performance period together with the probability of meeting the TSR condition. The EPS fair value is derived by discounting one third of the award respectively by the loss of expected dividends over the performance period. The same approach is applied to calculate the RoRWA fair value for one third of the award. In respect of the EPS and RoRWA components only, the number of shares expected to vest is adjusted for actual performance when calculating the charge for the year. The same fair value is applied to awards made to both directors and employees of the Group.

Grant Date	2013			2012	
	18 September	19 June	11 March	21 December	13 March
Share price at grant date (£)	15.14	14.62	18.22	15.84	15.65
Shares granted	9,636	9,304	530,166	4,142	624,382
Vesting period (years)	3	3	3	3	3
Expected dividends (yield) (%)	4.6	4.1	4.1	3.7	3.5
Fair value (EPS) (£)	4.43	4.32	5.38	4.73	4.71
Fair value (RoRWA) (£)	4.43	4.32	5.38	4.73	4.71
Fair value (TSR) (£)	1.80	1.76	2.19	1.86	1.85

The expected dividend yield is based on the historical dividend yield over the three years prior to grant.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)**

A reconciliation of movements for the year to 31 December 2013 and 2012 is shown below:

	2013	2012
	<i>No. of shares</i>	<i>No. of shares</i>
Outstanding at 1 January	1,081,556	503,484
Granted	549,106	628,524
Lapsed	(4,306)	(50,452)
Outstanding at 31 December	1,626,356	1,081,556
Weighted average remaining contractual life	8.30 years	8.83 years
Exercisable at 31 December	–	–

Deferred Share Awards

Valuation

The fair value, for all employees including directors, is based on 100% of the face value of the shares at date of grant as the share price will reflect expectations of all future dividends.

<i>Grant Date</i>	2013		<i>Restated 2012</i>		
	<i>19 June</i>	<i>11 March</i>	<i>19 September</i>	<i>20 June</i>	<i>13 March</i>
Share price at grant date (£)	14.62	18.22	14.82	14.17	15.65
Shares granted	2,955	1,089,867	10,828	105,442	1,330,562
Vesting period (years)	1/2/3	1/2/3	1/2/3	1/2/3	1/2/3
Expected dividends yield (%)	n/a	n/a	n/a	n/a	n/a
Fair value (£)	14.62	18.22	14.82	14.17	15.65

Deferred awards accrue dividend equivalent payments during the vesting period.

Restricted Share Awards

Valuation

The fair value is based on the market value less an adjustment to take into account the expected dividends over the vesting period. The same fair value is applied for awards made to both the directors and employees of the Group.

<i>Grant Date</i>	2013			
	<i>17 December</i>	<i>18 September</i>	<i>19 June</i>	<i>11 March</i>
Share price at grant date (£)	13.04	15.14	14.62	18.22
Shares granted	41,899	47,274	32,729	29,162
Vesting period (years)	2/3, 1/2/3/4	2/3, 1/2/3/4	2/3, 1/2/3/4	2/3, 1/2/3/4
Expected dividends (yield) (%)	4.9	4.6	4.6	4.6
Fair value (£)	11.59	13.54	13.05	16.27

<i>Grant Date</i>	<i>Restated 2012</i>			
	<i>21 December</i>	<i>19 September</i>	<i>20 June</i>	<i>13 March</i>
Share price at grant date (£)	15.84	14.82	14.17	15.65
Shares granted	37,872	53,048	6,536	152
Vesting period (years)	2/3, 1/2/3/4	2/3	2/3	2/3
Expected dividends (yield) (%)	3.7	3.0	3.8	3.8
Fair value (£)	14.46	13.76	12.91	14.26

The expected dividend yield is based on the historical dividend yield for three years prior to grant.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)****Deferred Share Awards/ Restricted Shares**

A reconciliation of movements for the year to 31 December 2013 and 2012 is shown below:

	<u>2013</u>	<u>2012</u>
	<i>No. of shares</i>	<i>No. of shares</i>
Outstanding at 1 January	1,594,849	137,005
Granted	1,243,886	1,544,440
Additional shares for Notional Dividend	45,126	–
Lapsed	(88,266)	(86,596)
Exercised	(444,579)	–
Outstanding at 31 December	2,351,016	1,594,849
Weighted average remaining contractual life	5.76 years	6.21 years
Exercisable at 31 December	62,995	–

1997/2006 Restricted Share Scheme (2006 RSS)

No share awards were granted in 2013 and 2012.

A reconciliation of movements for the year ended 31 December 2013 and 2012 is shown below:

	<u>2013</u>	<u>2012</u>
	<i>No. of shares</i>	<i>No. of shares</i>
Outstanding at 1 January	2,376,041	4,393,297
Additional shares for Notional Dividend	37,301	53,801
Lapsed	(185,733)	(219,520)
Exercised	(1,310,471)	(1,851,537)
Outstanding at 31 December	917,138	2,376,041
Weighted average remaining contractual life	3.77 years	4.53 years
Exercisable at 31 December	343,679	1,120,469

2007 Supplementary Restricted Share Scheme (2007 SRSS)

No share awards were granted in 2013 and 2012.

A reconciliation of movements for the year to 31 December 2013 and 2012 is shown below:

	<u>2013</u>	<u>2012</u>
	<i>No. of shares</i>	<i>No. of shares</i>
Outstanding at 1 January	446,703	1,525,196
Lapsed	(103,545)	(245,516)
Exercised	(162,877)	(832,977)
Outstanding at 31 December	180,281	446,703
Weighted average remaining contractual life	3.29 years	4.18 years
Exercisable at 31 December	175,094	292,095

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)****2000 Executive Share Option Scheme (2000 ESOS)**

No share awards were granted in 2013 and 2012.

A reconciliation of option movements for the year ended 31 December 2013 and 2012 is shown below:

	2013		2012	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	72,734	£7.67	541,426	£6.74
Lapsed	(32,729)	£7.40	(225,621)	£6.58
Exercised	(34,165)	£7.89	(243,071)	£6.62
Outstanding at 31 December	5,840	£7.89	72,734	£7.67
Exercisable at 31 December	5,840	£7.89	72,734	£7.67

Range of exercise price	2013			2012		
	Weighted average exercise price	No. of shares	Weighted average remaining contractual life	Weighted average exercise price	No. of shares	Weighted average remaining contractual life
at £7.89 (2012: £5.82/£8.76)	£7.89	5,840	0.17 year	£7.67	72,734	1.07 years

2001 Performance Share Plan (PSP)

No share awards were granted in 2013 and 2012.

A reconciliation of movements for the year ended 31 December 2013 and 2012 is shown below:

	2013	2012
	No. of shares	No. of shares
Outstanding at 1 January	208,690	648,053
Lapsed	(15,859)	(180,974)
Exercised	(162,031)	(258,389)
Outstanding at 31 December	30,800	208,690
Weighted average remaining contractual life	4.39 years	6.44 years
Exercisable at 31 December	30,800	88,364

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)****Sharesave (2004 International Sharesave, 2004 UK Sharesave and 2013 Sharesave)**

Valuation

Options are valued using a binomial option-pricing model. The fair value per option granted and the assumptions used in the calculation are as follows:

<i>Grant Date</i>	<u>2013</u>	<u>2012</u>
	<i>9 October</i>	<i>11 October</i>
Share price at grant date (£)	14.36	13.95
Exercise price (£)	11.78	11.40
Shares granted	424,553	820,453
Vesting period (years)	3	3
Expected volatility (%)	26.8	29.8
Expected option life (years)	3.33	3.33
Risk free rate (%)	0.8	0.4
Expected dividends (yield) (%)	4.3	3.1
Fair value (£)	3.30	3.28

The expected volatility is based on historical volatility over the last three to five years or three to five years prior to grant. The expected life is the average expected period to exercise. The risk free rate of return is the yield on zero-coupon UK Government bonds of a term consistent with the assumed option life. The expected dividend yield is based on historical dividend yield for three years prior to grant.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)****Sharesave (2004 International Sharesave and 2004 UK Sharesave)**

No share awards were granted in 2013.

A reconciliation of option movements for the year ended 31 December 2013 and 2012 is shown below:

	2013		2012	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	1,749,820	£11.57	1,703,989	£11.48
Granted	–	–	820,453	£11.40
Lapsed	(261,133)	£12.39	(179,473)	£12.42
Exercised	(217,896)	£11.42	(595,149)	£10.80
Outstanding at 31 December	1,270,791	£11.48	1,749,820	£11.57
Exercisable at 31 December	128,677	£14.21	174,964	£10.96

Range of exercise price	2013			2012		
	Weighted average exercise price	No. of shares	Weighted average remaining contractual life	Weighted average exercise price	No. of shares	Weighted average remaining contractual life
£9.79/£14.63 (2012: £9.79/£14.63)	£11.48	1,270,791	1.95 years	£11.57	1,749,820	2.57 years

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)****2013 Sharesave**

	2013	
	No. of shares	Weighted average exercise price
Outstanding at 1 January	–	–
Granted	424,553	£11.78
Lapsed	(11,440)	£11.78
Outstanding at 31 December	413,113	£11.78
Exercisable at 31 December	–	–

Range of exercise price	2013		
	Weighted average exercise price	No. of shares	Weighted average remaining contractual life
at £11.78	£11.78	413,113	3.42 years

(d) Loans to officers

Loans to officers of the Bank disclosed pursuant to section 161B of the Hong Kong Companies Ordinance are as follows:

	2013 HK\$'M	2012 HK\$'M
Aggregate amount of relevant loans by the Bank outstanding at 31 December	105	117
Maximum aggregate amount of relevant loans by the Bank outstanding during the year	116	131

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(e) Related party transactions with associates and joint ventures of the Group**

During the year, the Bank and its subsidiaries entered into transactions with associates and joint ventures of the Group in the ordinary course of its banking business and on substantially the same terms as for comparable transactions with third-party counterparties. The amounts of material transactions during the year are set out below:

	<i>2013</i>	<i>2012</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Amounts due from associates and joint ventures	185	474
Deposits from associates and joint ventures	159	287
Operating income	25	42

41 Ultimate holding company

The Bank's ultimate holding company is Standard Chartered PLC, a company registered in England and Wales. Standard Chartered PLC has listings on the London Stock Exchange and the Stock Exchange of Hong Kong. In addition, Standard Chartered PLC is also listed on the Bombay and National Stock Exchanges of India in a form of Indian Depository Receipts.

42 Significant accounting estimates and judgements

In determining the carrying amounts of certain assets and liabilities, the Bank and its subsidiaries make assumptions about the effects of uncertain future events on those assets and liabilities at the balance sheet date. These estimations and assumptions are based on historical experience and expectation of future events and are reviewed periodically as actual results may differ from these estimates.

Pensions

Actuarial assumptions are made in valuing future defined pension obligations as set out in note 30 and are updated periodically.

Taxes

Determining income tax provisions involves judgement on the future tax treatment of certain transactions. Deferred tax liabilities are recognised on all temporary differences and deferred tax assets are recognised on temporary differences where it is probable that there will be taxable revenue against which these can be offset. Management has made judgements as to the probability of future taxable revenues being generated against which tax losses will be available for offset.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

42 Significant accounting estimates and judgements (continued)

Fair value of financial instruments

Notes 2(i) and 38 provide further information on the Bank's fair value accounting policy and process.

Impairment of financial assets

Policies on impairment of financial assets are set out in note 2(k).

Goodwill impairment

An annual assessment is made, as set out in note 22, as to whether the current carrying value of goodwill is impaired.

Impairment of interest in associates

Details of impairment testing are set out in note 20.

43 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2013

Up to the date of issue of the financial statements, the HKICPA/IASB has issued a number of amendments, new standards and interpretations which are not yet effective for the accounting year ended 31 December 2013 and which have not been adopted in these financial statements.

These include:

- HKFRS 9/IFRS 9, *Financial instruments* (no specified effective date)
- HKAS 32/IAS 32, *Financial Instruments: Presentation – Offsetting financial assets and financial liabilities* (effective on 1 January 2014)
- Amendments to HKAS 39/IAS 39, *Novation of derivatives and continuation of hedge accounting* (effective on 1 January 2014)

The Bank and its subsidiaries are in the process of making an assessment of what the impact of these amendments is expected to be in the period of initial application. So far it has concluded that the adoption of these standards is unlikely to have a significant impact on the Bank and its subsidiaries' results of operations and financial position except for HKFRS 9/IFRS 9 which may have an impact on the Bank and its subsidiaries' results and financial position arising from changes in the Bank and its subsidiaries' classification and measurement of financial instruments.

44 Post balance sheet events

On 10 January 2014, the Group announced that with effect from 1 April 2014 the two businesses of the Group, Wholesale Banking and Consumer Banking would be intergrated to form one business. The new business will be organised into 3 segment groups (Corporate and Institutional; Commercial and Private banking; and Retail and Small business) serviced by 5 global product groups. The impact of this change will be reflected in the Bank's 2014 Consolidated Financial Statements.

Notes to the financial statements (continued)*(Expressed in millions of Hong Kong dollars)***45 Restatement of comparative figures*****Changes in accounting policy***

The impact of the retrospective application of the revised HKAS 19/IAS 19 Employee benefits and HKFRS 11/IFRS 11 Joint arrangements as mentioned in note 3 is set out below.

	<i>As previously reported HK\$'M</i>	<i>Effect of adoption of revised HKAS 19/ IAS 19 HK\$'M</i>	<i>Effect of adoption of HKFRS 11/ IFRS 11 HK\$'M</i>	<i>Restated HK\$'M</i>
For the year ended 31 December 2012				
Consolidated income statement				
Interest expense	(6,052)	–	5	(6,047)
Fee and commission expense	(702)	–	1	(701)
Other operating income	1,162	–	1	1,163
Staff cost	(6,693)	(92)	–	(6,785)
Taxation	(1,523)	15	1	(1,507)
Profit after taxation	8,238	(77)	8	8,169
Consolidated statement of comprehensive income				
Defined benefit plan:				
– Remeasurement of net defined benefit liability	(61)	92	–	31
– Related tax effect	10	(15)	–	(5)
Consolidated cash flow statement				
Net cash generated from operating activities	11,856	–	11	11,867
Net cash used in investing activities	(13,959)	–	(13)	(13,972)
Cash and cash equivalents	141,148	–	(2)	141,146
Interest paid	5,184	–	(5)	5,179
As at 31 December 2012				
Consolidated balance sheet				
Placements with banks and other financial institutions	143,581	–	(2)	143,579
Fixed assets	23,746	–	(41)	23,705
Deferred tax assets	89	–	(1)	88
Amount due to fellow subsidiaries	5,117	–	(32)	5,085
Other liabilities	18,204	–	(20)	18,184
Reserves	46,652	–	8	46,660

Comparative figures

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

Unaudited supplementary financial information

Disclosure on Remuneration for CG-5 Guideline on a Sound Remuneration System issued by the HKMA

Pursuant to section 3 of CG-5 on Guideline on a Sound Remuneration System of the Supervisory Policy manual issued by the Hong Kong Monetary Authority and the Pillar 3 disclosure requirements for remuneration by the Basel Committee on Banking Supervision, the following disclosures are made:

- a) Information relating to the governance structure of the remuneration system
- b) Information relating to the design and structure of the remuneration processes
- c) Description of the ways in which current and future risks are taken into account in the remuneration processes
- d) Description of the ways in which the Bank seeks to link performance during a performance measurement period with levels of remuneration
- e) Description of the ways in which the Bank seeks to adjust remuneration to take account of longer-term performance
- f) Description of the different forms of variable remuneration that the Bank utilizes and the rationale for using these different forms
- g) Number of meetings held by the Board Remuneration Committee during the financial year and remuneration paid to the staff

The Bank adopts the remuneration policy and systems of Standard Chartered PLC. Please refer to the Directors' Remuneration Report in the Annual Report of Standard Chartered PLC for details of the Board Remuneration Committee, the major characteristics of the remuneration system, and how risks are taken into account in the remuneration processes.

- h) Aggregate quantitative information on remuneration for Senior Management and Key Personnel (note 1) for the year ended 31 December 2013 and 31 December 2012 are as follows:

Analysis of remuneration split between fixed and variable compensation

	2013		2012	
	Senior Management HK\$'000	Key Personnel HK\$'000	Senior Management HK\$'000	Key Personnel HK\$'000
Fixed compensation	21,600	10,140	18,699	9,911
Variable compensation				
– Up front cash	14,000	9,569	15,779	12,072
– Up front shares	1,114	–	1,314	–
– Deferred cash	3,547	945	3,467	568
– Deferred shares:				
– Restricted shares	5,038	2,701	4,391	6,405
– Performance shares	11,964	1,118	9,278	951
Total	57,263	24,473	52,928	29,907
Number of staff at 31 December	7	4	7	4

Unaudited supplementary financial information (continued)**Disclosure on Remuneration for CG-5 Guideline on a Sound Remuneration System issued by the HKMA (continued)****Analysis of deferred remuneration (note 2)**

	2013		2012	
	Senior Management HK\$'000	Key Personnel HK\$'000	Senior Management HK\$'000	Key Personnel HK\$'000
At 1 January	38,267	16,371	35,525	14,443
Awarded during the year	20,549	4,764	17,136	7,924
Paid out during the year	(11,077)	(6,355)	(13,794)	(2,300)
Not vested due to performance adjustment	–	–	(2,007)	(233)
At 31 December	<u>47,739</u>	<u>14,780</u>	<u>36,860</u>	<u>19,834</u>
Vested during the year	<u>10,484</u>	<u>7,418</u>	<u>14,686</u>	<u>2,797</u>

Analysis of total amount of outstanding deferred remuneration

	2013		2012	
	Senior Management HK\$'000	Key Personnel HK\$'000	Senior Management HK\$'000	Key Personnel HK\$'000
At 31 December				
– Vested	452	1,063	1,003	497
– Not-vested	<u>47,287</u>	<u>13,717</u>	<u>35,857</u>	<u>19,337</u>
	<u>47,739</u>	<u>14,780</u>	<u>36,860</u>	<u>19,834</u>
At 31 December				
– Cash	5,858	1,323	3,467	568
– Shares	<u>41,881</u>	<u>13,457</u>	<u>33,393</u>	<u>19,266</u>
	<u>47,739</u>	<u>14,780</u>	<u>36,860</u>	<u>19,834</u>
Total amount of outstanding deferred remuneration exposed to ex post explicit and/or implicit adjustments (note 3)	<u>47,739</u>	<u>14,780</u>	<u>36,860</u>	<u>19,834</u>

Unaudited supplementary financial information (continued)**Disclosure on Remuneration for CG-5 Guideline on a Sound Remuneration System issued by the HKMA (continued)****Analysis of adjustments of deferred remuneration**

	2013		2012	
	Senior Management HK\$'000	Key Personnel HK\$'000	Senior Management HK\$'000	Key Personnel HK\$'000
Total amount of adjustments during the financial year due to				
– ex post explicit adjustments	–	–	(2,007)	(233)
– ex post implicit adjustments	(5,352)	(1,756)	3,463	1,996

No sign-on or severance payments were awarded to Senior Management or Key Personnel during 2013 and 2012.

Note 1: As defined in the CG-5 Guideline on a Sound Remuneration System issued by the HKMA, senior management are those who are responsible for oversight of either the Bank's company-wide strategy or activities or those of the Bank's material business lines. Key Personnel are individual employees whose duties or activities in the course of their employment involve the assumption of material risk or the taking on of material exposures on behalf of the Bank.

Note 2: The population of Key Personnel in 2013 differs from that of 2012.

Note 3: Ex post adjustments are adjustments made after the awards are granted.