

Standard Chartered Bank
(Hong Kong) Limited

Directors' Report and
Consolidated Financial
Statements

For the year ended
31 December 2019

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 2019.

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 17 to the consolidated financial statements.

Financial statements

The profit of the Bank and its subsidiaries (together the “Group”) for the year ended 31 December 2019 and the state of the Group’s affairs as at that date are set out in the consolidated financial statements on pages 12 to 167.

During the year ended 31 December 2019, the directors had declared and paid an ordinary dividend of HK\$0.74 per each Class A, B, C and D ordinary share totalling HK\$3,904 million (2018: HK\$2.02 per each Class A and B ordinary share totalling HK\$3,908 million). Dividends of HK\$144 million (2018: HK\$ nil), HK\$244 million (2018: HK\$245 million) and HK\$98 million (2018: HK\$98 million) were paid in respect of the US\$900 million floating rate undated Additional Tier 1 capital securities, the US\$500 million 6.25% perpetual non-cumulative convertible preference shares and the US\$250 million 5% perpetual non-cumulative subordinated capital securities classified as equity, respectively.

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

Charitable donations

Charitable donations made by the Group during the year amounted to HK\$43 million (2018: HK\$60 million).

Share capital

Details of the movements in the share capital of the Bank during the year are set out in note 29 to the consolidated financial statements.

Directors

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

Executive directors

Pi Cheng Benjamin HUNG (appointed on 1 June 2019)

Gregory John POWELL (appointed on 1 June 2019)

Darren Suk KIM (appointed on 1 June 2019)

Wai Yi Mary HUEN

Yee Mann HAU

Report of the directors (continued)

Non-Executive directors

Edward Martin WILLIAMS, appointed as Chairman on 1 June 2019

Pi Cheng Benjamin HUNG (Chairman from 1 January 2019 to 31 May 2019 and re-appointed as an Executive Director on 1 June 2019)

Cheuk Kuen Gloria LEE

Michael Andres GORRIZ

Ching FONG*

Stephen Robert ENO*

Wai Sun Edward CHENG*

Lieh Cheung Andrew TUNG*

** Independent non-executive directors*

A full list of the names of the directors of the Bank's subsidiaries is set out in Appendix II.

Directors' service contracts

The term of service contracts of all independent non-executive directors, and three non-executive directors, Edward Martin WILLIAMS, Michael Andres GORRIZ and Cheuk Kuen Gloria LEE, is 2 years. Their remuneration was approved by the shareholders.

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, Edward Martin WILLIAMS, Pi Cheng Benjamin HUNG, Gregory John POWELL, Darren Suk KIM, Wai Yi Mary HUEN, Yee Mann HAU, Michael Andres GORRIZ 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 transactions, arrangements or contracts

No transactions, arrangements or 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.

Management contracts

No contracts concerning the management and administration of the whole or any substantial part of the business of the Bank were entered into or existed during the year.

Report of the directors (continued)

Indemnity of directors

A permitted indemnity provision (as defined in section 469 of the Hong Kong Companies Ordinance) for the benefit of the directors of the Bank is currently in force and was in force throughout the year.

Auditor

The consolidated financial statements have been audited by KPMG who will step down and it is proposed that Ernst & Young will be appointed as the auditor of the Bank on 28 February 2020, subject to the shareholder approval.

On behalf of the Board

Edward Martin WILLIAMS
Chairman

Hong Kong, 27 February 2020



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

(Incorporated in Hong Kong with limited liability)

Opinion

We have audited the consolidated financial statements of Standard Chartered Bank (Hong Kong) Limited (the "Bank") and its subsidiaries (together "the Group") set out on pages 12 to 167, which comprise the consolidated statement of financial position as at 31 December 2019, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended and notes to the consolidated financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2019 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board ("IASB") and with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the HKICPA. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the Group in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code") and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.



**Independent auditor’s report to the members of
Standard Chartered Bank (Hong Kong) Limited (continued)**

(Incorporated in Hong Kong with limited liability)

Key audit matters (continued)

Impairment of loans and advances	
<i>Refer to note 14 to the consolidated financial statements and the accounting policies on pages 32 to 39</i>	
The Key Audit Matter	How the matter was addressed in our audit
<p>Impairment of loans and advances across the banking industry continues to be an area of concern and elevated focus, as counterparties continue to tackle liquidity and over-capacity concerns.</p> <p>The Group has loan exposures to Corporate & Institutional Banking (“CIB”) clients, Commercial Banking (“CB”) clients and loans and advances to banks. These exposures comprise larger loans that are monitored individually, based on the knowledge of each individual borrower. However, the Retail Banking and Private Banking clients’ exposure comprises much smaller value loans to a much greater number of customers. Accordingly, these loans are not monitored on an individual basis, but are grouped by product into homogeneous exposures. Exposures are then monitored through delinquency statistics, which also drive the assessment of loan loss provisions.</p> <p>The determination of loss allowances using the ECL model is subject to a number of key parameters and assumptions, including the identification of loss stages, estimates of probability of default, loss given default, exposures at default and discount rate, adjustments for forward-looking information and other adjustment factors. Management judgement is involved in the selection of those parameters and the application of the assumptions.</p> <p>In particular, the determination of the loss allowances is heavily dependent on the external macro environment and the Group’s internal credit risk management strategy. The ECL for corporate loans are derived from estimates including the historical losses, internal and external credit grading and other adjustment factors. The ECL for personal loans are derived from estimates whereby management takes into consideration historical overdue data, the historical loss experience for personal loans and other adjustment factors.</p>	<p>Our audit procedures to assess impairment of loans and advances included the following:</p> <ul style="list-style-type: none"> • understanding and assessing the design, implementation and operating effectiveness of key internal controls of financial reporting over the approval, recording and monitoring of loans and advances, the credit grading process, the ECL model build, approval, monitoring, governance and validation process, the measurement of impairment provisions for individually assessed loans and advances and key underlying systems used for the processing of transactions; • assessing the completeness and accuracy of data used for the key parameters in the ECL model. For key parameters derived from internal data relating to original loan agreements, we compared the total balance of the loan list used by management to assess the allowances for impairment with the general ledger, selecting samples and comparing individual loan information with the underlying agreements and other related documentation to assess the accuracy of compilation of the loan list. For key parameters derived from external data, we selected samples to inspect the accuracy of such data by comparing them with public resources. In addition, we involved our IT specialists to assess the logics and compilation of the overdue information and the operational process of the credit grading of corporate customers for selected samples;



**Independent auditor’s report to the members of
Standard Chartered Bank (Hong Kong) Limited (continued)**

(Incorporated in Hong Kong with limited liability)

Key audit matters (continued)

<p>Management also exercises judgement in determining the quantum of loss given default based on a range of factors. These include available remedies for recovery, the financial situation of the borrower, the recoverable amount of collateral, the seniority of the claim and the existence and cooperativeness of other creditors. Management refers to valuation reports issued by qualified third party valuers and considers the influence of various factors including the market price, location and use when assessing the value of property held as collateral. The enforceability, timing and means of realisation of collateral can also have an impact on the recoverable amount of collateral and, therefore, the amount of loss allowances as at the end of the reporting period. Furthermore, management judgement is exercised should ECL overlays be warranted.</p> <p>We identified impairment of loans and advances as a key audit matter because of the inherent uncertainty and management judgement involved and because of its significance to the financial results and capital of the Group.</p>	<ul style="list-style-type: none"> • for key parameters involving judgement, critically assessing input parameters by seeking evidence from external sources and comparing to the Group’s internal records including historical loss experience and type of collateral. As part of these procedures, we challenged management’s revisions to estimates and input parameters compared with prior period and considered the consistency of judgement. We compared the economic factors used in the models with market information to assess whether they were aligned with market and economic development; • comparing the forward looking macroeconomic factors used in the models with market information to assess whether they were aligned with market and economic development; • for selected samples of loans and advances to customers, assessing the appropriateness of credit grades, management determination of significant deterioration in the credit risk and the accuracy of ECL staging by evaluating management’s assessment on the forecast cash flows, valuation of collateral and repayment sources; • assessing the Stage 3 ECL balance by selecting a sample, based on specific risk criteria, of credit impaired loans and advances from the Bank’s Group Special Assets Management portfolio and loans in industries vulnerable to the current economic slowdown in CB and CIB for credit assessment. For these samples, we evaluated the timing and means of realisation of collateral, assessed the forecast of recoverable cash flows, challenged the viability of the Group’s recovery plans and evaluated other credit enhancements that are integral to the contract terms. We also evaluated the consistency of management’s application of key assumptions and compared them with loan overdue information, business operations and financial information and market information about borrowers’ businesses;
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**Independent auditor’s report to the members of
Standard Chartered Bank (Hong Kong) Limited (continued)**

(Incorporated in Hong Kong with limited liability)

Key audit matters (continued)

	<ul style="list-style-type: none"> • evaluating the experience, independence, competence and integrity of the external valuers engaged by the Bank to value certain property and illiquid collateral and comparing the valuations with externally derived data such as commodity prices and real estate valuations; • with the assistance of our internal specialists, assessing the reliability of the ECL model used by management in determining loss allowances, including assessing the appropriateness of the key parameters and assumptions in the ECL model, including the identification of loss stages, probability of default, loss given default, exposure at default, discount rate, adjustments for forward-looking information and other management adjustments; • recalculating the amount of credit loss allowance for 12 month and life time credit losses using the ECL model based on the above parameters and assumptions for a sample of loans and advances where the credit risk of the loan has not, or has, increased significantly since initial recognition, respectively; • assessing the appropriateness of material manual adjustments and overlays on ECL model outputs by evaluating management’s assessment in determining the adjustments and overlays; and • evaluating whether the relevant disclosures on impairment of loans and advances meet the disclosure requirements of prevailing accounting standards.
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Independent auditor's report to the members of Standard Chartered Bank (Hong Kong) Limited (continued)

(Incorporated in Hong Kong with limited liability)

Impairment of leased assets	
<p>Refer to notes 19 and 21 to the consolidated financial statements and the accounting policies on pages 22 and 44</p>	
<p>The Key Audit Matter</p> <p>As at 31 December 2019, the Group has a fleet of 81 aircraft, with a carrying value before impairment of HK\$24 billion. The aircraft are classified as 'Operating lease assets' within other property, plant and equipment in the Group's consolidated statement of financial position and the carrying value is stated at cost less accumulated depreciation and impairment. The Group has also a fleet of 48 vessels, with a net realisable value of HK\$6 billion. In February 2019, Standard Chartered PLC announced their intention to exit the ship leasing business. As at 31 December 2019, the vessels are therefore classified as 'Assets held for sale' within other assets in the Group's consolidated statement of financial position and are stated at the lower of carrying amount and fair value less costs to sell.</p> <p>On a quarterly basis, management performs an impairment assessment of the fleet. The carrying amount of each aircraft is compared to the recoverable amount, which is the higher of its (i) fair value less costs to sell and (ii) value in use. For each vessel the carrying amount is compared to its fair value less costs to sell. If the recoverable amount, in the case of aircraft, or, in the case of vessels the fair value less costs to sell, is less than the carrying amount, the carrying amount of that asset is reduced to its recoverable amount or fair value less costs to sell, as appropriate. The reduction is an impairment loss and is recognised in the consolidated statement of comprehensive income.</p> <p>The total impairment provisions amounted to HK\$776 million as at 31 December 2019.</p> <p>The impairment of leased assets is a highly subjective area due to the level of judgement applied by management in determining the value in use and fair value less costs to sell.</p> <p>Fair value less costs to sell is measured with reference to valuations provided by independent third party external appraisers and estimated costs of disposal, while value in use is determined by estimating the future cash flows anticipated for each aircraft over its remaining useful life and discounting these cash flows to present value using an appropriate discount rate.</p>	<p>How the matter was addressed in our audit</p> <p>Our audit procedures to assess impairment of leased assets included the following:</p> <ul style="list-style-type: none"> • assessing the appropriateness of the classification of leased assets with reference to the requirements of prevailing accounting standards; • evaluating the validity of the methodology applied to determine the fair value for the aircraft and vessels with reference to requirements of prevailing accounting standards; • evaluating the qualification, experience, independence, competence and integrity of the independent third party external appraisers utilised by the Group to determine fair value and future lease rates; • evaluating the validity of the models used in determining the value in use; • assessing the appropriateness of the assumptions and key inputs to the value in use model, including current contracted lease rates, future lease rates for subsequent leases, estimated residual value for sales proceeds, downtime assumptions, timing of cash flows and other costs, the discount rate adopted and the timing of any sales; • assessing the appropriateness of the assumptions used in determining the depreciation of assets, including the estimated useful life and residual value; • recalculating the impairment provision; • assessing the reliability of management's cash flow forecasting process by performing a retrospective review of the previous year's forecasts with the current year's results, discussing significant variances with management and considering the effect of such variances on the models used; and



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

(Incorporated in Hong Kong with limited liability)

<p>Management exercises judgement in determining the value in use based on a range of assumptions. These include the discount rate, current contracted lease rates, future lease rates for subsequent leases, estimated residual value for sales proceeds, other costs, and downtime assumptions.</p> <p>We identified impairment of leased assets as a key audit matter because of the inherent subjectivity and management judgement involved in calculating impairment provisions and because of its significance to the financial results and capital of the Group.</p>	<ul style="list-style-type: none"> assessing the financial statement disclosures in respect of the impairment assessments with reference to the requirements of the prevailing accounting standards.
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Assessing the fair value of level 3 financial instruments	
<i>Refer to note 35 to the consolidated financial statements and the accounting policies on pages 23 to 31</i>	
The Key Audit Matter	How the matter was addressed in our audit
<p>At 31 December 2019 the fair value of the Group's financial instruments totalled HK\$694,525 million of which HK\$4,381 million was classified under the fair value hierarchy as level 3 financial instruments.</p> <p>The valuation of level 3 financial instruments held at fair value through profit or loss or as fair value through other comprehensive income may be misstated due to the application of valuation techniques which often involve the exercise of judgement and the use of assumptions and estimates.</p> <p>A subjective estimate exists for instruments where the valuation method uses significant unobservable inputs, which is principally the case for level 3 financial instruments.</p> <p>In addition, the Group has developed its own models to value certain level 3 financial instruments, which also involves significant management judgement.</p> <p>We identified assessing the fair value of level 3 financial instruments as a key audit matter because of the degree of complexity involved in valuing certain financial instruments and because of the degree of judgement exercised by management in determining the inputs used in the valuation models.</p>	<p>Our audit procedures to assess the fair value of financial instruments included the following:</p> <ul style="list-style-type: none"> assessing the design, implementation and operating effectiveness of key internal controls over valuation and model approval; involving our internal valuation specialists to perform, on a sample basis, independent valuations of level 3 financial instruments and comparing these valuations with the Group's valuations. Our independent valuations included developing models, obtaining and independently verifying the inputs to the models; and assessing whether the financial statement disclosures, including fair value hierarchy information and sensitivity to key inputs, appropriately reflected the Group's exposure to financial instrument valuation risk in accordance with the requirements of the prevailing accounting standards.

Information other than the consolidated financial statements and auditor's report thereon

The Directors are responsible for the other information. The other information comprises all the information included in the Directors' Report and Consolidated Financial Statements, other than the consolidated financial statements and our auditor's report thereon.

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



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

(Incorporated in Hong Kong with limited liability)

Information other than the consolidated financial statements and auditor's report thereon (continued)

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

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

Responsibilities of the directors for the consolidated financial statements

The Directors are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with IFRSs issued by the IASB and with HKFRSs issued by the HKICPA 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 misstatement, whether due to fraud or error.

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

The Directors are assisted by the Audit Committee in discharging their responsibilities for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. This report is made solely to you, as a body, in accordance with section 405 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.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.



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

(Incorporated in Hong Kong with limited liability)

Auditor's responsibilities for the audit of the consolidated financial statements (continued)

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.
- Conclude on the appropriateness of the Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

We also provide the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence and, where applicable, related safeguards.

From the matters communicated with the Audit Committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Rhys, David Benjamin Lewellin.

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

27 February 2020

Consolidated income statement
For the year ended 31 December 2019
(Expressed in millions of Hong Kong dollars)

	Note	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
Interest income	4(a)	46,139	41,998
Interest expense	4(b)	(18,850)	(15,510)
Net interest income		<u>27,289</u>	<u>26,488</u>
Fee and commission income		11,684	11,519
Fee and commission expense		(2,284)	(1,811)
Net fee and commission income	4(c)	9,400	9,708
Net trading income	4(d)	6,688	6,066
Other operating income	4(e)	4,855	4,939
		<u>20,943</u>	<u>20,713</u>
Total operating income		48,232	47,201
Staff costs		(14,454)	(14,086)
Premises and equipment		(4,752)	(5,152)
Others		(10,583)	(9,588)
Operating expenses	4(f)	(29,789)	(28,826)
Operating profit before impairment		18,443	18,375
Credit impairment	5(a)	(1,648)	(687)
Other impairment	5(b)	(818)	(1,191)
Operating profit after impairment		15,977	16,497
Share of profit of an associate		1,934	1,562
Profit before taxation		17,911	18,059
Taxation	6(a)	(3,279)	(3,034)
Profit after taxation		<u>14,632</u>	<u>15,025</u>
Profit/(loss) attributable to:			
– Non-controlling interests		(93)	–
– Equity shareholders of the Bank		14,725	15,025
Profit after taxation		<u>14,632</u>	<u>15,025</u>

The notes on pages 18 to 167 form part of these consolidated financial statements.

Consolidated statement of comprehensive income**For the year ended 31 December 2019***(Expressed in millions of Hong Kong dollars)*

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
Profit after taxation	14,632	15,025
Other comprehensive income:		
<u>Items that will not be reclassified to the income statement:</u>		
Own credit adjustment:		
– Changes in own credit adjustment on financial liabilities designated at fair value through profit or loss	(950)	740
– Related tax effect	162	(54)
Defined benefit plans:		
– Remeasurement of retirement benefit obligations	107	(328)
– Related tax effect	(13)	62
Equity securities at fair value through other comprehensive income:		
– Changes in fair value recognised during the year	(52)	122
<u>Items that may be reclassified subsequently to the income statement:</u>		
Debt securities at fair value through other comprehensive income:		
– Changes in fair value recognised during the year	1,413	840
– Changes in fair value transferred to the income statement on disposal	(196)	(49)
– Transfer to the income statement on fair value hedged items attributable to hedged risk	(707)	(245)
– Expected credit loss	–	(29)
– Share of impact from an associate	175	273
– Related tax effect	(100)	(115)
Cash flow hedges:		
– Changes in fair value recognised during the year	(779)	263
– Transfer to the income statement on termination of hedging derivatives	18	29
– Related tax effect	123	(46)
Exchange difference	(2,549)	(3,602)
Other comprehensive income for the year, net of tax	(3,348)	(2,139)
Total comprehensive income	<u>11,284</u>	<u>12,886</u>
Total comprehensive income attributable to:		
– Non-controlling interests	(93)	–
– Equity shareholders of the Bank	<u>11,377</u>	<u>12,886</u>
Total comprehensive income	<u>11,284</u>	<u>12,886</u>

The notes on pages 18 to 167 form part of these consolidated financial statements.

Consolidated statement of financial position as at 31 December 2019*(Expressed in millions of Hong Kong dollars)*

	Note	2019 HK\$'M	2018 HK\$'M (restated)
Assets			
Cash and balances with banks, central banks and other financial institutions	9	83,000	72,124
Placements with banks and other financial institutions	10	114,807	194,676
Hong Kong SAR Government certificates of indebtedness	11	53,821	46,691
Financial assets at fair value through profit or loss	12	127,347	104,295
Investment securities	13	424,178	392,894
Advances to customers	14(a)	1,007,035	930,029
Amounts due from fellow subsidiaries	16	164,132	121,176
Interest in an associate	18	14,046	12,144
Property, plant and equipment	19	35,651	42,395
Goodwill and intangible assets	20	7,905	6,965
Current tax assets		53	132
Deferred tax assets	25	1,999	2,076
Other assets	21	84,674	50,097
		<u>2,118,648</u>	<u>1,975,694</u>
Liabilities			
Hong Kong SAR currency notes in circulation	11	53,821	46,691
Deposits and balances of banks and other financial institutions		37,564	39,269
Deposits from customers	22	1,530,112	1,456,667
Financial liabilities at fair value through profit or loss	24	96,549	100,864
Debt securities in issue	23	31,608	34,699
Amounts due to immediate holding company	16	30,655	–
Amounts due to fellow subsidiaries	16	76,962	72,300
Current tax liabilities		2,073	2,111
Deferred tax liabilities	25	775	609
Other liabilities	26	86,649	60,373
Subordinated liabilities	28	5,876	5,907
		<u>1,952,644</u>	<u>1,819,490</u>
Equity			
Share capital	29	65,025	65,025
Reserves	30	91,560	89,227
Shareholders' equity		156,585	154,252
Other equity instruments	29	8,983	1,952
Non-controlling interests		436	–
		<u>166,004</u>	<u>156,204</u>
		<u>2,118,648</u>	<u>1,975,694</u>

Approved and authorised for issue by the Board of Directors on 27 February 2020.

HUNG Pi Cheng Benjamin
Director**Gregory John POWELL**
Director

The notes on pages 18 to 167 form part of these consolidated financial statements.

Consolidated statement of changes in equity**For the year ended 31 December 2019***(Expressed in millions of Hong Kong dollars)*

	Attributable to equity shareholders of the Bank													
	Share capital	Own credit adjustment reserve	Cash flow hedge reserve	FVOCI reserve – Debt	FVOCI reserve – Equity	Exchange reserve	Statutory reserves	Other reserves	Retained profits	Share option equity reserve	Sub-total	Other equity instruments	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 2018, as previously stated	20,256	(18)	18	(315)	161	266	-	37	51,120	318	71,843	1,952	-	73,795
Effect of merger of commonly controlled entity	44,769	28	3	(166)	33	(3,992)	11,907	(4,409)	26,547	361	75,081	-	-	75,081
At 1 January 2018, as restated	65,025	10	21	(481)	194	(3,726)	11,907	(4,372)	77,667	679	146,924	1,952	-	148,876
Total comprehensive income	-	686	246	675	122	(3,602)	-	-	14,759	-	12,886	-	-	12,886
Dividend paid ¹	-	-	-	-	-	-	-	-	(4,251)	-	(4,251)	-	-	(4,251)
Cash contributions to a fellow subsidiary ²	-	-	-	-	-	-	-	-	(1,236)	-	(1,236)	-	-	(1,236)
Movement in respect of share-based compensation plans	-	-	-	-	-	-	-	-	-	(71)	(71)	-	-	(71)
Transfer from retained profits	-	-	-	-	-	-	620	-	(620)	-	-	-	-	-
At 31 December 2018	65,025	696	267	194	316	(7,328)	12,527	(4,372)	86,319	608	154,252	1,952	-	156,204
Issuance of other equity instruments, net of expenses	-	-	-	-	-	-	-	-	-	-	-	7,031	-	7,031
Total comprehensive income	-	(788)	(638)	585	(52)	(2,549)	-	-	14,819	-	11,377	-	(93)	11,284
Dividend paid ¹	-	-	-	-	-	-	-	-	(4,390)	-	(4,390)	-	-	(4,390)
Cash distributions to a fellow subsidiary ²	-	-	-	-	-	-	-	-	(4,552)	-	(4,552)	-	-	(4,552)
Movement in respect of share-based compensation plans	-	-	-	-	-	-	-	-	-	(135)	(135)	-	-	(135)
Contributions from non-controlling interests	-	-	-	-	-	-	-	-	33	-	33	-	529	562
Transfer from retained profits	-	-	-	-	-	-	1,020	-	(1,020)	-	-	-	-	-
At 31 December 2019	65,025	(92)	(371)	779	264	(9,877)	13,547	(4,372)	91,209	473	156,585	8,983	436	166,004

¹ During the year ended 31 December 2019, the directors had declared and paid an ordinary dividend of HK\$0.74 per each Class A, B, C and D ordinary shares totalling HK\$3,904 million (2018: HK\$2.02 per each Class A and B ordinary shares totalling HK\$3,908 million). Dividends of HK\$144 million (2018: HK\$ nil), HK\$244 million (2018: HK\$245 million) and HK\$98 million (2018: HK\$98 million) were paid in respect of the US\$900 million floating rate undated Additional Tier 1 Capital Securities, the US\$500 million 6.25% perpetual non-cumulative convertible preference shares and the US\$250 million 5% perpetual non-cumulative subordinated capital securities classified as equity, respectively.

² Cash distributions of HK\$4,083 million (2018: HK\$862 million) and HK\$469 million (2018: HK\$374 million) were made by Standard Chartered NEA Limited (“SC NEA”) and Standard Chartered Bank (Taiwan) Limited (“SCB Taiwan”) respectively, to a fellow subsidiary prior to the Bank’s acquisition of SC NEA and SCB Taiwan on 1 October 2019.

The notes on pages 18 to 167 form part of these consolidated financial statements.

Consolidated cash flow statement
For the year ended 31 December 2019
(Expressed in millions of Hong Kong dollars)

	Note	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
Operating activities			
Profit before taxation		17,911	18,059
Adjustments for:			
Credit impairment		1,648	687
Advances written off net of recoveries		699	567
Unwinding of discount on loan impairment provision		(82)	(97)
Other impairment		818	1,191
Depreciation on property, plant and equipment		3,478	2,546
Amortisation of intangible assets		550	311
Net gains on disposal and write off of property, plant and equipment		(635)	(579)
Net losses on revaluation of investment properties		96	36
Share of profit of an associate		(1,934)	(1,562)
Interest expense on subordinated liabilities and other borrowings		1,148	752
Interest expense on lease liabilities		175	–
Expense in respect of the defined benefits plans		272	275
Fair value losses transferred from reserves on cash flow hedges		18	29
Exchange translation on subordinated liabilities		(65)	8
Dividend income from an associate		–	(56)
		<u>24,097</u>	<u>22,167</u>
(Increase)/decrease in operating assets:			
Placements with banks and other financial institutions with original maturity beyond three months		20,475	9,760
Financial assets at fair value through profit or loss		(23,566)	(16,706)
Investment securities		(74,891)	17,839
Gross advances to customers		(90,394)	(30,046)
Amounts due from fellow subsidiaries		(50,543)	(10,986)
Other assets		(28,445)	(10,438)
Increase/(decrease) in operating liabilities:			
Deposits and balances of banks and other financial institutions		(1,712)	(8,445)
Deposits from customers		85,886	83,054
Debt securities in issue		(4,042)	(5,354)
Financial liabilities at fair value through profit or loss		(4,315)	14,950
Amounts due to immediate holding company and fellow subsidiaries		2,866	(38,712)
Other liabilities		21,937	11,495
		<u>(122,647)</u>	<u>38,578</u>
Cash (used in)/generated from operations		<u>(122,647)</u>	<u>38,578</u>
Hong Kong income tax paid		(1,560)	–
Overseas income tax paid		(1,348)	(1,397)
		<u>(125,555)</u>	<u>(1,397)</u>
Net cash (used in)/generated from operating activities		<u>(125,555)</u>	<u>37,181</u>

Consolidated cash flow statement (continued)**For the year ended 31 December 2019***(Expressed in millions of Hong Kong dollars)*

	<i>Note</i>	<i>2019 HK\$'M</i>	<i>2018 HK\$'M (restated)</i>
Investing activities			
Payment for purchase of property, plant and equipment		(2,906)	(7,969)
Payment for purchase of intangible assets		(1,632)	(641)
Proceeds from disposal of property, plant and equipment		4,289	7,865
Dividends received from an associate		542	18
Proceeds from disposal of an associate		–	1,076
		<hr/>	<hr/>
Net cash generated from investing activities		293	349
		<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
Financing activities			
Issuance of subordinated liabilities ¹		28,165	–
Issuance of other equity instrument		7,031	–
Contribution from non-controlling interest		562	–
Cash contributions to a fellow subsidiary		(4,552)	(1,236)
Dividend paid to shareholders of the Bank		(4,390)	(4,251)
Payment of lease liability		(1,234)	–
Interest paid on subordinated liabilities		(1,142)	(746)
Payment for redemption of subordinated liabilities		–	(641)
		<hr/>	<hr/>
Net cash generated from/(used in) financing activities		24,440	(6,874)
		<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
Net (decrease)/increase in cash and cash equivalents		(100,822)	30,656
Cash and cash equivalents at 1 January		284,542	261,092
Effect of foreign exchange		(3,182)	(7,206)
		<hr/>	<hr/>
Cash and cash equivalents at 31 December	31(a)	<u>180,538</u>	<u>284,542</u>
Cash flows from operating activities include:			
Interest received		45,697	41,326
Interest paid		19,048	15,064
Dividends received		16	84
		<hr/>	<hr/>

¹ The balance includes the subordinated liabilities to immediate holding company and a fellow subsidiary with the amount of HK\$24,133 million and HK\$4,032 million respectively.

The notes on pages 18 to 167 form part of these consolidated financial statements.

Notes to the consolidated 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 “Group”) 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. A summary of the significant accounting policies adopted by the Group is set out below.

The HKICPA has issued certain new and revised HKFRSs that are first effective or available for early adoption for the current accounting period of the Group. Note 3 provides information on any changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these financial statements.

(b) Basis of preparation of the financial statements

(i) Basis of Preparation

The consolidated financial statements for the year ended 31 December 2019 comprise the Group and its interest in an associate.

The measurement basis used in the preparation of the consolidated financial statements is the historical cost convention, as modified by the revaluation of financial assets and liabilities at fair value through other comprehensive income, financial assets and liabilities (including derivatives) at fair value through profit or loss and investment properties, which are carried at fair value.

Assets and disposal groups held for sale are stated at the lower of carrying amount and fair value less cost to sell.

The preparation of the consolidated 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 Group’s accounting policies. Actual results may differ from these estimates.

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(b) Basis of preparation of the financial statements (continued)****(i) Basis of Preparation (continued)**

Judgements made by management in the application of HKFRSs/IFRSs that have a significant effect on the financial statements and major sources of estimation uncertainty are discussed in note 40.

(ii) Application of merger accounting

The Group has applied Accounting Guideline No.5 – “Merger Accounting for Common Control Combinations” issued by the HKICPA in accounting for the following transactions in its consolidated financial statements.

1. Transfer of ownership of the Bank

On 4 March 2019, Standard Chartered PLC (“SC PLC”) acquired the direct ownership of the Bank held by the previous immediate holding company, Standard Chartered Bank (“SCB”). As a result, amounts due from/ to SC PLC and SCB are respectively reported as amounts due from/ to immediate holding company and fellow subsidiaries of the Bank accordingly.

2. Acquisition of Standard Chartered Bank (China) Limited (“SCB China”) and SC NEA and its subsidiaries (“SC NEA Group”)

On 1 June 2019, the Bank acquired 100 percent of the share capital of SCB China from a fellow subsidiary by issuance of Class C ordinary share capital amounting to HK\$21,165 million. On 1 October 2019, the Bank additionally acquired 100 percent of the share capital of SC NEA Group (which comprises Standard Chartered Bank Korea Limited (“SCB Korea”), Standard Chartered Bank (Taiwan) Limited (“SCB Taiwan”) and Standard Chartered Securities Korea Limited (“SCS Korea”)) from a fellow subsidiary by issuance of Class D ordinary share capital amounting to HK\$23,604 million.

As the Bank, SCB China and SC NEA Group were under the common control of SC PLC before and after the above-mentioned acquisition, in accordance with the principles of merger accounting, the consolidated financial statements have been presented as if the acquisition by the Bank had occurred from the date when SCB China and SC NEA Group first came under the control of SC PLC.

The net assets of SCB China and SC NEA Group have been recognised using the carrying amounts in the consolidated financial statements of the SC PLC Group. Comparative amounts have been restated so that they are presented as if SCB China and SC NEA Group had been combined and the Class C shares and Class D shares of the Bank had been issued at the earliest date presented in these consolidated financial statements notwithstanding their actual issuance on 1 June 2019 and 1 October 2019 respectively (see note 17(c)).

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(b) Basis of preparation of the financial statements (continued)****(iii) Consolidated Financial Statements**

During the year, the Group had subordinated and senior debt in issue which are traded in various stock exchanges. Consequently, the Group is required to prepare consolidated financial statements in accordance with HKFRS 10/IFRS 10 “Consolidated Financial Statements”.

(c) Subsidiaries and non-controlling interests

Subsidiaries are all entities, including structured entities (note 2(x)), which the Group controls. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the investee. Subsidiaries are fully consolidated from the date on which the Group effectively obtains 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 Group’s principal subsidiaries are given in note 17.

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 Group, whether directly or indirectly through subsidiaries, and in respect of which the Group has not agreed any additional terms with the holders of those interests which would result in the Group 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 statement of financial position 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.

In the Bank’s statement of financial position, investments in subsidiaries are stated at cost less impairment losses, if any.

(d) Associates

Associates are entities in respect of which the Group 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. Details of the Group’s interest in an associate are provided in note 18.

Investments in associates are accounted for using the equity method of accounting in the consolidated financial statements and are initially recognised at cost. The Group’s investment in associates includes goodwill, if any, identified on acquisition and accumulated impairment losses.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(d) Associates (continued)

The Group's share of its associates' post-acquisition profits or losses are recognised in the consolidated 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 statement of financial position. When the Group's share of losses in an associate is equal to or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless they have incurred obligations or made payments on behalf of the associate.

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

When the Group ceases to have significant influence over an associate, it is accounted for as a disposal of the entire interest in that investee, with a resulting gain or loss being recognised in the income statement. Any interest retained in that former investee at the date when significant influence is lost is recognised at fair value and this amount is regarded as the fair value on initial recognition of a financial asset (see note 2(i)).

In the Bank's statement of financial position, investments in associates are stated at cost less impairment losses and dividends from pre-acquisition profits, if any, unless they are classified as assets held for sale.

(e) Intangible assets

(i) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's 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 an associate".

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 Group at which the goodwill is monitored for internal management purposes. Note 20 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 an 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 reporting 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 consolidated 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 attributable to the asset that will flow from its use. 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.

(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 consolidated statement of financial position 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 consolidated income statement.

(g) 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 Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the consolidated income statement during the financial period in which they are incurred.

Depreciation on property, plant and equipment 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 up to 18 and 15 years respectively.
- Right-of-use assets held under lease (note 2(h)).

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

At each reporting 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 consolidated income statement.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(h) Leases

Where the Group is the lessee

Policies effective from 1 January 2019

The Group assesses whether a contract is a lease in scope of this policy by determining whether the contract gives it the right to use a specified underlying physical asset for a lease term greater than 12 months.

When the Group is a lessee and the lease is deemed in scope, it recognises a liability equal to the present value of lease payments over the lease term, discounted using the incremental borrowing rate applicable in the economic environment of the lease. The lease liability is recognised in 'Other liabilities'. A corresponding right-of-use asset equal to the lease liability, adjusted for any lease payments made at or before the commencement date, is recognised in 'Property, plant and equipment'. The lease term includes any extension options contained in the contract that the Group is reasonably certain it will exercise.

The Group subsequently depreciates the right-of-use asset using the straight-line method over the lease term and measures the lease liability using the effective interest method. Depreciation on the asset is recognised in 'Operating expenses', and interest on the lease liability is recognised in 'interest expense'.

Policies prior to 1 January 2019

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

Where the Group is the lessor

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

(i) Financial instruments

Classification and measurement of financial instruments

Classification

The Group classifies its financial assets into the following measurement categories: amortised cost; fair value through other comprehensive income; and fair value through profit or loss. Financial liabilities are classified as either amortised cost, or held at fair value through profit or loss. Management determines the classification of its financial assets and liabilities at initial recognition of the instrument or, where applicable, at the time of reclassification.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(i) Financial instruments (continued)****(1) Financial assets held at amortised cost and fair value through other comprehensive income ("FVOCI")**

Debt instruments held at amortised cost or held at FVOCI have contractual terms that give rise to cash flows that are solely payments of principal and interest ("SPPI characteristics"). Principal is the fair value of the financial asset at initial recognition but this may change over the life of the instrument as amounts are repaid. Interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period and for other basic lending risks and costs, as well as a profit margin.

In assessing whether the contractual cash flows have SPPI characteristics, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Group considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify the consideration of the time value of money – e.g. periodical reset of interest rates.

Whether financial assets are held at amortised cost or at FVOCI depend on the objectives of the business models under which the assets are held. A business model refers to how the Group manages financial assets to generate cash flows.

The Group makes an assessment of the objective of a business model in which an asset is held at the individual product business line, and where applicable within business lines depending on the way the business is managed and information is provided to management. Factors considered include:

- how the performance of the product business line is evaluated and reported to the Group's management;
- how managers of the business model are compensated, including whether management is compensated based on the fair value of assets or the contractual cash flows collected;
- the risks that affect the performance of the business model and how those risks are managed;
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and expectations about future sales activity.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(i) Financial instruments (continued)****(1) Financial assets held at amortised cost and fair value through other comprehensive income (“FVOCI”) (continued)**

Financial assets which have SPPI characteristics and that are held within a business model whose objective is to hold financial assets to collect contractual cash flows (“hold to collect”) are recorded at amortised cost. Conversely, financial assets which have SPPI characteristics but are held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets (“hold to collect and sell”) are classified as held at FVOCI.

Both hold to collect and hold to collect and sell business models involve holding financial assets to collect the contractual cash flows. However, the business models are distinct by reference to the frequency and significance that asset sales play in meeting the objective under which a particular group of financial assets is managed. Hold to collect business models are characterised by asset sales that are incidental to meeting the objectives under which a group of assets is managed. Sales of assets under a hold to collect business model can be made to manage increases in the credit risk of financial assets but sales for other reasons should be both infrequent and insignificant.

Cash flows from the sale of financial assets under a hold to collect and sell business model in contrast are integral to achieving the objectives under which a particular group of financial assets are managed. This may be the case where frequent sales of financial assets are required to manage the Group’s daily liquidity requirements or to meet regulatory requirements to demonstrate liquidity of financial instruments. Sales of assets under hold to collect and sell business models are therefore both more frequent and more significant in value than those under the hold to collect model.

Equity instruments designated as held at FVOCI

Non-trading equity instruments acquired for strategic purposes rather than capital gain may be irrevocably designated at initial recognition at FVOCI on an instrument by instrument basis. Gains and losses arising from changes in the fair value of these instruments, including foreign exchange gains and losses, are recognised directly in equity and are never reclassified to profit or loss even on derecognition.

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

Financial assets which are not held at amortised cost or not held at fair value through other comprehensive income are held at fair value through profit or loss. Financial assets and liabilities held at fair value through profit or loss are either mandatorily classified as fair value through profit or loss or irrevocably designated at fair value through profit or loss at initial recognition.

Mandatorily classified at fair value through profit or loss

Financial assets and liabilities which are mandatorily held at fair value through profit or loss are split between two sub-categories as follows:

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(i) Financial instruments (continued)****(2) Financial assets and liabilities held at fair value through profit or loss (continued)**

- Trading, including
 - financial assets and liabilities held for trading, which are those acquired principally for the purpose of selling in the short term; and
 - derivatives.
- Non-trading mandatorily at fair value through profit or loss, including
 - instruments (other than trading or derivatives) in a business which has a fair value business model;
 - hybrid financial assets that contain one or more embedded derivatives;
 - financial assets that would otherwise be measured at amortised cost or FVOCI but which do not have SPPI characteristics; and
 - equity instruments that have not been designated as held at FVOCI.

Designated at fair value through profit or loss

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 (“accounting mismatch”).

To reduce accounting mismatches, the Group has designated certain financial liabilities at fair value through profit or loss where the liabilities either:

- have fixed rates of interest and interest rate swaps or other interest rate derivatives have been entered with the intention of significantly reducing interest rate risk; or
- are exposed to foreign currency risk and derivatives have been acquired with the intention of significantly reducing exposure to market changes; or
- have been acquired to fund trading asset portfolios or assets.

Financial liabilities may also be designated at fair value through profit or loss where they are managed on a fair value basis or have a bifurcately embedded derivative where the Group is not able to separately value the embedded derivative component.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial instruments (continued)

(3) Financial liabilities held at amortised cost

Financial liabilities that are not financial guarantees or loan commitments and that are not classified as financial liabilities held at fair value through profit or loss are classified as financial liabilities held at amortised cost.

Financial guarantee contracts and loan commitments

The Group issues financial guarantee contracts and loan commitments in return for fees. Under a financial guarantee contract, the Group undertakes to meet a customer's obligations under the terms of a debt instrument if the customer fails to do so. Loan commitments are firm commitments to provide credit under pre-specified terms and conditions. Financial guarantee contracts and loan commitments issued at below market interest rates are initially recognised as liabilities at fair value, whilst financial guarantees and loan commitments issued at market rates are recorded off balance sheet. Subsequently these instruments are measured at the higher of the expected credit loss provision, and the amount initially recognised less the cumulative amount of income recognised in accordance with the principles of HKFRS 15/IFRS 15 – *Revenue from Contracts with Customers* ("HKFRS 15/IFRS 15").

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 at the measurement date in the principal market for the asset or liability, or in the absence of a principal market, the most advantageous market to which the Group has access at that date. The fair value of a liability includes the risk that the Group will not be able to honour its obligations.

The fair value of financial instruments is generally measured on the basis of the individual financial instrument. However, when a group of financial assets and financial liabilities is managed on the basis of its net exposure to either market risk or credit risk, the fair value of the group of financial instruments is measured on a net basis.

The fair values of quoted financial assets and 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 instrument, and for unlisted securities, is not active, the Group establishes fair value by using valuation techniques.

Initial recognition

Purchases and sales of financial assets and liabilities held at fair value through profit or loss, and debt securities classified as financial assets held at fair value through other comprehensive income are initially recognised on the trade-date (the date on which the Group commits to purchase or sell the asset). Loans and advances and other financial assets held at amortised cost are recognised on settlement date (the date on which cash is advanced to the borrowers). Financial liabilities, which include borrowings, not classified as held at fair value through profit or loss are classified at amortised cost on settlement date.

All financial instruments are initially recognised at fair value, which is normally the transaction price, plus directly attributable transaction costs for financial assets and financial liabilities which are not subsequently measured at fair value through profit or loss.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(i) Financial instruments (continued)****(3) Financial liabilities held at amortised cost (continued)**

In certain circumstances, the initial fair value may be based on a valuation technique which may lead to the recognition of profits or losses at the time of initial recognition. However, these profits or losses can only be recognised when the valuation technique used is based solely on observable market data. In those cases where the initially recognised fair value is based on a valuation model that uses unobservable inputs, the difference between the transaction price and the valuation model is not recognised immediately in the income statement but is amortised or released to the income statement as the inputs become observable, or the transaction matures or is terminated.

Subsequent measurement**(1) Financial assets and financial liabilities held at amortised cost**

Financial assets and financial liabilities held at amortised cost are subsequently carried at amortised cost using the effective interest method (see note 2(o)(i)). Foreign exchange gains and losses are recognised in the income statement.

Where a financial instrument carried at amortised cost is the hedged item in a qualifying fair value hedge relationship, its carrying value is adjusted by the fair value gain or loss attributable to the hedged risk.

(2) Financial assets held at FVOCI

Debt instruments held at FVOCI are subsequently carried at fair value, with all unrealised gains and losses arising from changes in fair value (including any related foreign exchange gains or losses) recognised in other comprehensive income and accumulated in a separate component of equity. Foreign exchange gains and losses on the amortised cost are recognised in the income statement. Changes in expected credit losses are recognised in the income statement and are accumulated in a separate component of equity. On derecognition, the cumulative fair value gains or losses, net of the cumulative expected credit loss in reserve, are transferred to the income statement.

Equity investments designated at FVOCI are subsequently carried at fair value with all unrealised gains and losses arising from changes in fair value (including any related foreign exchange gains or losses) recognised in other comprehensive income and accumulated in a separate component of equity. On derecognition, the cumulative reserve is transferred to retained earnings and is not recycled to the income statement.

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

Financial assets and liabilities mandatorily held at fair value through profit or loss and financial assets designated at fair value through profit or loss are subsequently carried at fair value, with gains and losses arising from changes in fair value (including contractual interest) recorded in "Net trading income" in the income statement unless the instrument is part of a cash flow hedging relationship.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(i) Financial instruments (continued)****(4) Financial liabilities designated at fair value through profit or loss**

Financial liabilities designated at fair value through profit or loss are held at fair value, with changes in fair value (including contractual interest) recognised in “Net trading income” in the income statement, other than that attributable to changes in own credit risk. Fair value changes attributable to own credit risk are recognised in other comprehensive income and recorded in a separate category of reserves unless this is expected to create or enlarge an accounting mismatch, in which case the entire change in fair value of the financial liability designated at fair value through profit or loss is recognised in the income statement.

The Group calculates own credit adjustment (“OCA”) on financial liabilities designated at fair value, including structured notes, in order to reflect changes in its own credit standing. The Group’s OCA adjustments will increase if its credit standing worsens and conversely, decrease if its credit standing improve. The Group’s OCA adjustments will reverse over time as its liabilities mature. An OCA adjustment is determined by discounting the contractual cash flows using a yield curve adjusted for market observed secondary senior unsecured credit spreads.

Derecognition of financial instruments

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership. If substantially all the risks and rewards have been neither retained nor transferred and the Group has retained control, the assets continue to be recognised to the extent of the Group’s continuing involvement.

Where financial assets have been modified, the modified terms are assessed on a qualitative and quantitative basis to determine whether a fundamental change in the nature of the instrument has occurred, such as whether the derecognition of the pre-existing instrument and the recognition of a new instrument is appropriate.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of the consideration received (including any new asset obtained less any new liability assumed) and any cumulative gain or loss that had been recognised in other comprehensive income is recognised in the income statement except for equity instruments elected FVOCI and cumulative fair value adjustments attributable to the credit risk of a liability that are held in other comprehensive income.

Financial liabilities are derecognised when they are extinguished. A financial liability is extinguished when the obligation is discharged, cancelled or expired and this is evaluated both qualitatively and quantitatively.

If the Group purchases its own debt, it is derecognised and the difference between the carrying amount of the liability and the consideration paid is included in ‘other operating income’ except for the cumulative fair value adjustments attributable to the credit risk of a liability that are held in other comprehensive income and are never recycled to the income statement.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial instruments (continued)

Modified financial instruments

Financial assets and financial liabilities whose original contractual terms have been modified, including those loans subject to forbearance strategies, are considered to be modified instruments. Modifications may include changes to the tenor, cash flows and or interest rates amongst other factors.

Where derecognition of financial assets is appropriate, the newly recognised residual loans are assessed to determine whether the assets should be classified as purchased or originated credit impaired assets ("POCI").

Where derecognition is not appropriate, the gross carrying amount of the applicable instruments are recalculated as the present value of the renegotiated or modified contractual cash flows discounted at the original effective interest rate (or credit adjusted effective interest rate for POCI financial assets). The difference between the recalculated values and the pre-modified gross carrying values of the instruments are recorded as a modification gain or loss in the income statement.

Gains and losses arising from modifications for credit reasons are recorded as part of 'credit impairment'. Modification gains and losses arising for non-credit reasons are recognised either as part of "credit impairment" or within income depending on whether there has been a change in the credit risk on the financial asset subsequent to the modification. Modification gains and losses arising on financial liabilities are recognised within income.

Reclassifications

Financial liabilities are not reclassified subsequent to initial recognition.

Reclassifications of financial assets are made when, and only when, the business model for those assets changes. Such changes are expected to be infrequent and arise as a result of significant external or internal changes such as the termination of a line of business or the purchase of a subsidiary whose business model is to realise the value of pre-existing held for trading financial assets through a hold to collect model.

Financial assets are reclassified at their fair value on the date of reclassification and previously recognised gains and losses are not restated. Moreover, reclassifications of financial assets between financial assets held at amortised cost and financial assets held at fair value through other comprehensive income do not affect effective interest rate or expected credit loss computations.

(1) Reclassified from amortised cost

Where financial assets held at amortised cost are reclassified to financial assets held at fair value through profit or loss, the difference between the fair value of the assets at the date of reclassification and the previously recognised amortised cost is recognised in the income statement.

For financial assets held at amortised cost that are reclassified to fair value through other comprehensive income, the difference between the fair value of the assets at the date of reclassification and the previously recognised gross carrying value is recognised in other comprehensive income. Additionally, the related cumulative expected credit loss amounts relating to the reclassified financial assets are reclassified from loan loss provisions to a separate reserve in other comprehensive income at the date of reclassification.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(i) Financial instruments (continued)****Reclassifications (continued)****(2) Reclassified from fair value through other comprehensive income**

Where financial assets held at fair value through other comprehensive income are reclassified to financial assets held at fair value through profit or loss, the cumulative gain or loss previously recognised in other comprehensive income is transferred to the income statement.

For financial assets held at fair value through other comprehensive income that are reclassified to financial assets held at amortised cost, the cumulative gain or loss previously recognised in other comprehensive income is adjusted against the fair value of the financial asset such that the financial asset is recorded at a value as if it had always been held at amortised cost. In addition, the related cumulative expected credit losses held within other comprehensive income are reversed against the gross carrying value of the reclassified assets at the date of reclassification.

(3) Reclassified from fair value through profit or loss

Where financial assets held at fair value through profit or loss are reclassified to financial assets held at fair value through other comprehensive income or financial assets held at amortised cost, the fair value at the date of reclassification is used to determine the effective interest rate on the financial asset going forward. In addition, the date of reclassification is used as the date of initial recognition for the calculation of expected credit losses. Where financial assets held at fair value through profit or loss are reclassified to financial assets held at amortised cost, the fair value at the date of reclassification becomes the gross carrying value of the financial asset.

(j) Hedge accounting

The Group has chosen to continue to apply hedging requirements under HKAS 39/IAS 39 *Financial instruments: recognition and measurement* rather than those of HKFRS 9/IFRS 9 *Financial instruments*. The accounting treatment of hedge transactions will differ according to the nature of the instrument hedged and whether the hedge qualifies as a hedging instrument for accounting purposes.

The Group designates certain derivatives as either:

- a) Hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge)
- b) Hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (cash flow hedge)
- c) Hedges of the net investment of a foreign operation (net investment hedges)

Hedge accounting is used for derivatives designated in this way, provided certain criteria are met.

The Group documents, 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 Group also documents 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.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(j) Hedge accounting (continued)****(i) Fair value hedge**

Changes in the fair value of derivatives that are designated and qualified as fair value hedging instruments are recorded in the consolidated 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 consolidated income statement over the period to maturity or derecognition.

(ii) Cash flow hedge

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

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

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 consolidated 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 consolidated income statement.

(iii) Net investment hedge

Hedges of net investments are accounted for in a similar manner to cash flow hedges, with gains and losses on the effective portion of the hedges deferred in "Exchange reserve" in equity until the net investment is disposed of. The ineffective portion of the hedges is recognised in "Net trading income" immediately.

(k) Impairment

The Group's expected credit losses ("ECL") calculations are outputs of complex models with a number of underlying assumptions. The significant judgements and estimates in determining ECL include:

- the Group's criteria for assessing if there has been a significant increase in credit risk;
- development of ECL models, including the choice of inputs relating to macroeconomic variables.

The calculation of credit-impairment provisions also involves expert credit judgement to be applied by the credit risk management team based upon counterparty information they receive from various sources including client-facing employees and on external market information.

ECL are determined for all financial debt instruments that are classified at amortised cost or fair value through other comprehensive income, undrawn commitments and financial guarantees.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment (continued)

An expected credit loss represents the present value of expected cash shortfalls over the residual term of a financial asset, undrawn commitment or financial guarantee.

A cash shortfall is the difference between the cash flows that are due in accordance with the contractual terms of the instrument and the cash flows that the Group expects to receive over the contractual life of the instrument.

Measurement

Expected credit losses are computed as unbiased, probability weighted amounts which are determined by evaluating a range of reasonably possible outcomes, the time value of money, and considering all reasonable and supportable information including that which is forward looking.

For material portfolios, the estimate of expected cash shortfalls is determined by multiplying the probability of default ("PD") with the loss given default ("LGD") with the expected exposure at the time of default ("EAD"). For less material Retail loan portfolios, the Group has adopted simplified approaches based on historical roll rates or loss rates.

Forward looking economic assumptions are incorporated into the PD, LGD and EAD where relevant and where they influence credit risk, such as GDP growth rates, interest rates, house price indices and commodity prices amongst others. These assumptions are incorporated using the Group's most likely forecast for a range of macroeconomic assumptions. These forecasts are determined using all reasonable and supportable information, which includes both internally developed forecasts and those available externally, and are consistent with those used for budgeting, forecasting and capital planning.

To account for the potential non-linearity in credit losses, multiple forward-looking scenarios are incorporated into the range of reasonably possible outcomes for all material portfolios. Both in respect of determining the PD, LGD and EAD and in determining the overall expected credit loss amounts. These scenarios are determined using a Monte Carlo approach centred around the Group's most likely forecast of macroeconomic assumptions.

The period over which cash shortfalls are determined is generally limited to the maximum contractual period for which the Group is exposed to credit risk. However, for certain revolving credit facilities, which include credit cards or overdrafts, the Group's exposure to credit risk is not limited to the contractual period. For these instruments, the Group estimates an appropriate life based on the period that the Group is exposed to credit risk, which includes the effect of credit risk management actions such as the withdrawal of undrawn facilities.

For credit-impaired financial instruments, the estimate of cash shortfalls may require the use of expert credit judgement. As a practical expedient, the Group may also measure credit impairment on the basis of an instrument's fair value using an observable market price.

The estimate of expected cash shortfalls on a collateralised financial instrument reflects the amount and timing of cash flows that are expected from foreclosure on the collateral less the costs of obtaining and selling the collateral, regardless of whether foreclosure is deemed probable.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment (continued)

Cash flows from unfunded credit enhancements held are included within the measurement of expected credit losses if they are part of, or integral to, the contractual terms of the instrument (this includes financial guarantees, unfunded risk participations and other non-derivative credit insurance).

Cash shortfalls are discounted using the effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired (“POCI”) instruments) on the financial instrument as calculated at initial recognition or if the instrument has a variable interest rate, the current effective interest rate determined under the contract.

<u>Instruments</u>	<u>Location of expected credit loss provisions</u>
Financial assets held at amortised cost	Loss provisions: netted against gross carrying value ¹
Debt instruments at FVOCI	Other comprehensive income (FVOCI Reserve) ²
Loan commitments and financial guarantees	Other liabilities ³

¹ POCI assets do not attract an ECL provision on initial recognition. An ECL provision will be recognised only if there is an increase in expected credit losses from that considered at initial recognition.

² Debt securities classified as FVOCI are held at fair value. The ECL attributed to these instruments is held as a separate reserve within OCI and is recycled to the profit and loss account along with any fair value measurement gains or losses held within FVOCI when the applicable instruments are derecognised.

³ ECL on loan commitments and financial guarantees are recognised as a liability provision. Where a financial instrument includes both a loan (i.e. financial asset component) and an undrawn commitment (i.e. loan commitment component), and it is not possible to separately identify the ECL on these components, ECL amounts on the loan commitment are recognised together with ECL amounts on the financial asset. To the extent the combined ECL exceeds the gross carrying amount of the financial asset, the ECL is recognised as a liability provision.

Recognition

(1) 12 months expected credit losses (stage 1)

Expected credit losses are recognised at the time of initial recognition of a financial instrument and represent the cash shortfalls arising from possible default events up to 12 months into the future from the balance sheet date. Expected credit losses continue to be determined on this basis until there is either a significant increase in the credit risk of an instrument or the instrument becomes credit-impaired. If an instrument is no longer considered to exhibit a significant increase in credit risk, expected credit losses will revert to being determined on a 12-month basis.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(k) Impairment (continued)****Recognition (continued)****(2) Significant increase in credit risk (stage 2)**

If a financial asset experiences a significant increase in credit risk (“SICR”) since initial recognition, an expected credit loss provision is recognised for default events that may occur over the lifetime of the asset.

Significant increase in credit risk is assessed by comparing the risk of default of an exposure at the reporting date to the risk of default at origination (after taking into account the passage of time). Significant does not mean statistically significant nor is it assessed in the context of changes in ECL. Whether a change in the risk of default is significant or not is assessed using a number of quantitative and qualitative factors, the weight of which depends on the type of product and counterparty. Financial assets that are 30 or more days past due and not credit-impaired will always be considered to have experienced a significant increase in credit risk. For less material portfolios where a loss rate or roll rate approach is applied to compute ECL, significant increase in credit risk is primarily based on 30 days past due.

Quantitative factors include an assessment of whether there has been a significant increase in the forward-looking PD since origination. A forward-looking PD is one that is adjusted for future economic conditions to the extent these are correlated to changes in credit risk. We compare the residual lifetime PD at the balance sheet date to the residual lifetime PD that was expected at the time of origination for the same point in the term structure and determine whether both the absolute and relative change between the two exceeds predetermined thresholds. To the extent that the differences between the measures of default outlined exceed the defined thresholds, the instrument is considered to have experienced a significant increase in credit risk.

Qualitative factors assessed include those linked to current credit risk management processes, such as lending placed on non-purely precautionary early alert (and subject to closer monitoring).

A non-purely precautionary early alert account is one which exhibits risk or potential weaknesses of a material nature requiring closer monitoring, supervision, or attention by management. Weaknesses in such an account, if left uncorrected, could result in deterioration of repayment prospects and the likelihood of being downgraded. Indicators could include a rapid erosion of position within the industry, concerns over management’s ability to manage operations, weak/deteriorating operating results, liquidity strain and overdue balances amongst other factors.

(3) Credit impaired (or defaulted) exposures (stage 3)

Financial assets are considered to be credit impaired where the obligors are unlikely to pay on the occurrence of one or more observable events that have a detrimental impact on the estimated future cash flows of the financial asset. Financial assets that are credit impaired (or in default) included those that are past due for more than 90 days in respect of principal and/or interest. It may not be possible to identify a single discrete event but instead the combined effect of several events may cause financial assets to become credit impaired.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(k) Impairment (continued)****Recognition (continued)****(3) Credit impaired (or defaulted) exposures (stage 3) (continued)**

Evidence that a financial asset is credit impaired includes observable data about the following events:

- Significant financial difficulty of the issuer or borrower;
- Breach of contract such as default or a past due event;
- For economic or contractual reasons relating to the borrower’s financial difficulty, the lenders of the borrower have granted the borrower concessions that lenders would not otherwise consider, which include forbearance actions;
- Pending or actual bankruptcy or other financial reorganisation to avoid or delay discharge of the borrower’s obligations;
- The disappearance of an active market for the applicable financial asset due to financial difficulties of the borrower;
- Purchase or origination of a financial asset at a deep discount that reflects incurred credit losses.

Irrevocable lending commitments to a credit impaired obligor that have not yet been drawn down are also included within the stage 3 credit impairment provision to the extent that the commitment cannot be withdrawn.

Loss provisions against credit impaired financial assets are determined based on an assessment of the recoverable cash flows under a range of scenarios, including the realisation of any collateral held where appropriate. The loss provisions held represent the difference between the present value of the cash flows expected to be recovered, discounted at the instrument’s original effective interest rate, and the gross carrying value of the instrument prior to any credit impairment.

Expert credit judgement

Instruments graded Credit Grade 13 or Credit Grade 14 are regarded as Non-Performing Loans, i.e. stage 3 or credit impaired exposures.

For individually significant financial assets within stage 3, Group Special Asset Management (“GSAM”) will consider all judgements that have an impact on the expected future cash flows of the asset. These include: the business prospects, industry and geo-political climate of the customer, quality of realisable value of collateral, the Group’s legal position relative to other claimants and any renegotiation/forbearance/modification options. The difference between the loan carrying amount and the discounted expected future cash flows will result in the stage 3 credit impairment amount. The future cash flow calculation involves significant judgements and estimates. As new information becomes available and further negotiations/forbearance measures are taken the estimates of the future cash flows will be revised, and will have an impact on the future cash flow analysis.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment (continued)

For financial assets which are not individually significant, such as the Retail portfolio or small business loans, which comprise a large number of homogenous loans that share similar characteristics, statistical estimates and techniques are used, as well as credit scoring analysis.

Retail banking clients are considered credit-impaired when they are more than 90 days past due. Retail products are also considered credit-impaired if the borrower files for bankruptcy or other forbearance programmes, the borrower is deceased or the business is closed in the case of a small business if the borrower surrenders the collateral, or there is an identified fraud on the account. Additionally, if the account is unsecured and the borrower has other credit accounts with the Group that are considered credit-impaired, the account may be also be credit-impaired.

Techniques used to compute impairment amounts use models which analyse historical repayment and default rates over a time horizon. Where various models are used, judgement is required to analyse the available information provided and select the appropriate model or combination of models to use.

Expert credit judgement is also applied to determine whether any post-model adjustments are required for credit risk elements which are not captured by the models.

Modified financial instruments

Where the original contractual terms of a financial asset have been modified for credit reasons and the instrument has not been derecognised, the resulting modification loss is recognised within impairment in the income statement with a corresponding decrease in the gross carrying value of the asset. If the modification involved a concession that the Group would not otherwise consider, the instrument is considered to be credit-impaired and is considered forborne.

These assets are assessed to determine whether there has been a significant increase in credit risk subsequent to the modification. Although loans may be modified for non-credit reasons, a significant increase in credit risk may occur. ECL for modified financial assets that have not been derecognised and are not considered to be credit-impaired will be recognised on a 12-month basis, or a lifetime basis, if there is a significant increase in credit risk.

In addition to the recognition of modification gains and losses, the revised carrying value of modified financial assets will impact the calculation of expected credit losses, with any increase or decrease in ECL recognised within impairment.

Forborne loans

Forborne loans are those loans that have been modified in response to customers' financial difficulties.

Loan modification varies from forbearance in that the former is a change in terms of original obligations due to a borrower's long-term inability to repay, whereas the latter merely provides short-term relief for borrowers who have temporary financial problems.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(k) Impairment (continued)**

Forbearance strategies assist clients who are temporarily in financial distress and are unable to meet their original contractual repayment terms. Forbearance can be initiated by the client, the Group or a third party including government sponsored programmes or a conglomerate of credit institutions. Forbearance may include debt restructuring such as new repayment schedules, payment deferrals, tenor extensions, interest only payments, lower interest rates, forgiveness of principal, interest or fees, or relaxation of loan covenants.

Forborne loans that have been modified (and not derecognised) on terms that are not consistent with those readily available in the market and/or where we have granted a concession compared to the original terms of the loans are considered credit impaired if there is a detrimental impact on cash flows. The modification loss is recognised in the income statement within impairment and the gross carrying value of the loan reduced by the same amount.

Write-offs of credit impaired instruments and reversal of impairment

To the extent a financial debt instrument is considered irrecoverable, the applicable portion of the gross carrying value is written-off against the related loan provision. Such loans are written-off after all the necessary procedures have been completed and it is decided that there is no realistic probability of recovery and the amount of the loss has been determined. Subsequent recoveries of amounts previously written-off decrease the amount of the provision for loan impairment in the income statement. If, in a subsequent period, the amount of the credit impairment loss decreases and the decrease can be related objectively to an event occurring after the credit impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised credit impairment loss is reversed by adjusting the impairment allowance. The amount of the reversal is recognised in the income statement.

Improvement in credit risk/curing

A period may elapse from the point at which instruments enter lifetime expected credit losses (stage 2 or stage 3) and are reclassified back to 12-month expected credit losses (stage 1). For financial assets that are credit-impaired (stage 3), a transfer to stage 2 is only permitted where the instrument is no longer considered to be credit-impaired. An instrument will no longer be considered credit-impaired when there is no shortfall of cash flows compared to the original contractual terms.

Financial assets within stage 2 or stage 3 can only be transferred to stage 1 when they are no longer considered to have experienced a significant increase in credit risk.

Where a significant decrease in credit risk is determined using quantitative measures, the instrument will be automatically transferred back to stage 1 when the original PD-based transfer criteria are no longer met. Where instruments are transferred to stage 2 due to an assessment of qualitative factors, the issues that led to the reclassification must be cured before the instruments can be reclassified to stage 1. This includes instances where management actions led to instruments being classified as stage 2, requiring those actions to be resolved before loans are reclassified to stage 1.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(k) Impairment (continued)****Write-offs of credit impaired instruments and reversal of impairment (continued)**

A forbore loan can only be removed from the disclosure (cured) if the loan is performing (stage 1 or 2) and a further two year probation period is met.

In order for a forbore loan to become performing, the following criteria have to be satisfied:

- At least a year has passed with no default based upon the forbore contract terms
- The customer is likely to repay its obligations in full without realising security
- The customer has no accumulated impairment against the amount outstanding

Subsequent to the criteria above, a further two year probation period has to be fulfilled, whereby regular payments are made by the customer and none of the exposures to the customer are more than 30 days past due.

(l) Offsetting financial transactions

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position 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 Group commonly acts 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 Group.

(n) Cash and cash equivalents

For the purposes of the consolidated 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, short-term investment securities, placements with banks and other financial institutions, and amounts due from fellow subsidiaries.

(o) Revenue recognition**(i) Net interest income and other gains or losses arising from financial instruments**

Interest income for financial assets held at either FVOCI or amortised cost, and interest expense on all financial liabilities held at amortised cost is recognised in the income statement using the effective interest method.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(o) Revenue recognition (continued)****(i) Net interest income and other gains or losses arising from financial instruments (continued)**

The effective interest 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 expected life of the instrument. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the gross carrying amount of a financial asset or the amortised cost of a financial liability. When calculating the effective interest rate for financial instruments other than credit impaired assets, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but does not consider expected credit losses. The calculation of effective interest rate includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability and all other premiums or discounts.

Interest income for financial assets that are either held at FVOCI or amortised cost that have become credit impaired subsequent to initial recognition (stage 3) and have had amounts written off, is recognised using the credit adjusted effective interest rate. This rate is calculated in the same manner as the effective interest rate except that expected credit losses are included in the expected cash flows. Interest income is therefore recognised on the amortised cost of the financial asset including expected credit losses. Should the credit risk on a stage 3 financial asset improve such that the financial asset is no longer considered credit impaired, interest income recognition reverts to a computation based on the rehabilitated gross carrying value of the financial asset.

Interest income and expense on financial instruments held at fair value through profit or loss is recognised within net trading income.

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 consolidated income statement in the period in which they arise.

Gains and losses arising from changes in the fair value of financial assets held at fair value through other comprehensive income 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 consolidated income statement, except for the investments in equity irrevocably designated at fair value through other comprehensive income.

Dividends on equity instruments are recognised in the income statement within other operating income when the Group's right to receive payment is established. Foreign exchange gains and losses on monetary items are recognised in net trading income.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(o) Revenue recognition (continued)****(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 Group has retained no part of the loan package for itself or has 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.

(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 reporting 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.

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

(q) Provisions

The Group recognises a provision for a present legal or constructive obligation resulting from a past event when it is more likely than not that it will be required to transfer economic benefits to settle the obligation and the amount of the obligation can be estimated reliably.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(q) Provisions (continued)**

Contingent liabilities are possible obligations arising from past events, whose existence will be confirmed only by uncertain future events, or present obligations arising from past events that are not recognised because either an outflow of economic benefits is not probable or the amount of the obligation cannot be reliably measured. Contingent liabilities are not recognised but information about them is disclosed unless the possibility of any outflow of economic benefits in settlement is remote.

(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 Group operates a number of defined contribution and defined benefit plans.

For defined contribution plans, the Group pays 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 Group has no further payment obligations once the contributions have been paid.

For funded defined benefit plans, the net liability recognised in the consolidated statement of financial position represents the present value of the defined benefit obligations at the reporting date less the fair value of plan assets. For unfunded defined benefit plans the liability recognised at the balance sheet date is the present value of the defined benefit obligation.

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 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.

The Group 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's immediate holding company, Standard Chartered PLC ("SC PLC"), operates equity-settled share-based compensation plans in which the Group's 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.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(r) Employee benefits (continued)****(iii) Share-based compensation (continued)**

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 reporting date, the Group revises 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 consolidated 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 consolidated 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 consolidated 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 consolidated 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 Group's presentation currency are accounted for as follows:

- assets and liabilities for each consolidated statement of financial position presented are translated at the closing rate at the reporting date.
- income and expenses for each consolidated income statement are translated at average exchange rates or at rates on the date of the transaction where exchange rates fluctuate significantly; and
- 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 consolidated income statement as part of the gain or loss on disposal.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(t) Related parties**

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has 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 Group and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, directors, significant shareholders and/or their close family members) or other entities and include (i) associates and joint ventures of SC PLC and its subsidiaries ("SC PLC Group"), (ii) entities which are under the significant influence of related parties of the Group where those parties are individuals, (iii) post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group, and (iv) entities or any member of the Group of which it is a part, provides key management personnel services to the Group or to the Group's parent.

(u) Segment reporting

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

(v) Sale and repurchase agreements

Securities sold subject to repurchase agreements ("repos") remain on the consolidated statement of financial position; the counterparty liability is included in "Deposits and balances of banks and other financial institutions", "Deposits from customers" or "Amounts due to immediate holding company", as appropriate. Securities purchased under agreements to re-sell ("reverse repos") are not recognised on the consolidated statement of financial position and the consideration paid is recorded in "Advances to customers", "Placements with banks and other financial institutions" or "Amounts due from immediate holding company" 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 consolidated 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.

(w) Assets held for sale

Non-current assets (such as property) and disposal groups (including both the assets and liabilities of the disposal groups) are classified as held for sale and measured at the lower of their carrying amount and fair value less cost to sell when: (i) their carrying amounts will be recovered principally through sale; (ii) they are available for sale in their present condition; and (iii) their sale is highly probable within 12 months from the date of classification.

Immediately before the initial classification as held for sale, the carrying amounts of the assets (or assets and liabilities in the disposal groups) are measured in accordance with the applicable accounting policies described above.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(x) Structured entities**

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity. Contractual arrangements determine the rights and therefore relevant activities of the structured entity. Structured entities are generally created to achieve a narrow and well defined objective with restrictions around their activities. Structured entities are consolidated when the substance of the relationship between the Group and that of the structured entity indicates the Group has power over the contractual relevant activities of the structured entity, are exposed to variable returns, and can use that power to affect the variable return exposure. In determining whether to consolidate a structured entity, the Group takes into account their ability to direct the relevant activities of the structured entity. Control over relevant activities is generally evidenced through a unilateral right to liquidate the structured entity, investment in a substantial proportion of the securities issued by the structured entity or where the Group holds specific subordinated securities that embody certain controlling rights. The Group may further consider relevant activities embedded within contractual arrangements such as call options which give the practical ability to direct the entity, special relationships between the structured entity and investors, and if a single investor has a large exposure to variable returns of the structured entity.

(y) Other equity instrument

Financial instruments including preference share capital issued are classified as equity, when there is no contractual obligation to transfer cash, other financial assets or issue a variable number of own equity instruments. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Securities, including Additional Tier 1 Capital Securities, which carry a discretionary coupon and have no fixed maturity or redemption date are classified as other equity instruments. Interest payments on these securities are recognised, net of tax, as distributions from equity in the period in which they are declared.

3 Changes in accounting policies**(a) HKFRS/IFRS 16 Leases**

On 1 January 2019, the Group adopted HKFRS/IFRS 16 Leases which replaced HKAS/IAS 17 Leases.

HKFRS/IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. HKFRS/IFRS 16 substantially carries forward the lessor accounting requirements in HKAS/IAS 17 Leases. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

3 Changes in accounting policies (continued)**(a) HKFRS/IFRS 16 Leases (continued)**

The significant judgements in the implementation were determining if a contract contained a lease, and the determination of whether the Group is reasonably certain that it will exercise extension options present in lease contracts. The significant estimates were the determination of incremental borrowing rates in the respective economic environments. The weighted average discount rate applied to lease liabilities on the transition date 1 January 2019 was 4.0%.

The impact of HKFRS/IFRS 16 on the Group is primarily where the Group is a lessee in property lease contracts. The Group has elected to adopt the simplified approach of transition and has not restated comparative information. Note 2(h) sets out the accounting policy after the adoption of HKFRS/IFRS 16.

(b) Interest income and expenses on financial instruments held at fair value through profit or loss

The Group has changed its accounting policies for net interest income and net trading income to align with the presentation of the Bank's immediate holding company. In previous years the Group recognised interest income and expense on financial instruments held at fair value through profit or loss in net interest income, except for fair value elected structured notes and structured deposits for which all gains and losses are recognised in net trading income. The Group now recognises all gains and losses on financial assets and liabilities held at fair value through profit or loss, including contractual interest, in net trading income. Prior period comparatives have been presented under the updated accounting policy.

(c) Amendments to HKFRS/IFRS 9 Financial Instruments, HKAS/IAS 39 Financial Instruments: Recognition and Measurement and HKFRS/IFRS 7 Financial Instruments: Disclosures: Interest rate benchmark reform

Interest rate benchmark reform is a global initiative to replace or reform interbank offered rates ("IBORs") that are used to determine interest cash flows on financial instruments such as loans to customers, debt securities and derivatives. Historically IBORs such as USD LIBOR have been determined by panels of banks with a heavy reliance on expert judgement. The objective of the reforms is to replace IBORs with alternative nearly risk-free rates ("RFRs") that are based on actual market transactions.

There remain many uncertainties associated with the IBOR transition, including the prospective assessment of hedge accounting effectiveness because it is not known when hedged items and hedging instruments will be amended to reference alternative RFRs, or how this will change the cash flows on these instruments.

The HKFRS/IFRS amendments include reliefs which apply to all hedging relationships that are directly affected by interest rate benchmark reform by allowing entities to assume the benchmark interest rate is not altered as a result of IBOR reform.

The Group has elected to early adopt the interest rate benchmark reform amendments for the current period. The amendments would have otherwise taken mandatory effect from 1 January 2020. This election reduces the effects of any uncertainty arising from IBOR reform on the current period's financial statements. Had it not made this election, the Group would have been required to further assess the effect of uncertainty arising from LIBOR reform on its existing hedge relationships, potentially resulting in discontinuation of hedge relationships.

Quantitative information on the extent to which the HKFRS/IFRS amendments apply to hedge accounting relationships is provided in note 32 to these financial statements.

Notes to the consolidated 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:

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
(a) Interest income		
Interest income arising from financial assets:		
– amortised cost ¹	38,746	35,757
– measured at fair value through other comprehensive income	7,393	6,241
	<u>46,139</u>	<u>41,998</u>

¹ The amount includes interest income from unwinding of discount on impairment provisions of HK\$82 million (2018 (restated): HK\$97 million), and fair value losses of HK\$66 million transferred from reserve on cash flow hedges (2018 (restated): losses of HK\$52 million).

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
(b) Interest expense		
Interest expense arising from financial liabilities measured at amortised cost ¹	18,675	15,510
Interest expenses on lease liabilities	175	–
	<u>18,850</u>	<u>15,510</u>

¹ The amount includes fair value gains of HK\$48 million transferred from reserve on cash flow hedges (2018 (restated): gains of HK\$23 million).

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
(c) Net fee and commission income		
Net fee and commission income in the consolidated income statement includes the following:		
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 at fair value through profit or loss:		
– fee and commission income	2,433	2,319
– fee and commission expense	416	359
	<u>2,433</u>	<u>2,319</u>
Net fee and commission income from trust and other fiduciary activities that results in the holding of assets on behalf of customers		
– fee and commission income	809	742
– fee and commission expense	193	187
	<u>809</u>	<u>742</u>

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

	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
(d) Net trading income		
Net gains on instruments held for trading	7,228	7,017
Net gain on financial assets mandatorily at fair value through profit or loss other than held for trading	812	378
Net losses on financial instruments designated at fair value through profit or loss	(1,352)	(1,329)
	<u>6,688</u>	<u>6,066</u>
	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
(e) Other operating income		
Rental income from operating lease assets	3,818	4,100
Dividend income from financial assets at fair value through other comprehensive income	16	84
Net gains on disposal of debt securities at fair value through other comprehensive income	196	49
Net gains on disposal and write-off of property, plant and equipment	635	579
Net gains on disposal of financial instruments measured at amortised cost	27	47
Net losses on revaluation of investment properties (note 19)	(96)	(36)
Others	259	116
	<u>4,855</u>	<u>4,939</u>
	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
(f) Operating expenses		
Staff costs		
– contributions to defined contribution plans	557	546
– expense in respect of the defined benefits plan (note 27(e))	272	275
– equity-settled share-based payment expenses	219	183
– salaries and other staff costs	13,407	13,082
Depreciation (note 19)	3,478	2,546
Premises and equipment expense, excluding depreciation		
– rental of premises	135	1,430
– others	1,139	1,176
Amortisation		
– other intangible assets (note 20)	550	311
Auditor's remuneration	70	66
Others	9,962	9,211
	<u>29,789</u>	<u>28,826</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***5 Impairment charges**

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
(a) Credit impairment		
Net expected credit loss charges/(releases) on:		
– placements with banks and other financial institutions	13	1
– advances to customers	1,642	766
– debt securities at amortised cost	1	1
– debt securities at fair value through other comprehensive income	–	(30)
– loan commitments and financial guarantees	(8)	(51)
	<u>1,648</u>	<u>687</u>
(b) Other impairment		
Charges for risk participation transactions	–	78
Charges for property, plant and equipment (note 19)	826	1,097
Charges for capitalised software and other intangible assets (note 20)	3	24
Others	(11)	(8)
	<u>818</u>	<u>1,191</u>

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

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
<i>Current tax</i>		
Hong Kong profits tax	1,612	1,327
Overseas taxation	1,213	1,326
Under/(over)-provision in respect of prior years	73	(59)
	<u>2,898</u>	<u>2,594</u>
<i>Deferred tax (note 25)</i>		
Origination/reversal of temporary differences	622	428
(Over)/under-provision in respect of prior years	(241)	12
	<u>381</u>	<u>440</u>
	<u>3,279</u>	<u>3,034</u>

The provision for Hong Kong profits tax for 2019 is calculated at 16.5% (2018: 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 consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***6 Taxation in the consolidated income statement (continued)****(b) Reconciliation between tax expenses and accounting profit at applicable tax rates:**

	2019 HK\$'M	2018 HK\$'M (restated)
Profit before taxation	17,911	18,059
Notional tax on profit before taxation, calculated at Hong Kong profits tax rate of 16.5%	2,955	2,980
Tax effect of non-deductible expenses	530	770
Tax effect of non-taxable revenue	(973)	(1,104)
Over provision in prior years	(168)	(47)
Tax effect of different tax rates of subsidiaries operating in other jurisdictions	523	511
Others	412	(76)
Actual tax expense	3,279	3,034

7 Directors' remuneration

Directors' remuneration disclosed pursuant to section 383(1) of the Hong Kong Companies Ordinance and Part 2 of the Companies (Disclosure of information about Benefits of Directors) Regulation are as follows:

	<i>Bank</i>	
	2019 HK\$'M	2018 ¹ HK\$'M
Fees	4	3
Short-term employment benefits	39	30
Post-employment benefits	1	1
Equity compensation benefits	11	11
	55	45

¹ Comparative amounts for 2018 shown above represent the level of remuneration for the directors of the Group in accordance with the organisation structure prior to the acquisition of SCB China and SC NEA Group.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

8 Segmental reporting

The Group's segmental reporting is prepared in accordance with HKFRS/IFRS 8 Operating Segments and is reported consistently with the internal performance framework and as presented to the Group's Management Team. This includes a client segments view and a geographical segments view.

Client segments

The Group manages its businesses by four client segments: Corporate & Institutional Banking, Commercial Banking, Private Banking and Retail Banking:

- **Corporate & Institutional Banking** supports clients with their transaction banking, corporate finance, financial markets and borrowing needs, providing solutions to clients in some of the world's fastest-growing economies and most active trade corridors. The Group's clients include large corporations, governments, and banks.
- **Commercial Banking** serves local corporations and medium-sized enterprises. The Group aims to be its clients' main international bank, providing a full range of international financial solutions in areas such as trade finance, cash management, financial markets and corporate finance.
- **Private Banking** offers a full suite of investment, credit and wealth planning solutions to grow and protect the wealth of high net worth individuals across the Group's footprint.
- **Retail Banking** serves individuals and small businesses with a focus on affluent and emerging affluent. The Group provides digital banking services with a human touch to its clients across deposits, payments, financing products and wealth management, as well as supporting client's business banking needs.

Besides the four client segments, Treasury Markets and certain items which are not managed directly by a client segment, including unallocated central costs are reported in "Central & Other Items". Financial information is presented internally to the Group's senior management using these segments.

Geographical segments

The Group comprises four geographical segments, Hong Kong, Mainland China, Taiwan and Korea. Geographical segment is classified by the location of the principal operations of the subsidiary.

(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.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***8 Segmental reporting (continued)****(a) Segment results, assets and liabilities (continued)****Client segments**

	2019					Consolidated HK\$'M
	Corporate & Institutional Banking HK\$'M	Commercial Banking HK\$'M	Private Banking HK\$'M	Retail Banking HK\$'M	Central & Other Items HK\$'M	
Operating income						
– Net interest income	7,908	3,114	988	14,405	(829)	25,586
– Other operating income	9,428	1,489	819	9,128	1,139	22,003
	17,336	4,603	1,807	23,533	310	47,589
Operating expenses ¹	(8,777)	(2,979)	(1,428)	(15,728)	(45)	(28,957)
Operating profit before impairment	8,559	1,624	379	7,805	265	18,632
Impairment charges	(196)	(192)	(20)	(1,259)	(12)	(1,679)
Share of profit of an associate	–	–	–	–	1,934	1,934
Profit before taxation²	8,363	1,432	359	6,546	2,187	18,887
Segment assets	656,206	110,287	44,726	578,287	644,749	2,034,255
Segment liabilities	731,064	168,501	51,914	785,525	148,887	1,885,891

² The Group has decided to exit the vessels leasing business, the Corporate & Institutional Banking segments does not include the profit before tax for commercial vessels leased to customers amounting to losses of HK\$467 million.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***8 Segmental reporting (continued)****(a) Segment results, assets and liabilities (continued)****Client segments (continued)**

	2018 (restated)					Consolidated HK\$'M
	Corporate & Institutional Banking HK\$'M	Commercial Banking HK\$'M	Private Banking HK\$'M	Retail Banking HK\$'M	Central & Other Items HK\$'M	
Operating income						
– Net interest income	7,463	2,907	741	13,630	23	24,764
– Other operating income	9,573	1,613	679	8,989	1,955	22,809
	17,036	4,520	1,420	22,619	1,978	47,573
Operating expenses ¹	(9,162)	(3,064)	(1,496)	(15,316)	(315)	(29,353)
Operating profit/(loss) before impairment	7,874	1,456	(76)	7,303	1,663	18,220
Impairment (charges)/releases	(623)	(199)	10	(818)	30	(1,600)
Share of profit of an associate	–	–	–	–	1,610	1,610
Profit/(loss) before taxation	7,251	1,257	(66)	6,485	3,303	18,230
Segment assets	617,030	113,001	38,647	540,849	674,531	1,984,058
Segment liabilities	666,594	177,187	57,749	762,399	128,289	1,792,218

¹ Operating expenses in the Corporate & Institutional Banking segment included depreciation charges of HK\$1,425 million for commercial aircraft leased to customers under operating leases (2018 (restated): HK\$2,025 million for commercial aircraft and vessels leased to customers under operating leases).

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***8 Segmental reporting (continued)****(b) Reconciliation of reportable segment operating income, profit before taxation, assets and liabilities**

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
Operating income		
Reportable segment revenue	47,589	47,573
Income relating to financial market products	(2,108)	(2,516)
Cost of free funds	2,323	2,061
Others	428	83
	<u>48,232</u>	<u>47,201</u>
Total operating income	<u>48,232</u>	<u>47,201</u>
	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
Profit before taxation		
Reportable segment profit before taxation	18,887	18,230
Income relating to financial market products	(2,108)	(2,516)
Cost of free funds	2,323	2,061
Reallocation of impairment charges	(420)	118
Others	(771)	166
	<u>17,911</u>	<u>18,059</u>
Profit before taxation	<u>17,911</u>	<u>18,059</u>
	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
Assets		
Reportable segment assets	2,034,255	1,984,058
Assets of group companies not included in consolidated total assets	(19,059)	(3,987)
Amounts due from fellow subsidiaries	201,927	123,745
Others	(98,475)	(128,122)
	<u>2,118,648</u>	<u>1,975,694</u>
Total assets	<u>2,118,648</u>	<u>1,975,694</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***8 Segmental reporting (continued)****(b) Reconciliation of reportable segment operating income, profit before taxation, assets and liabilities (continued)**

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
Liabilities		
Reportable segment liabilities	1,885,891	1,792,218
Liabilities of group companies not included in consolidated total liabilities	(1,369)	(2,012)
Amounts due to immediate holding company and fellow subsidiaries	128,633	64,863
Others	(60,511)	(35,579)
	<u>1,952,644</u>	<u>1,819,490</u>
Total liabilities	<u>1,952,644</u>	<u>1,819,490</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 Group's consolidated statement of financial position but which contribute to the reportable segment's income and profit before taxation.

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

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
Cash in hand	5,074	5,527
Balances with central banks	63,475	52,083
Balances with banks and other financial institutions	14,451	14,514
	<u>83,000</u>	<u>72,124</u>

10 Placements with banks and other financial institutions

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
Gross placements with banks and other financial institutions		
– maturing one month	52,520	94,530
– maturing one month to one year	61,547	98,930
– maturing one year to five years	767	1,230
	<u>114,834</u>	<u>194,690</u>
Less: Expected credit loss provision (note 15)	(27)	(14)
	<u>114,807</u>	<u>194,676</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***13 Investment securities**

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
At fair value through other comprehensive income		
Debt securities		
– Treasury bills	93,462	132,083
– Certificates of deposit held	49,380	53,902
– Other debt securities	264,490	198,507
	<u>407,332</u>	<u>384,492</u>
Equity shares	435	494
	<u>407,767</u>	<u>384,986</u>
	-----	-----
At amortised cost		
Debt securities		
– Treasury bills	1,343	1,642
– Other debt securities	15,081	6,278
Less: Expected credit loss provision (note 15)	(13)	(12)
	<u>16,411</u>	<u>7,908</u>
	-----	-----
	<u>424,178</u>	<u>392,894</u>

14 Advances to customers

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
(a) Advances to customers		
Gross advances to customers	1,009,882	932,050
Trade bills	1,884	2,473
	<u>1,011,766</u>	<u>934,523</u>
	-----	-----
Less: Expected credit loss provision (note 15)	(4,731)	(4,494)
	<u>1,007,035</u>	<u>930,029</u>
	-----	-----

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***14 Advances to customers (continued)**

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
(b) Impaired advances to customers		
Gross impaired advances to customers	5,250	5,983
Less:		
Stage 3 expected credit loss provision (note 15)	<u>(2,642)</u>	<u>(2,601)</u>
	<u>2,608</u>	<u>3,382</u>
Gross impaired advances to customers as a % of gross advances to customers	<u>0.52%</u>	<u>0.64%</u>
Fair value of collateral held against the covered portion of impaired advances to customers	2,279	2,311
Covered portion of impaired advances to customers	1,139	1,258
Uncovered portion of impaired advances to customers	<u>4,111</u>	<u>4,725</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 consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***16 Amounts due from/to fellow subsidiaries and amounts due to immediate holding company (continued)**

The amounts due from/to fellow subsidiaries and amounts due to immediate holding company stated on the consolidated statement of financial position included the following:

	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
Amounts due from fellow subsidiaries:		
Cash and balances with banks and other financial institutions	5,167	12,097
Placements with banks and other financial institutions	126,361	81,079
Financial assets at fair value through profit or loss		
– Positive fair values of trading derivatives	28,862	24,103
– Debt securities	13	22
Other assets		
– Positive fair values of hedging derivatives	870	1,005
– Others	2,859	2,870
	<u>164,132</u>	<u>121,176</u>
	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
Amounts due to fellow subsidiaries:		
Deposits and balances of banks and other financial institutions	26,496	21,294
Financial liabilities at fair value through profit or loss		
– Negative fair values of trading derivatives	30,283	28,408
Subordinated liability issued by the Bank:		
– US\$800 million 4.30% fixed rate Tier 2 notes 2026	–	6,263
Subordinated liabilities issued by subsidiaries of the Bank:		
– US\$200 million 4.5% fixed rate subordinated debt 2024	1,558	1,565
– KRW600 billion 2.65% fixed rate subordinated debt 2029	4,190	–
Other liabilities		
– Negative fair values of hedging derivatives	2,584	711
– Others	11,851	14,059
	<u>76,962</u>	<u>72,300</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***16 Amounts due from/to fellow subsidiaries and amounts due to immediate holding company (continued)**

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
Amounts due to immediate holding company:		
Subordinated liabilities issued by the Bank ¹ :		
<i>Tier 2 capital instruments:</i>		
– US\$800 million 4.30% fixed rate Tier 2 notes 2026 ²	6,228	–
– US\$450 million floating rate Tier 2 notes 2029	3,503	–
– US\$250 million floating rate Tier 2 notes 2031	1,946	–
<i>Non-capital Loss-Absorbing Capacity (“LAC”) debt instruments:</i>		
– US\$1,000 million floating rate notes 2022	7,785	–
– US\$600 million floating rate notes 2022	4,671	–
– US\$600 million floating rate notes 2023	4,671	–
– US\$200 million 3.15% fixed rate note 2023	1,557	–
Other liabilities		
– Negative fair values of hedging derivatives	127	–
– Others	167	–
	<u>30,655</u>	<u>–</u>

¹ Interest expenses on these subordinated liabilities amounted to HK\$579 million (2018: Nil)

² The Tier 2 Capital instrument was held by SCB in 2018, the instrument was transferred to SC PLC during 2019.

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

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
Financial guarantees and other credit related contingent liabilities	2,860	2,480
Loan commitments and other credit related commitments	98,676	24,757
	<u>101,536</u>	<u>27,237</u>

17 Investments in subsidiaries of the Bank and interests in structured entities**(a) Investments in subsidiaries**

	<i>Bank</i>	
	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
Unlisted shares, at cost	47,394	46,507
Less: accumulated impairment provision	(735)	(735)
	<u>46,659</u>	<u>45,772</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***17 Investments in subsidiaries of the Bank and interests in structured entities (continued)****(a) Investments in subsidiaries (continued)**

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

<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 Bank (China) Limited	Mainland China	10,727,000,000 ordinary shares	100%	Banking and related financial services
Standard Chartered NEA Limited	United Kingdom	4,205,165,153 ordinary shares of US\$1 each	100%	Investment holdings
Standard Chartered Bank (Korea) Limited	Republic of Korea	262,608,618 ordinary shares of KRW 5,000 each	100%	Banking and related financial services
Standard Chartered Bank (Taiwan) Limited	Taiwan	2,910,571,976 ordinary shares of TWD10 each	100%	Banking and related financial services

(b) Interests in consolidated and unconsolidated structured entities**Consolidated entity**

A structured entity is consolidated where the Group controls the structured entity. The following table presents the Group's interests in structured entities.

	<i>2019</i>	<i>2018</i>
	<i>Total assets</i>	<i>Total assets</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Aircraft and ship leasing	33,238	38,423
Assets – backed securitisation	2,731	2,644

Unconsolidated entity

An unconsolidated structured entity is a structured entity that is not controlled by the Group. The Group enters into transactions with unconsolidated structured entities in the normal course of business to facilitate customer transactions. An interest in a structured entity creates variability of the returns of the Group arising from the performance of the structured entities. Maximum exposure to loss is primarily limited to the carrying amount of the Group's on-balance sheet exposure to the structured entity. As at 31 December 2019, investment securities amounting to HK\$638 million (2018: HK\$ Nil) are recognised in the financial statements relating to variable interests held in unconsolidated structured entities.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***17 Investments in subsidiaries of the Bank and interests in structured entities (continued)****(c) Acquisition under common control**

On 1 June 2019 and 1 October 2019, the Bank acquired 100 percent of the share capital of SCB China and SC NEA Group (comprising SCB Taiwan, SCB Korea and SCS Korea) (collectively termed “entities acquired under common control”) from a fellow subsidiary company at a cost of HK\$21,165 million and HK\$23,604 million respectively. In accordance with the principles of merger accounting as stated in note 2(b)(ii), the consolidated financial statements including the comparative figures for the prior periods, have been presented as if the acquisition of the entities acquired under common control by the Bank had occurred from the date when the entities acquired under common control first came under the control of SC PLC Group.

The consolidated statement of financial position as at 31 December 2018 has been restated as follows:

	<i>Before acquisition HK\$'M</i>	<i>Entities acquired under common control HK\$'M</i>	<i>Adjustments¹ HK\$'M</i>	<i>After acquisition HK\$'M</i>
Goodwill and intangible assets	1,601	1,373	3,991	6,965
Other assets and liabilities	78,153	71,086	–	149,239
	<u>79,754</u>	<u>72,459</u>	<u>3,991</u>	<u>156,204</u>
Net assets	79,754	72,459	3,991	156,204
Share capital	20,256	36,369	8,400	65,025
Reserves	57,546	36,090	(4,409)	89,227
	<u>77,802</u>	<u>72,459</u>	<u>3,991</u>	<u>154,252</u>
Other equity instruments	1,952	–	–	1,952
	<u>79,754</u>	<u>72,459</u>	<u>3,991</u>	<u>156,204</u>

The consolidated income statement for the year ended 31 December 2018 has been restated as follows:

	<i>Before acquisition HK\$'M</i>	<i>Entities acquired under common control HK\$'M</i>	<i>Adjustments HK\$'M</i>	<i>After acquisition HK\$'M</i>
Profit after taxation	9,668	5,357	–	15,025

¹ The above adjustments represent the recognition of the goodwill of HK\$3,991 million created on initial acquisition of the entities acquired under common control; the issuance of share capital of HK\$44,769 million for the investment in the entities acquired under common control; the elimination of the share capital of HK\$36,369 million of the entities acquired under common control; and the recognition of a merger reserve of HK\$4,409 million.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***17 Investments in subsidiaries of the Bank and interests in structured entities (continued)****(c) Acquisition under common control (continued)**

The consolidated statement of financial position as at 31 December 2019 is as follows:

	<i>Before acquisition HK\$'M</i>	<i>Entities acquired under common control HK\$'M</i>	<i>Adjustments² HK\$'M</i>	<i>After acquisition HK\$'M</i>
Cost of investment in entities acquired under common control (included in "investment in subsidiaries")	44,769	–	(44,769)	–
Goodwill and intangible assets	2,381	1,533	3,991	7,905
Other assets and liabilities	89,515	68,584	–	158,099
	<u>136,665</u>	<u>70,117</u>	<u>(40,778)</u>	<u>166,004</u>
Net assets	136,665	70,117	(40,778)	166,004
Share capital	65,025	36,369	(36,369)	65,025
Reserves	62,221	33,748	(4,409)	91,560
	<u>127,246</u>	<u>70,117</u>	<u>(40,778)</u>	<u>156,585</u>
Other equity instruments	8,983	–	–	8,983
Non-controlling interests	436	–	–	436
	<u>136,665</u>	<u>70,117</u>	<u>(40,778)</u>	<u>166,004</u>

The consolidated income statement for the year ended 31 December 2019 is as follows:

	<i>Before acquisition HK\$'M</i>	<i>Entities acquired under common control HK\$'M</i>	<i>Adjustments HK\$'M</i>	<i>After acquisition HK\$'M</i>
Profit after taxation	10,204	4,428	–	14,632

² The above adjustments represent the recognition of the goodwill of HK\$3,991 million created on initial acquisition of the entities acquired under common control; the elimination of the cost of investment of HK\$44,769 million in the entities acquired under common control; the elimination of the share capital of HK\$36,369 million of the entities acquired under common control; and the recognition of a merger reserve of HK\$4,409 million.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***18 Interest in an associate**

	2019 HK\$'M	2018 HK\$'M (restated)
Share of net assets	<u>14,046</u>	<u>12,144</u>

<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>
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 ¹

¹ Bohai is a strategic partner for the Group to develop its China business.

The Group's investment in Bohai is considered to be an associate because of the significant influence the Group is able to exercise over the management of the company and its financial and operating policies. Significant influence is evidenced largely through the representation on the Board of Directors in Bohai.

In respect of the year ended 31 December 2019, Bohai's result was included in these consolidated financial statements based on accounts drawn up to 30 November 2019. The Group has 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.

The associate is accounted for using the equity method in the consolidated financial statements.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***18 Interest in an associate (continued)****Summary of financial information of the associate and reconciliation to the carrying amounts in the consolidated financial statements**

	2019 HK\$'M	2018 HK\$'M <i>(restated)</i>
Gross amounts of the associate		
Assets	1,218,301	1,156,836
Liabilities	<u>(1,148,038)</u>	<u>(1,096,088)</u>
Net assets	<u>70,263</u>	<u>60,748</u>
Operating income	<u>31,915</u>	<u>26,865</u>
Profit after taxation	<u>9,675</u>	<u>7,814</u>
Dividends received from the associate	542	18
Dividends receivable from the associate	<u>–</u>	<u>542</u>
Of which: recognised in consolidated income statement	<u>–</u>	<u>56</u>
Gross amount of net assets of the associate	70,263	60,748
Effective interest of the Group	<u>19.99%</u>	<u>19.99%</u>
Carrying amount in the consolidated financial statements	<u>14,046</u>	<u>12,144</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***19 Property, plant and equipment**

	2019					
	<i>Buildings and leasehold land held for own use</i> HK\$'M	<i>Equipment, furniture & fixtures</i> HK\$'M	<i>Operating lease assets as lessor</i> HK\$'M	<i>Operating lease assets as lessee</i> HK\$'M	<i>Investment properties</i> HK\$'M	<i>Total</i> HK\$'M
Cost or valuation:						
At 1 January 2019	9,126	3,171	41,542	–	830	54,669
Adoption of HKFRS/IFRS 16	–	–	–	4,748	–	4,748
Additions	364	202	2,340	531	–	3,437
Transfers to assets held for sale	–	–	(11,454)	–	–	(11,454)
Disposals and write-offs	(248)	(181)	(4,221)	(80)	–	(4,730)
Reclassifications	(71)	71	–	–	–	–
Fair value adjustments (note 4(e))	–	–	–	–	(96)	(96)
Exchange adjustment	(184)	(58)	(137)	(17)	–	(396)
At 31 December 2019	8,987	3,205	28,070	5,182	734	46,178
Representing:						
Cost	8,987	3,205	28,070	5,182	–	45,444
Valuation	–	–	–	–	734	734
	8,987	3,205	28,070	5,182	734	46,178
Accumulated depreciation and impairment:						
At 1 January 2019	2,471	2,311	7,492	–	–	12,274
Charge for the period (note 4(f))	208	308	1,782	1,180	–	3,478
Impairments (note 5(b))	4	3	776	43	–	826
Attributable to transfers to assets held for sale	–	–	(4,903)	–	–	(4,903)
Attributable to assets sold or written off	(91)	(181)	(724)	(42)	–	(1,038)
Exchange adjustment	(39)	(49)	(21)	(1)	–	(110)
At 31 December 2019	2,553	2,392	4,402	1,180	–	10,527
Net book value:						
At 31 December 2019	6,434	813	23,668	4,002	734	35,651

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***19 Property, plant and equipment (continued)**

	2018				
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Operating lease assets as lessor HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total HK\$'M</i>
Cost or valuation:					
At 1 January 2018, as previously stated	2,780	518	44,424	866	48,588
Effect of merger of commonly controlled entities	6,617	2,547	–	–	9,164
At 1 January 2018, as restated	9,397	3,065	44,424	866	57,752
Additions	133	386	7,450	–	7,969
Transfers to assets held for sale	–	–	(957)	–	(957)
Disposals and write-offs	(84)	(231)	(9,454)	–	(9,769)
Reclassifications	(69)	69	–	–	–
Fair value adjustments (note 4(e))	–	–	–	(36)	(36)
Exchange adjustment	(251)	(118)	79	–	(290)
At 31 December 2018	9,126	3,171	41,542	830	54,669
Representing:					
Cost	9,126	3,171	41,542	–	53,839
Valuation	–	–	–	830	830
	9,126	3,171	41,542	830	54,669
Accumulated depreciation and impairment:					
At 1 January 2018, as previously stated	951	229	6,776	–	7,956
Effect of merger of commonly controlled entities	1,411	2,097	–	–	3,508
At 1 January 2018, as restated	2,362	2,326	6,776	–	11,464
Charge for the period (note 4(f))	216	305	2,025	–	2,546
Impairments (note 5(b))	16	–	1,081	–	1,097
Attributable to transfers to assets held for sale	–	–	(217)	–	(217)
Attributable to assets sold or written off	(68)	(231)	(2,184)	–	(2,483)
Exchange adjustment	(55)	(89)	11	–	(133)
At 31 December 2018	2,471	2,311	7,492	–	12,274
Net book value:					
At 31 December 2018	6,655	860	34,050	830	42,395

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***19 Property, plant and equipment (continued)****(a) Operating lease assets as lessor**

Assets leased to customers under operating leases consist of commercial aircraft and vessels. The total future minimum lease receivables under operating leases are as follows:

	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
Within 1 year	2,481	3,744
After 1 year but within 5 years	6,419	12,224
After 5 years	5,944	7,546
	<u>14,844</u>	<u>23,514</u>

(b) Investment properties

	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
Freehold outside Hong Kong, at fair value	<u>734</u>	<u>830</u>

The investment property outside Hong Kong was revalued as at 31 December 2019 on an open market value basis. The valuation was carried out by an independent firm, CBRE DIFC 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.

The fair value is categorised as a level 2 valuation using observable inputs.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***20 Goodwill and intangible assets (continued)*****Impairment tests for cash-generating units containing goodwill*****CGU structure**

When considering the generation of independent cash inflows and appropriate level of management, Corporate & Institutional Banking and Private Banking are managed on a global basis, while Retail Banking is managed on a country basis.

Goodwill is allocated to the Group's cash-generating units ("CGUs") as follows:

	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
Country CGUs - Retail Banking		
Hong Kong	611	611
Taiwan	3,818	3,804
Global CGUs		
Corporate and Institutional Banking	1,049	1,049
Private Banking	118	118
	<u>5,596</u>	<u>5,582</u>

Testing of goodwill for impairment

An annual assessment is made as to whether the current carrying value of goodwill is impaired. For the purpose of impairment testing, goodwill is allocated at the date of acquisition to a CGU. Goodwill is considered to be impaired if the carrying amount of the relevant CGU exceeds its recoverable amount. The recoverable amounts for all the CGUs were measured based on Value-in-Use ("ViU"). The calculation of ViU for each CGU is calculated using five-year cash flow projections and an estimated terminal value based on a perpetuity value after year five. The cash flow projections are based on forecasts approved by management up to 2024. The perpetuity terminal value amount is calculated using year five cash flows using long-term GDP growth rates (5-year average). All cash flows are discounted using pre-tax discount rates which reflect market rates appropriate to the CGU.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***20 Goodwill and intangible assets (continued)**

The goodwill allocated to each CGU and key assumptions used in determining the recoverable amounts are set out below and are solely estimates for the purposes of assessing impairment of acquired goodwill.

	2019			2018 (restated)		
	Goodwill HK\$'M	Pre-tax discount rate percent	Long-term forecast GDP growth rates percent	Goodwill HK\$'M (restated)	Pre-tax discount rate percent	Long-term forecast GDP growth rates percent
Cash generating unit						
Country CGUs - Retail Banking						
Hong Kong	611	9.19	2.44	611	11.69	3.03
Taiwan	3,818	10.57	2.05	3,804	11.02	2.08
Global CGUs						
Private Banking	118	9.06	5.25	118	9.06	5.32
Corporate and Institutional Banking	1,049	9.06	5.25	1,049	9.06	5.32
	<u>5,596</u>			<u>5,582</u>		

21 Other assets

	2019 HK\$'M	2018 HK\$'M (restated)
Prepayments and accrued income	6,664	6,329
Sundry debtors	5,691	5,578
Acceptances and endorsements	11,538	9,060
Unsettled trades and others	54,613	28,243
Assets held for sale ¹	6,168	887
	<u>84,674</u>	<u>50,097</u>

¹ As at 31 December 2019, assets held for sale included vessels² and corporate loans. As at 31 December 2018, assets held for sale included commercial aircraft and corporate loans.

² The Group has decided to exit the vessels leasing business and the leasing vessels were classified as assets held for sale accordingly. The transactions are expected to be completed within 2020.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***22 Deposits from customers**

	2019 HK\$'M	2018 HK\$'M (restated)
Current accounts	322,040	316,775
Savings accounts	726,470	699,309
Time and other deposits	481,602	440,583
	<u>1,530,112</u>	<u>1,456,667</u>

23 Debt securities in issue

	2019 HK\$'M	2018 HK\$'M (restated)
Certificates of deposit	10,330	15,529
Other debt securities in issue	21,278	19,170
	<u>31,608</u>	<u>34,699</u>

24 Financial liabilities at fair value through profit or loss

	2019 HK\$'M	2018 HK\$'M (restated)
Trading liabilities		
– Short position in securities	19,425	13,311
– Negative fair values of trading derivatives	30,013	27,841
	<u>49,438</u>	<u>41,152</u>
Financial liabilities designated at fair value through profit or loss:		
– Structured deposits from banks and customers	26,930	35,131
– Debt securities issued	16,571	18,550
– Liabilities under sale and repurchase agreement	3,610	6,031
	<u>47,111</u>	<u>59,712</u>
	<u>96,549</u>	<u>100,864</u>

The Group 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.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***24 Financial liabilities at fair value through profit or loss (continued)**

At 31 December 2019, the carrying amount of these financial liabilities exceeded the contractual amount payable at maturity by HK\$947 million (2018 (restated): the contractual amount payable at maturity of these financial liabilities exceeded the carrying amount by HK\$1,307 million). Of this, the cumulative fair value movement relating to changes in own credit risk was a loss of HK\$120 million (2018 (restated): a gain of HK\$831 million). The amount of fair value movement relating to changes in own credit risk recognised in other comprehensive income during the year was a loss of HK\$950 million (2018 (restated): a gain of HK\$740 million).

25 Taxation in the consolidated statement of financial position***Deferred tax assets and liabilities:***

The components of gross deferred tax (assets)/liabilities recognised in the consolidated statement of financial position and the movements during the year are as follows:

	<i>Depreciation allowances in excess of related depreciation</i> HK\$'M	<i>Impairment losses on financial assets</i> HK\$'M	<i>Financial assets at fair value through other comprehensive income</i> HK\$'M	<i>Own credit adjustment</i> HK\$'M	<i>Tax loss</i> HK\$'M	<i>Others</i> HK\$'M	<i>Total</i> HK\$'M
<i>Deferred tax arising from:</i>							
At 1 January 2018,							
as previously stated	1,247	(288)	(24)	–	(713)	(119)	103
Effect of merger of commonly controlled entities	(203)	(643)	(70)	12	(460)	(1,006)	(2,370)
At 1 January 2018, as restated	1,044	(931)	(94)	12	(1,173)	(1,125)	(2,267)
Charge/(release) to consolidated income statement (note 6(a))	128	(131)	4	(2)	40	401	440
Charge/(release) to reserves	–	–	115	126	–	(17)	224
Others	9	41	4	(1)	45	38	136
At 31 December 2018	<u>1,181</u>	<u>(1,021)</u>	<u>29</u>	<u>135</u>	<u>(1,088)</u>	<u>(703)</u>	<u>(1,467)</u>
Charge to consolidated income statement (note 6(a))	164	124	–	–	63	30	381
Charge/(release) to reserves	–	–	100	(162)	–	(110)	(172)
Others	–	12	(1)	1	(8)	30	34
At 31 December 2019	<u>1,345</u>	<u>(885)</u>	<u>128</u>	<u>(26)</u>	<u>(1,033)</u>	<u>(753)</u>	<u>(1,224)</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***25 Taxation in the consolidated statement of financial position (continued)**

	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
<i>Analysed by:</i>		
Net deferred tax asset recognised on the consolidated statement of financial position	(1,999)	(2,076)
Net deferred tax liability recognised on the consolidated statement of financial position	775	609
	<u>(1,224)</u>	<u>(1,467)</u>

26 Other liabilities

	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
Accruals and deferred income	10,998	10,754
Provision for liabilities and charges	436	739
Acceptances and endorsements	11,538	9,060
Expected credit loss provision on loan commitments and financial guarantees (note 15)	158	166
Lease liabilities	4,182	–
Unsettled trades and others	59,337	39,654
	<u>86,649</u>	<u>60,373</u>

27 Employee retirement benefits

The Group operates five defined benefit plans.

SCB HK Scheme

Standard Chartered Bank Hong Kong Retirement Scheme (“HK 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 HK Scheme.

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

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

The HK Scheme exposes the Group 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 HK Scheme’s actuary in accordance with the ORSO requirements. The last funding valuation of the HK Scheme was carried out as at 31 December 2017.

Overseas plans

The principal overseas defined benefit arrangements operated by the Group are in Korea and Taiwan.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***27 Employee retirement benefits (continued)****(a) Amounts recognised in the consolidated statement of financial position**

	2019				2018 (restated)			
	Funded		Unfunded		Funded		Unfunded	
	HK	Overseas	Overseas	Total	HK	Overseas	Overseas	Total
	Scheme	Plans	Plans		Scheme	Plans	Plans	
HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	
Fair value of plan assets	1,858	1,936	–	3,794	1,716	1,812	–	3,528
Present value of obligations	(1,916)	(2,140)	(56)	(4,112)	(1,893)	(2,007)	(57)	(3,957)
Net liability recognised in the consolidated statement of financial position (included in "Other liabilities")	(58)	(204)	(56)	(318)	(177)	(195)	(57)	(429)

(b) Movements in the present value of the defined benefit obligations:

	2019				2018 (restated)			
	Funded		Unfunded		Funded		Unfunded	
	HK	Overseas	Overseas	Total	HK	Overseas	Overseas	Total
	Scheme	Plans	Plans		Scheme	Plans	Plans	
HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	
At 1 January	(1,893)	(2,007)	(57)	(3,957)	(1,954)	(1,795)	(56)	(3,805)
Benefits paid	165	99	–	264	173	71	–	244
Current service cost	(73)	(196)	(4)	(273)	(78)	(195)	(3)	(276)
Net interest cost	(35)	(41)	(1)	(77)	(31)	(42)	(2)	(75)
Settlement costs and transfers impact	–	53	2	55	–	9	–	9
Actuarial gain/(loss) – from experience	(12)	(28)	5	(35)	(31)	(45)	5	(71)
Actuarial gain/(loss) – from assumptions	(68)	(62)	(3)	(133)	28	(79)	(3)	(54)
Exchange rate adjustment	–	42	2	44	–	69	2	71
At 31 December	(1,916)	(2,140)	(56)	(4,112)	(1,893)	(2,007)	(57)	(3,957)

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***27 Employee retirement benefits (continued)****(c) Movements in the fair value of plan assets:**

	2019				2018 (restated)			
	Funded		Unfunded		Funded		Unfunded	
	HK	Overseas	Overseas	Total	HK	Overseas	Overseas	Total
	Scheme	Plans	Plans		Scheme	Plans	Plans	
HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	
At 1 January	1,716	1,812	-	3,528	1,988	1,622	-	3,610
Contributions	23	262	-	285	25	339	-	364
Benefits paid	(165)	(99)	-	(264)	(173)	(71)	-	(244)
Net interest cost	32	42	-	74	32	45	-	77
Settlement costs and transfers impact	-	(51)	-	(51)	-	(9)	-	(9)
Administrative expenses	-	-	-	-	(1)	-	-	(1)
Return on plan assets, excluding amounts included in interest income	252	23	-	275	(155)	(48)	-	(203)
Exchange rate adjustment	-	(53)	-	(53)	-	(66)	-	(66)
At 31 December	1,858	1,936	-	3,794	1,716	1,812	-	3,528

(d) Movements in the net (liabilities)/assets recognised in the consolidated balance sheet are as follows:

	2019				2018 (restated)			
	Funded		Unfunded		Funded		Unfunded	
	HK	Overseas	Overseas	Total	HK	Overseas	Overseas	Total
	Scheme	Plans	Plans		Scheme	Plans	Plans	
HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	
At 1 January	(177)	(195)	(57)	(429)	34	(173)	(56)	(195)
Contributions	23	262	-	285	25	339	-	364
Current service cost	(73)	(196)	(4)	(273)	(78)	(195)	(3)	(276)
Net interest income/(cost)	(3)	1	(1)	(3)	1	3	(2)	2
Settlement costs and transfers impact	-	2	2	4	-	-	-	-
Administrative expenses	-	-	-	-	(1)	-	-	(1)
Return on plan assets, excluding amounts included in interest income	252	23	-	275	(155)	(48)	-	(203)
Actuarial gain/(loss) – from experience	(12)	(28)	5	(35)	(31)	(45)	5	(71)
Actuarial gain/(loss) – from assumptions	(68)	(62)	(3)	(133)	28	(79)	(3)	(54)
Exchange rate adjustment	-	(11)	2	(9)	-	3	2	5
At 31 December ¹	(58)	(204)	(56)	(318)	(177)	(195)	(57)	(429)

¹ The deficit total of HK\$318 million (2018 (restated): HK\$429 million) is made up of plans in deficit of HK\$435 million (2018 (restated): HK\$577 million) net of plans in surplus with assets totalling HK\$117 million (2018 (restated): HK\$148 million).

The weighted average duration of the defined benefit obligation as at 31 December 2019 for HK Scheme is 6 years (2018: 5 years) and overseas plan is 8 years (2018: 8 years).

The Group's expected contribution to its defined benefit pension in 2020 is HK\$258 million.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***27 Employee retirement benefits (continued)****(e) Amounts recognised in the consolidated income statement for the year**

	2019				2018 (restated)			
	Funded		Unfunded		Funded		Unfunded	
	HK	Overseas	Overseas	Total	HK	Overseas	Overseas	Total
	Scheme	Plans	Plans		Scheme	Plans	Plans	
HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	
Total service cost	73	194	2	269	78	195	3	276
Net interest cost	3	(1)	1	3	(1)	(3)	2	(2)
Administrative expense	-	-	-	-	1	-	-	1
	<u>76</u>	<u>193</u>	<u>3</u>	<u>272</u>	<u>78</u>	<u>192</u>	<u>5</u>	<u>275</u>

(f) Principal actuarial assumptions used in the valuation and sensitivity analysis

	HK Scheme		Overseas Plans	
	2019	2018	2019	2018
Discount rate	1.8%	2.0%	0.7% – 2.5%	0.9% – 2.8%
Future salary growth rate	4.0%	4.0%	3.0% – 3.5%	3.0% – 3.5%

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\$29 million for the HK Scheme (2018: HK\$23 million) and HK\$54 million for overseas plans (2018: HK\$50 million)
- If the rate of growth of salaries was higher by 25 basis points the obligation would increase by approximately HK\$27 million for the HK Scheme (2018: HK\$22 million) and HK\$58 million for overseas plans (2018: HK\$53 million)

(g) Major categories of assets

	HK Scheme		Overseas Plans	
	2019	2018	2019	2018
Equities	61%	62%	9%	9%
Bonds	36%	36%	22%	4%
Investment funds	-	-	14%	-
Real estate/property	-	-	11%	-
Insurance contracts	-	-	39%	-
Cash and others	3%	2%	5%	87%
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

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

	2019 HK\$'M	2018 HK\$'M (restated)
Issued by the Bank:		
US\$750 million 5.875% Tier 2 fixed rate notes 2020	5,876	5,907

29 Share capital and other equity instruments

	2019		2018 (restated) ¹	
	No. of shares	HK\$'M	No. of shares	HK\$'M
Issued and fully paid				
<i>Ordinary share capital:</i>				
Class A ordinary shares	706 million	12,500	706 million	12,500
Class B ordinary shares	1,231 million	78	1,231 million	78
Class C ordinary shares	342 million	21,165	342 million	21,165
Class D ordinary shares	3,010 million	23,604	3,010 million	23,604
<i>Additional Tier 1 capital:</i>				
US\$500 million 6.25% perpetual non-cumulative convertible preference shares	10	3,878	10	3,878
Fully repurchased in prior years				
HK\$3,800 million 8.25% non-cumulative preference shares	–	3,800	–	3,800
		65,025		65,025
		2019 HK\$'M		2018 HK\$'M (restated)
Other equity instrument				
<i>Additional Tier 1 capital:</i>				
US\$250 million 5% perpetual non-cumulative capital securities		1,952		1,952
US\$900 million floating rate undated Additional Tier 1 capital securities		7,031		–
		8,983		1,952

¹ In accordance with the principle of merger accounting as stated in note 2(b)(ii), comparative amounts have been restated so that they are presented as if SCB China and SC NEA Group had been combined and the Class C shares and Class D shares of the Bank had been issued at the earliest date presented in these consolidated financial statements notwithstanding their actual issuance on 1 June 2019 and 1 October 2019 respectively.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

29 Share capital and other equity instruments (continued)

The Hong Kong Companies Ordinance was revised with effect from 3 March 2014. Under the new Companies Ordinance (Cap. 622), amounts which were previously credited to the share premium account and capital redemption reserve have been aggregated together as part of the Bank's share capital. Since the share premium amounting to HK\$12,477 million was originated from Class A and Class B ordinary shares, and the capital redemption reserve amounting to HK\$3,804 million was originated from partial redemption of Class A ordinary shares and full redemption of preference shares in prior years, they were allocated back to the ordinary shares and preference share capital accordingly.

In accordance with section 135 of the Hong Kong Companies Ordinance, the ordinary shares do not have a par value.

On 30 December 2014, 10 perpetual non-cumulative convertible preference shares were issued to Standard Chartered Bank at an aggregate issue price of US\$500 million with a liquidation preference of US\$500 million. Each preference share will be converted to 12,500,000 Class A Shares of US\$4.00 each upon a non-viability event as set out in the subscription agreement. The preference shares qualify as Additional Tier 1 capital under the Banking (Capital) Rules.

On 13 December 2017, the Bank issued perpetual non-cumulative subordinated capital securities with a face value of US\$250 million. The capital securities are undated and bear a 5 percent coupon until the first call date on 13 December 2024. The coupon will be reset thereafter if the capital securities are not redeemed, to a fixed rate equivalent to the prevailing US Treasury rate plus 2.702% per annum. The securities qualify as Additional Tier 1 capital under the Banking (Capital) Rules.

On 1 June 2019, the Bank acquired 100 percent of the share capital of SCB China from a fellow subsidiary by issuance of Class C ordinary share capital amounting to HK\$21,165 million.

On 24 June 2019, the Bank issued floating rate undated Additional Tier 1 capital securities with a face value of US\$900 million. The capital securities are undated with an optional call date on 12 April 2026 and bear a coupon rate equivalent to 3-month USD LIBOR plus 4.48 percent per annum. The securities qualify as Additional Tier 1 capital under the Banking (Capital) Rules and LAC debt instruments under the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements - Banking Sector) Rules ("LAC Rules").

On 1 October 2019, the Bank acquired 100 percent of the share capital of SC NEA Group from a fellow subsidiary by issuance of Class D ordinary share capital amounting to HK\$23,604 million.

The Preference Shares shall rank in priority to the Ordinary Shares with respect to the payment of dividends and any return of capital by the Bank. The Ordinary Shares shall rank *pari passu* with each other with respect to the payment of dividends by the Bank. The Class B ordinary shares, the Class C ordinary shares and the Class D ordinary shares shall rank *pari passu* with each other, but in priority to the Class A ordinary shares, with respect to any return of capital by the Bank.

30 Reserves

Nature and purpose of reserves

- (i) Own credit adjustment ("OCA") reserve

The own credit adjustment reserve represents the cumulative gains and losses on financial liabilities designated at fair value through profit or loss relating to the Group's own credit risk. Gains and losses on financial liabilities designated at fair value through profit or loss relating to own credit risk in the year have been taken through other comprehensive income into this reserve. On derecognition of applicable instruments the balance of any OCA will not be recycled to the income statement, but will be transferred within equity to retained earnings.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

30 Reserves (continued)

(ii) 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).

(iii) Investment in debt securities at fair value through other comprehensive income reserve ("FVOCI reserve – Debt") and Investment in equity securities at fair value through other comprehensive income reserve ("FVOCI reserve – Equity")

The FVOCI reserve – Debt and FVOCI reserve – Equity comprise respectively the cumulative net change in the fair value of the investment in debt securities and equity securities measured at fair value through other comprehensive income, less the ECL allowance recognised in profit or loss. The reserve is dealt with in accordance with the accounting policy in note 2(i).

(iv) Exchange reserve

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

(v) Statutory reserves

The statutory reserves are held by certain overseas subsidiaries to comply with local regulations.

(vi) Other reserves

Other reserves comprise:

- Merger reserve which arises on the acquisition of common control entities in accordance with the principles of merger accounting under the Accounting Guideline No.5 Merger Accounting for Common Control Combinations issued by the HKICPA. Note 2(b)(ii) and 17(c) set out the details of the amounts recognised in merger reserve.
- Capital contribution reserve which represents the excess of consideration received over the book value of a subsidiary transferred to a commonly controlled entity.

(vii) Share option equity reserve

SC PLC operates equity-settled share-based compensation plans in which the Group's 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.

The Hong Kong Monetary Authority ("HKMA") requires the Group to maintain a minimum level of impairment allowances which is in excess of the impairment allowances required under HKFRSs. Of the retained profits as at 31 December 2019, an amount of HK\$5,379 million (2018: HK\$3,954 million)¹ has been reserved for this purpose.

¹ This amount is not subject to Merger Accounting and has not been restated.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***31 Cash and cash equivalents****(a) Components of cash and cash equivalents in the consolidated cash flow statement**

	2019 HK\$'M	2018 HK\$'M (restated)
Cash and balances with banks, central banks and other financial institutions	83,000	72,124
Financial assets at fair value through profit or loss with original maturity within three months	–	514
Placements with banks and other financial institutions with original maturity within three months	46,405	105,786
Investment securities with original maturity within three months	57,912	102,831
Amounts due from immediate holding company and fellow subsidiaries with original maturity within three months	4,688	12,070
Less: Overdrafts included in “deposits and balances of banks and other financial institutions”	(8)	(1)
Less: Overdrafts included in “amounts due to fellow subsidiaries”	(11,459)	(8,782)
	<u>180,538</u>	<u>284,542</u>

(b) Reconciliation with the consolidated statement of financial position

	2019 HK\$'M	2018 HK\$'M (restated)
Cash and balances with banks, central banks, and other financial institutions	83,000	72,124
Financial assets at fair value through profit or loss	127,347	104,295
Placements with banks and other financial institutions	114,807	194,676
Investment securities	424,178	392,894
Amounts due from fellow subsidiaries	164,132	121,176
Overdrafts included in “deposits and balances of banks and other financial institutions”	(8)	(1)
Overdrafts included in “amounts due to fellow subsidiaries”	(11,459)	(8,782)
Amounts shown in the consolidated statement of financial position	901,997	876,382
Less: amounts with an original maturity of beyond three months	(721,459)	(591,840)
Cash and cash equivalents in the consolidated cash flow statement	<u>180,538</u>	<u>284,542</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***31 Cash and cash equivalents (continued)****(c) Reconciliation of liabilities arising from financing activities**

The table below details changes in the Group's liabilities arising from financing activities, including both cash and non-cash changes. Liabilities arising from financing activities are liabilities for which cash flows were, or future cash flows will be, classified in the Group's consolidated cash flow statement as cash flows from financing activities.

	2019			Total HK\$'M
	Subordinated liabilities to a fellow subsidiaries and immediate holding company HK\$'M	Subordinated liabilities to third parties HK\$'M	Lease liabilities HK\$'M	
At 1 January 2019	7,828	5,907	–	13,735
Effect of adoption of HKFRS/IFRS 16	–	–	4,748	4,748
Changes from financing cash flows:				
Issuance of subordinated liabilities	28,165	–	–	28,165
Interest paid on subordinated liabilities	(782)	(360)	–	(1,142)
Payment of lease liability	–	–	(1,234)	(1,234)
Total changes from financing cash flows	27,383	(360)	(1,234)	25,789
Exchange adjustments	(33)	(32)	–	(65)
Hedge accounting adjustment	149	(5)	–	144
Other changes:				
Net increase in lease liabilities from entering into new leases	–	–	493	493
Interest expense on subordinated liabilities and other borrowings	782	366	–	1,148
Interest expense on lease liabilities	–	–	175	175
Total other changes	782	366	668	1,816
At 31 December 2019	36,109	5,876	4,182	46,167

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***31 Cash and cash equivalents (continued)****(c) Reconciliation of liabilities arising from financing activities (continued)**

	<i>2018 (restated)</i>		
	<i>Subordinated liabilities to a fellow subsidiaries and immediate holding company HK\$'M</i>	<i>Subordinated liabilities to third parties HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2018, as previously stated	6,263	5,906	12,169
Effect of merger of commonly controlled entities	1,551	762	2,313
	<hr/>	<hr/>	<hr/>
At 1 January 2018, as restated	7,814	6,668	14,482
Changes from financing cash flows:			
Payment for redemption of subordinated liabilities	–	(641)	(641)
Interest paid on subordinated liabilities	(344)	(402)	(746)
	<hr/>	<hr/>	<hr/>
Total changes from financing cash flows	(344)	(1,043)	(1,387)
	<hr/>	<hr/>	<hr/>
Exchange adjustments	14	(6)	8
Hedge accounting adjustment	–	(120)	(120)
Other changes:			
Interest expenses on subordinated liabilities	344	408	752
	<hr/>	<hr/>	<hr/>
Total other changes	344	408	752
	<hr/>	<hr/>	<hr/>
At 31 December 2018	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

32 Derivative financial instruments

The use of derivatives for trading and their sale to customers as risk management products is an integral part of the Group's business activities. These instruments are also used to manage the Group's own exposures to market risk as part of its asset and liability management process. The principal derivative instruments used by the Group are foreign exchange related and interest rate related contracts, which are primarily over-the-counter derivatives. Most of the Group'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.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***32 Derivative financial instruments (continued)**

The tables below analyse the notional principal amounts and the positive and negative fair values of derivative financial instruments. The notional principal amount is the amount of principal underlying the contract at the reporting date.

	2019			2018 (restated)		
	Notional principal amounts HK\$'M	Fair value assets HK\$'M	Fair value liabilities HK\$'M	Notional principal amounts HK\$'M	Fair value assets HK\$'M	Fair value liabilities HK\$'M
Foreign exchange derivative contracts:						
Forward foreign exchange contracts	2,721,430	24,145	(22,801)	2,507,809	18,888	(19,669)
Currency swaps and options	3,215,124	16,570	(17,513)	3,922,040	19,358	(20,070)
	5,936,554	40,715	(40,314)	6,429,849	38,246	(39,739)
Interest rate derivative contracts:						
Swaps	4,352,698	15,937	(17,194)	2,606,651	12,413	(12,930)
Forward rate agreement and options	66,288	345	(2,929)	168,025	256	(2,326)
	4,418,986	16,282	(20,123)	2,774,676	12,669	(15,256)
Other derivative contracts						
	55,913	751	(2,645)	67,069	709	(2,274)
Total derivatives	10,411,453	57,748	(63,082)	9,271,594	51,624	(57,269)

Derivative held for hedging

The notional principal amounts and the positive and negative fair values of derivative financial instruments held for hedging purposes at the reporting date is as follows:

	2019			2018 (restated)		
	Notional principal amounts HK\$'M	Fair value assets (Included in Amounts due from fellow subsidiaries) HK\$'M	Fair value liabilities (Included in Amounts due to immediate holding company and fellow subsidiaries) HK\$'M	Notional principal amounts HK\$'M	Fair value assets (Included in Amounts due from fellow subsidiaries) HK\$'M	Fair value liabilities (Included in Amounts due to fellow subsidiaries) HK\$'M
Derivatives designated as fair value hedges:						
Interest rate swaps	86,336	145	(1,054)	71,355	115	(341)
Cross currency swaps	21,512	103	(181)	11,154	62	(39)
	107,848	248	(1,235)	82,509	177	(380)
Derivatives designated as cash flow hedges:						
Interest rate swaps	62,275	403	(450)	56,878	428	(166)
Cross currency swaps	34,067	219	(384)	19,733	400	(165)
	96,342	622	(834)	76,611	828	(331)
Derivatives designated as net investment hedges:						
Forward foreign exchange contracts	28,883	–	(515)	–	–	–
Total derivatives held for hedging	233,073	870	(2,584)	159,120	1,005	(711)

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***32 Derivative financial instruments (continued)**

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 and interest rate risk.

Maturity of hedging instruments

The Group held the following derivatives as hedging instruments in fair value hedges.

Risk category	2019				2018 (restated)			
	Less than one month HK\$'M	More than one month and less than one year HK\$'M	One to five years HK\$'M	More than five years HK\$'M	Less than one month HK\$'M	More than one month and less than one year HK\$'M	One to five years HK\$'M	More than five years HK\$'M
Interest rate risk								
Notional Amount								
Hedge of debt securities	135	6,491	30,985	3,810	-	1,490	21,824	-
Hedge of treasury bills	3,015	11,459	17,076	-	-	18,836	16,549	-
Hedge of advances to customers	-	1,561	5,531	434	-	1,085	5,217	483
Hedge of subordinated liabilities	-	5,839	-	-	-	-	5,871	-
	<u>3,150</u>	<u>25,350</u>	<u>53,592</u>	<u>4,244</u>	<u>-</u>	<u>21,411</u>	<u>49,461</u>	<u>483</u>
Foreign exchange risk and interest rate risk								
Notional Amount								
Hedge of debt securities	-	594	333	-	-	1,193	134	-
Hedge of treasury bills	715	18,730	1,140	-	-	8,687	912	-
Hedge of deposits from customers	-	-	-	-	-	228	-	-
	<u>715</u>	<u>19,324</u>	<u>1,473</u>	<u>-</u>	<u>-</u>	<u>10,108</u>	<u>1,046</u>	<u>-</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***32 Derivative financial instruments (continued)**

Hedged items

	2019					
	Carrying Amount		Accumulated amount of fair value hedge adjustments included in the carrying amount		Change in the value used for calculating hedge ineffectiveness	Accumulated amortising amount of fair value hedge adjustments no longer designated as hedges
	Asset	Liability	Asset	Liability		
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Debt securities	43,015	–	408	–	355	(163)
Treasury bills	52,408	–	409	–	343	(14)
Advances to customers	7,621	–	100	–	115	4
Subordinated liabilities	–	(5,876)	–	(39)	5	–
	<u>103,044</u>	<u>(5,876)</u>	<u>917</u>	<u>(39)</u>	<u>818</u>	<u>(173)</u>
	2018 (restated)					
	Carrying Amount		Accumulated amount of fair value hedge adjustments included in the carrying amount		Change in the value used for calculating hedge ineffectiveness	Accumulated amortising amount of fair value hedge adjustments no longer designated as hedges
	Asset	Liability	Asset	Liability		
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
	Debt securities	24,597	–	77	–	66
Treasury bills	44,959	–	94	–	119	19
Advances to customers	6,779	–	(4)	–	52	10
Deposits from customers	–	(234)	–	6	6	–
Subordinated liabilities	–	(6,308)	–	(45)	112	–
	<u>76,335</u>	<u>(6,542)</u>	<u>167</u>	<u>(39)</u>	<u>355</u>	<u>56</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***32 Derivative financial instruments (continued)**

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.

Maturity of hedging instruments

The Group held the following derivatives as hedging instruments in cash flow hedges.

Risk category	2019				2018 (restated)			
	More than one month		One to five years	More than five years	More than one month		One to five years	More than five years
	Less than one month	and less than one year			Less than one month	and less than one year		
HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	
Interest rate risk								
Notional Amount								
Hedge of debt securities	-	-	-	-	3,500	-	-	-
Hedge of advances to customers	1,500	29,635	11,956	-	27,723	399	-	-
Hedge of deposits from customers	-	4,713	8,609	5,862	2,900	13,565	8,791	-
	<u>1,500</u>	<u>34,348</u>	<u>20,565</u>	<u>5,862</u>	<u>34,123</u>	<u>13,964</u>	<u>8,791</u>	<u>-</u>
Foreign exchange risk and interest rate risk								
Notional Amount								
Hedge of debt securities	-	322	4,122	-	-	3,312	-	-
Hedge of intragroup lending	-	20,540	-	-	-	-	-	-
Hedge of deposits from customers	3,137	5,155	791	-	6,367	10,054	-	-
	<u>3,137</u>	<u>26,017</u>	<u>4,913</u>	<u>-</u>	<u>6,367</u>	<u>13,366</u>	<u>-</u>	<u>-</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***32 Derivative financial instruments (continued)**

Hedging instruments and ineffectiveness

	2019						
	Notional HK\$'M	Carrying Amount*		Change in fair value used to calculate hedge ineffectiveness HK\$'M	Changes in the value of the hedging instrument recognised in OCI HK\$'M	Ineffectiveness recognised in net trading income HK\$'M	Amount reclassified from reserves to net interest income HK\$'M
		Asset HK\$'M	Liability HK\$'M				
Interest rate risk							
Interest rate swaps – Hedge of debt securities	-	-	-	-	-	-	(7)
Interest rate swaps – Hedge of advances to customers	43,091	388	-	(10)	(9)	(1)	(74)
Interest rate swaps – Hedge of deposits from customers	19,184	15	(450)	(551)	(549)	(2)	63
	<u>62,275</u>	<u>403</u>	<u>(450)</u>	<u>(561)</u>	<u>(558)</u>	<u>(3)</u>	<u>(18)</u>
Foreign exchange risk and Interest rate risk							
Cross currency swaps – Hedge of debt securities	4,444	89	-	44	43	1	-
Cross currency swaps – Hedge of intragroup lending	20,540	56	(329)	(313)	(313)	-	-
Cross currency swaps – Hedge of deposits from customers	9,083	74	(55)	(23)	(23)	-	-
	<u>34,067</u>	<u>219</u>	<u>(384)</u>	<u>(292)</u>	<u>(293)</u>	<u>1</u>	<u>-</u>

* The carrying amount represents the fair value of the hedging instruments including its respective accrued interest

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***32 Derivative financial instruments (continued)**

Hedging instruments and ineffectiveness (continued)

	2018 (restated)						
	Notional HK\$'M	Carrying Amount*		Change in fair value used to calculate hedge ineffectiveness HK\$'M	Changes in the value of the hedging instrument recognised in OCI HK\$'M	Ineffectiveness recognised in net trading income HK\$'M	Amount reclassified from reserves to net interest income HK\$'M
		Asset HK\$'M	Liability HK\$'M				
Interest rate risk							
Interest rate swaps – Hedge of debt securities	3,500	–	(2)	(2)	(2)	–	(6)
Interest rate swaps – Hedge of advances to customers	28,122	148	(15)	72	72	–	(87)
Interest rate swaps – Hedge of deposits from customers	25,256	280	(149)	39	39	–	64
	<u>56,878</u>	<u>428</u>	<u>(166)</u>	<u>109</u>	<u>109</u>	<u>–</u>	<u>(29)</u>
Foreign exchange risk and Interest rate risk							
Cross currency swaps – Hedge of debt securities	547	–	(6)	(2)	(1)	(1)	–
Cross currency swaps – Hedge of intragroup lending	–	–	–	–	–	–	–
Cross currency swaps – Hedge of deposits from customers	19,186	400	(159)	445	445	–	–
	<u>19,733</u>	<u>400</u>	<u>(165)</u>	<u>443</u>	<u>444</u>	<u>(1)</u>	<u>–</u>

Hedged items

	2019		
	Change in the value used for calculating hedge ineffectiveness HK\$'M	Cash flow hedge reserve HK\$'M	Balances remaining in the cash flow hedge reserve from hedging relationships for which hedge accounting is no longer applied HK\$'M
Debt securities	(43)	13	–
Advances to customers	9	(2)	(23)
Deposits from customers	572	(406)	(31)
Intragroup lending	313	–	–
	<u>851</u>	<u>(395)</u>	<u>(54)</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***32 Derivative financial instruments (continued)**

Hedged items (continued)

	2018 (restated)		
	<i>Change in the value used for calculating hedge ineffectiveness</i> HK\$'M	<i>Cash flow hedge reserve</i> HK\$'M	<i>Balances remaining in the cash flow hedge reserve from hedging relationships for which hedge accounting is no longer applied</i> HK\$'M
Debt securities	3	(6)	(7)
Loans and advances to customers	(72)	31	(73)
Deposits from customers	(484)	110	262
	<u>(553)</u>	<u>135</u>	<u>182</u>

Net investment hedges

A foreign currency exposure arises from a net investment in subsidiaries that have a different functional currency from that of the Group. This risk arises from the fluctuation in spot exchange rates between the functional currencies of the subsidiaries and the functional currency of the Group, which causes the value of the investments to vary.

As at 31 December 2019, the derivatives that the Group held as hedging instruments are maturing less than one month.

Hedging instruments and ineffectiveness

	2019						
	<i>Notional</i> HK\$'M	<i>Carrying Amount</i>		<i>Change in fair value used to calculate hedge ineffectiveness</i> HK\$'M	<i>Changes in the value of the hedging instrument recognised in OCI</i> HK\$'M	<i>Ineffectiveness recognised in net trading income</i> HK\$'M	<i>Amount reclassified from reserves to net trading income</i> HK\$'M
		<i>Asset</i> HK\$'M	<i>Liability</i> HK\$'M				
Foreign exchange risk							
Foreign exchange forwards							
– Hedge of net investments in subsidiaries	28,883	–	(515)	(515)	515	–	–
		<u>–</u>	<u>(515)</u>	<u>(515)</u>	<u>515</u>	<u>–</u>	<u>–</u>

Hedged items

	2019		
	<i>Change in the value used for calculating hedge ineffectiveness</i> HK\$'M	<i>Exchange reserve</i> HK\$'M	<i>Balances remaining in the exchange reserve from hedging relationships for which hedge accounting is no longer applied</i> HK\$'M
Net investments in subsidiaries	515	(515)	–
	<u>515</u>	<u>(515)</u>	<u>–</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***32 Derivative financial instruments (continued)**

Interest rate benchmark reform

As explained in note 3(c), the Group has early adopted amendments to HKFRS 9/IFRS 9, HKAS 39/IFRS 39 and HKFRS 7/IFRS 7 which allow the Group to assume that cash flows associated with designated hedge relationships will continue to be highly probable after LIBOR is replaced with alternative risk-free rate. This transition is due to take effect after 31 December 2021.

As at 31 December 2019, the following populations of derivative instruments designated in fair value or cash flow hedge accounting relationships were linked to USD LIBOR:

	<i>Fair value hedge</i>		<i>Cash flow hedge</i>		<i>Total</i>
	<i>Notional</i>	<i>Notional</i>	<i>Notional</i>	<i>Notional</i>	
	<i>designated up to</i>	<i>designated beyond</i>	<i>designated up to</i>	<i>designated beyond</i>	
	<i>31 December 2021</i>	<i>31 December 2021</i>	<i>31 December 2021</i>	<i>31 December 2021</i>	
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Total notional of hedging instruments	48,105	29,735	5,060	12,524	95,425

33 Contingent liabilities and commitments

(a) The following is a summary of the contractual amounts of each significant contingent liability and commitment:

	<i>2019</i>	<i>2018</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
		<i>(restated)</i>
Direct credit substitutes	11,056	12,972
Transaction-related contingencies	32,787	31,435
Trade-related contingencies	13,117	11,935
Forward asset purchases	197	198
Forward forward deposits placed	390	–
Other commitments:		
which are not unconditionally cancellable:		
with original maturity of not more than one year	16,247	4,744
with original maturity of more than one year	124,202	109,935
which are unconditionally cancellable	632,226	536,976
	<u>830,222</u>	<u>708,195</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.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

33 Contingent liabilities and commitments (continued)

(b) Capital commitments

Capital commitments outstanding at 31 December in respect of property, plant and equipment purchases not provided for in the consolidated financial statements were HK\$3,239 million (2018 (restated): HK\$3,496 million).

(c) Contingencies

The Group receives legal claims against it arising in the normal course of business. The Group considers none of these matters as material. Where appropriate the Group recognises a provision for liabilities when it is probable that an outflow of economic resources embodying economic benefits will be required and for which a reliable estimate can be made of the obligation.

34 Risk management

The coverage of risk management activities of the Group has expanded in alignment to the change in legal entity structure through the creation of a Greater China & North Asia (“GCNA”) hub, which included Standard Chartered Bank (Hong Kong) Limited and its subsidiaries in China, Korea, and Taiwan. The regional senior management of the Group, with the support of the senior management at individual subsidiary level, are responsible in the management of risk for the GCNA hub.

Risk management approach

Enterprise Risk Management Framework (“ERMF”)

Effective risk management is essential to consistent and sustainable performance for all of our stakeholders and is therefore a central part of the financial and operational management of the Group. The Group adds value to clients and therefore the communities in which it operates, generating returns for shareholders by taking and managing risk.

At the start of 2018, the Group introduced a new Enterprise Risk Management Framework (“ERMF”) which enables the Group to manage enterprise-wide risks, with the objective of maximising risk-adjusted returns while remaining within our risk appetite. Over the year, awareness of the ERMF has increased significantly and we have made good progress in delivering the key initiatives started in 2017 to embed the framework across the organization.

Throughout the year, awareness of the ERMF has increased leading to a stronger risk culture across the three lines of defence. We have achieved the following:

- Formalised the links between our strategy, Risk Appetite and risk identification to develop management processes that integrate risk considerations into strategic decision-making;
- Established clear individual accountability for risk management;
- Enhanced our risk scanning processes to enable more dynamic and forward looking assessments of risk;
- Established a well-balanced risk taxonomy including financial and non-financial Principal Risk Types;
- Developed consistent, integrated and distinct Risk Type Frameworks for our ten Principal Risk Types;
- Increased Risk Appetite coverage on non-financial Principal Risk Types;

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)**Risk management approach (continued)****Enterprise Risk Management Framework (“ERMF”) (continued)**

- Completed a 2018 ERMF Effectiveness Review which provides an objective baseline against which progress can be measured over the coming years.

The Group will carry this momentum into 2020 as we continue to roll out the ERMF and Risk Type Frameworks across the Group, as well as launching training programmes to ensure awareness and stakeholder engagement.

Risk culture

The Group’s risk culture provides the guiding principles for the behaviours expected from our people when managing risk. The Board has approved a risk culture statement that encourages the following behaviours and outcomes:

- An enterprise level ability to identify and assess current and future risks, openly discuss and take prompt actions;
- The highest level of integrity by being transparent and proactive in disclosing and managing all types of risks;
- A constructive and collaborative approach in providing oversight and challenge, and taking decisions in a timely manner;
- Everyone to be accountable for their decisions and feel safe using their judgment to make these considered decisions.

The Group acknowledges that banking inherently involves risk taking and undesired outcomes will occur from time to time; however, the Group shall take the opportunity to learn from its experience and formalise what the Group can do to improve. The Group expects managers to demonstrate a high awareness of risk and control by self-identifying issues and managing them in a manner that will deliver lasting change.

Strategic risk management

The Group approaches strategic risk management by:

- Including in the strategy review process an impact analysis on the risk profile from the growth plans, strategic initiatives and business model vulnerabilities with an aim to proactively identify and manage new risks or existing risks that need to be reprioritised;
- Including in the strategy review process a confirmation that growth plans and strategic initiatives can be delivered within the approved risk appetite and or propose additional Risk Appetite for Board consideration; and
- Validating the corporate plan against the approved or proposed Risk Appetite Statement to the Board. The Board approves the strategy review and the five-year Corporate Plan with a confirmation from the Regional / Country Chief Risk Officer (“CRO”) that it is aligned with the ERMF and the Regional / Country Risk Appetite Statement where projections allow.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****Risk management approach (continued)*****Roles and responsibilities****Three Lines of Defence model*

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.

Lines of Defence	Definition	Key responsibilities
First	The businesses and functions engaged in or supporting revenue generating activities that own and manage risks	<ul style="list-style-type: none"> Propose the risks required to undertake revenue-generating. Identify, monitor, and escalate risks and issues to Second Line and the Senior Management and promote a healthy risk culture and good conduct. Manage risks within Risk Appetite, ensure laws and regulations are being complied with. Ensure systems meet risk data aggregation, risk reporting and data quality requirements set by the Second Line.
Second	The control functions independent of the First Line that provide oversight and challenge of risk management to provide confidence to the Chief Risk Officer, the Senior Management and the Board	<ul style="list-style-type: none"> Identify, monitor, and escalate risks and issues to the Chief Risk Officer, the Senior Management and the Board or Board level committees, and promote a healthy risk culture and good conduct. Oversee and challenge First Line risk taking activities and review First Line risk proposals. Propose Risk Appetite ("RA") to the Board, monitor and report adherence to RA and intervene to curtail business if it is not in line with existing or adjusted RA. Set risk data aggregation, risk reporting and data quality requirements.
Third	The internal audit function provides independent assurance over the effectiveness of controls that support First Line's risk management of business activities, and the processes maintained by the Second Line. Its role is defined and overseen by the Audit Committee of the Board	<ul style="list-style-type: none"> Independently assess whether management has identified the key risks in the business and whether these are reported and governed in line with the established risk management processes. Independently assess the adequacy of the design of controls and their operating effectiveness.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

Risk management approach (continued)

The Risk function

The Chief Risk Officer directly manages the Risk function that is separate and independent from the origination, trading and sales functions of the businesses. The Risk function is responsible for:

- Maintaining the ERMF, ensuring it remains appropriate to the Group's business activities, is effectively communicated and implemented across the Group and administering related governance and reporting processes;
- Upholding the overall integrity of the Group's risk and return decisions to ensure that risks are properly assessed, that these decisions are made transparently on the basis of this proper assessment and that risks are controlled in accordance with the Group's standards and RA; and
- Overseeing and challenging the management of Principle Risk Types under the ERMF.

The independence of the Risk function is to ensure that the necessary balance in making risk and return decisions is not compromised by short-term pressures to generate revenues.

In addition, the Risk function is a centre of excellence that provides specialist capabilities of relevance to risk management processes in the wider organisation.

The Risk function supports the Group's commitment to be Here for good by building a sustainable framework that places regulatory and compliance standards, and a culture of appropriate conduct at the forefront of the Group's agenda in a manner proportionate to the nature, scale and complexity of the Group's business.

As of 1st January 2019, the Group has rebranded the Compliance function as Conduct, Financial Crime and Compliance ("CFCC"), reflecting the integration of the different areas within the function, under the Management Team leadership of the Group Head CFCC. CFCC works alongside the Risk function, within the framework of the ERMF, to deliver an aligned Second Line of Defence.

Risk Appetite and profile

The Group recognises the following constraints which determine the risks that the Group is willing to take in pursuit of its strategy and the development of a sustainable business:

- **Risk capacity** is the maximum level of risk the Group can assume, given its current capabilities and resources, before breaching constraints determined by capital and liquidity requirements, internal operational environment (including but not limited to technical infrastructure, risk management capabilities, expertise), or otherwise failing to meet the expectations of regulators and law enforcement agencies.
- **Risk appetite** is defined by the Group and approved by the Board. It is the maximum amount and type of risk that the Group is willing to assume in pursuit of its strategy. Risk appetite cannot exceed risk capacity.

The Board has approved a Risk Appetite Statement, which is underpinned by a set of financial and operational control parameters, known as Risk Appetite metrics and associated thresholds. These directly constrain the aggregate risk exposures that can be taken across the Group. The Risk Appetite Statement is supplemented by an overarching statement outlining the Group's Risk Appetite Principles.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

Risk management approach (continued)

Risk Appetite and profile (continued)

Risk Appetite Principles: The Group's Risk Appetite is in accordance to its overall approach to risk management and its risk culture. The Group follows the highest ethical standards required by its stakeholders and ensure a fair outcome for its clients, the effective operation of financial markets, while at the same time meeting expectations of regulators and law enforcement agencies. The Group sets its risk appetite to enable it to grow sustainably and to avoid shocks to earnings or its general financial health and to manage its reputational risk in a way that would not materially undermine the confidence of its investors and all internal and external stakeholders.

Risk Appetite Statement: the Group will not compromise adherence to its risk appetite in order to pursue revenue growth or higher returns. The Group's risk profile is its overall exposure to risk at a given point in time, covering all applicable risk types. Risk control tools such as exposure limits, underwriting standards, scorecard cut-offs and policies and other operational control parameters are used to keep the Group's risk profile within risk appetite (and therefore also risk capacity). Status against risk appetite is reported to the Board Risk Committee, the Regional Executive Risk Committee ("RERC") on the consolidated basis and the Executive Risk Committee ("ERC") on the solo basis. This includes the reporting of breaches. Country Risk Appetite is managed at a country level with Group and regional oversight.

The RERC and the Regional Asset and Liability Committee ("RALCO") are responsible for ensuring that the Group's risk profile is managed in compliance with the Risk Appetite set by the Board. The Board Risk Committee advises the Board on the Risk Appetite Statement and monitors the Group's compliance with it.

Risk identification and assessment

Identification and assessment of potential adverse risk events is an essential first step in managing the risks of any business or activity. To ensure consistency in communication the Group uses Principal Risk Types to classify its risk exposures. Nevertheless, the Group also recognises the need to maintain an overall perspective since a single transaction or activity may give rise to multiple types of risk exposure, risk concentrations may arise from multiple exposures that are closely correlated, and a given risk exposure may change its form from one risk type to another.

To facilitate the above, the Group maintains a dynamic risk scanning process with inputs on the internal and external risk environment, as well as potential threats and opportunities from the business and client perspectives. The Group maintains an inventory of the Principal Risk Types and sub-types that are inherent to the strategy and business model, near-term emerging risks that can be measured and mitigated to some extent, and uncertainties that are longer-term matters that should be on the radar but are not yet fully measurable.

Stress testing

The objective of stress testing is to support the Group in assessing that it:

- Does not have a portfolio with excessive concentrations of risk that could produce unacceptably high losses under severe but plausible scenarios;

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

Stress testing (continued)

- Has sufficient financial resources to withstand severe but plausible scenarios;
- Has the financial flexibility to respond to extreme but plausible scenarios; and
- Understands the Group's key business model risks, considers what kind of event might crystallise those risks – even if extreme with a low likelihood of occurring – and has identified, as required, actions to mitigate the likelihood and/or the impact of those events.

Enterprise Stress Tests include Capital and Liquidity Adequacy Stress Tests including in the context of Recovery and Resolution and stress tests that assess scenarios where the Group's business model becomes unviable such as Reverse Stress tests.

Various stress tests are performed at country, business and portfolio level. Bespoke scenarios are applied to the Group's market and liquidity positions. In addition to these, stress tests may also focus on the potential impact of macroeconomic, geo-political and physical events on relevant regions, client segments and risk types.

The Board delegates the approval of the Enterprise Stress Tests to Board Risk Committee. The Board Risk Committee relies on the recommendation from the RERC on the consolidated basis and the ERC on the solo basis. A Stress Testing Forum is appointed by the RERC to review and challenge the Stress Tests.

Based on the stress test results, the Chief Risk Officer and Chief Financial Officer can recommend strategic actions to ensure that the Group strategy remains within the Board approved Risk Appetite.

Principal risk types

Principal Risk Types are risks that are inherent in the Group's strategy and the Group's business model and have been formally defined in the Group's ERMF. These risks are managed through distinct Risk Type Frameworks (RTF) which are approved by the Chief Risk Officer and the RERC. The Principal Risk Types and associated Risk Appetite Statements are approved by the Board.

The table below shows the Group's current Principal Risk Types:

Principal risks

Credit	Potential for loss due to the failure of a counterparty to meet its agreed obligations to pay the Group.
Country	Potential for default losses due to political or economic events in a country.
Traded	Potential for loss resulting from activities undertaken by the Group in financial markets.
Capital & liquidity	Capital: potential for insufficient level, composition or distribution of capital to support or normal activities. Liquidity: potential for loss where we may not have sufficient stable or diverse sources of funding or financial resources to meet our obligations as they fall due.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

Principal risk types (continued)

Principal risks

Operational	Potential for loss resulting from inadequate or failed internal processes and systems, human error, or from the impact of external events (including legal risks).
Reputational	Potential damage to the franchise, resulting in loss of earnings or adverse impact on the market capitalization because stakeholders taking a negative view of the organization, its actions or inactions – leading stakeholders to change their behavior.
Compliance	Potential for penalties or loss to the Group or for an adverse impact to our clients, stakeholders or to the integrity of the markets we operate in through a failure on our part to comply with laws or regulations.
Conduct	Risk of detriment to the Group's customers and clients, investors, shareholders or to the integrity of the markets we operate through a failure on our part to comply with laws or regulations.
Information and Cyber Security	Potential for loss from a breach of confidentiality, integrity and availability of the Group's information systems and assets through cyber attack, insider activity, error or control failure.
Financial Crime	Potential for legal or regulatory penalties, material financial loss or reputational damage resulting from the failure to comply with applicable laws and regulations relating to International Sanctions, Anti-Money Laundering and Anti-Bribery and Corruption.

Executive and Board risk oversight

Overview

The Board has ultimate responsibility for risk management and is supported by the Executive Committee, Board Audit Committee, Board Risk Committee and Nomination Committee. The Board approves the ERMF based on the recommendation from the Board Risk Committee, which also recommends the Group risk appetite statement.

The Board appoints the Executive Committee to maintain a sound system of internal control and risk management. The RERC, through its authority delegated by the Board via Executive Committee, oversees effective implementation of the ERMF and is responsible for the management of all risks other than those delegated to the RALCO and the Country Pensions Committee. The Regional Chief Risk Officer, as Chair of the RERC, approves the use of sub-committees and forums to support the RERC overseeing risk at Region, Business, Country, or Principal Risk Type level.

The Board Risk Committee receives regular reports on risk management, including the Group's portfolio trends, policies and standards, stress testing, liquidity and capital adequacy, and is authorised to investigate or seek any information relating to an activity within its terms of reference. The Board Risk Committee also conducts deep dive reviews on a rolling basis of different sections of the consolidated risk information report that is provided at each scheduled committee meeting.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

Executive and Board risk oversight (continued)

Overview (continued)

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

Regional Executive Risk Committee

The RERC is responsible for ensuring the effective management of risk throughout the Group in support of the Group's strategy. The Regional Chief Risk Officer chairs the RERC, whose members are drawn from the management team. The Committee determines the overall ERMF for the Group on consolidate basis, including the delegation of any part of its authorities to appropriate individuals or properly constituted committees. The RERC is supported by the Executive Risk Committee ("ERC") in managing matters on solo perspective (jointly referred to as ERCs).

The RERC requests and receives information to fulfil its governance mandates relating to the risks to which the Group is exposed. As with the Board Risk Committee, the RERC and RALCO receive reports that include information on risk measures, Risk Appetite metrics and thresholds, risk concentrations, forward-looking assessments, updates on specific risk situations or actions agreed by these committees to reduce or manage risk.

Asset and Liability Committee

The ALCO is chaired by the Chief Executive Officer. The ALCO is responsible for determining the Group's approach to balance sheet management, recovery and resolution planning and ensuring that, in executing the Group's strategy, the Group operates within internally approved risk appetite and external regulatory requirements relating to capital adequacy, loss absorbing capacity, liquidity, leverage, and earning risk. It is also responsible for policies relating to Recovery and Resolution planning, balance sheet management, including management of the Group's liquidity, capital adequacy and structural foreign exchange positions.

Country Pensions Committee

The Chief Executive Officer supported by an appointed Country Pensions Committee is responsible for the overall retirement benefits arrangements for the Group.

Risk profile

The Group manages and controls our Principal Risk Types through distinct risk types frameworks, policies and Board-approved Risk Appetite.

(a) Credit risk

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

Credit risk is managed through a framework that sets out policies and procedures covering the measurement and management of credit risk. The Group manages its credit exposures following the principle of diversification across products, regions, industries, collateral types and client segments.

The credit quality of the portfolio continues to benefit from steps taken over the last two years, with more recent added focus on the implementation of a more granular risk appetite and active portfolio management.

SC PLC group-wide credit policies and standards are established and approved by SC PLC's Group Risk Committee ("GRC") or individuals with authority delegated. The GRC oversees the delegation of credit approval and loan impairment provisioning authorities. The principles for the delegation, review and maintenance of credit approval authorities are defined in the Risk Authorities policy. In addition, there are other Group-wide policies integral to credit risk management such as those relating to stress testing, risk measurement and impairment provisioning.

The RERC and the ERC ("the ERCs"), as appropriate, approve policies and standards based on those approved by GRC. When approving risk policies and standards, each of the RERC and ERC take into account the requirements of the local Hong Kong regulations and the guidelines issued by the HKMA.

Credit rating and measurement

Risk measurement plays a central role, along with judgement and experience, in informing risk-taking and portfolio management decisions.

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

A standard alphanumeric credit risk-grade system for Corporate & Institutional Banking and Commercial Banking is used. The numeric grades run from 1 to 14 and some of the grades are further sub-classified. Lower numeric credit grades are indicative of a lower likelihood of default. Credit grades 1 to 12 are assigned to performing customers, while credit grades 13 and 14 are assigned to non-performing or defaulted customers.

Retail Banking IRB portfolios use application and behaviour credit scores that are calibrated to generate a probability of default and then mapped to the standard alphanumeric credit risk grade system. The Group refers to external ratings from credit bureau, however, the Group does not rely solely on these to determine Retail Banking credit grades.

Advanced IRB models cover a substantial majority of the Group's exposure and are used in assessing risks at customer and portfolio level, setting strategy and optimising the Group's risk-return decisions.

IRB risk measurement models are approved by the RERC, on the recommendation of the Model Assessment Forum ("MAF"). Prior to review by the MAF, all IRB models are validated in detail by a model validation team, which is separate from the teams which develop and maintain the models. Models undergo annual validation by the model validation team. Reviews are also triggered if the performance of a model deteriorates materially against predetermined thresholds during the ongoing model performance monitoring process which takes place between the annual validations.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)**(a) Credit risk (continued)*****Credit Approval***

The Bank has been locally incorporated since 1 July 2004. Since then, the approval process reflects strategic decisions that are being made in accordance with individual managers' delegated authorities and the terms of reference of appropriate committees. It is recognised that, as a major part of SC PLC, all significant risk decisions emanating from individual countries have an impact to SC PLC, be it regulatory, concentration, strategic, etc. It is therefore recognised that it is essential for SC PLC to consider such transactions to ensure that these issues are included as part of the decision making process. Delegated authorities approved by the RERC are delegated to the key risk managers to ensure that all risk decisions are made within the Group.

All credit proposals are subject to a robust credit risk assessment. It includes a comprehensive evaluation of the client's credit quality, including willingness, ability and capacity to repay. The primary lending consideration is usually based on the client's credit quality and the repayment capacity from operating cash flows for counterparties; and personal income or wealth for individual borrowers. The risk assessment gives due consideration to the client's liquidity and leverage position. Where applicable, the assessment includes a detailed analysis of the credit risk mitigation arrangements to determine the level of reliance on such arrangements as the secondary source of repayment in the event of a significant deterioration in a client's credit quality leading to default. Lending activities that are considered as high risk or non-standard are subjected to stricter minimum requirements and require escalation to a senior credit officer or authorised body.

Credit concentration risk

Credit concentration risk may arise from a single large exposure to a counterparty or a group of connected counterparties, or from multiple exposures across the portfolio that are closely correlated.

Large exposure concentration risk is managed through concentration limits set by counterparty or group of connected counterparties based on control and economic dependence criteria. Risk appetite metrics are set at portfolio level and monitored to control concentration, where appropriate, by industry, specific product, tenor, collateralisation level and credit risk profile.

Credit concentrations are monitored by the RERC and ERC and concentration limits that are material to the Group are reviewed and approved at least annually by the RERC and ERC.

Credit monitoring

The Group regularly monitors credit exposures, portfolio performance, and external trends that may impact risk management outcomes.

Internal risk management reports that are presented to risk committees contain information on key environmental, political and economic trends across major portfolios and countries; portfolio delinquency and loan impairment performance.

The Credit Issues Committee ("CIC") meets regularly to assess the impact of external events and trends on the Corporate & Institutional Banking and Commercial Banking credit risk portfolios and to define and implement the Group's response in terms of appropriate changes to portfolio shape, portfolio and underwriting standards, risk policy and procedures.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

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, financial deterioration, breach of covenants, non-performance of an obligation within the stipulated period, or there are concerns relating to ownership or management.

Such accounts and portfolios are subjected to a dedicated process overseen by the CIC. Client account strategies and credit grades are re-evaluated. In addition, 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 Group's specialist recovery unit.

The Retail Banking Credit Issues Forum ("CIF") is a sub-forum of the ERC. The CIF meets regularly to assess relevant credit matters, which include market developments with direct credit implications, credit policy changes, prominent or emerging credit concerns, portfolio performance monitoring, and mitigating actions.

For Retail Banking exposures, portfolio delinquency trends are monitored continuously at a detailed level. Individual customer behaviour is also tracked and considered for lending decisions. Accounts that are past due or charge-off are subject to a collections or recovery process respectively, and managed independently by the Risk function.

Credit mitigation

Credit policies set out the key consideration for eligibility, enforceability and effectiveness of credit risk mitigation arrangements. 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 guarantees. The reliance that can be placed on these mitigants is carefully assessed in light of issues such as legal certainty and enforceability, market valuation correlation and counterparty risk of the guarantor. The requirement for risk mitigation is, however, not a substitute for the ability to pay, which is the primary consideration for any lending decisions.

Collateral types which are eligible for risk mitigation include: cash; account receivables; residential, commercial and industrial property; fixed assets such as motor vehicles, aircraft, plant and machinery; marketable securities; commodities; risk participations; guarantees; credit insurance; and standby letters of credit. The Group also enters into collateralised reverse repurchase agreements. Physical collateral, such as property, fixed assets and commodities, and financial collateral must be independently valued and an active secondary resale market must exist. The collateral must be valued prior to drawdown and regularly thereafter. The valuation frequency is at minimum annual and more frequent valuations are driven by the level of price volatility of each type of collateral and the nature of the underlying product or risk exposure. For financial collateral to be eligible for recognition the collateral must be sufficiently liquid, and its value over time sufficiently stable, to provide appropriate certainty as to the credit protection achieved. Risk mitigation benefits may be reduced or removed where the collateral value is not supported by a recent independent valuation.

Documentation must be held to enable the Group to realise the collateral without the cooperation of the obligor in the event that this is necessary.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

For certain types of lending, typically mortgages or asset financing where a first charge over the risk mitigant must be attained, the right to take charge over physical assets is significant in terms of determining appropriate pricing and recoverability in the event of default. Physical collateral is required to be insured at all times against risk of physical loss or damage.

Collateral values are, where appropriate, adjusted to reflect current market conditions, the probability of recovery and the period of time to realise the collateral in the event of liquidation. Stress tests are performed on changes in collateral values for key portfolios to assist senior management in managing the risks in those portfolios. The Group also seeks to diversify its collateral holdings across asset classes and markets.

Where guarantees, credit insurance, standby letter of credit or credit derivatives are used as credit risk mitigation, the creditworthiness of the protection provider is assessed and monitored using the same credit approval process applied to the obligor. The main types of guarantors include banks, insurance companies, parent companies, governments and export credit agencies.

Traded Products

Credit risk from traded products derives from the positive mark-to-market value of the underlying instruments, and an additional component to cater for potential future market movements. This counterparty credit risk is managed within the Group's overall credit risk appetite for corporate and financial institutions. In addition to analysing potential future movements, the Group uses various single and multi-risk factor stress test scenarios to identify and manage counterparty credit risk across derivatives and securities financing transactions.

Securities

Within Corporate & Institutional Banking and Commercial Banking, the portfolio limits and parameters for the underwriting and purchase of all pre-defined securities assets to be held for sale are approved by the Group's Excess Approval Committee with support by the Group's Underwriting Committee ("UC"). The Excess Approval Committee is established under the authority of ERC. Corporate & Institutional Banking and Commercial Banking business 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 a specialist team within the Risk function whose activities include oversight and approval within the levels delegated by the UC. Issuer credit risk, including settlement and pre-settlement risk, and price risk are controlled by the Risk function.

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.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(a) Credit risk (continued)****HKFRS 9/IFRS 9 methodology*****Approach for determining expected credit losses****Credit loss terminology*

Component	Definition
Probability of default (PD)	<p>The probability at a point in time that a counterparty will default, calibrated over up to 12 months from the reporting date (stage 1) or over the lifetime of the product (stage 2) and incorporating the impact of forward-looking economic assumptions that have an effect on credit risk, such as interest rates, unemployment rates and GDP forecasts.</p> <p>The PD is estimated at a point in time which means it will fluctuate in line with the economic cycle. The term structure of the PD is based on statistical models, calibrated using historical data and adjusted to incorporate forward-looking economic assumptions.</p>
Loss given default (LGD)	<p>The loss that is expected to arise on default, incorporating the impact of forward-looking economic assumptions where relevant, which represents the difference between the contractual cash flows due and those that the bank expects to receive.</p> <p>The Group estimates LGD based on the history of recovery rates and considers the recovery of any collateral that is integral to the financial asset, taking into account forward-looking economic assumptions where relevant.</p>
Exposure at default (EAD)	<p>The expected balance sheet exposure at the time of default, taking into account the expected change in exposure over the lifetime of the exposure. This incorporates the impact of drawdowns of committed facilities, repayments of principal and interest, amortisation and prepayments, together with the impact of forward-looking economic assumptions where relevant.</p>

To determine the expected credit loss, these components are multiplied together (PD for the reference period (up to 12 months or lifetime) x LGD at the year end x EAD at the year end) and discounted to the balance sheet date using the effective interest rate as the discount rate.

Although the HKFRS 9/IFRS 9 models leverage the existing Basel advanced IRB risk components, several significant adjustments are required to ensure the resulting outcome is in line with the HKFRS 9/IFRS 9 requirements.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(a) Credit risk (continued)**

Key differences between regulatory and IFRS expected credit loss models

	Basel advanced IRB Expected Loss (EL)	HKFRS 9/IFRS 9 Expected credit loss
Rating philosophy	Mix of point-in-time, through-the-cycle or hybrid	Point-in-time, forward looking
Parameters calibration	Often conservative, due to regulatory floors and downturn calibration	Unbiased estimate, based on conditions known at the balance sheet date
– PD		Inclusion of forward-looking information and removal of conservatism and bias
– LGD		Removal of regulatory floors, exclusion of non-direct costs
– EAD	Floored at outstanding amount	Recognises ability to have a reduction in exposure from the balance sheet date to the default date
Timeframe	12-month period	Up to 12 months and lifetime
Discounting applied	Discounting at the weighted average cost of capital to the time of default	Discounting at the effective interest rate (EIR) to the balance sheet reporting date

Global IFRS 9 expected credit loss models have been developed for the Corporate & Institutional Banking and Commercial Banking businesses. Given the global nature of these portfolios; these models are global in nature at the base level. However, for some of the most material countries, country-specific models have been developed for the Corporate & Institutional Banking and Commercial Banking clients.

The calibration of forward-looking information is assessed at a country level to take into account local macroeconomic conditions.

Retail banking expected credit loss models are country and product specific given the local nature of the Retail Banking business.

For less material Retail Banking loan portfolios, the SC PLC Group has adopted simplified approaches based on historical roll rates or loss rates:

- For medium-sized Retail Banking portfolios, a roll rate model is applied, which uses a matrix that gives average loan migration rate from delinquency states from period to period. A matrix multiplication is then performed to generate the final PDs by delinquency bucket over different time horizons.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

- For smaller Retail Banking portfolios, loss rate models are applied. These use an adjusted gross charge-off rate, developed using monthly write-off and recoveries over the preceding 12 months and total outstanding balances.

Application of lifetime

Expected credit loss is estimated based on the shorter of the expected life and the maximum contractual period for which the Group is exposed to credit risk. For Retail Banking credit cards and Corporate & Institutional Banking overdraft facilities, however, the Group does not typically enforce the contractual period. As a result, for these instruments, the lifetime of the exposure is based on the period the Group is exposed to credit risk. This period has been determined by reference to the extent to which credit risk management actions curtail the period of exposure. For credit cards, this has resulted in an average life of between 3 and 10 years across the SC PLC Group's footprint markets. Overdraft facilities have a 22-month lifetime.

Key assumptions and judgements in determining expected credit loss***Incorporation of forward-looking information and the impact of non-linearity***

The evolving economic environment is a key determinant of the ability of a bank's clients to meet their obligations as they fall due. It is a fundamental principle of HKFRS 9/IFRS 9 that the provisions held against potential future credit risk losses should depend not just on the health of the economy today, but should also take account of potential changes to the economic environment in the future. For example, if a bank were to anticipate a sharp slowdown in the world economy over the coming year, it should hold more provisions today to absorb the credit losses likely to occur in the near-future.

To capture the effect of changes to the economic environment in the future, the computation of probability of default ("PD"), loss given default ("LGD") and so expected credit loss incorporates forward-looking information; assumptions on the path of economic variables and asset prices that are likely to have an effect on the repayment ability of the Group's clients. For example, economic variables specific to individual countries include economic growth, interest rates, unemployment rates, property prices, and prices of assets that trade on global markets such as oil, industrial metals and other commodities. Less sophisticated approaches, such as loss rate models, do not directly incorporate forward-looking information.

The starting point for the projections of economic variables and asset prices is based on management's view, which underlies the plan to deliver the Group's strategy and ensure that it has sufficient capital over the medium term.

Management's view covers a core set of economic variables and asset prices required to set the strategic plan. To reach the full set of economic variables and asset prices required to compute expected credit loss for all the SC PLC Group's clients in all the SC PLC Group's footprint markets, management's view is augmented with projections from the SC PLC Group's in-house research team and outputs from a range of models that project specific economic variables and asset prices.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)**(a) Credit risk (continued)*****Forecast of key macroeconomic variables underlying the expected credit loss calculation***

The base forecast – management’s view of the most likely outcome – is that the synchronised expansion of the global economy will continue over the coming years alongside a normalisation of monetary policy in the developed world and the successful rebalancing of the Chinese economy, with US-China trade tensions putting China’s export sectors under some pressure.

While the most likely outcome is the basis for the Group’s strategic plan, one of the key requirements of HKFRS 9/IFRS 9 is that the assessment of provisions should be based on a range of potential outcomes for the future economic environment. For example, the global economy may grow more quickly or more slowly than the most likely outcome and these variations would have different implications for the provisions that the Group should hold today. As the Group’s clients tend to be more affected when the economic environment weakens than when it strengthens, it is possible that the range of expected credit loss outcomes resulting from a range of scenarios around the most likely scenario may be skewed to the downside. So, if the Group computes expected credit loss uniquely on the basis of the most likely outcome, it might not end up with the appropriate level of provisions. This is the concept of non-linearity in expected credit loss under HKFRS 9/IFRS 9.

To address the potential non-linearity in expected credit loss, the Group simulates a set of scenarios around the base forecast and generates 50 scenarios upon which to compute expected credit loss. These scenarios are generated by a Monte Carlo simulation, which considers the degree of uncertainty (or volatility) around economic outcomes, how these outcomes have tended to move in relation to one another together (or correlation).

While the 50 scenarios do not each have a specific narrative, they reflect a range of plausible hypothetical alternative outcomes for the global economy. Some imply an unwinding of the current shocks and uncertainty leading to higher global economic activity and higher asset prices while others represent an intensification of current shocks or introduction of new shocks that raise uncertainty, leading to lower global economic activity and lower asset prices.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

Credit-impaired assets managed by Group Special Assets Management (“GSAM”) incorporate forward-looking economic assumptions in respect of the recovery outcomes identified and are assigned individual probability weightings. These assumptions are not based on a Monte Carlo simulation but are informed by the base forecast.

Significant increase in credit risk (“SICR”)**Quantitative criteria**

SICR is assessed by comparing the risk of default at the reporting date to the risk of default at origination. Whether a change in the risk of default is significant or not is assessed using quantitative and qualitative criteria. These quantitative significant deterioration thresholds have been separately defined for each business and where meaningful are consistently applied across business lines.

Assets are considered to have experienced SICR if they have breached both relative and absolute thresholds for the change in the average annualised lifetime probability of default over the residual term of the exposure.

The absolute measure of increase in credit risk is used to capture instances where the PDs on exposures are relatively low at initial recognition as these may increase by several multiples without representing a significant increase in credit risk. Where PDs are relatively high at initial recognition, a relative measure is more appropriate in assessing whether there is a significant increase in credit risk, as the PDs increase more quickly.

For Corporate & Institutional Banking and Commercial Banking clients, the relative threshold is a 100 percent increase in PD and the absolute change in PD is between 50-100 basis points.

For Retail Banking clients, the relative threshold is a 100 percent increase in PD and the absolute change in PD is between 100-350 basis points depending on the product.

Private Banking clients are assessed qualitatively, based on a delinquency measure relating collateral top-ups or sell-downs.

Debt securities with an internal credit rating mapped to an investment grade equivalent are allocated to stage 1 and all other debt securities to stage 2.

Qualitative factors that indicate there has been a significant increase in credit risk include processes linked to current risk management, such as placing loans on non-purely precautionary Early Alert, or through delinquency measures.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

The SICR thresholds have been calibrated based on the following principles:

- Stability – The thresholds are set to achieve a stable stage 2 population at a portfolio level, trying to minimise the number of accounts moving back and forth between stage 1 and stage 2 in a short period of time
- Accuracy – The thresholds are set such that there is a materially higher propensity for stage 2 exposures to eventually default than is the case for stage 1 exposures
- Dependency from backstops – The thresholds are stringent enough such that a high proportion of accounts transfer to stage 2 due to movements in forward-looking PD rather than relying on backward-looking backstops such as arrears
- Relationship with business and product risk profiles – The thresholds reflect the relative risk differences between different products, and are aligned to business processes

Qualitative criteria

Qualitative factors that indicate there has been a significant increase in credit risk include processes linked to current risk management.

Backstop

Across all portfolios, accounts that are 30 or more days past due (DPD) on contractual payments of principal and/or interest that have not been captured by the criteria above are considered to have experienced a significant increase in credit risk.

Expert credit judgement may be applied in assessing significant increase in credit risk to the extent that certain risks may not have been captured by the models or through the above criteria. Such instances are expected to be rare, for example due to events arising close to the reporting date.

Corporate & Institutional Banking and Commercial Banking clients**Quantitative criteria**

Exposures are assessed based on both the absolute and the relative movement in the PD from origination to the reporting date as described above.

To account for the fact that the mapping between internal credit grades (used in the origination process) and PDs is non-linear (e.g. a one-notch downgrade in the investment grade universe results in a much smaller PD increase than in the sub-investment grade universe), the absolute thresholds have been differentiated by credit quality at origination, as measured by internal credit grades being investment grade or sub-investment grade.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)**(a) Credit risk (continued)****Qualitative criteria**

All assets of clients that have been placed on Early Alert (for non-purely precautionary reasons) are deemed to have experienced a significant increase in credit risk.

An account is placed on non-purely precautionary Early Alert if it exhibits risk or potential weaknesses of a material nature requiring closer monitoring, supervision or attention by management. Weaknesses in such a borrower's account, if left uncorrected, could result in deterioration of repayment prospects and the likelihood of being downgraded. Indicators could include a rapid erosion of position within the industry, concerns over management's ability to manage operations, weak/deteriorating operating results, liquidity strain and overdue balances among other factors.

All assets of clients that have been assigned a CG12 rating, equivalent to 'Higher Risk', are deemed to have experienced a significant increase in credit risk. Accounts rated CG12 are managed by the GSAM unit. All Corporate & Institutional Banking and Commercial Banking clients are placed on CG12 when they are 30 DPD unless they are granted a waiver through a strict governance process.

Retail Banking clients**Quantitative criteria**

Material portfolios for which a statistical model has been built are assessed based on both the absolute and relative movement in the PD from origination to the reporting date as described above. For these portfolios, the original lifetime PD term structure is determined based on the original Application Score or Risk Segment of the client.

Qualitative criteria

Accounts that are 30 DPD that have not been captured by the quantitative criteria are considered to have experienced a significant increase in credit risk. For less material portfolios, which are modelled based on a roll-rate or loss-rate approach, significant increase in credit risk is primarily assessed through the 30 DPD trigger.

Private Banking clients

For Private Banking clients, significant increase in credit risk is assessed by referencing the nature and the level of collateral against which credit is extended (known as 'Classes of Risk').

Qualitative criteria

For all Private Banking Classes, in line with risk management practice, an increase in credit risk is deemed to have occurred where margining or loan-to-value covenants have been breached.

For Class I assets, if these margining requirements have not been met within 30 days of a trigger, significant credit deterioration is assumed to have occurred.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

For Class I and Class III assets, a significant increase in credit risk is assumed to have occurred where the bank is unable to 'sell down' the applicable assets to meet revised collateral requirements within 5 days of a trigger.

Class II assets are typically unsecured or partially secured, or secured against illiquid collateral such as shares in private companies. Significant credit deterioration of these assets is deemed to have occurred when any Early Alert trigger has been breached.

Debt Securities**Quantitative criteria**

The bank is utilising the low credit risk simplified approach. All debt securities with an internal credit rating mapped to an investment grade equivalent are allocated to stage 1 and all other debt securities are allocated to stage 2.

Qualitative criteria

Debt securities utilise the same qualitative criteria as the Corporate & Institutional Banking and Commercial Banking client segments, including being placed on Early Alert or being classified as credit grade 12.

Assessment of credit-impaired financial assets**Retail Banking Clients**

The core components in determining credit-impaired expected credit loss provisions are the value of gross charge off and recoveries. Gross charge off and/or loss provisions are recognised when it is established that the account is unlikely to pay through the normal process. Recovery of unsecured debt post credit-impairment is recognised based on actual cash collected, either directly from clients or through the sale of defaulted loans to third-party institutions. Release of credit-impairment provisions for secured loans is recognised if the loan outstanding is paid in full (release of full provision), or the provision is higher than the loan outstanding (release of the excess provision). If the loan is paid to current and remains in current for more than 180 days (1 year for forbore loans) the account will be transferred to stage 2.

Corporate & Institutional Banking, Commercial Banking and Private Banking Clients

Credit-impaired accounts are managed by the Group's specialist recovery unit, GSAM which is independent from its main businesses. Where any amount is considered irrecoverable, a stage 3 credit-impairment provision is raised. This stage 3 provision is the difference between the loan carrying amount and the probability weighted present value of estimated future cash flows, reflecting a range of scenarios (typically the best, worst and most likely recovery outcomes). Where the cash flows include realisable collateral, the values used will incorporate the impact of forward looking economic information.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

The individual circumstances of each client are considered when GSAM estimates future cash flows and timing of future recoveries which involve significant judgement. All available sources, such as cash flow arising from operations, selling assets or subsidiaries, realising collateral or payments under guarantees, are considered. In any decision relating to the raising of provisions, the Group attempts to balance economic conditions, local knowledge and experience, and the results of independent asset reviews.

Write-offs

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

Governance and application of expert credit judgement in respect of expected credit losses

Expected credit loss models are approved by the RERC, on the recommendation of the Model Assessment Forum ("MAF"), who assesses the model for fitness for purpose and adequacy to interpretation of HKFRS 9/IFRS 9 requirements. Prior to review by the MAF, all models used for expected credit loss computation are validated in detail by an independent model validation team, which is separate from the teams which develop and maintain the models. Models undergo annual validation by the model validation team and results are presented to MAF for oversight and recommendation to RERC on decisions for continued use of models.

Key inputs into the calculation and resulting expected credit loss provisions are subject to review and approval by Risk, Finance and Economic Research. Risk and Finance jointly review and approve the expected credit loss provisions and any judgmental override that may be necessary on a quarterly basis.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(a) Credit risk (continued)**

Expected credit loss for financial assets classified as stages 1, 2 and 3 for each reporting period, as well as material adjustments and overlays are reviewed and approved by Risk and Finance functions. Macroeconomic forecasts are approved via the Credit Issue Committee on a quarterly basis and utilised in the forward-looking expected credit loss computation.

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 statement of financial position. For off-balance sheet instruments, the maximum exposure to credit risk, which excludes loan commitments which are unconditionally cancellable, is the contractual nominal amounts as set out below:

	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
Financial guarantees and other credit related contingent liabilities	56,960	56,342
Loan commitments and other credit related commitments	<u>141,036</u>	<u>114,877</u>
	<u>197,996</u>	<u>171,219</u>

The requirement for collateral is not a substitute for the ability to pay. However, it is an important consideration for any lending decisions. In determining the financial effect of collateral held against loans neither past due nor credit impaired, the Group has assessed the significance of the collateral held in relation to the type of lending.

*(i) Loans and advances**Loans not credit impaired*

At 31 December 2019, the Group has HK\$433,405 million (2018 (restated): HK\$409,984 million) of mortgage loans in Retail Banking that are not credit impaired. These are generally fully secured exposures (2018: fully secured).

In Corporate & Institutional Banking and Commercial Banking, the Group has HK\$396,603 million (2018 (restated): HK\$363,040 million) of corporate exposures that are not credit impaired. Based on the fair value of the collateral held, 20% (2018 (restated): 22%) of these exposures are secured by collateral.

The Group also undertakes collateralised lending and borrowing (reverse repos and repos) arrangements, and the collateral held against these types of loans are set out in note 36 to the financial statements.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(a) Credit risk (continued)***Repossessed collateral*

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

	2019 HK\$'M	2018 HK\$'M (restated)
Property, plant and equipment	62	110

Loan collateral acquired from borrowers due to restructuring or their inability to repay, continues to be recorded as "Advances to customers" in the statement of financial position 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 Group.

(ii) Off-balance sheet exposures

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

Credit quality*Loans and advances*

The following table sets out an analysis of the credit quality for loans and advances.

Mapping of credit quality

The group uses the following internal risk mapping to determine the credit quality for loan.

<i>Credit quality description</i>	<i>Corporate & Institutional Banking and Commercial Banking</i>	<i>Private Banking¹</i>	<i>Retail Banking</i>
	<i>Default grade mapping</i>	<i>Internal ratings</i>	<i>Number of days past due</i>
Strong	Grade 1 - 5	Class I and Class IV	Current loans (neither past due nor impaired)
Satisfactory	Grade 6 - 8 Grade 9 - 11	Class II and Class III	Up to 29 days
Higher Risk	Grade 12	GSAM managed	30 to 90 days

¹ For Private Banking, classes of risk represent the type of collateral held. Class I represents facilities with liquid collateral, such as cash and marketable securities. Class II represents unsecured/partially secured facilities and those with illiquid collateral, such as equity in private enterprises. Class III represents facilities with residential or commercial real estate collateral. Class IV covers margin trading facilities.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(a) Credit risk (continued)****Credit quality (continued)***Loans and advances (continued)*

	2019		2018 (restated)	
	<i>Advances to customers</i> HK\$'M	<i>Balances with bank</i> HK\$'M	<i>Advances to customers</i> HK\$'M	<i>Balances with bank</i> HK\$'M
Stage 1				
– Strong	799,357	121,018	744,220	198,659
– Satisfactory	153,171	7,220	155,341	10,128
Stage 2				
– Strong	16,947	1	10,752	89
– Satisfactory	35,273	1,046	15,727	328
– Higher risk	1,768	–	2,500	–
<i>Of which (stage 2):</i>				
– <i>Less than 30 days past due</i>	1,483	–	1,693	51
– <i>More than 30 days past due</i>	825	177	802	–
Stage 3, credit impaired	5,250	–	5,983	–
Gross loans and advances	<u>1,011,766</u>	<u>129,285</u>	<u>934,523</u>	<u>209,204</u>

Debt securities

The following table analyses debt securities (including certificates of deposit) and treasury bills. The standard credit ratings used by the Group are those used by Standard & Poor's or their equivalent. Debt securities held which have a short-term rating are reported against the long-term rating of the issuer.

	2019		2018 (restated)	
	<i>Treasury bills</i> HK\$'M	<i>Other debt securities</i> HK\$'M	<i>Treasury bills</i> HK\$'M	<i>Other debt securities</i> HK\$'M
AAA	3,602	82,803	621	66,779
AA- to AA+	83,828	158,324	132,528	130,000
A- to A+	19,650	123,783	12,654	91,090
Lower than A-	–	15,591	–	11,653
Unrated	–	4,958	–	3,938
Gross amount of debt securities	<u>107,080</u>	<u>385,459</u>	<u>145,803</u>	<u>303,460</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(a) Credit risk (continued)*****Movement in credit impairment***

The table below sets out the movement in gross exposures and credit impairment by stage in respect of advances to customers. Gross exposures in this context means the balance sheet amount outstanding, together with undrawn committed facilities and undrawn cancellable facilities relating to overdrafts and credit cards.

Impairment allowances on loans to banks, debt securities and financial guarantees are not material to the Group.

The table is an aggregate of monthly movements. Transfers between stages are deemed to occur at the beginning of a month and therefore amounts transferred net to zero. The re-measurement of expected credit loss resulting from a change in stage is reported within the profit and loss line of the stage in which they are transferred to.

Loans and advances to customers

	Stage 1			Stage 2			Stage 3			Total		
	Total	Net	Gross	Total	Net	Gross	Total	Net	Gross	Total	Net	Gross
	credit	carrying		credit	carrying		credit	carrying		credit	carrying	
	balance	impairment	amount	balance	impairment	amount	balance	impairment	amount	balance	impairment	amount
	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 2019	899,561	1,254	898,307	28,979	639	28,340	5,983	2,601	3,382	934,523	4,494	930,029
Net changes in loss allowance during the period:												
Net transfers between stages	(72,756)	1,161	(73,917)	68,776	(1,613)	70,389	3,980	452	3,528	-	-	-
Net changes in exposures	136,786	328	136,458	(43,373)	(69)	(43,304)	(2,951)	(2,189)	(762)	90,462	(1,930)	92,392
Net changes in models	-	(64)	64	-	(131)	131	-	-	-	-	(195)	195
Net changes in risk parameters	-	(911)	911	-	1,289	(1,289)	-	3,140	(3,140)	-	3,518	(3,518)
Net re-measurement from stage change	-	(479)	479	-	706	(706)	-	22	(22)	-	249	(249)
Unwinding discount	-	-	-	-	-	-	-	(82)	82	-	(82)	82
Write offs (net of recoveries)	-	-	-	-	-	-	(2,062)	(1,363)	(699)	(2,062)	(1,363)	(699)
Exchange translation differences	(11,063)	(17)	(11,046)	(394)	(4)	(390)	300	61	239	(11,157)	40	(11,197)
At 31 December 2019	952,528	1,272	951,256	53,988	817	53,171	5,250	2,642	2,608	1,011,766	4,731	1,007,035
Income statement charge/(release)		(1,126)			1,795			973			1,642	

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(a) Credit risk (continued)****Movement in credit impairment (continued)***Loans and advances to customers (continued)*

	Stage 1			Stage 2			Stage 3			Total		
	Gross balance	Total credit impairment	Net carrying amount									
	HK\$'M	HK\$'M	HK\$'M									
At 1 January 2018, as previously stated	460,666	401	460,265	15,099	278	14,821	3,365	1,094	2,271	479,130	1,773	477,357
Effect of merger of commonly controlled entities	412,482	1,189	411,293	27,609	510	27,099	3,536	1,591	1,945	443,627	3,290	440,337
At 1 January 2018, as restated	873,148	1,590	871,558	42,708	788	41,920	6,901	2,685	4,216	922,757	5,063	917,694
Net changes in loss allowance during the period:												
Net transfers between stages	(36,665)	1,289	(37,954)	32,305	(1,716)	34,021	4,360	427	3,933	-	-	-
Net changes in exposures	78,728	314	78,414	(45,124)	(231)	(44,893)	(3,546)	(2,470)	(1,076)	30,058	(2,387)	32,445
Net changes in models	-	-	-	-	81	(81)	-	-	-	-	81	(81)
Net changes in risk parameters	-	(1,501)	1,501	-	1,466	(1,466)	-	3,084	(3,084)	-	3,049	(3,049)
Net re-measurement from stage change	-	(373)	373	-	396	(396)	-	-	-	-	23	(23)
Unwinding discount	-	-	-	-	-	-	-	(97)	97	-	(97)	97
Write offs (net of recoveries)	-	-	-	-	-	-	(1,628)	(1,061)	(567)	(1,628)	(1,061)	(567)
Exchange translation differences	(15,650)	(65)	(15,585)	(910)	(145)	(765)	(104)	33	(137)	(16,664)	(177)	(16,487)
At 31 December 2018	899,561	1,254	898,307	28,979	639	28,340	5,983	2,601	3,382	934,523	4,494	930,029
Income statement charge/(release)		(1,560)			1,712			614			766	

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)**(b) Country risk**

The Group defines Country Risk as the potential for default or losses due to political or economic events in a country. The Group manages its country cross-border exposures following the principle of diversification across geographies and control the business activities in line with the level of jurisdiction risk.

Roles and responsibilities

The Country Risk Type Framework provides clear accountability and roles for managing risk through the three lines of defence model. The Global Head, Enterprise Risk Management is responsible for the management and control of Country Risk across the Group and is supported by the Regional Chief Risk Officers and the Country Chief Risk Officers who provide second line oversight and challenge to the first line Country Risk management activities. The first line ownership of Country Risk resides with the Regional and Country Chief Executive Officer (“CEO”) who are responsible for the implementation of policy and allocation of approved Country Risk limits across relevant businesses and product lines, as well as the identification and measurement of Country Risks and communication of these and any non-compliance with policy or standards to the second line.

Mitigation

Policies and standards are developed and deployed to implement requirements and controls to ensure effective management of country risk. The policies include standards for the acceptance and effective management of Country Risk in particular around identification, measurement, reporting and setting, calibrating and allocating Country Risk limits. The procedures outline the process for Country Risk limit setting and monitoring and reporting exposures. In response to growing concerns over the Country Risk outlook for a particular country, sovereign ratings may be downgraded and country limits may also be reduced.

Governance Committee Oversight

At the Board level, the Board Risk Committee oversees the effective management of Country Risk. At the executive level, the ERCs are responsible for approving policies and control risk parameters, monitoring material risk exposures and directing appropriate action in response to material risk issues or themes that come to the Committee’s attention that relate to Country Risk. At a country level, the ERC is responsible for monitoring all risk issues for Hong Kong, including Country Risk.

Decision Making authorities and delegation

The Country Risk Type Framework is the formal mechanism through which the delegation of Country Risk authorities is made. Decision making and approval authorities are guided by reference levels for countries. Reference levels are guidelines to set country limits in respect of Country Risk. The capacity levels are assessed by the Group Country Risk function and are derived from factors including: Group Tier 1 capital, transfer risk grade, Group strategy, portfolio composition (short and medium-term) and each country’s total foreign currency earnings.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)**(b) Country risk (continued)****Monitoring**

Monitoring and reporting of Country Risk is included in the policy and standards and covers the monitoring of exposures relative to Risk Appetite thresholds and limits, as well as the reporting of material exposures to internal committees and externally where appropriate. The RERC monitors Risk Appetite thresholds which provide an early warning indicator of stress and concentration risk and an escalation process to Board Risk Committee is in place.

Stress Testing

The Group Country Risk team produces stressed Sovereign ratings which are used by the relevant Credit and Traded Risk teams in calculating risk-weighted assets during described extreme but plausible stress scenarios.

(c) Traded Risk

Traded Risk is the potential for loss resulting from activities undertaken by the bank in financial markets. Under the Enterprise Risk Management Framework, the introduction of the Traded Risk Type Framework ("TRTF") in 2018 sought to bring together all risk types exhibiting risk features common to Traded Risk.

These risk types include Market Risk, Counterparty Credit Risk and Issuer Risk. Traded Risk Management ("TRM") is the core risk management function supporting market facing businesses, specifically Financial Markets and Treasury Markets.

Roles and responsibilities

The TRTF, which sets the roles and responsibilities in respect of Traded Risk for the Group, is owned by the Global Head, Traded Risk Management. TRTF is adopted at the regional level and approved by the Regional CRO. The front office, acting as first line of defence, are responsible for the effective management of risks within the scope of its direct organizational responsibilities set by the Board. The TRM function is the second line control function that performs independent challenge, monitoring and oversight of the Traded Risk management practices of the first line of defence. The first and second lines of defence are supported by the organization structure, job descriptions and authorities delegated by Traded Risk control owners.

Risk Mitigation

The Group controls its trading portfolio and activities to ensure that Traded Risk losses (financial or reputational) do not cause material damage to the Group's franchise by assessing the various Traded Risk factors. These are captured and analyzed using proprietary and custom-built analytical tools, in addition to risk managers' specialist market and product knowledge.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)**(c) Traded Risk (continued)*****Risk Mitigation (continued)***

TRM has a framework, policies and standards in place ensuring that appropriate Traded Risk limits are implemented. The Group's Traded Risk exposure is aligned with its appetite for Traded Risk, and assessment of potential losses that might be incurred by the Group because of extreme but plausible events.

Traded Risk limits are applied as required by the TRTF and related standards. All businesses incurring Traded Risk must do so in compliance with the TRTF. The TRTF requires that Traded Risk limits are defined at a level appropriate to ensure that the Group remains within Traded Risk Appetite. All exposures throughout the Group that the TRM function is responsible for aggregate up to TRM's Group-level reporting. This aggregation approach ensures that the limits structure across the Group is consistent with the Group's Risk Appetite.

The TRTF and Enterprise Stress Testing Policy ensure that adherence to stress-related Risk Appetite metrics is achieved. Stress testing aims at supplementing other risk metrics used within the Group by providing a forward-looking view of positions and an assessment of their resilience to stressed market conditions. Stress testing is performed on all Group businesses with Traded risk exposures, either where the risk is actively traded or where material risk remains. This additional information is used to inform the management of the Traded risks taken within the Group. The outcome of stress tests is discussed across the various business lines and management levels so that existing and potential risks can be reviewed, and related management actions can be decided upon where appropriate.

Policies are reviewed and approved by the RERC annually to ensure their ongoing effectiveness and sustainability.

Governance committee oversight

At the Board level, the Board Risk Committee oversees the effective management of Traded Risk. At the executive level, the Group Risk Committee delegates responsibilities to the RERC to act as the primary risk governance body for Traded Risk. RERC further delegates stress testing and model risk to the Stress Testing Forum and Model Assessment Forum respectively.

Decision-making authorities and delegation

The Group's Risk Appetite Statement, along with the key associated Risk Appetite metrics, is approved by the Board with responsibility for Traded Risk limits, then tiered accordingly. Delegations of authority are granted from Global Head, TRM to country Traded Risk representatives and Regional/Country CRO.

Authorities are reviewed at least annually to ensure they remain appropriate and to assess the quality of decisions taken by the authorised person. Key risk-taking decisions are made only by certain individuals with the skills, judgement and perspective to ensure that the Group's control standards and risk-return objectives are met. Authority delegators are responsible for monitoring the quality of the risk decisions taken by their delegates and the ongoing suitability of their authorities.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(c) Traded Risk (continued)

Monitoring

TRM monitors the overall portfolio risk and ensures that it is within specified limits and therefore Risk Appetite. The annual and mid-year limit review processes provide opportunities for the business and TRM to review risk considering performance. Traded Risk exposures are monitored daily against approved limits. Intra-day risk exposures may vary from those reported at the end of the day. Limit excess approval decisions are informed by factors such as an assessment of the returns that will result from an incremental increase to the business risk exposure. Limits and excesses can only be approved by a Traded Risk manager with the appropriate delegated authority. TRM reports and monitors limits applied to stressed exposures. Stress scenario analysis is performed on non-trading and trading books. Stress loss excesses are discussed with the business.

Market Risk

Market risk is the potential for loss of economic value due to adverse changes in financial market rates or prices. The Group's exposure to Market Risk arises predominantly from the following sources:

- Trading book: The Group provides clients access to financial markets, facilitation of which entails the Group taking moderate market risk positions. All trading teams support client activity; there are no proprietary trading teams. Hence, income earned from related activities is primarily driven by the volume of client activity rather than risk-taking.
- Non-trading book: The Treasury Markets desk is required to hold a liquid assets buffer, much of which is held in high-quality marketable debt securities

The primary categories of Market Risk for the Group are:

- Interest rate risk: arising from changes in yield curves, and implied volatilities on interest rate options;
- Foreign exchange rate risk : arising from changes in currency exchange rates and implied volatilities on foreign exchange options.
- Credit spread risk: arising from changes in credit spreads. It represents the risk specific to the issuer or for the industry representing the issuer.

Value at Risk ("VaR")

The Group measures the risk of losses arising from future potential adverse movements in market rates, prices and volatilities using a VaR methodology. 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.

VaR is calculated for expected movements over a minimum of one business day and to a confidence level of 97.5 percent. VaR is calculated on our exposure as at the close of business.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)**(c) Traded Risk (continued)****Value at Risk (continued)**

The Group applies two VaR methodologies:

- Historical simulation: 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. This approach is applied for general Market Risk factors and the majority of specific (credit spread) risk VaRs.
- Monte Carlo simulation: this methodology is similar to historical 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. This approach is applied for some of the specific (credit spread) risk VaR in relation to idiosyncratic exposures in credit markets.

In both methods, an historical observation period of one year is chosen and applied.

Stress Testing

The VaR measurement is complemented by weekly stress testing of Market Risk exposures to highlight the potential risk that may arise from extreme market events that are deemed rare but plausible. Stress testing is an integral part of the Traded 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 market liquidity that often occurs. Stress scenarios are regularly updated to reflect changes in risk profile and economic events. The TRM function reviews stress testing results and, where necessary, enforces reductions in overall Market Risk exposure. The Regional Executive Risk Committee considers the results of stress tests as part of its supervision of Risk Appetite. Regular stress test scenarios are applied to interest rates, credit spreads, exchange rates, commodity prices and equity prices. This covers all asset classes in the non-trading and trading books. Ad hoc scenarios are also prepared, reflecting specific market conditions and for particular concentrations of risk that arise within the business.

Market risk VaR coverage

Interest rate risk from non-trading book portfolios is transferred to Treasury Markets under the supervision of the ALCO. Treasury Markets deals in the market in approved financial instruments in order to manage the net interest rate risk, subject to approved VaR and risk limits.

VaR and stress tests are therefore applied to non-trading book exposures in the same way as for the trading book, including the fair value securities, loan and receivables and held to maturity securities.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(c) Traded Risk (continued)****Market risk VaR coverage (continued)**Trading and Non-trading (VaR at 97.5%, 1 day)

Value at risk:	2019				2018 [#]			
	Average	High ^{**}	Low ^{**}	Actual [*]	Average	High ^{**}	Low ^{**}	Actual [*]
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Total	80.9	110.7	57.9	100.4	43.5	53.4	36.5	52.3

Trading (VaR at 97.5%, 1 day)

Value at risk:	2019				2018 [#]			
	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	9.9	17.3	4.7	10.6	4.3	6.4	2.3	5.2
Foreign exchange risk	3.3	10.7	1.1	3.9	3.4	7.5	1.1	3.4
Credit Spread risk	2.8	7.0	1.2	3.2	3.8	7.7	1.4	3.0
Total [^]	12.1	18.2	4.6	13.1	7.2	12.1	4.6	7.4

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

Value at risk:	2019				2018 [#]			
	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 ^{^^}	75.9	100.5	57.2	95.1	41.7	53.1	34.8	51.7

* Actual one day VaR at period end date.

^{**} Highest and lowest VaR for each risk factor are independent and usually occur on different days.[^] Total Trading VaR shown in the tables above is not a sum of the component risks due to offsets between them.^{^^} Includes credit spread risk arising from fair value through profit or loss 'FVTPL' and fair value other comprehensive income 'FVOCI' securities, and amortised cost exposures.[#] Comparative amounts for 2018 shown in the tables above represent the VaR of the Group in accordance with the organisation structure prior to the acquisition of SCB China and SC NEA Group.

Total trading VaR include Equity risk which is immaterial in exposure.

Market risk changes

With the ongoing US China Trade War and talks of potential tariffs being imposed on goods, markets became more volatile in 2019. With this backdrop, the average and actual levels of total VaR (trading and non-trading) in 2019 moved higher to HK\$80.9 million and HK\$100.4 million respectively.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)**(c) Traded Risk (continued)*****Market risk changes (continued)***

In addition, the increase in the total VaR (both average and actual) was also driven by surplus liquidity available to deploy in high-quality liquid assets 'HQLA' which has impacted the non-trading book VaR to stand at HK\$95.1 million.

The average and actual levels of trading book VaR in 2019 were HK\$12.1 million and HK\$13.1 million respectively. These were higher than those in 2018, mainly driven by Interest Rate risk with FX and Credit spread VaR remaining relatively stable.

Counterparty credit risk

Counterparty Credit Risk is the potential for loss in the event of the default of a derivative counterparty, after considering the value of eligible collaterals and risk mitigation techniques. The Group's counterparty credit exposures are included in the Credit Risk section.

Credit Risk from traded products derives from the positive mark-to market value of the underlying instruments, and an additional component to cater for potential future market movements. This Counterparty Credit Risk is managed within the Group's overall credit Risk Appetite for corporate and financial institutions. In addition to analyzing potential future movements, the Group uses various single factor or multi-risk factor stress test scenarios to identify and manage Counterparty Credit Risk across derivatives and securities financing transactions.

Derivative financial instruments credit risk mitigation

The Group enters into master netting agreements, which in the event of default result in a single amount owed by or to the counterparty through netting the sum of the positive and negative mark-to-market values of applicable derivative transactions.

In addition, the Group enters into credit support annexes ("CSAs") with counterparties where collateral is deemed a necessary or desirable mitigant to the exposure. Cash collateral includes collateral called under a variation margin process from counterparties if total uncollateralized mark-to-market exposure exceeds the threshold and minimum transfer amount specified in the CSA. With certain counterparties, the CSA is reciprocal and requires us to post collateral if the overall mark-to-market values of positions are in the counterparty's favor and exceed an agreed threshold.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(d) Foreign exchange risk**

Foreign exchange trading exposures are principally derived from customer driven transactions.

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

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

	<i>2019</i> <i>HK\$'M</i>	<i>2018*</i> <i>HK\$'M</i>
US dollars exposure		
Spot assets	603,529	402,213
Spot liabilities	(674,398)	(388,575)
Forward purchases	3,206,554	1,758,336
Forward sales	(3,132,583)	(1,769,182)
Net option position	(616)	–
	<u>2,486</u>	<u>2,792</u>
Net long non-structural position	<u>2,486</u>	<u>2,792</u>
	<i>2019</i> <i>HK\$'M</i>	<i>2018*</i> <i>HK\$'M</i>
Chinese Renminbi exposure		
Spot assets	262,221	55,506
Spot liabilities	(255,036)	(62,590)
Forward purchases	1,246,985	941,446
Forward sales	(1,255,105)	(933,691)
Net option position	263	–
	<u>(672)</u>	<u>671</u>
Net (short)/long non-structural position	<u>(672)</u>	<u>671</u>
	<i>2019</i> <i>HK\$'M</i>	<i>2018*</i> <i>HK\$'M</i>
South Korean Won exposure		
Spot assets	389,765	779
Spot liabilities	(371,263)	(1)
Forward purchases	808,543	1,309
Forward sales	(826,711)	(2,080)
Net option position	165	–
	<u>499</u>	<u>7</u>
Net long non-structural position	<u>499</u>	<u>7</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(d) Foreign exchange risk (continued)**

The Group had the following structural foreign currency positions which exceeded 10% of the net structural position in all foreign currencies:

	<i>2019</i> <i>HK\$'M</i>	<i>2018[#]</i> <i>HK\$'M</i>
Chinese Renminbi	26,008	12,400
US dollars	22,202	2,762
South Korean Won	21,033	–
	<u>69,243</u>	<u>15,162</u>

Comparative amounts for 2018 shown in the tables above represent the foreign exchange positions of the Group with the organisation structure prior to the acquisition of SCB China and SC NEA Group.

(e) Interest rate risk in the banking book

The Group defines interest rate risk in the banking book (“IRRBB”) as the potential for a reduction in future earnings or economic value due to changes in interest rates. The Group monitors such in line with the HKMA Supervisory Policy Manual module IR-1 “Interest Rate Risk Management”. As at 31 December 2019, the IRRBB metric remained within the regulatory threshold.

(f) Liquidity and Funding risk

Liquidity and Funding risk is the risk that we may not have sufficient stable or diverse sources of funding to meet our obligations as they fall due.

The Group’s Liquidity and Funding Risk framework requires each country to ensure that it operates within predefined liquidity limits and remains in compliance with the liquidity policies and practices, as well as local regulatory requirements.

The Group achieves this through a combination of setting risk appetite and associated limits, policy formation, risk measurement and monitoring, prudential and internal stress testing, governance and review.

Since the beginning of the year there were no significant changes in treasury policies.

Primary sources of funding

The Group’s funding strategy is largely driven by its policy to maintain adequate liquidity at all times, in all geographic locations and for all currencies, and hence to be in a position to meet all obligations as they fall due. The Group’s funding profile is therefore well diversified across different sources, maturities and currencies.

A substantial portion of our assets are funded by customer deposits, aligned with our policy to fund customer assets predominantly using customer deposits. Wholesale funding is diversified by type and maturity and represents a stable source of funds for the Group.

The Group maintains access to wholesale funding markets in all major financial centres in which the Group operates. This seeks to ensure that the Group has market intelligence, maintains stable funding lines and can obtain optimal pricing when performing its interest rate risk management activities.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(f) Liquidity and Funding risk (continued)

Liquidity risk management

The Treasury Risk and Finance Functions are responsible for developing a risk type framework for liquidity risk and for complying with regulatory requirements in the countries in which the Group operates. The Treasury Risk and Finance functions provide independent challenge and oversight of the first line risk management activities relating to liquidity risk.

The Group develops and adopts policies to address material liquidity risks and aims to maintain its risk profile within the Group's Risk Appetite. The Group also maintains a Recovery Plan at each country level which is a live document to be used by management in a liquidity or solvency stress. The Recovery Plan includes a set of Recovery Indicators, an escalation framework and a set of management actions capable of being implemented in a stress.

At Group and country level, the Group implements various business-as-usual and stress risk measures and monitors these against limits and management action triggers. This ensures that the Group maintains an adequate and well-diversified liquidity buffer and stable funding base, and that it meets its liquidity and funding regulatory requirements. A funding plan is also developed for efficient liquidity projection to ensure the Group is adequately funded, in required currency, to meet its obligations and client funding needs.

Governance

At the Board level, the Board Risk Committee oversees the effective management of liquidity risk. At the executive level, the Regional Asset and Liability Committee ensures the effective management of risk throughout the Group in support of the Group's strategy, and guides the Group's strategy on balance sheet optimization and ensure that the Group operates within the internally approved Risk Appetite, as well as external and internal liquidity requirements.

Country oversight under the liquidity framework resides with country Asset and Liability Committees. Countries must ensure that they remain in compliance with group liquidity policies and practices, as well as local regulatory requirements.

Monitoring

On a day-to-day basis, the management of liquidity is performed by Treasury Markets. The Group regularly reports and monitors liquidity risks inherent in its business activities and those that arise from internal and external events. The management of liquidity is monitored by Treasury Risk and Finance with appropriate escalation processes in place.

Internal risk management reports covering the balance sheet and the liquidity position of the Group are presented to Regional Asset and Liability Committee. The reports contain key information on balance sheet trends, exposures against Risk Appetite and supporting risk measures which enable members to make informed decisions around the overall management of the Group's balance sheet. Oversight at a country level is provided by the country Asset and Liability Committee, with a focus on the local liquidity risks, local prudential requirements and risks that arise from local internal and external events.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(f) Liquidity and Funding risk (continued)

Liquidity and Funding risk metrics

The Group monitors key liquidity metrics regularly, both on a country basis and in aggregate across the Group.

The following Liquidity and Funding Board Risk Appetite metrics define the maximum amount and type of risk that the Group is willing to assume in pursuit of its strategy: Liquidity Coverage Ratio (LCR), liquidity stress survival horizons, external wholesale borrowing, and advances-to-deposits ratio.

Liquidity Coverage Ratio (“LCR”)

The LCR is a regulatory requirement set to ensure that the Group has sufficient unencumbered high quality liquid assets to meet its liquidity needs in a 30-calendar-day liquidity stress scenario.

The Group monitors and reports its liquidity position in line with the Banking (Liquidity) Rules issued by the HKMA and has maintained its liquidity position above the prudential requirement.

Stress Coverage

The Group intends to maintain a prudent and sustainable funding and liquidity position, in all countries and currencies, such that it can withstand a severe but plausible liquidity stress.

The Group’s approach to managing liquidity and funding risk is reflected in the following Board-level Risk Appetite Statement.

“The Group should hold an adequate buffer of high-quality liquid assets to survive extreme but plausible liquidity stress scenarios for at least 60 days without recourse to extraordinary central bank support.”

The Group’s internal liquidity stress testing framework covers the following stress scenarios:

Standard Chartered-specific – This scenario captures the liquidity impact from an idiosyncratic event affecting Standard Chartered only i.e. the rest of the market is assumed to operate normally.

Market-Wide – This scenario captures the liquidity impact from a market-wide crisis affecting all participants in a country, region or globally.

Combined – This scenario assumes both Standard Chartered-specific and Market-Wide events affecting the Group simultaneously and hence the most severe scenario.

All scenarios include, but are not limited to, modelled outflows for retail and wholesale funding, off-balance sheet funding risk, cross currency funding risk, intraday risk, franchise risk and risks associated with a deterioration of the Group’s credit rating.

Stress testing results show that a positive surplus was maintained under all scenarios at 31 December 2019 i.e. respective countries are able to survive for a period of time as defined under each scenario. The combined scenario at 31 December 2019 showed the Group maintained liquidity resources to survive greater than 60 days, as per the Group’s Board Risk Appetite. The results take into account currency convertibility and portability constraints across all major presence countries.

The Group’s credit ratings as at 31 December 2019 were A+ with stable outlook (S&P) and A1 with stable outlook (Moody’s). A downgrade in the Group’s long-term credit ratings would increase derivative collateral requirements and outflows due to rating-linked liabilities. The impact of a two-notch long term ratings downgrade has a minimal impact on the Group’s derivatives collateral requirements.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(f) Liquidity and Funding risk (continued)****External wholesale borrowing**

The Board sets a risk limit to prevent excessive reliance on wholesale borrowing. Limits are applied to all operating subsidiaries in the Group and as at the reporting date the Group remained within Board Risk Appetite.

Advances-to-deposits ratio

This is defined as the ratio of total loans and advances to customers relative to total customer deposits. An advances-to-deposits ratio of below 100 percent demonstrates that customer deposits exceed customer loans as a result of the emphasis placed on generating a high level of funding from customers.

	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
Advances to customers	1,007,035	930,029
Deposits from customers	1,530,112	1,456,667
Advances-to-deposits ratio	<u>65.8%</u>	<u>63.8%</u>

Net stable funding ratio ("NSFR")

The Group monitors and reports the NSFR in line with the Banking (Liquidity) Rules issued by the HKMA.

The NSFR is a balance sheet metric which requires institutions to maintain a stable funding profile in relation to the characteristics of their assets and off-balance sheet activities over a one-year horizon. It is the ratio between the amount of available stable funding ("ASF") and the amount of required stable funding ("RSF"). ASF factors are applied to the balance sheet liabilities and capital, based on their perceived stability and the amount of stable funding they provide. Likewise, RSF factors are applied to assets and off-balance sheet exposures according to the amount of stable funding they require. At the last reporting date, the Group NSFR remained above 100 percent.

Maturity profiles**(i) Contractual maturity of assets and liabilities**

The following table presents assets and liabilities by maturity groupings based on the remaining period to the contractual maturity date as at the balance sheet date on a discounted basis. Contractual maturities do not necessarily reflect actual repayments or cash flow.

Within the tables below, cash and balances with central banks, interbank placements, and investment securities that are fair value through other comprehensive income are used by the Group principally for liquidity management purposes.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(f) Liquidity and Funding risk (continued)****(i) Contractual maturity of assets and liabilities (continued)**

	2019							Total HK\$'M
	Repayable on demand 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	Undated HK\$'M	
Assets								
Cash and balances with banks, central banks and other financial institutions	83,000	-	-	-	-	-	-	83,000
Placements with banks and other financial institutions	-	52,493	28,261	30,546	3,507	-	-	114,807
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	53,821	53,821
Financial asset at fair value through profit or loss	2,069	8,639	20,238	40,370	33,094	21,438	1,499	127,347
Investment securities	-	58,398	49,324	117,420	191,237	7,364	435	424,178
Advances to customers	28,615	132,700	87,962	131,591	190,484	435,683	-	1,007,035
Amounts due from fellow subsidiaries	4,157	78,846	14,844	29,494	26,667	10,088	36	164,132
Others	20,446	35,389	20,579	2,172	2,344	36	63,362	144,328
Total Assets	138,287	366,465	221,208	351,593	447,333	474,609	119,153	2,118,648
Liabilities								
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	53,821	53,821
Deposits and balances of banks and other financial institutions	20,831	12,674	157	2,767	1,135	-	-	37,564
Deposits from customers	1,046,151	164,048	139,393	158,911	11,484	10,125	-	1,530,112
Financial liabilities at fair value through profit or loss	6	15,857	12,011	20,918	13,054	34,703	-	96,549
Debt securities in issue	12	4,564	2,645	7,379	16,335	673	-	31,608
Amounts due to immediate holding company	-	127	-	-	18,809	11,719	-	30,655
Amounts due to fellow subsidiaries	13,133	9,762	15,058	14,155	9,705	10,701	4,448	76,962
Subordinated liabilities	-	-	-	5,876	-	-	-	5,876
Others	16,209	34,945	14,540	4,472	3,761	2,010	13,560	89,497
<i>of which: Lease liabilities</i>	-	-	-	86	2,086	2,010	-	4,182
Total Liabilities	1,096,342	241,977	183,804	214,478	74,283	69,931	71,829	1,952,644

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(f) Liquidity and Funding risk (continued)****(i) Contractual maturity of assets and liabilities (continued)**

	Repayable on demand HK\$'M	Due within 1 month HK\$'M	2018 (restated)				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	Due after 5 years HK\$'M		
Assets								
Cash and balances with banks, central banks and other financial institutions	71,705	419	-	-	-	-	-	72,124
Placements with banks and other financial institutions	78	94,449	44,665	54,257	1,227	-	-	194,676
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	46,691	46,691
Financial assets at fair value through profit or loss	1,859	5,746	15,156	31,669	31,235	18,036	594	104,295
Investment securities	-	80,526	68,327	148,562	85,231	9,754	494	392,894
Advances to customers	21,770	125,107	75,710	121,017	176,955	409,470	-	930,029
Amounts due from fellow subsidiaries	12,132	75,261	11,558	12,459	5,495	4,256	15	121,176
Others	3,862	8,814	13,103	2,695	186	186	84,963	113,809
Total Assets	111,406	390,322	228,519	370,659	300,329	441,702	132,757	1,975,694
Liabilities								
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	46,691	46,691
Deposits and balances of banks and other financial institutions	23,591	9,486	299	4,801	1,078	14	-	39,269
Deposits from customers	1,003,707	153,965	104,831	169,891	12,100	12,173	-	1,456,667
Financial liabilities at fair value through profit or loss	-	18,575	15,412	26,079	13,048	27,750	-	100,864
Debt securities in issue	20	1,924	8,587	21,551	1,916	701	-	34,699
Amounts due to fellow subsidiaries	19,030	7,406	16,632	9,637	8,193	11,275	127	72,300
Subordinated liabilities	-	-	-	-	5,907	-	-	5,907
Others	7,386	20,191	9,875	5,937	1,471	223	18,010	63,093
Total Liabilities	1,053,734	211,547	155,636	237,896	43,713	52,136	64,828	1,819,490

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)**(f) Liquidity and Funding risk (continued)****(ii) Behavioural maturity of financial assets and liabilities**

The cash flows presented in previous section reflect the cash flows that will be contractually payable over the residual maturity of the instruments. However, contractual maturities do not necessarily reflect the timing of actual repayments or cash flow. In practice, certain assets and liabilities behave differently from their contractual terms, especially for short-term customer accounts, credit card balances and overdrafts, which extend to a longer period than their contractual maturity. On the other hand, mortgage balances tend to have a shorter repayment period than their contractual maturity date. Expected customer behaviour is assessed and managed on a country basis using qualitative and quantitative techniques, including analysis of observed customer behaviour over time.

(iii) Maturity of financial liabilities on an undiscounted basis

The following tables analyses the contractual cash flows payable for the Group's financial liabilities by remaining contractual maturities on an undiscounted basis. The financial liability balances in the tables below will not agree to the balances reported in the consolidated balance sheet as the tables incorporate all contractual cash flows, on an undiscounted basis, relating to both principal and interest payments.

Within the 'Undated' maturity band are undated financial liabilities, on which interest payments are not included as this information would not be meaningful given the instruments are undated. Interest payments on these instruments are included within the relevant maturities up to five years.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(f) Liquidity and Funding risk (continued)**

(iii) Maturity of financial liabilities on an undiscounted basis (continued)

	2019							
	Repayable on demand	Due within 1 months	Due	Due	Due	Due after 5 years	Undated	Total
			between 1 month to 3 months	between 3 months to 1 year	between 1 year to 5 years			
HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	
Deposits and balances of banks and other financial institutions	20,875	12,718	264	3,403	1,347	–	–	38,607
Deposits from customers	1,046,650	164,996	140,663	162,498	12,258	13,748	–	1,540,813
Derivative financial instruments ¹	11	10,579	12,108	17,331	14,275	8,778	–	63,082
Financial liabilities at fair value through profit or loss	6	11,161	5,562	11,088	6,449	32,327	–	66,593
Debt securities in issue	12	4,593	2,702	7,657	17,392	4,621	–	36,977
Amounts due to immediate holding company	–	–	–	–	18,809	11,719	–	30,528
Amounts due to fellow subsidiaries	13,134	4,079	9,438	6,664	2,035	4,299	4,448	44,097
Subordinated liabilities	–	–	–	6,220	–	–	–	6,220
Others	16,209	34,870	14,540	4,558	5,072	4,020	67,381	146,650
Total Liabilities	1,096,897	242,996	185,277	219,419	77,637	79,512	71,829	1,973,567

	2018 (restated)							
	Repayable on demand	Due within 1 months	Due	Due	Due	Due after 5 years	Undated	Total
			between 1 month to 3 months	between 3 months to 1 year	between 1 year to 5 years			
HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	
Deposits and balances of banks and other financial institutions	23,591	9,524	390	5,106	1,415	22	–	40,048
Deposits from customers	1,003,762	155,145	105,863	172,513	12,990	16,658	–	1,466,931
Derivative financial instruments ¹	–	9,215	9,757	16,918	13,815	7,564	–	57,269
Financial liabilities at fair value through profit or loss	–	14,167	11,207	17,060	5,458	25,196	–	73,088
Debt securities in issue	20	1,968	8,672	21,742	1,967	6,978	–	41,347
Amounts due to immediate holding company	–	–	–	–	–	6,263	–	6,263
Amounts due to fellow subsidiaries	19,030	2,909	11,093	1,754	2,005	–	127	36,918
Subordinated liabilities	–	–	–	346	6,081	–	–	6,427
Others	7,386	19,881	9,875	5,937	1,471	223	64,701	109,474
Total Liabilities	1,053,789	212,809	156,857	241,376	45,202	62,904	64,828	1,837,765

¹ Derivatives are on a discounted basis.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

The Group defines Operational risk as the potential for loss resulting from inadequate or failed internal processes, systems, human error, or from the impact of external events. The potential for operational risk events to occur is a constant challenge as operational risk arises from all activities carried out within the Group. To address this the Group maps risks across the Group at a process level with controls installed to mitigate these risks. The Group benchmarks practices against peers and regulatory requirements.

Operational Risk Governance

The ERC and RERC provide oversight of operational risk management across the Group. They are supported by country level forums and sub-committees including the Business / Function Risk Forums, Country Fraud Risk Management Committee ("CFRMC"), Third Party Risk Management Committee ("TPRMC") and regional level sub-committee such as Data Governance Committee ("DGC"), to oversee operational risks arising from businesses and functions, internal and external fraud, third party risk management and data quality management, respectively.

Risk Appetite approach

Operational risk is managed to achieve the Risk Appetite Statement approved by the Board. The Group aims to control operational risks to ensure that operational losses (financial or reputational), including any losses related to conduct of business matters, do not cause material damage to the Group's franchise.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 Risk management (continued)****(g) Operational risk (continued)****Risk classification**

Operational Risk sub-types are the different ways that the Group may be operationally exposed to loss. The Group uses operational risk sub-types principally as an aid to ensure comprehensive and consistent identification of operational risks, wherever they may arise. Operational risk sub-types are listed in the table:

OPERATIONAL RISK SUB-TYPES

Execution Capability	Transaction processing	Potential for loss due to failure in the design or execution of client facing transactions.
	Product management	Potential for loss due to the failure to design and / or meet product management standards and product-related regulatory requirements.
	People management	Potential for loss due to the failure to meet standards for people management including relevant regulations (e.g. employment, remuneration and benefits).
Operational Resilience	Client service resilience	Potential for loss or adverse impact due to failures to maintain or manage processes supporting client service.
	System availability	Potential for loss or adverse impact due to failures to maintain systems (including the design and setup of software and architecture).
	Data quality	Potential for loss due to the failure to define and/or meet data quality standards including resilience requirements.
	Vendor service	Potential for loss or adverse impact due to failures to maintain vendor service (including resilience requirements).
	Change management	Potential for loss or adverse impact due to failures to manage project related change.
Fraud	Internal fraud	Potential for loss due to action by staff which is intended to defraud, or to circumvent the law or company policy (including Rogue Trading).
	External fraud	Potential for loss due to criminal acts by external parties such as the misappropriation or theft of financial assets.
Corporate Governance	Corporate governance and authorities	Potential for loss due to non-compliance with relevant laws, regulations, ordinances or market guidance (which a Group entity would customarily comply with) relating to an entity's board, directors, members and shareholders.
	Exchange listing rules	Potential for loss due to non-compliance with laws or stock exchange rules for a listed Group entity.
Reporting and Obligations	Financial books and records	Potential for loss or adverse impact due to failure to comply with laws and regulations for financial books and records.
	Tax obligations	Potential for loss or adverse impact due to failure to comply with laws and regulations for tax.
Model		Potential for loss or adverse impact due to incorrect design or use of models.
Safety and security		Potential for loss or damage due to failure to create a safe, secure, and healthy environment for staff and clients. This risk considers both the protection of property and physical assets, health and safety standards, and resilience requirements.
Legal enforceability		The potential for loss due to difficulty in enforcing the Group's contractual rights.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(h) Reputational risk

The Group defines Reputational Risk as the potential for loss of damage to the franchise, resulting in loss of earnings or adverse impact on market capitalisation because of stakeholders taking a negative view of the organisation or its actions or inactions – leading stakeholders to change their behavior. The Group aims to protect the franchise from material damage to its reputation by ensuring that any business activity is satisfactorily assessed and managed by the appropriate level of management and governance oversight.

Mitigation

The Group's Reputational Risk policy sets out the principal sources of Reputational Risk and the responsibilities and procedures for identifying, assessing and escalating primary and secondary reputational risks. The policy also defines the control and oversight standards to effectively manage Reputational Risk. The Group takes a structured approach to the assessment of risks associated with how individual client, transaction, product and strategic coverage decisions may affect perceptions of the organisation and its activities. Wherever a potential for stakeholder concerns is identified, issues are subject to prior approval by a management authority commensurate with the materiality of matters being considered. Such authorities may accept or decline the risk or impose conditions upon proposals, to protect the Group's reputation. Secondary Reputational Risk mitigation derives from the effective management of other Principal Risk Types.

Governance Committee Oversight

The Board retains Board-level oversight responsibility for Reputational Risk. Oversight from an operational perspective falls under the remit of the ERCs and the Board Risk Committee.

Decision making authorities and delegation

The RERC provides Group-wide oversight on Reputational Risk, approves policy and monitors material risks. The RERC is authorised to approve or decline Reputational Risk aspects of any business transaction, counterparty, client, product, line of business and market within the boundaries of the Group's Risk Appetite, and any limits and policies set by authorised bodies of the Group.

Monitoring

Reputational Risk policies and standards are applicable to the Group. However, HKMA may impose additional guidelines and requirements on how banks manage and track Reputational Risk. In such cases, these are complied with in addition to the policies and standards. Exposure to Reputational Risk is monitored through:

- A requirement that process owners establish triggers to prompt consideration of Reputational Risk and escalation where necessary
- The tracking of risk acceptance decisions
- The tracking of thematic trends in secondary risk arising from other Principal Risk Types
- The analysis of prevailing stakeholder concerns

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)**(h) Reputational risk (continued)****Stress testing**

Reputational risk is incorporated into the Group's stress testing scenarios. For example, the Group may consider what impact a hypothetical event leading to loss of confidence among liquidity providers in a particular market might have, or what the implications might be for supporting part of the organisation in order to protect the brand.

(i) Compliance

The Group defines Compliance Risk as "Potential for penalties or loss to the Bank or for an adverse impact to our clients, stakeholders or to the integrity of the markets we operate in through a failure on our part to comply with laws, or regulations".

The Compliance function develops and deploys relevant policies and procedures, and sets out standards and controls for adherence by the Group to ensure continued compliance with applicable laws and regulations. Through a combination of control monitoring and attestation, the Compliance function ensures that all policies are operating as expected to mitigate the risk that they cover.

Monitoring of controls designed to mitigate the risk of regulatory non-compliance in processes is carried out in line with the Operational Risk Framework. Determination of whether the Group remains within the Risk Appetite is through monitoring of defined and approved metrics including the number of regulatory fines or the cumulative value of penalties suffered by the Group.

(j) Conduct

The Group defines Conduct Risk as "Risk of detriment to the Group's clients, investors, shareholders, market integrity, competition and counter-parties, or risk of detriment from the inappropriate supply of financial services, including instances of wilful or negligent misconduct".

Conduct risk management and abiding by the Group Code of Conduct are the responsibilities of all employees in the Group. The First Line businesses and functions review their processes and identify the conduct related outcomes that are relevant and ensure there are controls in place to mitigate these conduct risks. The Compliance function as Second Line for Conduct Risk has oversight and challenge responsibilities to ensure the adequacy of the Conduct risk management and that the Group remains within risk appetite.

The overall Conduct approach is stated in the Group's Conduct Risk Type Framework and the Code of Conduct. It is backed by a number of more detailed policies and procedures, and any employees who identify an issue with the Group's conduct are encouraged to speak up using processes and safeguards documented in the Speaking Up Policy. The Policy sets out the requirements to ensure a consistent approach to the identification, measurement, management, monitoring and reporting of conduct related risk.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)**(k) Information and Cyber Security****Information and cyber security risk**

The Bank defines Information and cyber security risk ('ICS') as the potential for loss from a breach of confidentiality, integrity and availability of Bank information systems and assets through cyber attack, insider activity, error or control failure. It is aimed to avoid risk and uncertainty for its critical information assets and systems and has a low appetite for material incidents affecting these or the wider operations and reputation of the Bank.

During 2019, the SCBHK Group further improved clarity of first line of defence responsibility for information and cyber security risk, and created a more business and client-aligned ICS support team.

The role of the Chief Information Security Officer ('CISO') position has been incorporated to the first line under the Chief Operating Officer ('COO') function, who holds the full accountability for the end-to-end ICS strategy. The second line role has been re-framed as the Chief Information Security Risk Officer ('CISRO'), who continues to have the overall responsibility for governance, oversight and challenge of ICS, and provide insight to Senior Management and the Board on the ICS management. In addition, CISRO function continues to set both the strategy and policy framework through which the risk to information assets and systems are managed by the respective first line teams.

In 2019, the Information and Cyber Security risk governance and monitoring capability continued to be enhanced and embedded in various risk management activities, including reporting for risk committee oversight, risk appetite setting and monitoring, stress testing, and monthly risk profile assessments across the lines of defence. Specifically within SCBHK Group, the Regional Head of Information and Cyber Security of the first line of defence, and the Regional Information Security Risk Officer of the second line of defence, manage and oversee the ICS risk as a whole, supporting such control and risk governance activities locally.

(l) Financial Crime**Financial crime risk**

The Group defines Financial Crime risk as the potential for legal or regulatory penalties, material financial loss or reputational damage resulting from the failure to comply with applicable laws and regulations relating to International Sanctions, Anti-Money Laundering and Anti-Bribery and Corruption.

Financial Crime risk within the Group is governed by the countries' FCRC which is appointed by and reports into the respective ERC. The FCRCs are concerned with ensuring the effective management of Financial Crime Compliance risk in supporting of the Group's strategy and in line with the Group's Risk Appetite, as determined under the ERMF.

Metrics and tolerances covering the key operational processes in support of Financial Crime risk management have been documented. Metrics are subject to periodic review and performance against them is regularly reported to the countries' FCRC.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)**(m) Capital management**

The HKMA sets capital and loss absorbing capacity (“LAC”) requirements for the Bank and certain subsidiaries specified by the HKMA. In implementing current capital requirements, the HKMA requires the Group to maintain prescribed ratios of capital to risk-weighted assets and a leverage ratio of tier 1 capital to total on- and off-balance sheet exposures. The leverage ratio is a complementary volume-based measure to the risk-based capital requirements. The Group calculates its capital adequacy ratios and leverage ratio in accordance with the Banking (Capital) Rules of the Hong Kong Banking Ordinance. Individual banking subsidiaries are directly regulated by their local banking supervisors, who set and monitor their capital adequacy requirements. Non-banking subsidiaries are also subject to the supervision and capital requirements of local regulatory authorities.

In implementing LAC requirements, the HKMA requires the Group to maintain a prescribed ratio of total LAC to total risk-weighted assets. The Group calculates its LAC ratios in accordance with the LAC Rules.

Hong Kong LAC Rules came into operation on 14 December 2018. Following classification by the HKMA (as resolution authority), in-scope entities are required under these rules to issue LAC instruments that can be written down or converted in the event of failure, and maintain minimum LAC resources.

The Bank was notified by HKMA of its classification as a material subsidiary under the LAC rules with effect from 1 April 2019, with Standard Chartered PLC (“SC PLC”) as the non-HK resolution entity. Following this classification, the Bank has met its minimum LAC requirements since 1 July 2019.

In addition to meeting the regulatory requirements, the Group’s primary objectives when managing capital are to safeguard the Group’s 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 Group 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 RALCO and Country ALCO and is reviewed regularly by the Board. With oversight by RALCO, each subsidiary manages their allocated capital to support their planned business growth and meet their local regulatory requirements.

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

The Group has complied with all externally imposed capital and LAC requirements during 2019.

The Group uses the IRB approach for both the measurement of credit risk weighted assets and the management of credit risk for the majority of its portfolios. The Group also uses the standardised (credit risk) approach for certain insignificant portfolios exempted from IRB. The Group adopts the securitisation external ratings-based approach to calculate its credit risk for securitisation exposures.

For market risk, the Group adopts the standardised (market risk) approach for the majority of its exposures and uses a stochastic asset-liability model approach for two guaranteed retirement funds. In addition, the Group adopts the standardised (operational risk) approach for operational risk.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(m) Capital management (continued)

The Banking (Capital) Rules issued by the HKMA require all authorised institutions in Hong Kong to meet three levels of minimum capital ratios, namely common equity tier 1, tier 1 and total capital ratios, and minimum leverage ratio.

The Group's consolidated capital as at 31 December 2019 consists of tier 1 capital after deduction of HK\$138,097 million (2018: HK\$63,279 million) and tier 2 capital after deductions of HK\$15,951 million (2018: HK\$11,241 million). Tier 2 capital includes subordinated debt and impairment allowances and regulatory reserve eligible for inclusion in Tier 2 capital.

35 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 consolidated statement of financial position 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 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	Directly or indirectly observable inputs other than unadjusted quoted prices included within Level 1 that are observable ¹	Significant inputs for the asset or liability that are not based on observable market data (unobservable inputs) (see note 35 (a)(i))

¹ These included valuation models such as 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 consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 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:

	2019			
	Level 1 HK\$'M	Level 2 HK\$'M	Level 3 HK\$'M	Total HK\$'M
Financial assets at fair value through profit or loss:				
– Trading assets	32,042	71,518	191	103,751
– Non-trading financial assets mandatorily at fair value through profit or loss	64	18,537	2,833	21,434
– Financial assets designed at fair value through profit or loss	–	2,162	–	2,162
Investment securities at fair value through other comprehensive income	225,873	181,459	435	407,767
Amounts due from fellow subsidiaries				
– Positive fair values of trading and hedging derivatives	64	29,668	–	29,732
– Debt securities	–	13	–	13
Other assets				
– Positive fair values of hedging derivatives	–	48	–	48
Total assets measured at fair value	<u>258,043</u>	<u>303,405</u>	<u>3,459</u>	<u>564,907</u>
Financial liabilities at fair value through profit or loss:				
– Trading liabilities	16,674	32,691	73	49,438
– Financial liabilities designated at fair value through profit or loss	–	46,265	846	47,111
Amounts due to immediate holding company				
– Negative fair values of hedging derivatives	–	127	–	127
Amounts due to fellow subsidiaries				
– Negative fair values of trading and hedging derivatives	98	32,766	3	32,867
Other liabilities				
– Negative fair values of hedging derivatives	–	75	–	75
Total liabilities measured at fair value	<u>16,772</u>	<u>111,924</u>	<u>922</u>	<u>129,618</u>

There were no significant transfers between level 1 and level 2 instruments during 2019.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)**

	2018 (restated)			Total HK\$'M
	Level 1 HK\$'M	Level 2 HK\$'M	Level 3 HK\$'M	
Financial assets at fair value through profit or loss:				
– Trading assets	31,839	47,599	113	79,551
– Non-trading financial assets mandatorily at fair value through profit or loss	673	16,820	4,612	22,105
– Financial assets designed at fair value through profit or loss	–	2,639	–	2,639
Investment securities at fair value through other comprehensive income	216,524	167,968	494	384,986
Amounts due from fellow subsidiaries				
– Positive fair values of trading and hedging derivatives	68	25,040	–	25,108
– Debt securities	–	22	–	22
Other assets				
– Positive fair values of hedging derivatives	–	457	–	457
Total assets measured at fair value	249,104	260,545	5,219	514,868
Financial liabilities at fair value through profit or loss:				
– Trading liabilities	10,121	31,027	4	41,152
– Financial liabilities designated at fair value through profit or loss	–	58,795	917	59,712
Amounts due to fellow subsidiaries				
– Negative fair values of trading and hedging derivatives	54	29,065	–	29,119
Other liabilities				
– Negative fair values of hedging derivatives	–	309	–	309
Total liabilities measured at fair value	10,175	119,196	921	130,292

There were no significant transfers between level 1 and level 2 instruments during 2018.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)**

(i) Valuation of financial instruments with significant unobservable inputs

The movements during the year for level 3 financial assets and liabilities are as follows:

Financial assets

	<i>2019</i>		
	<i>Financial assets at fair value through profit or loss</i>	<i>Financial assets at fair value through other comprehensive income</i>	<i>Total level 3 assets</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
At 1 January 2019	4,725	494	5,219
Total gains recognised in the income statement			
– Net trading income	284	–	284
Total losses recognised in other comprehensive income			
– Net change in fair value	–	(59)	(59)
Purchases	855	–	855
Sales	(1,401)	–	(1,401)
Settlements	(1,613)	–	(1,613)
Transferred into level 3 ¹	187	–	187
Transferred out of level 3 ¹	(13)	–	(13)
	<u>3,024</u>	<u>435</u>	<u>3,459</u>
At 31 December 2019			
Total gains recognised in the income statement relating to assets held at 31 December 2019			
– Net trading income	<u>26</u>	<u>–</u>	<u>26</u>

¹ 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 consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****(i) Valuation of financial instruments with significant unobservable inputs (continued)***Financial liabilities*

	2019		
	<i>Financial liabilities at fair value through profit or loss HK\$'M</i>	<i>Amount due to fellow subsidiaries HK\$'M</i>	<i>Total level 3 liabilities HK\$'M</i>
At 1 January 2019	921	–	921
Total gains recognised in the income statement			
– Net trading income	(16)	–	(16)
Additions	885	–	885
Settlements	(871)	–	(871)
Transferred into level 3 ¹	–	3	3
	<u>919</u>	<u>3</u>	<u>922</u>
At 31 December 2019			
Total gains recognised in the income statement relating to liabilities held at 31 December 2019			
– Net trading income	<u>(16)</u>	<u>–</u>	<u>(16)</u>

¹ Transfers into level 3 during the year relate to financial instruments where the valuation parameters became unobservable during the year.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****(i) Valuation of financial instruments with significant unobservable inputs (continued)***Financial assets*

	<i>2018 (restated)</i>		
	<i>Financial</i>	<i>Financial</i>	
	<i>assets at fair</i>	<i>assets at fair</i>	
	<i>value through</i>	<i>value through</i>	<i>Total level 3</i>
	<i>profit or loss</i>	<i>other</i>	<i>assets</i>
	<i>HK\$'M</i>	<i>comprehensive</i>	<i>income</i>
		<i>HK\$'M</i>	<i>HK\$'M</i>
At 1 January 2018, as previously stated	4,567	227	4,794
Effect of merger of commonly controlled entities	487	68	555
	<u>4,567</u>	<u>227</u>	<u>4,794</u>
At 1 January 2018, as restated	5,054	295	5,349
Total gains recognised in the income statement			
– Net trading income	155	–	155
Total gains recognised in other comprehensive income			
– Net change in fair value	–	122	122
Purchases	868	77	945
Sales	(454)	–	(454)
Settlements	(900)	–	(900)
Transferred into level 3 ¹	2	–	2
	<u>4,725</u>	<u>494</u>	<u>5,219</u>
At 31 December 2018	<u>4,725</u>	<u>494</u>	<u>5,219</u>
Total gains recognised in the income statement relating to assets held at 31 December 2018			
– Net trading income	<u>168</u>	<u>–</u>	<u>168</u>

¹ Transfers into level 3 during the year relate to financial instruments where the valuation parameters became unobservable during the year.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)****(i) Valuation of financial instruments with significant unobservable inputs (continued)***Financial liabilities*

	<i>2018 (restated)</i>	
	<i>Financial liabilities at fair value through profit or loss HK\$'M</i>	<i>Total level 3 liabilities HK\$'M</i>
At 1 January 2018, as previously stated	1,164	1,164
Effect of merger of commonly controlled entities	568	568
	<hr/>	<hr/>
At 1 January 2018, as restated	1,732	1,732
Total gains recognised in the income statement		
– Net trading income	(68)	(68)
Additions	33	33
Settlements	(776)	(776)
	<hr/>	<hr/>
At 31 December 2018	921	921
	<hr/>	<hr/>
Total gains recognised in the income statement relating to liabilities held at 31 December 2018		
– Net trading income	(68)	(68)
	<hr/>	<hr/>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 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.

<u>Type of instruments</u>	<u>Principal valuation technique</u>	<u>Significant unobservable inputs</u>	<u>Range¹</u>	<u>Weighted average²</u>	
Debt securities	Discounted cash flows	Price/Yield	3.80% (2018: 1.0% to 11.0%)	3.80% (2018: 3.70%)	
Advances to customers	Discounted cash flows	Recovery rates	88.50% to 100.0% (2018: 90.0% to 100.0%)	95.90% (2018: 95.20%)	
		Price/Yield	0.50% to 0.60% (2018: NA)	0.50% (2018: NA)	
Equity shares	Discounted cash flows	Discount rates	8.40% to 16.20% (2018: 7.30% to 10.0%)	9.60% (2018: 9.50%)	
Debt securities issued	Discounted cash flows	Credit spreads	1.40% (2018: 1.30% to 4.00%)	1.40% (2018: 2.80%)	
Structured deposits	Discounted cash flows	Credit spreads	1.0% to 1.80% (2018: 1.00%)	1.40% (2018: 1.00%)	
Derivatives	Discounted cash flows	Credit spreads	7.90% (2018: NA)	7.90% (2018: NA)	
		Internal Pricing Model	Equity-Equity Correlation	1.0% to 90.0% (2018: 4.50% to 89.50%)	58.0% (2018: 67.0%)
		Equity-Foreign Exchange Correlation	-80.0% to 70.0% (2018: -80.0% to 80.0%)	-29.0% (2018: -20.0%)	

¹ The ranges of values shown represent the highest and lowest used in the valuation of the level 3 financial instruments as at 31 December 2019 and 31 December 2018. The ranges of values used are reflective of the underlying characteristics of these level 3 financial instruments based on the market conditions at the reporting date. However, these ranges of values may not represent the uncertainty in fair value measurements of these level 3 financial instruments.

² Weighted average for non-derivative financial instruments have been calculated by weighting inputs by the relative fair value.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 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 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.

Recovery rates

Recovery rates are the expectation of the rate of recovery resulting from the liquidation of a particular loan. As the probability of default increases for a given instrument, the valuation of that instrument will increasingly reflect its expected recovery level assuming default. An increase in the recovery rate, in isolation, would result in a favourable movement in the fair value of the loan.

Credit spreads

Credit spreads represent the additional yield that a market participant would demand for taking exposures to the credit risk of an instrument. An increase in credit spread, in isolation, would result in a decrease in fair value measurement.

Discount rates

Discount rates is applied to discount future dividend in the discounted cash flow model. An increase in the discount rate, in isolation, would result in decrease in a fair value measurement.

Equity-Equity correlation and Equity-Foreign Exchange correlation

Correlation is the measure of how movement in one variable influences the movement in another variable. An equity-equity correlation is the correlation between two equity instruments while an equity-foreign exchange correlation refers to the correlation between equity instrument and foreign exchange instrument.

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

Where the fair values 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 percent 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, *Financial Instruments: Disclosures*. The percentage shift is determined by statistical analyses performed on a set of reference prices, which include certain equity indices, credit indices and volatility indices, based on the composition of the 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.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)**

<i>Financial instruments</i>	<i>Fair value changes</i>	<i>At 31 December</i>	<i>At 31 December</i>
		<i>2019</i>	<i>2018</i>
		<i>HK\$'M</i>	<i>HK\$'M</i>
			<i>(restated)</i>
Held at fair value through profit or loss	Possible increase	85	151
	Possible decrease	121	182
Held at fair value through other comprehensive income	Possible increase	42	51
	Possible decrease	45	49

(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 2019 and 2018, 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.

	<i>2019</i>			<i>2018</i>		
	<i>Carrying amount</i>	<i>Fair value Level 1</i>	<i>Fair value Level 2</i>	<i>Carrying amount</i>	<i>Fair value Level 1</i>	<i>Fair value Level 2</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>
				<i>(restated)</i>	<i>(restated)</i>	<i>(restated)</i>
Subordinated liabilities ¹	<u>41,985</u>	<u>5,931</u>	<u>36,123</u>	<u>13,735</u>	<u>6,064</u>	<u>7,832</u>

¹ The subordinated liabilities comprise of internal issuance grouped under amount due to immediate holding company and amount due to fellow subsidiaries (note 16), and external issuance grouped under subordinated liabilities (note 28).

The following sets out the Group'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), 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 consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 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 Group enters into collateralised repurchase agreements (repos). These transactions typically entitle the Group 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 consolidated statement of financial position as the Group 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 Group as collateral for repurchase transactions:

	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
Collateral pledged against repurchase agreements		
On balance sheet		
Investment securities	17,743	12,163
	<u>17,743</u>	<u>12,163</u>
Balance sheet liabilities – repurchase agreements		
Amount due to banks	3,320	1,804
Amount due to customers	13,980	10,029
Amount due to fellow subsidiaries	–	12
	<u>17,300</u>	<u>11,845</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 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.

	2019					Net amount HK\$'M
	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities offset in the consolidated statement of financial position	Net amounts of financial assets presented in the consolidated statement of financial position	Net amounts of financial liabilities presented in the consolidated statement of financial position	Related amounts not offset in the consolidated statement of financial position	
Assets						
Positive fair values of derivative financial instruments	57,748	–	57,748	(44,815)		12,933
Reverse repos, securities borrowing and similar agreements	67,689	–	67,689	(62,753)		4,936
	<u>125,437</u>	<u>–</u>	<u>125,437</u>	<u>(107,568)</u>		<u>17,869</u>
Liabilities						
Negative fair values of derivative financial instruments	63,082	–	63,082	(46,670)		16,412
Repos and similar agreements	17,300	–	17,300	(10,000)		7,300
	<u>80,382</u>	<u>–</u>	<u>80,382</u>	<u>(56,670)</u>		<u>23,712</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Financial instruments (continued)****(d) Offsetting financial assets and financial liabilities (continued)**

	2018 (restated)				
	<i>Gross amounts of recognised financial liabilities offset in the consolidated statement of financial assets</i>	<i>Gross amounts of recognised financial liabilities</i>	<i>Net amounts of financial assets presented in the consolidated statement of financial position</i>	<i>Related amounts not offset in the consolidated statement of financial position</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	51,624	–	51,624	(37,701)	13,923
Reverse repos, securities borrowing and similar agreements	83,568	–	83,568	(68,357)	15,211
	<u>135,192</u>	<u>–</u>	<u>135,192</u>	<u>(106,058)</u>	<u>29,134</u>
<i>Liabilities</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>Net amount</i>
Negative fair values of derivative financial instruments	57,269	–	57,269	(42,242)	15,027
Repos and similar agreements	11,845	–	11,845	(9)	11,836
	<u>69,114</u>	<u>–</u>	<u>69,114</u>	<u>(42,251)</u>	<u>26,863</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Financial instruments (continued)****(d) Offsetting financial assets and financial liabilities (continued)**

The Group is 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 consolidated statement of financial position.

Under repos and reverse repos, the Group 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 consolidated statement of financial position 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.

36 Assets pledged as security for liabilities

The Group maintains pledged cash and securities accounts to secure any borrowings or other obligations resulting from the Group's use of clearing systems and to cover short positions. As at 31 December 2019, the Group had securities amounting to HK\$19,425 million (2018 (restated): HK\$13,311 million) to cover the short positions.

Reverse repos and securities borrowing transactions

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

	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
Consolidated statement of financial position assets - reverse repos and securities borrowing		
Placements with banks and other financial institutions	5,889	24,563
Advances to customers	2,365	6,400
Amounts due from fellow subsidiaries	59,435	52,605
	<u>67,689</u>	<u>83,568</u>

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

	<i>2019</i> <i>HK\$'M</i>	<i>2018</i> <i>HK\$'M</i> <i>(restated)</i>
Securities and collateral that can be repledged or sold (at fair value)	63,841	71,266
Thereof repledged/transferred to others under repos (at fair value)	<u>–</u>	<u>–</u>

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

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Material related party transactions**

In addition to the transactions and balances disclosed elsewhere in these financial statements, the Group entered into the following material related party transactions. Comparative amounts for 2018 shown in note 37 below were not restated and represent the organisation structure prior to the acquisition of SCB China and SC NEA Group.

(a) Key management personnel remuneration

Remuneration for key management personnel of the Group, including amounts paid to the directors as disclosed in note 7 is as follows:

	2019 HK\$'M	2018 HK\$'M
Short-term employee benefits	79	69
Post-employment benefits	3	3
Equity compensation benefits	16	16
	<u>98</u>	<u>88</u>

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

(b) Credit facilities and loans to key management personnel

During the year, the Group provided credit facilities to key management personnel of the Group 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.

	2019 HK\$'M	2018 HK\$'M
Loan balances:		
At 1 January	<u>19</u>	<u>34</u>
At 31 December	<u>23</u>	<u>19</u>
Average balance during the year	<u>29</u>	<u>25</u>
Income earned	<u>1</u>	<u>–</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Material related party transactions (continued)****(c) Loans, quasi-loans and other dealings to directors and entities controlled by directors**

Information of the Group disclosed pursuant to section 383(1)(d) of the Hong Kong Companies Ordinance and Part 3 of the Companies (Disclosure of Information about Benefits of Directors) Regulation are as follows:

	2019 HK\$'M	2018 HK\$'M
Aggregate amount of relevant loans by the Group outstanding at 31 December	8	9
Maximum aggregate amount of relevant loans by the Group outstanding during the year	35	37

(d) Related party transactions with associates and joint ventures of SC PLC Group

During the year, the Group entered into transactions with associates and joint ventures of SC PLC 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:

	2019 HK\$'M	2018 HK\$'M
Amounts due from associates and joint ventures	1	21
Deposits from associates and joint ventures	261	128
Operating income	26	47

38 Share based payments

SC PLC operates a number of share-based arrangements for its directors and employees.

2011 Standard Chartered Share Plan (the '2011 Plan')

The 2011 Plan was approved by shareholders in May 2011 and is SC PLC's main share plan. Since approval, it has been used to deliver various types of share awards:

(i) Long Term Incentive Plan ('LTIP')

These are awards granted with vesting subject to performance measures. Performance measures attached to awards granted previously include: total shareholder return ('TSR'); return on equity ('RoE') with a common equity tier 1 ('CET 1') underpin; strategic measures; earnings per share ('EPS') growth; and return on risk-weighted assets ('RoRWA'). Each measure is assessed independently over a three-year period. Awards granted from 2016 have an individual conduct gateway that results in the award lapsing if not met.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Share based payments (continued)**2011 Standard Chartered Share Plan (the '2011 Plan') (continued)****(ii) Deferred share awards**

Deferred awards are used to deliver the deferred portion of variable remuneration, in line with both market practice and regulatory requirements. These awards vest in instalments on anniversaries of the award date specified at the time of grant. Deferred awards are not subject to any plan limit. This enables SC PLC to meet regulatory requirements relating to deferral levels, and is in line with market practice.

(iii) Restricted shares

Restricted share awards, made outside of the annual performance process as replacement buy-out awards to new joiners who forfeit awards on leaving their previous employers, vest in instalments on the anniversaries of the award date specified at the time of grant. This enables SC PLC to meet regulatory requirements relating to buy-outs, and is in line with market practice. In line with similar plans operated by the Group's competitors, restricted share awards are not subject to an annual limit and do not have any performance measures.

Under the 2011 Plan, no grant price is payable to receive an award. The remaining life of the 2011 Plan during which new awards can be made is two years.

2001 Performance Share Plan (2001 PSP)

SC PLC's previous plan for delivering performance shares was the 2001 PSP. There are no outstanding vested awards under this plan. This plan is closed and no further awards will be granted under this plan.

2013 Sharesave Plan

Under the 2013 Sharesave Plan, employees have the choice of opening a savings contract. Within a period of six months after the third anniversary, 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 percent on the share price at the date of invitation. There are no performance measures attached to options granted under the 2013 Sharesave Plan.

The 2013 Sharesave Plan was approved by shareholders of SC PLC in May 2013 and all future Sharesave invitations are made under this plan. The remaining life of the 2013 Sharesave Plan is three years.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Share based payments (continued)****2011 Standard Chartered Share Plan (the 2011 plan)****Valuation – LTIP**

The vesting of awards granted in both 2018 and 2019 is subject to the satisfaction of RoE (subject to a capital underpin) and relative TSR performance measures and achievement of a strategic scorecard. The fair value of the TSR component is calculated using the probability of meeting the measures over a three-year performance period, using a Monte Carlo simulation model. The number of shares expected to vest is evaluated at each reporting date, based on the expected performance against the RoE and strategic measures in the scorecard, to determine the accounting charge.

No dividend equivalents accrue for the LTIP awards made in 2018 or 2019 and the fair value takes this into account, calculated by reference to market consensus dividend yield.

<i>Grant Date</i>	<u>2019</u>	<u>2018</u>
	<i>11 March</i>	<i>9 March</i>
Share price at grant date (£)	6.11	7.78
Vesting period (years)	3-7	3-7
Expected dividends (yield) (%)	4.20	5.00
Fair value (RoE) (£)	2.02	2.59,2.59
Fair value (TSR) (£)	0.97,0.91	1.14,1.11
Fair value (Strategic) (£)	2.02	2.59, 2.59

Valuation – deferred shares and restricted shares

The fair value for deferred awards which are not granted to material risk takers is based on 100 percent of the face value of the shares at the date of grant as the share price will reflect expectations of all future dividends. For awards granted to material risk takers in 2019, the fair value of awards takes into account the lack of dividend equivalents, calculated by reference to market consensus dividend yield.

Deferred shares and underpin shares accrue dividend equivalent payments during the vesting period.

<i>Grant Date</i>	<u>2019</u>				<u>2018</u> <i>(restated)</i>			
	<u>24 June</u>		<u>11 March</u>		<u>18 June</u>		<u>9 March</u>	
	<i>Share price at grant date (£)</i>	7.03	6.11	7.12	7.78			
<i>Vesting Period</i>	<i>Expected dividend yield (%)</i>	<i>Fair value (£)</i>	<i>Expected dividend yield (%)</i>	<i>Fair value (£)</i>	<i>Expected dividend yield (%)</i>	<i>Fair value (£)</i>	<i>Expected dividend yield (%)</i>	<i>Fair value (£)</i>
1-3 years	N/A,4.20	7.03,6.47,6.21	N/A,4.20	6.11,6.52	N/A,5.0,5.0	7.12,6.45,6.15	N/A,5.0,5.0	7.78,7.06,6.73
1-5 years	4.20	-	4.20,4.20	5.29,5.40	5.0	6.0	5.0,5.0	6.74,6.58
3-7 years	-	-	4.20,4.20	4.77,4.97	-	-	5.0,5.0	6.11,5.82

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Share based payments (continued)****Restricted Share Awards**

Grant Date	2019							
	28 November		1 October		24 June		11 March	
	Share price at grant date (£)		6.84		7.03		6.11	
Vesting Period	Expected dividend yield (%)		Expected dividend yield (%)		Expected dividend yield (%)		Expected dividend yield (%)	
	Fair value (£)	Fair value (£)	Fair value (£)	Fair value (£)	Fair value (£)	Fair value (£)	Fair value (£)	Fair value (£)
6 months	-	-	-	-	-	-	-	-
1 year	4.2	6.75	4.2	6.57	4.2	6.74	4.2	5.86,5.62,5.74
2 years	4.2	6.48	4.2	6.30	4.2	6.47	4.2	5.62,5.4
2-3 years	-	-	-	-	-	-	-	-
3 years	4.2	6.22	4.2	6.05	4.2	6.21	4.2	5.4
4 years	-	-	4.2	5.80	4.2	5.96	4.2	5.18
5 years	-	-	4.2	5.57	4.2	5.72	-	-
6 years	-	-	-	-	-	-	-	-

Grant Date	2018							
	28 November		2 October		18 June		9 March	
	Share price at grant date (£)		6.16		7.12		7.78	
Vesting Period	Expected dividend yield (%)		Expected dividend yield (%)		Expected dividend yield (%)		Expected dividend yield (%)	
	Fair value (£)	Fair value (£)	Fair value (£)	Fair value (£)	Fair value (£)	Fair value (£)	Fair value (£)	Fair value (£)
6 months	-	-	-	-	-	-	-	-
1 year	5.0	5.82	5.0	5.86	5.0	6.78,6.45	5.0	7.41
2 years	5.0	5.54	5.0	5.58	5.0	6.45,6.15	5.0	7.06
2-3 years	5.0	5.41	-	-	-	-	-	-
3 years	5.0	5.28	5.0	5.32	5.0	6.15,5.85	5.0	6.72
4 years	-	-	5.0	5.06	5.0	5.57	5.0	6.40
5 years	-	-	5.0	4.82	-	-	5.0	6.10
6 years	-	-	-	-	-	-	-	-

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

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 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>	<i>2019</i>	<i>2018</i>
	<i>1 October</i>	<i>2 October</i>
Share price at grant date (£)	6.84	6.16
Exercise price (£)	4.98	5.13
Vesting period (years)	3	3
Expected volatility (%)	25.3	33.8
Expected option life (years)	3.33	3.33
Risk free rate (%)	0.26	0.87
Expected dividends (yield) (%)	4.20	5.00
Fair value (£)	1.62	1.39

The expected volatility is based on historical volatility over the last three years, or three 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 the historical dividend yield for three years prior to grant.

Reconciliation of share award movements for the year to 31 December 2019

	<i>2011 Plan</i>				<i>Weighted average Sharesave exercise price (£)</i>
	<i>LTIP</i>	<i>Deferred/ Restricted shares</i>	<i>PSP</i>	<i>2013 Sharesave</i>	
Outstanding at 1 January 2019	2,940,770	4,102,989	13,191	6,572,643	5.49
Granted	146,329	2,269,223	–	2,404,368	4.98
Lapsed	(207,270)	(204,389)	–	(628,085)	5.50
Exercised	(754,769)	(1,768,087)	(8,313)	(2,418,228)	5.49
Outstanding at 31 December 2019	2,125,060	4,399,736	4,878	5,930,698	5.28
Exercisable at 31 December 2019	–	531,318	7,506	714,574	
Range of exercise prices (£)	–	–	–	4.98 – 6.20	
Weighted average contractual remaining life (years)	6.50	8.09	1.64	2.40	

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 Share based payments (continued)****Reconciliation of share award movements for the year to 31 December 2018**

	<u>2011 Plan</u>				2013 Sharesave	Weighted average Sharesave exercise price (£)
	LTIP	Deferred/ Restricted shares	PSP	RSS		
Outstanding at 1 January 2018, as previously stated	2,431,307	3,100,042	7,629	15,815	981,765	5.86
Effect of merger of commonly controlled entity	372,857	930,954	13,388	22,803	5,394,938	N/A
Outstanding at 1 January 2018, as restated	2,804,164	4,030,996	21,017	38,618	6,376,703	6.17
Granted	136,606	1,835,174	–	–	1,928,612	5.13
Lapsed	–	(226,379)	(1,209)	(14,001)	(1,396,250)	8.09
Exercised	–	(1,536,802)	(6,617)	(24,617)	(336,422)	5.58
Outstanding at 31 December 2018	2,940,770	4,102,989	13,191	–	6,572,643	5.49
Exercisable at 31 December 2018	–	761,468	13,191	–	1,909,541	
Range of exercise prices (£)	–	–	–	–	5.13 - 6.20	
Weighted average contractual remaining life (years)	7.30	7.92	1.55	–	1.88	

39 Ultimate and immediate holding company

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Significant accounting estimates and judgements

In determining the carrying amounts of certain assets and liabilities, the Group makes assumptions about the effects of uncertain future events on those assets and liabilities at the reporting 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 defined benefit obligations as set out in note 27 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.

Fair value of financial instruments

Notes 2(i) and 35 provide further information on the Group'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 20, as to whether the current carrying value of goodwill is impaired.

41 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2019

Up to the date of issue of the consolidated 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 2019 and which have not been adopted in these financial statements. These include the following which may be relevant to the Group.

- Amendments to HKFRS 3, *Definition of a business* (effective on 1 January 2020)
- Amendments to HKAS 1 and HKAS 8, *Definition of material* (effective on 1 January 2020)

The Group is in the process of making an assessment of what the impact of these amendments, new standards and interpretations is expected to be in the period of initial application. As the Group has not completed its assessment, further impact may be identified in due course and will be taken into consideration when determining whether to adopt any of these new requirements before their effective date.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***42 Statement of financial position as at 31 December 2019**

	2019 HK\$'M	2018 HK\$'M (restated)
Assets		
Cash and balances with banks, central banks and other financial institutions	20,869	13,309
Placements with banks and other financial institutions	88,214	153,497
Hong Kong SAR Government certificates of indebtedness	53,821	46,691
Financial assets at fair value through profit or loss	65,047	36,891
Investment securities	265,360	241,545
Advances to customers	555,136	503,661
Amounts due from fellow subsidiaries	134,850	83,922
Amounts due from subsidiaries of the Bank	81,977	60,535
Investments in subsidiaries of the Bank	46,659	45,772
Interest in an associate	3,168	3,168
Property, plant and equipment	5,399	3,091
Goodwill and intangible assets	2,056	1,399
Deferred tax assets	48	–
Other assets	41,717	16,842
	<u>1,364,321</u>	<u>1,210,323</u>
Liabilities		
Hong Kong SAR currency notes in circulation	53,821	46,691
Deposits and balances of banks and other financial institutions	24,095	21,652
Deposits from customers	948,677	907,083
Financial liabilities at fair value through profit or loss	35,371	26,981
Debt securities in issue	350	–
Amounts due to immediate holding company	30,655	–
Amounts due to fellow subsidiaries	39,133	42,654
Amounts due to subsidiaries of the Bank	46,994	12,414
Current tax liabilities	1,678	1,655
Deferred tax liabilities	–	4
Other liabilities	52,880	31,609
Subordinated liabilities	5,875	5,906
	<u>1,239,529</u>	<u>1,096,649</u>
Equity		
Share capital	65,025	65,025
Reserves	50,784	46,697
Shareholders' equity	115,809	111,722
Other equity instruments	8,983	1,952
	<u>124,792</u>	<u>113,674</u>
	<u>1,364,321</u>	<u>1,210,323</u>

Approved and authorised for issue by the Board of Directors on 27 February 2020.

HUNG Pi Cheng Benjamin
Director

Gregory John Powell
Director

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***43 Statement of changes in equity for the year ended 31 December 2019**

	Share capital HK\$'M	Own credit adjustment reserve HK\$'M	Cash flow hedge reserve HK\$'M	FVOCI reserve – Debt HK\$'M	FVOCI reserve – Equity HK\$'M	Other reserves HK\$'M	Retained profits HK\$'M	Share option equity HK\$'M	Sub-total HK\$'M	Other equity instruments HK\$'M	Total HK\$'M
At 1 January 2018, as previously stated	20,256	(18)	18	(165)	161	154	40,682	228	61,316	1,952	63,268
Effect of merger of commonly controlled entity ¹	44,769	-	-	-	-	-	-	-	44,769	-	44,769
At 1 January 2018, as restated	65,025	(18)	18	(165)	161	154	40,682	228	106,085	1,952	108,037
Total comprehensive income	-	733	268	80	92	-	8,782	-	9,955	-	9,955
Dividend paid	-	-	-	-	-	-	(4,251)	-	(4,251)	-	(4,251)
Movement in respect of share-based compensation plans	-	-	-	-	-	-	-	(67)	(67)	-	(67)
At 31 December 2018	<u>65,025</u>	<u>715</u>	<u>286</u>	<u>(85)</u>	<u>253</u>	<u>154</u>	<u>45,213</u>	<u>161</u>	<u>111,722</u>	<u>1,952</u>	<u>113,674</u>
Issuance of other equity instruments, net of expenses	-	-	-	-	-	-	-	-	-	7,031	7,031
Total comprehensive income	-	(745)	(668)	272	(43)	-	9,666	-	8,482	-	8,482
Dividend paid	-	-	-	-	-	-	(4,391)	-	(4,391)	-	(4,391)
Movement in respect of share-based compensation plans	-	-	-	-	-	-	-	(4)	(4)	-	(4)
At 31 December 2019	<u>65,025</u>	<u>(30)</u>	<u>(382)</u>	<u>187</u>	<u>210</u>	<u>154</u>	<u>50,488</u>	<u>157</u>	<u>115,809</u>	<u>8,983</u>	<u>124,792</u>

¹ In accordance with the principles of merger accounting as stated in note 2(b)(ii), the comparative amounts have been restated so that they are presented as if SCB China and SC NEA Group had been combined and the Class C and Class D ordinary shares of the Bank had been issued at the earliest date presented in these financial statements notwithstanding their actual issuance on 1 June 2019 and 1 October 2019 respectively.

44 Comparative figures

As explained in note 2(b), comparative amounts have been restated as a result of the adoption of merger accounting for the common control combinations taking place during the year. Further details are set out in note 17(c). In addition, comparative amounts of interest income and expense arising from financial instruments at fair value through profit or loss have been restated to conform with the current year presentation as set out in note 3(b).

45 Post balance sheet event

The existence of novel coronavirus (Covid-19) was confirmed in early 2020 and has spread across mainland China and beyond, causing disruptions to businesses and economic activity. The Group considers this outbreak to be a non-adjusting post balance sheet event. As the situation is fluid and rapidly evolving, we do not consider it practicable to provide a quantitative estimate of the potential impact of this outbreak on the Group. The impact of this outbreak on the macroeconomic forecasts will be incorporated into the Group's HKFRS/IFRS9 estimates of expected credit loss provisions in 2020.

Appendix I: Corporate Governance Report

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the Hong Kong Monetary Authority (“HKMA”)

Corporate Governance Practices and objectives

Standard Chartered Bank (Hong Kong) Limited (the “Bank”) has followed the module on “Corporate Governance of Locally Incorporated Authorised Institutions” (“CG-1”) under the Supervisory Policy Manual (“SPM”) issued by the HKMA throughout the year ended 31 December 2019.

Organisational and governance structure and policies

During 2019, the Bank underwent structural change (“Restructuring”). It became directly owned by Standard Chartered PLC in March 2019. The Bank also acquired control of overseas subsidiaries in the Greater China and North Asia (“GCNA”) region on 1 June 2019 (“Phase I Restructuring”) and 1 October 2019 (“Phase II Restructuring”) respectively to become a regional hub, with consolidation and regulatory oversight of subsidiaries in China, Korea and Taiwan.

Board Composition

Chairperson

Edward Martin WILLIAMS (appointed on 1 June 2019)
Pi Cheng Benjamin HUNG (ceased to be the Chairman on 1 June 2019)

Executive Directors

Pi Cheng Benjamin HUNG (appointed on 1 June 2019)
Gregory John POWELL (appointed on 1 June 2019)
Darren Suk KIM (appointed on 1 June 2019)
Wai Yi Mary HUEN
Yee Mann HAU

Non-Executive Directors

Pi Cheng Benjamin HUNG (ceased to be a Non-Executive Director on 31 May 2019 and was appointed as an Executive Director on 1 June 2019)
Edward Martin WILLIAMS
Cheuk Kuen Gloria LEE
Michael Andres GORRIZ

Independent Non-Executive Directors

Ching FONG
Stephen Robert ENO
Wai Sun Edward CHENG
Lieh Cheung Andrew TUNG

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Composition (continued)

Edward Martin WILLIAMS

Chairman, Non-Executive Director

Mr. Williams was appointed to the Board in August 2015 and became the Chairman on 1 June 2019.

Prior to 2017, Mr. Williams was the Deputy Group Chief Risk Officer for Standard Chartered Group and responsible for risk governance for a significant number of the Group's major operating subsidiaries. He was also responsible for approvals and the oversight of a significant number of Standard Chartered's largest and most complex transactions and counter-party exposures, as well as significant consumer bank portfolios. Mr. Williams was actively involved in Standard Chartered Group's problem credit portfolio and most significant risk problems.

Mr. Williams has over 40 years of financial services experience, with over 20 years in Asia. He has worked at the Standard Chartered Group for over 17 years, holding or having held directorships of the Standard Chartered Group's subsidiaries in China, Korea, Taiwan and Malaysia. Mr. Williams was previously Group Head of Group Special Assets Management, the corporate restructuring and workout division. Prior to joining Standard Chartered Group, Mr. Williams had held a variety of senior management positions at Citicorp/Citibank and Westpac Banking Corporation in various countries.

Mr. Williams holds a master's degree in Business Administration from Harvard Graduate School of Business, a Master of Science degree in Aerospace Engineering from Massachusetts Institute of Technology, and a Bachelor of Science degree in Aerospace Engineering from Princeton University.

Pi Cheng Benjamin HUNG

Executive Director and Regional Chief Executive Officer

Mr. Hung was appointed to the Board in January 2008 and was the Chairperson between May 2014 and May 2019.

Mr. Hung is the Regional CEO for GCNA, the CEO of Retail Banking and the CEO of Wealth Management business globally for Standard Chartered Bank. He sits on the Standard Chartered Group's Management Team. He is also the chairperson of Standard Chartered Bank (China) Limited.

Mr. Hung joined Standard Chartered Group in 1992 and has held a number of senior management positions spanning corporate, commercial and retail banking. Prior to his current role, Mr. Hung was the Regional CEO of Greater China. Mr. Hung had worked in American Express Bank Canada and Spar Aerospace Canada before joining Standard Chartered.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Composition (continued)

Pi Cheng Benjamin HUNG (continued)

Mr. Hung is a member of the Hong Kong Chief Executive's Council of Advisers on Innovation and Strategic Development, the Exchange Fund Advisory Committee, the Hong Kong Exchanges and Clearing Limited's Board of Directors, the General Committee of the Hong Kong General Chamber of Commerce. He was previously the chairman of the Hong Kong Association of Banks, a member of the Financial Services Development Council, a board member of the Hong Kong Airport Authority and the Hong Kong Hospital Authority, and a Council Member of the University of Hong Kong.

He holds a Master of Business Administration from University of Toronto and a Bachelor of Arts in Business Administration from University of Washington.

Wai Yi Mary HUEN

Executive Director and Chief Executive Officer, Hong Kong

Ms. Huen was appointed to the Board in September 2016, becoming the Chief Executive Officer, Hong Kong, in March 2017.

Prior to the current role, Ms. Huen was the Regional Head of Retail Banking, GCNA, responsible for setting the strategic agenda and driving the performance delivery of all the retail operations in the region. Before taking on the regional role, as the Head of Retail Banking, Hong Kong, she led the Retail Banking business in Hong Kong into becoming one of the most successful business segments in the Group globally, delivering strong income growth and generating remarkable profit contribution.

Ms. Huen has over 25 years of experience in business management and banking services. Since joining the Bank in 1991, she has held various key positions across the management of balance sheet products, Wealth Management and distribution.

Ms. Huen is the Chairman of the Hong Kong Association of Banks, Vice President of the council of the Hong Kong Institute of Bankers, a board member of the Hong Kong Interbank Clearing Limited, and a council member of the Treasury Markets Association. She is also a member of the Banking Advisory Committee, and the Exchange Fund Advisory Committee Financial Infrastructure and Market Development Sub-Committee as well as the Currency Board Sub-committee of the Hong Kong Monetary Authority. She has been invited as member of the Hong Kong Academy of Finance since its establishment in 2019.

Outside of banking, she is a council member of the Hong Kong Trade Development Council (HKTDC), a member of the HKTDC Belt and Road & Greater Bay Area Committee, Chairman of the HKTDC Financial Services Advisory Committee and the HKTDC Asian Financial Forum Steering Committee, a member of the Board of the Community Chest of Hong Kong and the Hong Kong Tourism Board, a panel member of the Anti-Money Laundering and Counter-Terrorist Financing Review Tribunal, an elected council member of the Hong Kong Management Association, a member of the Advisory Board of the MBA Programmes at the Chinese University of Hong Kong and a member of the Women's Commission established under the Labour and Welfare Bureau of the Hong Kong government.

Ms. Huen received a Bachelor of Arts degree from the University of Hong Kong.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Composition (continued)

Gregory John POWELL

Executive Director and Regional Chief Financial Officer

Mr. Powell was appointed to the Board on 1 June 2019. He has been the Regional Chief Financial Officer for GCNA since March 2017.

Mr. Powell joined the Standard Chartered Group in 1996 and has held a number of senior management roles in Finance including the Regional Chief Financial Officer of Standard Chartered Bank (Korea) Limited from September 2013 to January 2016 and the Group Head of Performance Management from December 2008 to August 2013. He is also the Chairman and non-executive director for Standard Chartered Bank (Taiwan) Limited since August 2017.

Mr. Powell is a member of the Institute of Chartered Accountant in England and Wales and holds a Bachelor of Sciences (Honors) in Biology from University of Sussex.

Darren Suk KIM

Executive Director and Regional Chief Risk Officer & Regional Chief Credit Officer

Mr. Kim was appointed to the Board on 1 June 2019. He has been the Regional Chief Risk Officer for GCNA since July 2017 and the Regional Chief Credit Officer for GCNA since August 2017.

Mr. Kim first joined Standard Chartered Group in February 2014 as the Head of Corporate Institutional and Commercial Risk. In November 2015, he started double-hatting as Chief Credit Officer of Corporate Institutional and Commercial Risk in Korea and SCB Tokyo Branch & Chief Risk Officer of Standard Chartered Bank Korea. Prior to his roles in Standard Chartered Group, Darren held multiple credit and market risk roles at Bank of America before he moved to Hong Kong to join Merrill Lynch as Regional Credit Officer before becoming the Head of Risk Management Asia/Oceania ex-Japan at Daiwa.

Mr. Kim holds a Master of Business Administration with concentration in Finance from Fordham University and a Bachelor of Arts degree in Economics from University of Connecticut.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Composition (continued)

Yee Mann HAU

Executive Director and Chief Financial Officer, Hong Kong

Ms. Hau was appointed to the Board in April 2017 and became the Chief Financial Officer, Hong Kong at the same time. Prior to her current role, Ms. Hau was the Chief Financial Officer and Executive Director of Standard Chartered Bank (China) Limited.

Ms Hau joined the Standard Chartered Group in Hong Kong in 2007 and was previously Financial Controller, Hong Kong. Ms. Hau qualified as a chartered accountant with KPMG in London, and moved to Hong Kong with KPMG. Ms. Hau has over 20 years of banking experience. Before joining the Bank, Ms. Hau worked for 12 years with HSBC in Hong Kong.

Ms. Hau is a chartered accountant with the Institute of Chartered Accountants in England and Wales, and Hong Kong Institute of Certified Public Accountants.

Cheuk Kuen Gloria LEE

Non-Executive Director

Ms. Lee was appointed to the Board in May 2017.

Prior to her appointment as Non-executive Director of the Bank, Ms. Lee had held numerous roles in Standard Chartered Group including Vice Chair, Commercial Banking, Hong Kong; Vice Chair, Corporate & Institutional Clients, Hong Kong; Head, Corporate & Institutional Clients, Hong Kong; Head of Origination & Client Coverage, Hong Kong; Head of Client Relationships, Hong Kong; Head of Local Corporates, Hong Kong and Pearl River Delta and Senior Manager, General Manufacturing and Trading, Hong Kong.

Ms. Lee received a Bachelor of Social Sciences Degree majoring in Economics from the University of Hong Kong.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Composition (continued)

Michael Andres GORRIZ

Non-Executive Director

Mr. Gorriz was appointed to the Board in February 2018.

Mr. Gorriz was appointed Group Chief Information Officer in July 2015 and is currently responsible for the systems development and technology infrastructure which underpin Standard Chartered Group's client services, and defines and implements Standard Chartered Bank's digital and innovation agenda.

Prior to joining Standard Chartered, Mr. Gorriz was Vice President and Chief Information Officer at Daimler AG where he was globally responsible for strategy, planning and development of the Daimler Group's IT systems, as well as the operation of its technical infrastructure. During his 28 years at Daimler, Mr. Gorriz progressed through specialist research and design roles in aerospace to general management roles.

Mr. Gorriz is a physicist and engineer by background and obtained a PhD in Engineering. He is based in Singapore.

FONG Ching

Independent Non-Executive Director

Dr. Fong was appointed to the Board in May 2013.

Dr. Fong was the former Non-Executive Chairman of the Securities and Futures Commission from 2006 to 2012 in Hong Kong. He serves as an independent non-executive director of Standard Chartered Bank (China) Limited and MTR Corporation Limited. He is also the Chairman of Lifeline Express Hong Kong Foundation.

His past public services include serving as a Non-Executive Director of the Hong Kong Mortgage Corporation Limited and Mandatory Provident Fund Schemes Authority; a member of the Hong Kong Housing Authority and Chairman of the Open University of Hong Kong.

Dr. Fong received his education both in Hong Kong and in the United Kingdom. He graduated from the University of Kent in the United Kingdom and subsequently qualified as a member of the Institute of Chartered Accountants in England and Wales. Upon returning to Hong Kong, he continued to pursue a career in public accounting. He was a senior audit partner with PricewaterhouseCoopers until his retirement in 2003.

Dr. Fong was appointed a Justice of the Peace in 1996 and was awarded the Gold Bauhinia Star in 2008 by the HKSAR Government. He was awarded an Honorary Doctor of Civil Law by the University of Kent in July 1997 and an Honorary Doctor of Social Services by the Hong Kong Open University in December 2017. He was also awarded an Honorary Fellowship by the Hong Kong Academy for Performing Arts in 2010.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Composition (continued)

Stephen Robert ENO

Independent Non-Executive Director

Mr. Eno was appointed to the Board in July 2013.

Mr. Eno was a partner of Baker & McKenzie from July 1987 to December 2011 and continued as a global consultant from 1 January 2012 to 30 June 2013. He was the Chairman of the Education Committee of the British Chamber of Commerce from 2004 to 2014, and a member of the Board of Governors of Chinese International School from 1995 to 2017. He is also currently a director of the Hong Kong Youth Arts Foundation.

Mr. Eno holds a BA (hons.) degree in law (2:1) from the University of Kent in England. He is qualified as a solicitor in Hong Kong and England and Wales, as a notary in Hong Kong, and is also an accredited Hong Kong Mediator.

Wai Sun Edward CHENG

Independent Non-Executive Director

Mr. Cheng was appointed to the Board in April 2014.

Mr. Cheng is the Deputy Chairman and Chief Executive of Wing Tai Properties Limited, and the Chairman of Lanson Place Hospitality Management Limited.

Mr. Cheng has many years of public service experience in urban renewal, housing, finance, corruption prevention, technology and education. He was the Chairman of each of the Urban Renewal Authority and the University Grants Committee of Hong Kong. He is currently a non-executive director of the Securities and Futures Commission and a member of the Chief Executive's Council of Advisers on Innovation and Strategic Development.

Mr. Cheng has a Bachelor's degree in political science and economics from Cornell University, and a Bachelor's degree in jurisprudence and a Master's degree from Oxford University. He was qualified as a solicitor in England and Wales as well as in Hong Kong. He is a Justice of the Peace, and has been awarded the Gold Bauhinia Star by the HKSAR Government.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Composition (continued)

Lieh Cheung Andrew TUNG

Independent Non-Executive Director

Mr. Tung was appointed to the Board in July 2015.

Mr. Tung has been an Executive Director of Orient Overseas (International) Limited since 2 November 2011 and is a member of the Executive Committee, the Finance Committee, the Inside Information Committee and the Risk Committee of Orient Overseas (International) Limited. He has been a Director and a member of the Executive Committee of Orient Overseas Container Line Limited (“OOCL”), a wholly-owned subsidiary of Orient Overseas (International) Limited, since March 2006, and re-designated from the Chief Executive Officer to Co-Chief Executive Officer of OOCL since 3 August 2018. He is also a director of various subsidiaries of Orient Overseas (International) Limited. Between 1993 and 1998, he has served the Orient Overseas Container Line Group in various capacities including Director of Reefer Trade of OOCL. The last position Mr. Tung held in Hong Kong Dragon Airlines Limited prior to joining OOCL in 2006 was the Chief Operating Officer.

Mr. Tung holds a Bachelor’s degree from Princeton University and a Master of Business Administration degree from Stanford University in the USA. Mr. Tung is an independent non-executive director of Cathay Pacific Airways Limited (a company listed in Hong Kong). He is currently a member of the Hong Kong Logistics Development Council, a member of the Hong Kong Maritime and Port Board, and the Chairman of the Maritime and Port Development Committee. He was the Vice-Chairman of the International Chamber of Commerce Commission for Transport & Logistics.

Board selection process

The Nomination Committee regularly reviews the structure, size and composition of the Board and identifies individuals suitably qualified to become members of the Board. The Committee makes recommendations to the Board on the appointment of and succession planning for Directors (subject to the approval of the HKMA), having regard to the skills, knowledge, experience and diversity the candidate adds to the Board and compliance with corporate governance standards set out in the HKMA Supervisory Policy Manual CG-1 and the guidance on Empowerment of Independent Non-Executive Directors (“INEDs”) in the Banking Industry in Hong Kong issued by the HKMA.

A candidate being considered for Board appointment is expected to devote adequate time to attend all Board meetings and, where relevant, Committee meetings in person. An individual who is to be appointed as an INED should also meet the independence status prior to their appointment.

In accordance with the Articles of Association of the Bank, a Director appointed by the Board shall hold office only until the next following Annual General Meeting and shall be eligible for re-election.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Committees

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

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

The Board has held four scheduled meetings in 2019.

The below committees operate under the direct authority of the Board.

(b) *Regional Executive Committee (“REXCO”)*

The REXCO was created on 1 June 2019 with a GCNA regional scope and supervision responsibility for the overseas subsidiaries. The REXCO meets regularly in relation to the day to day management, operation and control of GCNA the business. It also sub-delegates to various committees certain aspects of the conduct of the business as detailed below. The REXCO includes the Regional Chief Executive Officer, the Regional Chief Financial Officer, the Regional Chief Risk Officer (“CRO”), the country CEOs of the overseas subsidiaries and the regional heads of various businesses and functions.

Since its inception, the REXCO has held six meetings.

(c) *Audit Committee (“AC”)*

The AC reviews, on behalf of the Board, the Bank’s internal financial controls to identify, assess, manage and monitor financial risks and to review the bank’s internal control systems. The AC also reviews the annual and interim financial statements, discusses matters raised by Internal Audit and external auditors and ensures that audit recommendations are implemented accordingly. After the Restructuring, the AC had an expanded scope to oversee GCNA subsidiaries.

Prior to the Restructuring, the AC comprises three independent non-executive directors (“INEDs” or “INED”) and two non-executive directors (“NEDs” or “NED”) namely Fong Ching (AC Chairperson and INED), Stephen Robert Eno (INED), Cheng Wai Sun Edward (INED), Edward Martin Williams (NED) and Lee Cheuk Kuen Gloria (NED). After the Phase I Restructuring in June, Edward Martin Williams resigned from the AC. The other members remained the same.

During the year, four AC meetings have been held.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Committees (continued)

(d) Board Risk Committee (“BRC”)

The BRC exercises oversight on behalf of the Board of the overall risk appetite and risk management strategy and its implementation by management. The BRC reviews the appropriateness and effectiveness of the Bank’s risk management systems and controls. The BRC also advises and assists the Board in discharging its responsibilities for the Bank’s culture-related matters, including the oversight of effective mechanisms to assess behavioural standards and whistleblowing policy. After the Restructuring, the BRC has an expanded scope to oversee GCNA subsidiaries.

The BRC comprises three INEDs and two NEDs namely Stephen Robert Eno (BRC Chairperson and INED), Fong Ching (INED), Tung Lieh Cheung Andrew (INED), Edward Martin Williams (NED) and Lee Cheuk Kuen Gloria (NED). The Restructuring did not affect the members.

During the year, four BRC meetings have been held.

(e) Nomination Committee (“NomCo”)

The NomCo is responsible for identifying individuals suitably qualified to become members of the Board or of key senior management, and selecting, or recommending such individuals to the Board. The NomCo reviews succession plans of the Board and key senior management roles. It also reviews the structure, size and composition of the Board and makes recommendations to the Board with regard to any adjustments that are deemed necessary.

The NomCo comprises three INEDs and one NED namely Cheng Wai Sun Edward (NomCo Chairman and INED), Stephen Robert Eno (INED), and Tung Lieh Cheung Andrew (INED) and Hung Pi Cheng Benjamin (NED). The Restructuring did not affect the scope of the committee and the members remained the same.

During the year, two NomCo meetings have been held.

(f) Remuneration Committee (“RemCo”)

The RemCo was established on 1 October 2018. It is responsible for reviewing the framework and policies for remuneration and compliance with the applicable laws and regulatory guidelines. The RemCo shall ensure, on behalf of the Board, that the Company’s remuneration policies are consistent with effective risk management.

Following the establishment of the revised SCB HK corporate governance structure in 2019, the RemCo discharges the necessary oversight and control of the subsidiaries remuneration for SCB China, SCB Korea and SCB Taiwan, under the GCNA hub in Hong Kong, through:

- (i) Adoption of a detailed and consistent remuneration framework that already exists across the SCB Group where the subsidiaries are all subject to the Group Subsidiary Governance Policy and have adopted Group remuneration policies and procedures similar to those of SCB HK; and

Organisational and governance structure and policies (continued)**Board Committees (continued)****(f) Remuneration Committee (“RemCo”) (continued)**

- (ii) Existing subsidiary corporate governance, which are already subject to local guidance, regulations and rules including requirements relating to their independent directors, boards and committees.

The RemCo comprises three INEDs and one ED namely Tung Lieh Cheung Andrew (RemCo Chairman and INED), Fong Ching (INED), Cheng Wai Sun Edward (INED) and Hung Pi Cheng Benjamin (ED).

During the year, three Remco meetings have been held.

Sub-committees of EXCO**(a) Regional Asset and Liability Committee (“RALCO”)**

The RALCO, appointed by the REXCO, is responsible for the implementation of, and compliance with, the Group’s balance sheet management policies, including those relating to liquidity, capital, interest rate risk in the banking book (“IRRBB”) and recovery and resolution planning requirements. The RALCO comprises of the Regional CEO, the Regional CFO and the Regional CRO as voting members, with attendance from key business and risk management heads, the subsidiary CEOs and Hong Kong CEO. The RALCO also ensures that the GCNA Group jointly and severally complies, at all times, with the rules and regulations set by the Group’s lead regulator, the Hong Kong Monetary Authority and individual regulators in the countries in which the GCNA Group has a presence.

(b) Regional Executive Risk Committee (“RERC”)

The RERC, through its authority delegated by the REXCO, is responsible for the management of all Principle Risk Types (“PRTs”) in the GCNA Region other than those delegated to Regional Asset and Liability Committee (“RALCO”) and the Country Pensions Committee (“CPC”). The RERC oversees effective application of the Bank’s Enterprise Risk Management Framework (“ERMF”), recommends risk appetite for approval by the SCBHK Board or Board level committee, approves and reviews new models and risk control parameters including policies, risk exposure limits, or other control levers. The RERC is chaired by the Regional CRO with members including the Regional CEO, the Regional CFO, and the key business and risk management heads. There were in total eight standing RERC meetings held in 2019.

(c) Pillar III Committee (“Pillar III”)

The Pillar III, through its authority delegated by the Board, is responsible for reviewing, approving and compliance of the Pillar III disclosure statement in accordance with the Bank’s Disclosure Policy, the Banking (Disclosure) Rules and the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules. The Pillar III is chaired by the Regional CFO and the Regional CRO, with members including key finance and risk management heads. There were four meetings held in 2019.

(d) Hong Kong Management Committee (“HKMANCO”)

Prior to the Restructuring, a Hong Kong Executive Committee was responsible for day to day management, operation and control of the Hong Kong business. At Phase I Restructuring, the Hong Kong Executive Committee was renamed to HKMANCO and continued to focus on Hong Kong business. The HKMANCO meets regularly and sub-delegates to various committees certain aspects of the conduct of the business. The HKMANCO includes the Chief Executive Officer, Hong Kong, the Chief Financial Officer, Hong Kong and the Hong Kong heads of various businesses and functions. During the year, 12 HKMANCO meetings have been held.

Risk appetite

The details of the Group's risk appetite are disclosed in note 34 to the consolidated financial statements.

Major share ownership and voting rights

The Bank was wholly owned by Standard Chartered PLC through Standard Chartered Holdings Limited ("SCHL") and Standard Chartered Bank ("SCB"). SCHL and SCB (the Bank's immediate holding company) held 49% and 51% of the voting rights in the Bank respectively. Each of SC PLC and SCHL is a company incorporated in England and Wales whereas SCB is a company incorporated in England by Royal Charter.

In March 2019, Standard Chartered PLC acquired 100% of the Bank's voting rights from SCHL and SCB respectively and became the immediate holding company of the Bank.

Related party transactions

All related party transactions during the year ended 31 December 2019 are disclosed in notes 16 and 37 to the consolidated financial statements.

Complex structures

A structured entity is consolidated into the Group's consolidated financial statements where the Group controls the structured entity. For details, please refer to note 17 to the consolidated financial statements.

Appendix II: directors of the Bank's subsidiaries

The names of all directors who have served on the board of the subsidiaries of the Bank during the year and up to 27 February 2020:

- * Nigel ANTON
- * AU Siu Luen
- * Peter William BURNETT
- # CHAN Fong
- * CHEUNG Wai Hing
- * Byung Ho CHUNG
- * Kieran CORR
- * FENG Yan
- * FONG Ching
- * Michael Andres GORRIZ
- * Deniz GUVEN
- * HAU Yee Mann
- * HUEN Mary Wai Yi
- * HUI Hon Hing Susanna
- * Dinesh KUMAR
- * LAI Yan Hong
- * LAM Hui Yip
- * MA Kam Sing Allen
- * Shikkoh MALIK
- * Peter MOYLAN
- * NG Chau Shing Dantes
- * NG Chi Ming
- * Abhishek PANDEY
- * Xiaomin RONG
- * Samir SUBBERWAL
- * TAN Ming Kiu John
- * Amit Kishorchandra TANNA
- * Biswajyoti UPADHYAY
- * YEUNG Mei Chun Jeny
- ^ YIM Mei Ling Carolyn
- * Paul Stuart CHAMBERS
- * Christopher John DANIELS
- * Simon William GARDINER
- * Gregory John POWELL
- * Sandeep Singh RAI
- * CHEN Ban-Ren
- * CHAN Mignonne Man-Jung
- * Andrew James HARDACRE
- * CHANG Wea Meng
- * LIN Anthony Yuen Tung
- * LIN Su-Chen
- * Hormuz DUBASH
- * Jong Nam OH
- * Eun Hyung LEE
- * Jee In JANG
- * Byoung Ok SOHN
- * Darren KIM
- * Jong Bok PARK
- * Joo Hyun OH
- * Jeong Woo YANG

Appendix II: directors of the Bank's subsidiaries (continued)

- * HUNG Benjamin Pi Cheng
- * Norman LYLE
- * ZHANG Jerry Xiao Lei
- * LEE Hoi Keung
- * XIE Wen
- * Fong Eddy Ching
- * WANG Jun
- * WANG Yuan
- * John Peter SHELLEY (subject to regulatory approval)

* Directors serving the Board as at 27 February 2020

Director until 27 December 2019

^ Director until 30 December 2019