

Standard Chartered Bank
(Hong Kong) Limited

Directors' Report and
Consolidated Financial
Statements

For the year ended
31 December 2017

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 2017.

Principal place of business

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

Principal activities

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

Financial statements

The profit of the Bank and its subsidiaries (together the “Group”) for the year ended 31 December 2017 and the state of the Group’s affairs as at that date are set out in the consolidated financial statements on pages 10 to 139.

During the year ended 31 December 2017, the directors had declared and paid an ordinary dividend of HK\$1.61276 (2016: HK\$3.17479) per each “A” and “B” ordinary share totalling HK\$3,124 million (2016: HK\$6,150 million). A total dividend of HK\$244 million (2016: HK\$242 million) was paid in respect of the US\$500 million 6.25% perpetual non-cumulative convertible preference shares classified as equity.

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\$7 million (2016: HK\$8 million).

Share capital

Details of the movements in the share capital of the Bank during the year are set out in note 32 to the consolidated financial statements.

Directors

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

Executive directors

Huen Wai Yi Mary (re-designated as an executive director on 1 March 2017)

Hau Yee Mann (appointed on 1 April 2017)

Tan Siew Boi (resigned on 1 March 2017)

Ling Fou Tsong (resigned on 1 April 2017)

Report of the directors (continued)

Non-executive directors

Hung Pi Cheng Benjamin, Chairperson

Edward Martin Williams

Anna Elizabeth Marrs (resigned on 7 February 2018)

Lee Cheuk Kuen Gloria (appointed on 26 May 2017)

Michael Andres Gorriz (appointed on 7 February 2018)

Fong Ching*

Stephen Robert Eno*

Cheng Edward Wai Sun*

Tung Lieh Cheung Andrew*

** Independent non-executive directors*

Michael Andres Gorriz will be subject to re-election at the 2018 annual general meeting in accordance with Article 110 of the Bank's Article of Association.

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

Directors' service contracts

The term of service contracts of all independent non-executive directors, and two non-executive directors, Edward Martin Williams and Lee Cheuk Kuen Gloria, 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, Anna Elizabeth Marrs, Hung Pi Cheng Benjamin, Edward Martin Williams, Huen Wai Yi Mary, Tan Siew Boi and Hau Yee Mann 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 retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as the auditor of the Bank is to be proposed at the forthcoming annual general meeting.

On behalf of the Board

Hung Pi Cheng Benjamin
Chairman

Hong Kong, 27 February 2018



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 10 to 139, which comprise the consolidated statement of financial position as at 31 December 2017, 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 2017 and of its financial performance and its 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.

Impairment of loans and advances	
<i>Refer to note 15 to the consolidated financial statements and the accounting policies on pages 25 to 26</i>	
The Key Audit Matter	How the matter was addressed in our audit
Impairment of loans and advances across the banking industry continues to be an area of concern and elevated focus, as counterparties (particularly in Mainland China) continue to tackle liquidity and over-capacity concerns.	Our audit procedures to assess impairment of loans and advances included the following: <ul style="list-style-type: none"> assessing the design, implementation and operating effectiveness of key internal controls over the approval, recording, monitoring and restructuring of loans and advances, the credit grading process and the measurement of impairment provisions for individually assessed loans and advances;



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>The Group has loan exposures to Corporate & Institutional Banking (“CIB”) clients, Commercial Banking (“CB”) clients and loans and advances to banks (collectively ‘Larger Clients’). The exposures comprise larger loans that are monitored individually, based on the knowledge of each individual borrower. However, the Retail Banking and Private Banking clients’ exposures comprise 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 gross amount of impaired loans and advances of the Group decreased from HK\$3,693 million as at 31 December 2016 to HK\$3,278 million as at 31 December 2017 and the total impairment provisions amounted to HK\$1,150 million as at 31 December 2017.</p> <p>The impairment of loans and advances is a subjective area due to the level of judgement applied by management in determining provisions.</p> <p>From the Bank’s perspective, the impairment allowances of certain portfolios are relatively more sensitive to management judgement, namely those to clients that operate in stressed industries, for example commodities and related exposures, where the loans and advances are unsecured or where the loans and advances are subject to potential collateral shortfalls.</p> <p>The determination of the portfolio impairment provision (“PIP”) is heavily dependent on the external macro environment and the Bank’s internal credit risk management. The Bank’s PIP is derived from estimates including the Bank’s historical losses for loans and advances, the historical emergence period (i.e. the time lapse between the occurrence of the event causing eventual default to the actual recording of a loss) and other adjustment factors such as business cycle adjustments and country specific adjustments.</p>	<ul style="list-style-type: none"> • evaluating the validity of the models used and assumptions adopted by the Bank by assessing the inputs into the models, making comparisons with data from external sources and comparing the historical losses against the Bank’s other internal records and our prior year records; • comparing the economic factors used in the models with market information to assess whether they were aligned with market and economic development. We also assessed the emergence period by tracing the lifecycle of overdue accounts from the specific credit event to downgrading the account to either early alert or Group Special Assets Management (“GSAM”); • assessing the emergence period, business cycle adjustments and country specific adjustments to the models, through the benchmarking of PIP coverage against other large banks, comparing the PIP with actual impairment in prior years and discussing with senior management any management overlays; • assessing the IIP balance by selecting a sample, based on specific risk criteria, of individually impaired loans and advances, non-impaired loans and advances from the Bank’s Early Alert Report (“EAR”) and loans in industries vulnerable to the current economic slowdown in CB and CIB for credit assessment. For these samples, we assessed the forecast of recoverable cash flows through inquiry, applying judgement and our own research. We also evaluated the consistency of management’s application of key assumptions and compared them with our own data sources; • evaluating the experience, independence, competence and integrity of the external valuers engaged by the Bank to value certain property and illiquid collateral. Where possible, we compared the valuations with externally derived data such as commodity prices and real estate valuations;
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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)

<p>An individual impairment provision ("IIP") is estimated by management once objective evidence of impairment becomes apparent.</p> <p>Management exercises judgement in determining the quantum of loss based on a range of factors. These include available remedies for recovery, the financial situation of the borrower, collateral valuation, the seniority of the claim and the existence and cooperativeness of other creditors.</p> <p>Whilst the Bank appoints external valuers for the valuation of certain property and other illiquid collateral, enforceability, timing and means of realisation also affect the ultimate collectability and, thereby, the amount of IIP as at the reporting date.</p> <p>We identified impairment of loans and advances as a key audit matter because of the inherent uncertainty 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"> recalculating the IIP to evaluate the application of the Bank's methodology; and for the key underlying systems used for the processing of transactions we involved our information technology specialists to test a selection of automated controls within these systems. We also assessed the design, implementation and operating effectiveness of the key internal controls over these underlying systems, for example, controls over access to systems and controls over data and change management.
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Assessing the fair value of financial instruments

Refer to note 38 to the consolidated financial statements and the accounting policies on pages 21 to 24

The Key Audit Matter

At 31 December 2017 the fair value of the Group's financial instruments totalled HK\$293,565 million of which HK\$134,889 million, HK\$156,787 million and HK\$1,889 million were classified under the fair value hierarchy as level 1, 2 and 3 financial instruments respectively.

The valuation of the Group's financial instruments is based on a combination of market data and valuation models which often require a considerable number of inputs. Many of these inputs are obtained from readily available data for liquid markets.

Where such observable data is not readily available, as in the case of level 3 financial instruments, then estimates need to be developed which can involve significant management judgement.

How the matter was addressed in our audit

Our audit procedures to assess the fair value of financial instruments included the following:

- assessing the design, implementation and operating effectiveness of key internal controls over valuation, independent price verification, front office/back office reconciliations and model approval;
- comparing the fair values applied by the Group with publicly available market data for all level 1 securities and on a sample basis for level 1 derivative positions;



**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>In addition, the Group has developed its own models to value certain level 2 and level 3 financial instruments, which also involves significant management judgement.</p> <p>We identified assessing the fair value of 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>	<ul style="list-style-type: none"> • engaging our internal valuation specialists to perform, on a sample basis, independent valuations of level 2 and level 3 financial instruments and comparing these valuations with the Group’s valuations. Our independent valuations included developing models, obtaining inputs independently and verifying the inputs; • engaging our internal valuation specialists to evaluate a sample of models key to the independent price verification process of complex financial instruments; • inquiring of management about changes in the credit and funding adjustment methodologies and assessing the inputs into the model and re-performing the netting logic applied by the system; • 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, and • for the key underlying systems used for the processing of transactions we involved our information technology specialists to test a selection of automated controls within these systems. We also assessed the design, implementation and operating effectiveness of the key internal controls over these underlying systems, for example, controls over access to systems and controls over data and change management.
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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 HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with HKSAs, 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.



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)

- 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.
- 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 Donowho, Simon Christopher.

KPMG

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

27 February 2018

Consolidated income statement
For the year ended 31 December 2017
(Expressed in millions of Hong Kong dollars)

	Note	2017 HK\$'M	2016 HK\$'M
Interest income	4(a)	16,109	13,672
Interest expense	4(b)	(4,102)	(3,547)
Net interest income		<u>12,007</u>	<u>10,125</u>
Fee and commission income		7,493	7,434
Fee and commission expense		(701)	(440)
Net fee and commission income	4(c)	6,792	6,994
Net trading income	4(d)	2,001	1,576
Net losses from financial instruments designated at fair value through profit or loss	4(e)	(99)	(751)
Net gains from disposal of available-for-sale securities	5	24	164
Other operating income	4(f)	4,172	5,651
		<u>12,890</u>	<u>13,634</u>
Total operating income		24,897	23,759
Staff costs		(6,395)	(6,126)
Premises and equipment		(3,596)	(3,196)
Others		(6,266)	(5,131)
Operating expenses	4(g)	(16,257)	(14,453)
Operating profit before impairment		8,640	9,306
Impairment credit/(charge) on advances to customers	6(a)	85	(1,310)
Other impairment charges	6(b)	(608)	(412)
Operating profit after impairment		8,117	7,584
Share of profit of associates		1,828	1,360
Profit before taxation		9,945	8,944
Taxation	7(a)	(1,462)	(1,015)
Profit after taxation		<u>8,483</u>	<u>7,929</u>

The notes on pages 16 to 139 form part of these consolidated financial statements.

Consolidated statement of comprehensive income**For the year ended 31 December 2017***(Expressed in millions of Hong Kong dollars)*

	2017 HK\$'M	2016 HK\$'M
Profit after taxation	8,483	7,929
Other comprehensive income:		
<u>Items that will not be reclassified to the income statement:</u>		
Own credit adjustment:		
– Losses arising from fair value of own credit on financial liabilities designated at fair value through profit of loss	(381)	–
Defined benefit plans:		
– Remeasurement of net defined benefit liability	330	92
– Related tax effect	(54)	(15)
<u>Items that may be reclassified subsequently to the income statement:</u>		
Available-for-sale securities:		
– Changes in fair value recognised during the year	351	(182)
– Changes in fair value transferred to the income statement on disposal	(24)	(164)
– Transfer to the income statement on fair value hedged items attributable to hedged risk	99	128
– Share of available-for-sale investment reserve of associates	(142)	(67)
– Related tax effect	(33)	18
Cash flow hedges:		
– Changes in fair value recognised during the year	234	(215)
– Transfer to the income statement on termination of hedging derivatives	18	(36)
– Related tax effect	(42)	41
Exchange difference	867	(652)
	<hr/>	<hr/>
Other comprehensive income/(loss) for the year, net of tax	1,223	(1,052)
	<hr/>	<hr/>
Total comprehensive income for the year	9,706	6,877

The notes on pages 16 to 139 form part of these consolidated financial statements.

Consolidated statement of financial position as at 31 December 2017*(Expressed in millions of Hong Kong dollars)*

	Note	2017 HK\$'M	2016 HK\$'M
Assets			
Cash and balances with banks, central banks and other financial institutions	10	18,350	15,332
Placements with banks and other financial institutions	11	150,256	156,750
Hong Kong SAR Government certificates of indebtedness	12	42,341	42,211
Trading assets	13	22,483	15,634
Financial assets designated at fair value	14	336	370
Investment securities	17	207,927	207,471
Advances to customers	15(a)	480,867	440,022
Amounts due from immediate holding company	18	59,075	46,521
Amounts due from fellow subsidiaries	18	24,208	16,328
Interest in associate	20	11,638	9,166
Property, plant and equipment	21	40,632	39,471
Goodwill and intangible assets	22	1,392	1,302
Current tax assets		11	112
Deferred tax assets	27	275	349
Other assets	23	15,258	14,983
		<u>1,075,049</u>	<u>1,006,022</u>
Liabilities			
Hong Kong SAR currency notes in circulation	12	42,341	42,211
Deposits and balances of banks and other financial institutions		19,613	19,674
Deposits from customers	24	833,899	778,242
Trading liabilities	28	8,301	8,289
Financial liabilities designated at fair value	26	11,474	9,568
Debt securities in issue	25	3,066	2,173
Amounts due to immediate holding company	18	44,246	42,282
Amounts due to fellow subsidiaries	18	9,477	11,932
Current tax liabilities		439	3
Deferred tax liabilities	27	470	404
Other liabilities	29	21,292	19,444
Subordinated liabilities	31	6,003	6,088
		<u>1,000,621</u>	<u>940,310</u>
Equity			
Share capital	32	20,256	20,256
Reserves	33	52,220	45,456
Shareholders' equity		72,476	65,712
Other equity instruments	32	1,952	–
		<u>1,075,049</u>	<u>1,006,022</u>

Approved and authorised for issue by the Board of Directors on 27 February 2018.

Huen Wai Yi Mary
Director

Yee Mann Hau
Director

The notes on pages 16 to 139 form part of these consolidated financial statements.

Consolidated statement of changes in equity**For the year ended 31 December 2017***(Expressed in millions of Hong Kong dollars)*

	<i>Attributable to equity shareholders of the Group</i>										
	Share capital HK\$'M	Own credit adjustment reserve ² HK\$'M	Cash flow hedge reserve HK\$'M	Available- for-sale investment reserve HK\$'M	Revaluation reserve HK\$'M	Exchange reserve HK\$'M	Retained profits HK\$'M	Share option equity reserve HK\$'M	Capital contribution reserve ¹ HK\$'M	Other equity instruments ³ HK\$'M	Total HK\$'M
At 1 January 2016	20,256	-	18	(7)	146	(204)	44,834	306	-	-	65,349
Total comprehensive income	-	-	(210)	(267)	-	(652)	8,006	-	-	-	6,877
Dividend paid	-	-	-	-	-	-	(6,392)	-	-	-	(6,392)
Movement in respect of share-based compensation plans	-	-	-	-	-	-	-	(122)	-	-	(122)
At 31 December 2016	<u>20,256</u>	<u>-</u>	<u>(192)</u>	<u>(274)</u>	<u>146</u>	<u>(856)</u>	<u>46,448</u>	<u>184</u>	<u>-</u>	<u>-</u>	<u>65,712</u>
Transfer of own credit adjustment, net of taxation	-	363	-	-	-	-	(363)	-	-	-	-
Total comprehensive income	-	(381)	210	251	-	867	8,759	-	-	-	9,706
Dividend paid	-	-	-	-	-	-	(3,368)	-	-	-	(3,368)
Other equity instruments issued, net of expenses	-	-	-	-	-	-	-	-	-	1,952	1,952
Movement in respect of share-based compensation plans	-	-	-	-	-	-	-	134	-	-	134
Effect of deemed disposal of interest in an associate	-	-	-	-	(146)	255	146	-	-	-	255
Effect of transfer of a subsidiary to a commonly controlled entity	-	-	-	-	-	-	-	-	37	-	37
At 31 December 2017	<u>20,256</u>	<u>(18)</u>	<u>18</u>	<u>(23)</u>	<u>-</u>	<u>266</u>	<u>51,622</u>	<u>318</u>	<u>37</u>	<u>1,952</u>	<u>74,428</u>

¹ The capital contribution reserve arose as a result of the transfer of a wholly-owned subsidiary, Standard Chartered Global Business Services Co., Ltd ("GBS"), to Standard Chartered Bank, which is an entity under the common control of Standard Chartered PLC. The reserve represents the difference between the consideration received and the book value of the subsidiary transferred (Note 2(b)(i)).

² The Group early adopted HKFRS 9/IFRS 9 Financial Instruments to present own credit adjustments within other comprehensive income (rather than net trading income).

³ On 13 December 2017, the Group issued US\$250 million 5 per cent fixed rate perpetual non-cumulative subordinated capital securities as Additional Tier 1 capital under the Banking (Capital) Rules.

During the year ended 31 December 2017, the directors had declared and paid an ordinary dividend of HK\$1.61276 (2016: HK\$3.17479) per each 'A' and 'B' ordinary share totalling HK\$3,124 million (2016: HK\$6,150 million). A total dividend of HK\$244 million (2016: HK\$242 million) was paid in respect of the US\$500 million 6.25% perpetual non-cumulative convertible preference shares classified as equity.

Note 33 includes a description of each reserve.

The notes on pages 16 to 139 form part of these consolidated financial statements.

Consolidated cash flow statement
For the year ended 31 December 2017
(Expressed in millions of Hong Kong dollars)

	<i>Note</i>	<i>2017</i>	<i>2016</i>
		<i>HK\$'M</i>	<i>HK\$'M</i>
Operating activities			
Profit before taxation		9,945	8,944
Adjustments for:			
Impairment (credit)/charge on advances to customers		(85)	1,310
Advances written off net of recoveries		(738)	(1,359)
Unwinding of discount on loan impairment provision		(27)	(59)
Other impairment charges		608	412
Depreciation on property, plant and equipment		2,211	1,870
Amortisation of intangible assets		161	146
Gains on disposal of property, plant and equipment		(397)	(51)
Net loss on deemed disposal of an associate arising from loss of significant influence		240	–
Gains on disposal of Mandatory Provident Fund and Occupational Retirement Schemes Ordinance businesses		–	(1,964)
Net losses/(gains) on revaluation of investment properties		92	(21)
Share of profit of associates		(1,828)	(1,360)
Interest expense on subordinated liabilities and other borrowings		481	675
Expense in respect of the defined benefit plan		89	98
Fair value losses/(gains) transferred from reserves on cash flow hedges		18	(36)
Stock dividend from associates		–	(4)
Exchange translation on subordinated liabilities		45	65
		<hr/>	<hr/>
		10,815	8,666
(Increase)/decrease in operating assets:			
Placements with banks and other financial institutions with original maturity beyond three months		11,625	(27,753)
Trading assets		(5,486)	1,893
Financial assets designated at fair value		34	296
Investment securities		(11,164)	(10,994)
Gross advances to customers		(39,995)	(24,889)
Amounts due from immediate holding company and fellow subsidiaries		(17,091)	(449)
Other assets		(7,714)	5,651
Increase/(decrease) in operating liabilities:			
Deposits and balances of banks and other financial institutions		179	(5,345)
Deposits from customers		55,661	32,532
Debt securities in issue		893	964
Financial liabilities designated at fair value		1,525	(4,156)
Amounts due to immediate holding company and fellow subsidiaries		502	19,414
Trading liabilities		12	(558)
Other liabilities		1,302	4,198
		<hr/>	<hr/>
Cash generated from/(used in) operations		1,098	(530)
Income tax paid		(925)	(434)
		<hr/>	<hr/>
Net cash from/(used) in operating activities		173	(964)
		-----	-----

Consolidated cash flow statement (continued)**For the year ended 31 December 2017***(Expressed in millions of Hong Kong dollars)*

	<i>Note</i>	<i>2017 HK\$'M</i>	<i>2016 HK\$'M</i>
Investing activities			
Payment for purchase of property, plant and equipment		(13,200)	(8,121)
Payment for purchase of intangible assets		(251)	(373)
Proceeds from disposal of property, plant and equipment		9,561	4,003
Proceeds from disposal of a subsidiary		271	2,271
		<u> </u>	<u> </u>
Net cash used in investing activities		<u>(3,619)</u>	<u>(2,220)</u>
Financing activities			
Issue of Additional Tier 1 capital		1,952	–
Payment for redemption of subordinated liabilities		–	(4,178)
Interest paid on subordinated liabilities		(474)	(637)
Dividend paid to shareholders of the Group		(3,368)	(6,392)
		<u> </u>	<u> </u>
Net cash used in financing activities	34(c)	<u>(1,890)</u>	<u>(11,207)</u>
Net decrease in cash and cash equivalents		(5,336)	(14,391)
Cash and cash equivalents at 1 January		140,893	162,860
Effect of foreign exchange		8,143	(7,576)
		<u> </u>	<u> </u>
Cash and cash equivalents at 31 December	34	<u>143,700</u>	<u>140,893</u>
Cash flows from operating activities include:			
Interest received		15,793	13,030
Interest paid		3,573	2,920
Dividends received		33	27
		<u> </u>	<u> </u>

The notes on pages 16 to 139 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 2017 comprise the Group and its interest in associates.

The measurement basis used in the preparation of the consolidated financial statements is the historical cost convention, as modified by the revaluation of available-for-sale assets, 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 42.

Application of merger accounting

On 6 December 2017, the Group transferred 100 per cent of the equity interest of its wholly owned subsidiary, GBS, to its immediate holding company at a consideration of HK\$271 million. As the Group and its immediate holding company, Standard Chartered Bank, are under the common control of Standard Chartered PLC, the Group has applied Accounting Guideline No.5 – “Merger Accounting for Common Control Combinations” issued by the HKICPA/IASB in accounting for the transfer of GBS in its consolidated financial statements. In accordance with the principles of merger accounting, the difference between the consideration received from Standard Chartered Bank and the book value of the wholly-owned subsidiary transferred is recognised as a capital contribution from Standard Chartered Bank.

The transaction costs for the transfer were expensed in the consolidated income statement.

(ii) Consolidated Financial Statements

During the year, the Group had subordinated and senior debts 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”.

The accounting policies set out below have been applied consistently across the Group and to all periods presented in these 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 they are exposed to, or have rights to, variable returns from their involvement with the entity and have the ability to affect those returns through their power over the investee. Subsidiaries are fully consolidated from the date on which the 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 19.

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

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 Group. 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 Group.

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 associate are provided in note 20.

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.

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)).

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(d) Associates (continued)**

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 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 22 sets out the major cash-generating units to which goodwill has been allocated.

(ii) Acquired intangibles

At the date of acquisition of a subsidiary or associate, intangible assets which are deemed separable and that arise from contractual or other legal rights are capitalised and included within the net identifiable assets acquired. These intangible assets are initially measured at fair value, which reflects market expectations of the probability that the future economic benefits embodied in the asset will flow to the entity, and are amortised on the basis of their expected useful lives (4 to 16 years). At each 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.

(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 (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.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(g) Other property, plant and equipment**

Property, plant and equipment is stated at cost less accumulated depreciation and impairment, if any. Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the 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 over 18 and 15 years respectively.

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.

(h) Leases

Where the Group is the lessee

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.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial assets and liabilities (excluding derivatives)

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

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

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

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

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

(ii) Loans and receivables

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

(iii) Available-for-sale assets

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

(iv) Financial liabilities held at amortised cost

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

Initial recognition

Purchases and sales of financial assets and liabilities held at fair value through profit or loss and financial assets classified as available-for-sale are initially recognised using trade date accounting (the date on which the Group commits to purchase or sell the asset). Loans and receivables are recognised when cash is advanced to the borrowers. All financial instruments are initially recognised at fair value, which is normally the transaction price plus, for those financial assets and liabilities not carried at fair value through profit and loss, directly attributable transaction costs.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

Financial assets and liabilities held at fair value through profit or loss are subsequently carried at fair value, with gains and losses arising from changes in fair value taken directly to the consolidated income statement except for changes in fair value on financial liabilities designated at fair value attributable to the Group's own credit presented directly within other comprehensive income.

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

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

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

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

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 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 reflects its non-performance risk.

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

Reclassifications

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

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

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

Renegotiated loans

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

Derecognition

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

Financial liabilities are derecognised when they are extinguished, i.e. when the obligation is discharged, cancelled or expired. If the Group purchases its own debt, it is removed from the consolidated statement of financial position, and the difference between the carrying amount of the liability and the consideration paid is included in 'Other operating income'.

(j) Derivative financial instruments and hedge accounting

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

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

The 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.

(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.

Derivatives that do not qualify for hedge accounting

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(k) Impairment of financial assets**

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

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

- whether the counterparty is in default of principal or interest payments;
- a counterparty files for bankruptcy protection (or the local equivalent) where this would avoid or delay repayment of its obligation;
- the Group files to have the counterparty declared bankrupt or file a similar order in respect of a credit obligation;
- the Group consents to a restructuring of the obligation, resulting in a diminished financial obligation, demonstrated by a material forgiveness of debt or postponement of scheduled payments;
- the Group sells a credit obligation at a material credit-related economic loss; or
- there is observable data indicating that there is a measurable decrease in the estimated future cash flows of a group of financial assets, although the decrease cannot yet be identified with specific individual financial assets.

Assets carried at amortised cost

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(k) Impairment of financial assets (continued)***Assets carried at amortised cost (continued)*

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

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

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

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

Available-for-sale assets

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

(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.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(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, trading assets, placements with banks and other financial institutions, and amounts due from immediate holding company and fellow subsidiaries.

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

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

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

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

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

(ii) Fees and commissions

Fees and commissions are generally recognised on an accrual basis when the service has been provided or significant act performed. Loan syndication fees are recognised as revenue when the syndication has been completed and the 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.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(o) Revenue recognition (continued)***(iii) Other income from financial assets and liabilities*

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

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

Dividends on equity instruments are recognised in the consolidated income statement when the Group's right to receive payment is established.

(p) Income tax

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

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the 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.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)**(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.

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. The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligations is determined by discounting the estimated future cash outflows using an interest rate equal to the yield on government bonds that are denominated in the currency in which the benefits will be paid, and that have a term to maturity approximating to the term of the related pension liability.

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

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.

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**

SCPLC 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.

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, significant shareholders and/or their close family members) or other entities and include (i) associates and joint ventures of SCPLC and its subsidiaries (“SCPLC 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.

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 issued are classified as equity, including preference share capital, 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

Amendments to HKFRSs/IFRSs and new interpretation

The HKICPA/IASB has issued the following amendments to HKFRSs/IFRSs that are first effective for the current accounting period commencing 1 January 2017.

- Amendments to HKAS 7/IAS 7, Statement of cash flows
- Amendments to HKAS 12/IAS 12, Income taxes
- Annual Improvements to HKFRSs 2014-2016 cycle
- Amendments to HKFRS 12, Disclosure of interests in other entities

The Group adopted the above amendments to existing accounting standards from 1 January 2017. The application of these amendments did not have a material impact on these consolidated financial statements, except for additional disclosure that has been included in note 34(c) to satisfy the new disclosure requirements introduced by the amendments to HKAS 7, Statement of cash flows: Disclosure initiative, which require entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***3 Changes in accounting policies (continued)***New accounting standards adopted by the Group*

The requirements for the classification and measurement of financial liabilities are specified in HKAS 39/IAS 39, including the ability to designate financial liabilities as fair value through profit or loss. During the year, the Group elected to early apply the requirements for the presentation of gains and losses on financial liabilities designated as at fair value through profit or loss relating to own credit in other comprehensive income rather than net trading income (without applying the other requirements in HKFRS 9/IFRS 9). The own credit amounts are accounted for as a separate category of equity. Opening retained earnings has been adjusted to reclassify the cumulative own credit adjustment component of the cumulative fair value adjustment on financial liabilities designated at fair value through profit or loss. These amounts will not be recycled to the income statement but will be recycled to retained earnings on derecognition of the applicable instruments. HKFRS 9/IFRS 9 does not require the prior year to be restated.

The reporting of fair value changes relating to own credit in other comprehensive income is only permitted where this does not create or enlarge an accounting mismatch. Where an accounting mismatch arises, the fair value changes are reported in the income statement. The Group currently designates financial liabilities at fair value through profit or loss only on the basis that they contain a bifurcated embedded derivative and not as a result of an accounting mismatch. There is no economic offset between fair value changes in own credit and the fair value changes in financial assets measured at fair value.

4 Operating profit

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

	2017 HK\$'M	2016 HK\$'M
(a) Interest income		
Interest income on listed securities	879	789
Interest income on unlisted securities	1,378	1,409
Other interest income (note)	13,852	11,474
	<u>16,109</u>	<u>13,672</u>
Amount shown in the consolidated income statement	16,109	13,672
Less: interest income arising from trading assets	(377)	(293)
Less: interest income arising from financial assets designated at fair value	(7)	(26)
	<u>(384)</u>	<u>(319)</u>
Total interest income on financial assets that are not measured at fair value through profit or loss	<u>15,725</u>	<u>13,353</u>

(note) The amount includes interest income from unwinding of discounts on loan impairment provisions of HK\$27 million (note 16) (2016: HK\$59 million), and fair value losses of HK\$19 million transferred from reserves on cash flow hedges (2016: gains of HK\$33 million).

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

	2017 HK\$'M	2016 HK\$'M
(b) Interest expense		
Interest expense on customer deposits, deposits of banks, certificates of deposit issued, debt securities issued, trading liabilities and financial liabilities designated at fair value (note)	3,621	2,872
Interest expense on subordinated liabilities	481	624
Interest expense on other borrowings	–	51
	<u>4,102</u>	<u>3,547</u>
Amount shown in the consolidated income statement	4,102	3,547
Less: interest expense arising from trading liabilities	(24)	(68)
Less: interest expense arising from financial liabilities designated at fair value	(60)	(23)
	<u>4,018</u>	<u>3,456</u>
Total interest expense on financial liabilities that are not measured at fair value through profit or loss	<u>4,018</u>	<u>3,456</u>

(note) The amount includes fair value gains of HK\$1 million transferred from reserve on cash flow hedges (2016: HK\$3 million).

	2017 HK\$'M	2016 HK\$'M
(c) Net fee and commission income		
Net fee and commission income (other than amounts included in determining the effective interest rate) arising from financial assets or financial liabilities that are not held for trading or designated at fair value		
– fee and commission income	2,075	1,961
– fee and commission expense	152	144
	<u>2,075</u>	<u>1,961</u>
Net fee and commission income from trust and other fiduciary activities where the Group holds or invests assets on behalf of its customers		
– fee and commission income	438	396
– fee and commission expense	121	99
	<u>438</u>	<u>396</u>

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

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
(d) Net trading income		
Gains less losses from dealing in foreign currencies	1,986	1,765
Gains less losses from trading securities	48	15
Gains less losses from other dealing activities	(33)	(204)
	<hr/>	<hr/>
Amount shown in the consolidated income statement	2,001	1,576
Add: interest income arising from trading assets	377	293
Less: interest expense arising from trading liabilities	(24)	(68)
	<hr/>	<hr/>
Net income from trading instruments	<u>2,354</u>	<u>1,801</u>
	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
(e) Net losses from financial instruments designated at fair value through profit or loss		
Net losses as shown in the consolidated income statement	(99)	(751)
Add: interest income arising from financial assets designated at fair value	7	26
Less: interest expense arising from financial liabilities designated at fair value	(60)	(23)
	<hr/>	<hr/>
	<u>(152)</u>	<u>(748)</u>
	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
(f) Other operating income		
Rental income from operating lease assets	3,916	3,513
Dividend income from listed available-for-sale securities	–	3
Dividend income from unlisted available-for-sale securities	33	24
Net gains on disposal of property, plant and equipment	397	51
Net losses on disposal of financial instruments measured at amortised cost	(5)	(51)
Net (losses)/gains on revaluation of investment properties (note 21)	(92)	21
Net loss on deemed disposal of an associate arising from loss of significant influence (note 46)	(240)	–
Net gains on disposal of Mandatory Provident Fund and Occupational Retirement Schemes Ordinance businesses	–	1,964
Others	163	126
	<hr/>	<hr/>
	<u>4,172</u>	<u>5,651</u>

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

	2017 HK\$'M	2016 HK\$'M
(g) Operating expenses		
Staff costs		
– contributions to defined contribution plans	211	197
– expense in respect of the defined benefits plan (note 30(c))	89	98
– equity-settled share-based payment expenses	131	100
– salaries and other staff costs	5,964	5,731
Depreciation (note 21)	2,211	1,870
Premises and equipment expense, excluding depreciation		
– rental of premises	848	948
– others	537	378
Amortisation		
– other intangible assets (note 22)	161	146
Auditor's remuneration	18	18
Others	6,087	4,967
	<u>16,257</u>	<u>14,453</u>

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

	2017 HK\$'M	2016 HK\$'M
Net gains transferred from reserves	<u>24</u>	<u>164</u>

6 Impairment charges

	2017 HK\$'M	2016 HK\$'M
(a) Impairment credit/(charge) on advances to customers		
Individual impairment provisions (note 16)		
– additions	(964)	(1,916)
– releases	156	155
– recoveries	573	206
	<u>(235)</u>	<u>(1,555)</u>
Portfolio impairment releases (note 16)	<u>320</u>	<u>245</u>
	<u>85</u>	<u>(1,310)</u>
(b) Other impairment charges		
Charges for risk participation transactions	–	(83)
Charges for property, plant and equipment (note 21)	(572)	(329)
Others	(36)	–
	<u>(608)</u>	<u>(412)</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***7 Taxation in the consolidated income statement****(a) Taxation in the consolidated income statement represents:**

	2017 HK\$'M	2016 HK\$'M
<i>Current tax</i>		
Hong Kong profits tax	1,308	849
Overseas taxation	12	15
Under-provision in respect of prior years	157	13
	<u>1,477</u>	<u>877</u>
<i>Deferred tax (note 27)</i>		
Origination/reversal of temporary differences	127	45
(Over)/under-provision in respect of prior years	(142)	93
	<u>(15)</u>	<u>138</u>
	<u>1,462</u>	<u>1,015</u>

The provision for Hong Kong profits tax for 2017 is calculated at 16.5% (2016: 16.5%) of the estimated assessable profits for the year. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

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

	2017 HK\$'M	2016 HK\$'M
Profit before taxation	<u>9,945</u>	<u>8,944</u>
Notional tax on profit before taxation, calculated at		
Hong Kong profits tax rate of 16.5%	1,641	1,476
Tax effect of non-deductible expenses	347	252
Tax effect of non-taxable revenue	(547)	(802)
Under-provision in prior years	15	106
Tax effect of different tax rates of subsidiaries operating in other jurisdictions	(21)	(24)
Others	27	7
	<u>1,462</u>	<u>1,015</u>
Actual tax expense	<u>1,462</u>	<u>1,015</u>

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

8 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>	
	<i>2017</i>	<i>2016</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Fees	3	2
Short-term employment benefits	29	35
Post-employment benefits	1	1
Equity compensation benefits	7	4
Termination benefits	5	–
	<u>45</u>	<u>42</u>

9 Segmental reporting

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

- **Corporate & Institutional Banking (CIB)** 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 in many of the world's fastest-growing cities. 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.

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

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

2017	<i>Corporate & Institutional Banking HK\$'M</i>	<i>Commercial Banking HK\$'M</i>	<i>Private Banking HK\$'M</i>	<i>Retail Banking HK\$'M</i>	<i>Central & Other Items HK\$'M</i>	<i>Consolidated Total HK\$'M</i>
<i>Operating income</i>						
– Net interest income	2,647	1,586	631	6,519	804	12,187
– Other operating income	7,116	896	620	5,258	320	14,210
	9,763	2,482	1,251	11,777	1,124	26,397
Operating expenses (note)	(5,490)	(1,518)	(1,426)	(6,185)	(62)	(14,681)
Operating profit/(loss) before impairment	4,273	964	(175)	5,592	1,062	11,716
Impairment (charges)/releases	(744)	225	416	(399)	(13)	(515)
Profit before taxation	3,529	1,189	241	5,193	1,049	11,201
Segment assets	392,367	66,906	34,171	262,210	341,971	1,097,625
Segment liabilities	346,698	106,711	53,805	421,696	76,060	1,004,970

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***9 Segmental reporting (continued)****(a) Segment results, assets and liabilities (continued)**

2016	Corporate & Institutional Banking HK\$'M	Commercial Banking HK\$'M	Private Banking HK\$'M	Retail Banking HK\$'M	Central & Other Items HK\$'M	Consolidated Total HK\$'M
<i>Operating income</i>						
– Net interest income	1,838	1,482	590	5,802	960	10,672
– Other operating income	6,786	1,037	545	4,742	2,100	15,210
	8,624	2,519	1,135	10,544	3,060	25,882
Operating expenses (note)	(5,485)	(1,681)	(1,349)	(5,433)	(102)	(14,050)
Operating profit/(loss) before impairment	3,139	838	(214)	5,111	2,958	11,832
Impairment (charges)/release	(1,057)	(434)	1	(487)	1	(1,976)
Profit/(loss) before taxation	2,082	404	(213)	4,624	2,959	9,856
Segment assets	367,669	56,308	27,698	258,183	354,364	1,064,222
Segment liabilities	361,012	108,680	54,344	379,011	71,648	974,695

(note) Operating expenses in the Corporate & Institutional Banking segment included depreciation charges of HK\$1,998 million (2016: HK\$1,662 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)***9 Segmental reporting (continued)****(b) Reconciliation of reportable segment operating income, profit before taxation, assets and liabilities**

	2017 HK\$'M	2016 HK\$'M
Operating income		
Reportable segment revenue	26,397	25,882
Income relating to Financial Market products	(208)	(225)
Cost of free funds	226	84
Others	(1,518)	(1,982)
	<u>24,897</u>	<u>23,759</u>
	2017 HK\$'M	2016 HK\$'M
Profit before taxation		
Reportable segment profit before taxation	11,201	9,856
Income relating to Financial Market products	(208)	(225)
Cost of free funds	226	84
Reallocations of impairment charges	(9)	253
Others	(1,265)	(1,024)
	<u>9,945</u>	<u>8,944</u>
	2017 HK\$'M	2016 HK\$'M
Assets		
Reportable segment assets	1,097,625	1,064,222
Assets of group companies not included in consolidated total assets	(3,180)	(2,066)
Amounts due from immediate holding company and fellow subsidiaries	83,283	62,849
Others	(102,679)	(118,983)
	<u>1,075,049</u>	<u>1,006,022</u>

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

	2017 HK\$'M	2016 HK\$'M
Liabilities		
Reportable segment liabilities	1,004,970	974,695
Liabilities of group companies not included in consolidated total liabilities	(1,774)	(1,437)
Amounts due to immediate holding company and fellow subsidiaries	53,723	54,214
Others	(56,298)	(87,162)
	<u>1,000,621</u>	<u>940,310</u>
Total liabilities	<u>1,000,621</u>	<u>940,310</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.

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

	2017 HK\$'M	2016 HK\$'M
Cash in hand	2,152	2,095
Balances with central banks	8,678	8,352
Balances with banks and other financial institutions	7,520	4,885
	<u>18,350</u>	<u>15,332</u>

11 Placements with banks and other financial institutions

	2017 HK\$'M	2016 HK\$'M
Gross placements with banks and other financial institutions		
– maturing within one month	63,984	64,658
– maturing between one month to one year	80,377	87,100
– maturing between one year to five years	5,175	4,078
– maturing between five years to ten years	720	914
	<u>150,256</u>	<u>156,750</u>
Less: impairment provision – individually assessed	–	–
	<u>150,256</u>	<u>156,750</u>

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

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

13 Trading assets

	<i>2017</i>	<i>2016</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Trading securities	18,642	14,484
Advances to customers	2,649	116
Positive fair values of trading derivatives	1,192	1,034
	<u>22,483</u>	<u>15,634</u>
Trading securities:		
Treasury bills	4,287	4,345
Certificates of deposit held	424	2,127
Debt securities	13,928	8,008
Equity securities	3	4
	<u>18,642</u>	<u>14,484</u>
Issued by:		
Central governments and central banks	10,231	8,619
Public sector entities	259	61
Banks and other financial institutions	5,520	4,286
Corporate entities	2,632	1,518
	<u>18,642</u>	<u>14,484</u>
By place of listing:		
Listed in Hong Kong	8,255	6,160
Listed outside Hong Kong	4,168	1,426
	<u>12,423</u>	<u>7,586</u>
Unlisted	6,219	6,898
	<u>18,642</u>	<u>14,484</u>

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

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
Debt securities	<u>336</u>	<u>370</u>
Issued by:		
Corporate entities	<u>336</u>	<u>370</u>
By place of listing:		
Listed outside Hong Kong	236	228
Unlisted	<u>100</u>	<u>142</u>
	<u>336</u>	<u>370</u>

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

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

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
Gross advances to customers	480,239	440,347
Trade bills	<u>1,778</u>	<u>1,675</u>
	482,017	442,022
Less : Impairment provision		
– individually assessed (note 16)	(907)	(1,437)
– collectively assessed (note 16)	<u>(243)</u>	<u>(563)</u>
	<u>480,867</u>	<u>440,022</u>

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

	2017 HK\$'M	2016 HK\$'M
Gross impaired advances to customers	3,278	3,693
Impairment provision – individually assessed	(907)	(1,437)
	<u>2,371</u>	<u>2,256</u>
Gross impaired advances to customers as a % of gross advances to customers	<u>0.68%</u>	<u>0.84%</u>
Fair value of collateral held against the covered portion of impaired advances to customers	<u>1,344</u>	<u>1,340</u>
Covered portion of impaired advances to customers	1,064	934
Uncovered portion of impaired advances to customers	<u>2,214</u>	<u>2,759</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 Movement in impairment provision on advances to banks and customers*****Advances to customers***

	<i>Individually assessed HK\$'M</i>	<i>2017 Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2017	1,437	563	2,000
Amounts written off	(1,311)	–	(1,311)
Recoveries of advances written off in previous years	573	–	573
Net charge/(release) to the consolidated income statement (note 6(a))	235	(320)	(85)
Unwind of discount on loan impairment provision (note 4(a))	(27)	–	(27)
	<u>907</u>	<u>243</u>	<u>1,150</u>
At 31 December 2017 (note 15(a))	<u>907</u>	<u>243</u>	<u>1,150</u>
	<i>Individually assessed HK\$'M</i>	<i>2016 Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2016	1,300	808	2,108
Amounts written off	(1,565)	–	(1,565)
Recoveries of advances written off in previous years	206	–	206
Net charge/(release) to the consolidated income statement (note 6(a))	1,555	(245)	1,310
Unwind of discount on loan impairment provision (note 4(a))	(59)	–	(59)
	<u>1,437</u>	<u>563</u>	<u>2,000</u>
At 31 December 2016 (note 15(a))	<u>1,437</u>	<u>563</u>	<u>2,000</u>

As at 31 December 2017 and 31 December 2016, there were no individually assessed provision to banks and other financial institutions.

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

	2017 HK\$'M	2016 HK\$'M
Available-for-sale securities		
Treasury bills	86,608	60,393
Certificates of deposit held	19,378	25,291
Debt securities	96,190	113,236
Equity shares	701	480
Less: impairment provision	–	(6)
	<u>202,877</u>	<u>199,394</u>
Loans and receivables – Debt securities	<u>5,050</u>	<u>8,077</u>
	<u>207,927</u>	<u>207,471</u>
Issued by:		
Available-for-sale securities		
Central governments and central banks	120,552	115,808
Public sector entities	10,004	5,094
Banks and other financial institutions	55,274	61,387
Corporate entities	17,047	17,105
	<u>202,877</u>	<u>199,394</u>
Loans and receivables – Debt securities		
Corporate entities	<u>5,050</u>	<u>8,077</u>
	<u>207,927</u>	<u>207,471</u>
By place of listing:		
Available-for-sale securities		
Listed in Hong Kong	15,910	7,895
Listed outside Hong Kong	57,940	87,043
	<u>73,850</u>	<u>94,938</u>
Unlisted	<u>129,027</u>	<u>104,456</u>
	<u>202,877</u>	<u>199,394</u>
Loans and receivables – Debt securities		
Listed outside Hong Kong	1,739	4,329
Unlisted	<u>3,311</u>	<u>3,748</u>
	<u>5,050</u>	<u>8,077</u>
	<u>207,927</u>	<u>207,471</u>

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

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

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

During the year, none of the above deposits were transferred from/to a related company (2016: HK\$269 million transferred from). As at 31 December 2017, the amounts due from immediate holding company shown on the consolidated statement of financial position is stated net of provision of HK\$ nil (2016: HK\$912 million) in respect of such obligations.

During the year, the Group transferred 100 per cent of its wholly-owned subsidiary, GBS, to its immediate holding company at a consideration of HK\$271 million. The difference between the consideration received and the book value of wholly-owned subsidiary transferred is recognised as a capital contribution in the consolidated financial statements.

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

	<i>Immediate holding company</i>		<i>Fellow subsidiaries</i>	
	<i>2017</i>	<i>2016</i>	<i>2017</i>	<i>2016</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Operating income	944	1,767	(211)	(111)
Operating expenses	2,589	1,726	648	584

Material transactions entered during the year between the Bank and its subsidiaries included operating income of HK\$1,966 million (2016: HK\$1,816 million) and operating expense of HK\$85 million (2016: HK\$85 million). Intra-group transactions are eliminated in full in the consolidated income statement.

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

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

	2017		2016	
	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M
Amounts due from:				
Cash and balances with banks and other financial institutions	6,945	2,431	3,626	1,962
Placements with banks and other financial institutions	26,258	20,993	17,202	14,240
Trading assets				
– Positive fair values of trading derivatives	22,213	712	22,083	54
– Debt securities	7	–	–	–
Other assets				
– Positive fair values of hedging derivatives	596	–	1,567	7
– Others	3,056	72	2,043	65
	<u>59,075</u>	<u>24,208</u>	<u>46,521</u>	<u>16,328</u>
	2017		2016	
	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M
Amounts due to:				
Deposits and balances of banks and other financial institutions	3,658	7,134	2,500	10,070
Trading liabilities:				
– Negative fair values of trading derivatives	23,179	586	22,643	10
Debt securities in issue	–	–	–	1,494
Subordinated liabilities (note)	6,252	–	6,204	–
Other liabilities				
– Negative fair values of hedging derivatives	396	405	1,108	–
– Others	10,761	1,352	9,827	358
	<u>44,246</u>	<u>9,477</u>	<u>42,282</u>	<u>11,932</u>

(note) US\$800 million subordinated debt with interest rate at 3 months USD Libor plus 250 basis points, payable quarterly in arrears, to the maturity date on 19 December 2026. On 19 June 2017, the subordinated debt was restructured from a floating rate coupon into a fixed rate coupon at 4.30 per cent per annum.

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

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

	2017		2016	
	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M
Financial guarantees and other credit related contingent liabilities	2,029	21	3,728	27
Loan commitments and other credit related commitments	1,527	32,226	–	27,520

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

	Bank	
	2017 HK\$'M	2016 HK\$'M
Unlisted shares, at cost	1,181	1,298
Less: accumulated impairment provision	(412)	(412)
	769	886

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 APR Limited	United Kingdom	21,971,715 ordinary shares of US\$1 each	100%	Investment holdings
Standard Chartered Securities (Hong Kong) Limited	Hong Kong	1,000,000 ordinary shares	100%	Institutional brokerage
Standard Chartered Leasing Group Limited	Hong Kong	30,000 ordinary shares	100%	Provision of leasing services
Standard Chartered Trade Support (HK) Limited	Hong Kong	53,431 ordinary shares	100%	Provision of financing and other services and activities closely related to banking to clients for inventory and extended payments

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***19 Investments in subsidiaries of the Bank and interests in structured entities (continued)****(b) Interests in consolidated structured entities**

A structured entity is consolidated where the Group controls the structured entity.

The following table presents the Group's interests in structured entities.

	2017 Total assets HK\$'M	2016 Total assets HK\$'M
Aircraft and ship leasing	40,991	41,008

20 Interest in associate

	2017 HK\$'M	2016 HK\$'M
Share of net assets	11,638	9,166

<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 (Note 1)

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

The Group's investment in Bohai is less than 20% but the company 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 presence of management personnel.

In respect of the year ended 31 December 2017, Bohai's result was included in the consolidated financial statements based on accounts drawn up to 30 November 2017. 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)***20 Interest in associate (continued)****Summary of financial information of the associate and reconciliation to the carrying amounts in the consolidated financial statements**

	2017 HK\$'M	2016 HK\$'M
Gross amounts of the associate		
Assets	1,223,496	979,959
Liabilities	<u>(1,165,275)</u>	<u>(934,105)</u>
Net assets	<u>58,221</u>	<u>45,854</u>
Operating income	<u>30,035</u>	<u>25,006</u>
Profit after taxation	8,939	6,495
Other comprehensive income	<u>(713)</u>	<u>(67)</u>
Total comprehensive income	<u>8,226</u>	<u>6,428</u>
Dividends received from the associate	<u>–</u>	<u>–</u>
Gross amount of net assets of the associate	58,221	45,854
Effective interest of the Group	<u>19.99%</u>	<u>19.99%</u>
Carrying amount in the consolidated financial statements	<u>11,638</u>	<u>9,166</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***21 Property, plant and equipment**

	2017					
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Operating lease assets HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total property, plant and equipment HK\$'M</i>
Cost or valuation:						
At 1 January 2017	2,959	458	41,689	45,106	958	46,064
Additions	161	185	12,854	13,200	–	13,200
Disposals and write-offs	(317)	(148)	(10,119)	(10,584)	–	(10,584)
Reclassifications	(23)	23	–	–	–	–
Fair value adjustments (note 4(f))	–	–	–	–	(92)	(92)
	<u>2,780</u>	<u>518</u>	<u>44,424</u>	<u>47,722</u>	<u>866</u>	<u>48,588</u>
At 31 December 2017	2,780	518	44,424	47,722	866	48,588
Representing:						
Cost	2,780	518	44,424	47,722	–	47,722
Valuation	–	–	–	–	866	866
	<u>2,780</u>	<u>518</u>	<u>44,424</u>	<u>47,722</u>	<u>866</u>	<u>48,588</u>
Accumulated depreciation:						
At 1 January 2017	942	237	5,414	6,593	–	6,593
Charge for the period (note 4(g))	106	107	1,998	2,211	–	2,211
Impairments (note 6(b))	–	–	572	572	–	572
Attributable to assets sold or written off	(97)	(115)	(1,208)	(1,420)	–	(1,420)
	<u>951</u>	<u>229</u>	<u>6,776</u>	<u>7,956</u>	<u>–</u>	<u>7,956</u>
At 31 December 2017	951	229	6,776	7,956	–	7,956
Net book value:						
At 31 December 2017	<u>1,829</u>	<u>289</u>	<u>37,648</u>	<u>39,766</u>	<u>866</u>	<u>40,632</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***21 Property, plant and equipment (continued)**

	2016					Total property, plant and equipment HK\$'M
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Operating lease assets HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	
Cost or valuation:						
At 1 January 2016	2,878	483	38,108	41,469	937	42,406
Additions	112	77	7,932	8,121	–	8,121
Disposals and write-offs	(29)	(104)	(4,351)	(4,484)	–	(4,484)
Reclassifications	(2)	2	–	–	–	–
Fair value adjustments (note 4(f))	–	–	–	–	21	21
	<u>2,959</u>	<u>458</u>	<u>41,689</u>	<u>45,106</u>	<u>958</u>	<u>46,064</u>
At 31 December 2016	2,959	458	41,689	45,106	958	46,064
Representing:						
Cost	2,959	458	41,689	45,106	–	45,106
Valuation	–	–	–	–	958	958
	<u>2,959</u>	<u>458</u>	<u>41,689</u>	<u>45,106</u>	<u>958</u>	<u>46,064</u>
Accumulated depreciation:						
At 1 January 2016	837	263	3,826	4,926	–	4,926
Charge for the period (note 4(g))	130	78	1,662	1,870	–	1,870
Impairments (note 6(b))	–	–	329	329	–	329
Attributable to assets sold or written off	(25)	(104)	(403)	(532)	–	(532)
	<u>942</u>	<u>237</u>	<u>5,414</u>	<u>6,593</u>	<u>–</u>	<u>6,593</u>
At 31 December 2016	942	237	5,414	6,593	–	6,593
Net book value:						
At 31 December 2016	<u>2,017</u>	<u>221</u>	<u>36,275</u>	<u>38,513</u>	<u>958</u>	<u>39,471</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***21 Property, plant and equipment (continued)****(a) Buildings and leasehold land held for own use**

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
Leasehold in Hong Kong, at cost		
– medium-term leases	1,709	1,771
– short-term leases	120	131
	<u>1,829</u>	<u>1,902</u>
Freehold outside Hong Kong, at cost	<u>–</u>	<u>115</u>
	<u>1,829</u>	<u>2,017</u>

(b) Investment properties

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
Freehold outside Hong Kong, at fair value	<u>866</u>	<u>958</u>

The investment property outside Hong Kong was revalued as at 31 December 2017 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.

(c) Operating lease assets:

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

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
Within 1 year	3,911	3,836
After 1 year but within 5 years	13,679	14,461
After 5 years	9,486	8,474
	<u>27,076</u>	<u>26,771</u>

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

	2017		
	<i>Capitalised software and other intangible assets</i> HK\$'M	<i>Goodwill</i> HK\$'M	<i>Total</i> HK\$'M
Cost:			
At 1 January 2017	977	729	1,706
Additions	251	–	251
Disposals and write-offs	(189)	–	(189)
	<u>1,039</u>	<u>729</u>	<u>1,768</u>
At 31 December 2017	1,039	729	1,768
Accumulated amortisation:			
At 1 January 2017	404	–	404
Charge for the year (note 4(g))	161	–	161
Attributable to intangible assets sold or written off	(189)	–	(189)
	<u>376</u>	<u>–</u>	<u>376</u>
At 31 December 2017	376	–	376
Carrying amount:			
At 31 December 2017	<u>663</u>	<u>729</u>	<u>1,392</u>
	2016		
	<i>Capitalised software and other intangible assets</i> HK\$'M	<i>Goodwill</i> HK\$'M	<i>Total</i> HK\$'M
Cost:			
At 1 January 2016	685	729	1,414
Additions	373	–	373
Disposals and write-offs	(81)	–	(81)
	<u>977</u>	<u>729</u>	<u>1,706</u>
At 31 December 2016	977	729	1,706
Accumulated amortisation:			
At 1 January 2016	339	–	339
Charge for the year (note 4(g))	146	–	146
Attributable to intangible assets sold or written off	(81)	–	(81)
	<u>404</u>	<u>–</u>	<u>404</u>
At 31 December 2016	404	–	404
Carrying amount:			
At 31 December 2016	<u>573</u>	<u>729</u>	<u>1,302</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***22 Goodwill and intangible assets (continued)*****Impairment tests for cash-generating units containing goodwill***

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

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
Lending	611	611
Private Banking	118	118
	<u>729</u>	<u>729</u>

The recoverable amounts of the CGUs are determined based on value in use calculations. The key assumptions and approach to determining value in use calculations, as set out below, are solely used for the purpose of assessing impairment on acquired goodwill. These calculations use cash flow projections over a 20-year period based on budgets and forecasts approved by management. These budgets and forecasts cover periods of five years and are extrapolated forward using steady growth rates of 3.0 per cent (2016: 2.8 per cent).

In assessing impairment of goodwill, the Group assumed growth at a steady rate in line with long-term forecast GDP growth. A discount rate of 13.1 per cent (2016: 12.1 per cent) was used.

23 Other assets

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
Prepayments and accrued income	2,892	4,754
Sundry debtors	2,913	3,414
Acceptances and endorsements	3,047	3,745
Unsettled trades and others	4,449	2,050
Assets held for sale (note)	1,957	1,020
	<u>15,258</u>	<u>14,983</u>

(note) Assets held for sale as of 31 December 2017 and 2016 included the Group's interest in Asia Commercial Joint Stock Bank ("ACB"). The details of the assets held for sale are disclosed in note 46.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***24 Deposits from customers**

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
Current accounts	165,554	164,374
Savings accounts	484,275	437,750
Time, call and notice deposits	177,029	164,354
Deposits and balances of central banks	7,041	11,764
	<u>833,899</u>	<u>778,242</u>

25 Debt securities in issue

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
Certificates of deposit	1,870	–
Senior debt securities	1,196	2,173
	<u>3,066</u>	<u>2,173</u>

26 Financial liabilities designated at fair value

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
Structured deposits from banks and customers	3,940	3,420
Debt securities issued	7,534	6,148
	<u>11,474</u>	<u>9,568</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.

At 31 December 2017, the contractual amount payable at maturity of these financial liabilities exceeded the carrying amount by HK\$256 million (2016: HK\$718 million). Of this, the cumulative fair value movement relating to changes in credit risk was a gain of HK\$61 million (2016: a gain of HK\$433 million). The amount of fair value movement relating to changes in credit risk recognised in other comprehensive income during the year was a loss of HK\$372 million (2016: a loss of HK\$679 million recognised in the consolidated income statement).

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***27 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:

	2017				
	<i>Depreciation allowances in excess of related depreciation</i> HK\$'M	<i>Impairment losses on financial assets</i> HK\$'M	<i>Available-for-sale securities</i> HK\$'M	<i>Others</i> HK\$'M	<i>Total</i> HK\$'M
Deferred tax arising from:					
At 1 January 2017	1,215	(93)	(55)	(1,012)	55
Charge/(release) to consolidated income statement (note 7(a))	22	(106)	–	69	(15)
Charge to reserves	–	–	33	96	129
Others	10	1	–	15	26
	<u>1,247</u>	<u>(198)</u>	<u>(22)</u>	<u>(832)</u>	<u>195</u>
	2016				
At 1 January 2016	888	(134)	(35)	(759)	(40)
Charge/(release) to consolidated income statement (note 7(a))	327	40	–	(229)	138
Release to reserves	–	–	(18)	(26)	(44)
Others	–	1	(2)	2	1
	<u>1,215</u>	<u>(93)</u>	<u>(55)</u>	<u>(1,012)</u>	<u>55</u>
				2017 HK\$'M	2016 HK\$'M
Analysed by:					
Net deferred tax asset recognised on the consolidated statement of financial position				(275)	(349)
Net deferred tax liability recognised on the consolidated statement of financial position				<u>470</u>	<u>404</u>
				<u>195</u>	<u>55</u>

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

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
Short positions in securities	5,813	7,710
Negative fair values of trading derivatives	2,488	579
	<u>8,301</u>	<u>8,289</u>

29 Other liabilities

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
Accruals and deferred income	4,086	4,078
Provision for liabilities and charges	129	397
Acceptances and endorsements	3,047	3,745
Unsettled trades and others	14,030	11,224
	<u>21,292</u>	<u>19,444</u>

30 Employee retirement benefits

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

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

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

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

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

The Group's contributions are determined with reference to the funding valuation carried out by the Scheme's actuary in accordance with the ORSO requirements. The last funding valuation of the Scheme was carried out as at 31 December 2017.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***30 Employee retirement benefits (continued)****(a) Amounts recognised in the consolidated statement of financial position**

	2017 HK\$'M	2016 HK\$'M
Fair value of plan assets	1,988	1,813
Present value of wholly or partly funded obligations	(1,954)	(2,045)
Net asset/(liability) recognised in the consolidated statement of financial position (included in "Other assets/liabilities")	<u>34</u>	<u>(232)</u>

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

	2017		
	Assets HK\$'M	Obligations HK\$'M	Total HK\$'M
At 1 January 2017	1,813	(2,045)	(232)
Contributions	25	–	25
Benefits paid	(198)	198	–
Current service cost	–	(84)	(84)
Net interest income/(cost)	29	(33)	(4)
Administrative expenses	(1)	–	(1)
Return on plan assets, excluding amounts included in interest income	320	–	320
Actuarial gain – from experience	–	11	11
Actuarial loss – from financial assumptions	–	(1)	(1)
At 31 December 2017	<u>1,988</u>	<u>(1,954)</u>	<u>34</u>
	2016		
	Assets HK\$'M	Obligations HK\$'M	Total HK\$'M
At 1 January 2016	1,970	(2,226)	(256)
Contributions	30	–	30
Benefits paid	(229)	229	–
Current service cost	–	(94)	(94)
Net interest income/(cost)	23	(26)	(3)
Administrative expenses	(1)	–	(1)
Return on plan assets, excluding amounts included in interest income	20	–	20
Actuarial gain – from experience	–	24	24
Actuarial gain – from financial assumptions	–	48	48
At 31 December 2016	<u>1,813</u>	<u>(2,045)</u>	<u>(232)</u>

The weighted average duration of the defined benefit obligation as at 31 December 2017 is 5 years (2016: 5 years).

The Group expects to contribute approximately HK\$26 million to the Scheme in 2018.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***30 Employee retirement benefits (continued)****(c) Amounts recognised in the consolidated income statement for the year**

	2017 HK\$'M	2016 HK\$'M
Current service cost	84	94
Net interest cost	4	3
Administrative expenses	1	1
	<u>89</u>	<u>98</u>

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

	2017 HK\$'M	2016 HK\$'M
Discount rate	1.70%	1.70%
Future salary increases	4.00%	4.00%

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\$25 million (2016: HK\$27 million).
- if the rate of growth of salaries was higher by 25 basis points the obligation would increase by approximately HK\$24 million (2016: HK\$26 million).

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

(e) Major categories of assets

	2017 HK\$'M	2016 HK\$'M
Equities	63%	61%
Bonds	36%	37%
Cash	1%	2%
	<u>100%</u>	<u>100%</u>

As at 31 December 2017, the Scheme did not invest in the Group's own financial instruments and properties (2016: Nil). The Scheme has a benchmark asset allocation of 60% in equities and 40% in bonds and cash (2016: 60% in equities and 40% in bonds and cash). The long term strategic asset allocations of the Scheme are set and reviewed from time to time by the trustees taking into account the Scheme's membership, liability profile, liquidity requirements, and the risk appetite of the Group.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***31 Subordinated liabilities**

	2017 HK\$'M	2016 HK\$'M
US\$750 million 5.875% Fixed Rate Notes 2020 (note 1)	6,003	6,088

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

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

32 Share capital and other equity instruments

	2017		2016	
	No. of share	HK\$'M	No. of share	HK\$'M
Issued and fully paid				
A' ordinary shares	706 million	12,500	706 million	12,500
B' ordinary shares	1,231 million	78	1,231 million	78
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
		20,256		20,256
Other equity instruments		1,952		–
		22,208		20,256

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 '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.

The convertible preference shares rank in priority to the 'A' ordinary shares and 'B' ordinary shares with respect to the payment of dividends and any return of capital. The 'B' ordinary shares rank in priority to the 'A' ordinary shares with respect to any return of capital.

On 13 December 2017, the Group issued US\$250 million perpetual non-cumulative subordinated capital securities at a fixed rate of 5 per cent. The securities qualify as Additional Tier 1 capital under the Banking (Capital) Rules.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

33 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. Following the Group’s decision to early apply HKFRS/IFRS 9 with respect to gains and losses on financial liabilities designated at fair value through profit or loss relating to own credit, the cumulative own credit adjustment component of HKD363 million has been transferred from opening retained earnings to the OCA reserve. Gains and losses on financial liabilities designated at fair value through profit or loss relating to own credit 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.

(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) Available-for-sale investment reserve

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

(iv) Revaluation reserve

The revaluation reserve comprises the share of the change in fair value of an associate’s identifiable net assets prior to the Group obtaining significant influence in a step-acquisition. Upon deemed disposal of the associate, the reserve balance is transferred to retained earnings.

(v) 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).

(vi) Share option equity reserve

SCPLC 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.

(vii) Capital contribution reserve

Capital contribution reserve represents the excess of consideration received over the book value of a subsidiary transferred to a commonly controlled entity.

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 2017, an amount of HK\$5,145 million (2016: HK\$5,208 million) has been reserved for this purpose.

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

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
(a) Components of cash and cash equivalents in the consolidated cash flow statement		
Cash and balances with banks, central banks and other financial institutions	18,350	15,332
Trading assets with original maturity within three months	1,413	50
Placements with banks and other financial institutions with original maturity within three months	57,395	52,263
Investment securities with original maturity within three months	35,500	47,468
Amounts due from immediate holding company and fellow subsidiaries with original maturity within three months	31,257	26,787
Less: Overdrafts included in "deposits and balances of banks and other financial institutions"	(127)	(367)
Less: Overdrafts included in "amounts due to immediate holding company"	(88)	(640)
	<u>143,700</u>	<u>140,893</u>
	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
(b) Reconciliation with the consolidated statement of financial position		
Cash and balances with banks, central banks, and other financial institutions	18,350	15,332
Trading assets	22,483	15,634
Placements with banks and other financial institutions	150,256	156,750
Investment securities	207,927	207,471
Amounts due from immediate holding company and fellow subsidiaries	83,283	62,849
Overdrafts included in "deposits and balances of banks and other financial institutions"	(127)	(367)
Overdrafts included in "amounts due to immediate holding company"	(88)	(640)
	<u>482,084</u>	<u>457,029</u>
Less: amounts with an original maturity of beyond three months	<u>(338,384)</u>	<u>(316,136)</u>
	<u>143,700</u>	<u>140,893</u>
Cash and cash equivalents in the consolidated cash flow statement	<u>143,700</u>	<u>140,893</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***34 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.

	<i>Other equity instruments</i> HK\$'M	<i>Subordinated liabilities (Note 31)</i> HK\$'M	<i>Subordinated liabilities (Note 18)</i> HK\$'M	<i>Preference shares</i> HK\$'M	<i>Ordinary shares</i> HK\$'M	<i>Total</i> HK\$'M
At 1 January 2017	–	6,088	6,204	3,878	12,578	28,748
Changes from financing cash flows:						
Issue of Additional Tier 1 capital	1,952	–	–	–	–	1,952
Interest paid on subordinated liabilities	–	(225)	(249)	–	–	(474)
Dividends paid to shareholders of the Group	–	–	–	(244)	(3,124)	(3,368)
	<u>1,952</u>	<u>(225)</u>	<u>(249)</u>	<u>(244)</u>	<u>(3,124)</u>	<u>(1,890)</u>
Total changes from financing cash flows	1,952	(225)	(249)	(244)	(3,124)	(1,890)
Exchange adjustments	–	45	47	–	–	92
Hedge accounting adjustment	–	(136)	–	–	–	(136)
Other changes:						
Dividends on shares	–	–	–	244	3,124	3,368
Interest expense on subordinated liabilities	–	231	250	–	–	481
	<u>–</u>	<u>231</u>	<u>250</u>	<u>244</u>	<u>3,124</u>	<u>3,849</u>
Total other changes	–	231	250	244	3,124	3,849
At 31 December 2017	<u>1,952</u>	<u>6,003</u>	<u>6,252</u>	<u>3,878</u>	<u>12,578</u>	<u>30,663</u>

35 Derivative financial instruments

The use of derivatives for trading and their sale to customers as risk management products is an integral part of the 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)***35 Derivative financial instruments (continued)****(a) Notional amounts of derivatives**

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

The following is a summary of the notional amounts of each significant type of derivative entered into by the Group:

	2017			
	<i>Qualifying for hedge accounting HK\$'M</i>	<i>Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$'M</i>	<i>Others, including held for trading HK\$'M</i>	<i>Total HK\$'M</i>
Exchange rate contracts				
Forwards	–	–	339,177	339,177
Cross currency swaps	21,751	447	2,433,042	2,455,240
Options purchased	–	39	16,067	16,106
Options written	–	210	22,459	22,669
Interest rate contracts				
Swaps	83,172	9	200,595	283,776
Options purchased	–	111	22,986	23,097
Options written	–	6,667	23,055	29,722
Other derivatives	–	6,091	29,518	35,609
	<u>104,923</u>	<u>13,574</u>	<u>3,086,899</u>	<u>3,205,396</u>
2016				
Exchange rate contracts				
Forwards	–	–	1,012,402	1,012,402
Cross currency swaps	32,607	2,491	1,001,251	1,036,349
Options purchased	–	1,986	874	2,860
Options written	–	631	5,285	5,916
Interest rate contracts				
Swaps	75,072	–	98,458	173,530
Options purchased	–	31	–	31
Options written	–	4,929	128	5,057
Other derivatives	–	4,355	3,254	7,609
	<u>107,679</u>	<u>14,423</u>	<u>2,121,652</u>	<u>2,243,754</u>

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

	2017			2016		
	<i>Fair value assets</i>	<i>Fair value liabilities</i>	<i>Credit risk weighted amount</i>	<i>Fair value assets</i>	<i>Fair value liabilities</i>	<i>Credit risk weighted amount</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Exchange rate contracts	21,577	22,415	4,420	21,941	21,867	2,691
Interest rate contracts	2,439	2,321	1,163	2,653	2,372	818
Other derivatives	697	2,318	969	151	101	305
	<u>24,713</u>	<u>27,054</u>	<u>6,552</u>	<u>24,745</u>	<u>24,340</u>	<u>3,814</u>

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

(c) Fair value of derivative financial instruments designated as hedging instruments

The following is a summary of the fair values of derivatives held for hedging purposes by product type entered into by the Group:

	2017	
	<i>Assets (Included in Amounts due from immediate holding company and fellow subsidiaries)</i>	<i>Liabilities (Included in Amounts due to immediate holding company and fellow subsidiaries)</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Exchange rate contracts	245	685
Interest rate contracts	351	116
	<u>596</u>	<u>801</u>
	2016	
	<i>Assets (Included in Amounts due from immediate holding company and fellow subsidiaries)</i>	<i>Liabilities (Included in Amounts due to immediate holding company and fellow subsidiaries)</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Exchange rate contracts	1,225	824
Interest rate contracts	349	284
	<u>1,574</u>	<u>1,108</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***35 Derivative financial instruments (continued)****(c) Fair value of derivative financial instruments designated as hedging 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. At 31 December 2017, the net negative fair value of derivatives held as fair value hedges was HK\$431 million (2016: positive HK\$543 million) comprising assets of HK\$257 million (2016: HK\$1,402 million) and liabilities of HK\$688 million (2016: HK\$859 million). The losses on the hedging instruments for the year were HK\$115 million (2016: losses of HK\$606 million). The gains on the hedged item attributable to the hedged risk were HK\$113 million (2016: gains of HK\$611 million).

Cash flow hedges

The cash flow hedges principally consist of interest rate swaps and cross currency swaps that are used to hedge against the variability in cash flows of certain floating rate assets and liabilities. At 31 December 2017, the net positive fair value of derivatives held as cash flow hedges was HK\$226 million (2016: negative HK\$77 million) comprising assets of HK\$339 million (2016: HK\$172 million) and liabilities of HK\$113 million (2016: HK\$249 million). During the year, there was no ineffectiveness recognised in the consolidated income statement that arose from cash flow hedges (2016: Nil).

The time periods in which the hedged cash flows are expected to occur and affect the consolidated statement of comprehensive income are as follows:

	2017						Total HK\$'M
	Less than 1 year HK\$'M	1 to 2 years HK\$'M	2 to 3 years HK\$'M	3 to 4 years HK\$'M	4 to 5 years HK\$'M	More than 5 years HK\$'M	
Forecast receivable cash flows	306	54	–	–	–	–	360
Forecast payable cash flows	(382)	(399)	(353)	(341)	(330)	(949)	(2,754)
	<u>(76)</u>	<u>(345)</u>	<u>(353)</u>	<u>(341)</u>	<u>(330)</u>	<u>(949)</u>	<u>(2,394)</u>
	2016						Total HK\$'M
	Less than 1 year HK\$'M	1 to 2 years HK\$'M	2 to 3 years HK\$'M	3 to 4 years HK\$'M	4 to 5 years HK\$'M	More than 5 years HK\$'M	
Forecast receivable cash flows	276	147	109	40	31	–	603
Forecast payable cash flows	(35)	(45)	(19)	(5)	(1)	–	(105)
	<u>241</u>	<u>102</u>	<u>90</u>	<u>35</u>	<u>30</u>	<u>–</u>	<u>498</u>

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

	2017 HK\$'M	2016 HK\$'M
Direct credit substitutes	6,919	8,079
Transaction-related contingencies	7,341	7,312
Trade-related contingencies	10,560	13,522
Forward asset purchases	197	196
Forward forward deposits placed	1,527	–
Other commitments: which are not unconditionally cancellable:		
with original maturity of not more than one year	1,178	4,898
with original maturity of more than one year	27,827	19,259
which are unconditionally cancellable	321,564	332,358
	<u>377,113</u>	<u>385,624</u>
Credit risk weighted amount	<u>33,013</u>	<u>35,726</u>

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

(b) Capital commitments

Capital commitments outstanding at 31 December in respect of property, plant and equipment purchases not provided for in the consolidated financial statements were as follows:

	2017 HK\$'M	2016 HK\$'M
Contracted for	3,640	13,458
Authorised but not contracted for	41	14
	<u>3,681</u>	<u>13,472</u>

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

36 Contingent liabilities and commitments (continued)

(c) Lease commitments

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

	2017 HK\$'M	2016 HK\$'M
Within 1 year	824	787
After 1 year but within 5 years	1,599	1,839
After 5 years	186	319
	<u>2,609</u>	<u>2,945</u>

During the year, HK\$980 million (2016: HK\$1,005 million) was recognised as an expense in the consolidated income statement in respect of operating leases. The Group leases various premises and equipment under non-cancellable operating lease agreements.

(d) 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.

The Securities and Futures Commission ("SFC") in Hong Kong has been investigating Standard Chartered Securities (Hong Kong) Limited's ("SCSHK") role as a joint sponsor of an initial public offering of a company listed on The Stock Exchange of Hong Kong in 2009. The SFC is pursuing disciplinary action against SCSHK, and there may be financial consequences for SCSHK in connection with this action.

37 Risk management

Risk management approach

Enterprise risk management framework ("ERMF")

Risk management is essential to consistent and sustainable performance for all of its 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 replaces the existing Risk Management Framework ("RMF"). The ERMF provides better articulation of the principles and standards in how the Group manage risk in a more proactive way. Through the ERMF the Group manages enterprise-wide risks, with the objective of maximising risk-adjusted returns while remaining within its risk appetite.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**Risk management approach (continued)****Enterprise risk management framework (“ERMF”) (continued)**

The key changes under ERMF include the following:

- Refreshed the risk culture and risk appetite statements;
- Changes in Principal Risk Types which include:
 - o Elevating Conduct, Compliance, Financial Crime and Information and Cyber Security to Principal Risk Types;
 - o The scope of Country Cross Border risk has been broadened to cover Country Risk;
 - o Pension risk is now a risk sub-type of Market risk;
 - o Integration of Strategy Risk as part of the overall Framework; and
 - o Consolidation of Capital and Liquidity risk types as one Principal Risk Type.
- Strengthen risk assessment process by introducing a dynamic risk identification process; and
- Further clarity on accountability and responsibility by strengthening of the three lines of defence.

The new revised ERMF is effective from 23 February 2018 and will be further embedded in 2018.

Risk culture

The Group’s Risk Culture provides the guiding principles for the behaviours expected from its people when managing risk. The risk culture statement 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 get better. The Group expects managers to demonstrate a high awareness of risk and control approach by self-identifying issues and managing them in a manner that will deliver lasting change.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

Risk management approach (continued)

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.

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 the risks	<ul style="list-style-type: none"> • 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 and processes 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 and make decisions. • Propose Risk Appetite (“RA”) to the Board, monitor and report adherence to Risk Appetite 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 and ensure that their systems and processes meet these requirements.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

Risk management approach (continued)

Roles and responsibilities (continued)

Lines of Defence	Definition	Key responsibilities
Third	The internal audit function provides independent assurance of the effectiveness of controls that support First Line's risk management of business activities, and the processes maintained by the Second Line	<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.

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 roles of the function are:

- To maintain the ERMF, ensuring it remains appropriate to the Group's activities, effectively communicated and implemented across the Group, and to administer related governance and reporting processes;
- To uphold the overall integrity of the Group's risk/return decisions, and in particular to ensure that risks are properly assessed, that risk/return decisions are made transparently on the basis of this proper assessment, and controlled in accordance with the Group's standards and risk appetite; and
- To oversee and challenge the management of credit, market, country and operational risk types and reputational risk.

The independence of the Risk function is to ensure that the necessary balance in risk/return decisions is not compromised by short-term pressures to generate revenues. This is particularly important given that revenues are recognised from the point of sale, while losses arising from risk positions typically manifest themselves over time.

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

Risk management approach (continued)

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, 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.

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 and the Executive Risk Committee ("ERC"). This includes the reporting of breaches.

The ERC and the Asset and Liability Committee ("ALCO") 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 standard 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.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

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;
- 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.

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, the stress tests also focus on the potential impact of macroeconomic, geo-political and physical events on relevant regions, client segments and risk types.

The Board approves the stress tests endorsed by the Board Risk Committee who relies on the recommendation from the ERC. The ERC bases their recommendation on the discussion from the Stress Testing Forum, which is appointed to review and challenge the stress test scenarios, assumptions and results.

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 risks are those risks that are inherent in the Group's strategy and the Group's business model. As part of the overall risk management framework review in 2018 the Group also reviewed its principal risk types. The table below shows the Group's principal risks.

Principal risks

Credit	Potential for loss due to the failure of a counterparty to meet its agreed obligations to pay the Group.
Market	Potential for loss of earnings or economic value due to adverse changes in financial market rates or prices
Capital and Liquidity	Capital: Potential for insufficient level or inappropriate composition of capital to support the Group's normal activities. Liquidity: Potential for loss where we may not have sufficient stable or diverse sources of funding or financial resources to meet the obligations as they fall due.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 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.
Country	Potential for default losses due to political or economic events in a country.
Reputational	Potential for loss of earnings or market capitalisation as a result of stakeholders taking a negative view of the organisation or its actions.
Compliance	Potential for regulatory sanctions or loss from a failure on the Group's part to comply with laws, or regulations.
Conduct	Potential regulatory sanctions or loss from a failure on the Group's part to abide by the Group Code of Conduct.
Information and Cyber Security	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.
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 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 ERC, 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 ALCO and the Pensions Executive Committee. The Chief Risk Officer, as Chair of the ERC, approves the use of sub-committees and forums to support the Executive Risk Committee overseeing risk at Business, Regional, 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)

37 Risk management (continued)

Executive and Board risk oversight (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.

Executive Risk Committee

The ERC is chaired by the Chief Risk Officer. The ERC is responsible for ensuring the effective management of risk throughout the Group in support of the Group's strategy. The Committee determines the overall ERMF for the Group, including the delegation of any part of its authorities to appropriate individuals or properly constituted committees below the ERC.

The ERC requests and receives information to fulfil its governance mandates relating to the risks to which the Group is exposed. Similar to the Board Risk Committee, the ERC and ALCO 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 and ensuring that, in executing the Group's strategy, the Group operates within internally approved risk appetite and external requirements relating to capital, liquidity and leverage risks. It is also responsible for policies relating to balance sheet management, including management of the Group's liquidity, capital adequacy and structural foreign exchange positions.

Pensions Executive Committee

The Pensions Executive Committee is chaired by the Chief Executive Officer. The Pensions Executive Committee is responsible for all retirement benefit arrangements of the Group.

Risk profile

The Group has a well-established risk governance structure and it closely manages its risks to maintain the Group's risk profile in compliance with the Risk Appetite Statement. Market conditions continued to be challenging in 2017 and the economic outlook remains uncertain. The Group manages these uncertainties through a framework that provides a forward-looking 12 to 18 months view of the economic, business and credit conditions across the Group's key markets, enabling it to proactively manage its portfolio.

The Group continues to take action to reposition the Group's corporate portfolio, exiting weaker credit or lower return clients and adding new clients selectively. The Group's portfolio is now more diversified across dimensions such as industry sectors, geographies and single names.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(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.

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.

SCPLC group-wide credit policies and standards are established and approved by SCPLC'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 ERC approves policies and standards based on those approved by GRC. When approving risk policies and standards, the ERC takes into account the requirements of the Hong Kong Banking Ordinance and the guidelines issued by the HKMA with respect to large exposures, connected lending and provisioning requirements.

Credit rating and measurement

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

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.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(a) Credit risk (continued)*****Credit rating and measurement (continued)***

IRB risk measurement models are approved by the ERC, 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.

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 SCPLC, all significant risk decisions emanating from Hong Kong have an impact to SCPLC, be it regulatory, concentration, strategic, etc. It is therefore recognised that it is essential for SCPLC to consider such transactions to ensure that these issues are included as part of the decision making process. Delegated authorities approved by the ERC are delegated to the key risk managers to ensure that all risk decisions are made within the Group. Where proposals fall outside of the individual’s authorities, the advice and guidance of SCPLC is sought. In such cases, the relevant SCPLC’s authority, whether an individual or a committee, reviews the proposal from SCPLC’s perspective and give their recommendation. On receipt of such recommendation, the Group’s Excess Approval Committee (“EAC”), being a sub-committee of the ERC, meets to consider such advice and reach a suitable decision. Summary of the credit applications approved by the EAC are reported at each ERC meeting for noting.

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, collateralization level and credit risk profile.

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

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.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

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.

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.

The Group uses bilateral and multilateral netting to reduce pre-settlement and settlement counterparty credit risk. Pre-settlement risk exposures are normally netted using bilateral netting documentation in legally approved jurisdictions. Settlement exposures are generally netted using Delivery versus Payments or Payment versus Payments systems. Master netting agreements are generally enforced only in the event of default. In line with IAS 32 / HKAS 32, derivative exposures are presented on a gross basis in the financial statements as such transactions are not intended to be settled net in the ordinary course of business.

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

In addition, the Group enters into Credit Support Annexes (“CSA”) with counterparties where collateral is deemed a necessary or desirable mitigant to the exposure.

Wrong way risk occurs when an exposure increase is coupled with a decrease in the credit quality of the obligor. Specifically, as the mark-to-market on a derivative contract increases in favour of the Group, the driver of this mark-to-market change also reduces the ability of the counterparty to meet its payment, margin call or collateral posting requirements. The Group employs various policies and procedures to ensure that wrong way risk exposures are identified, measured and managed.

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.

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>2017</i>	<i>2016</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Financial guarantees and other credit related contingent liabilities	24,820	28,913
Loan commitments and other credit related commitments	30,729	24,353
	<u>55,549</u>	<u>53,266</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(a) Credit risk (continued)***(i) Loans and advances*

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

Loans neither past due nor impaired

At 31 December 2017, the Group has HK\$221,120 million (2016: HK\$221,870 million) of mortgage loans in Retail Banking that are neither past due nor impaired. These are generally fully secured exposures (2016: fully secured).

In Corporate & Institutional Banking and Commercial Banking, the Group has HK\$186,143 million (2016: HK\$156,713 million) of corporate exposures that are neither past due nor impaired. Based on the fair value of the collateral held, 17% (2016: 23%) of these exposures are secured by tangible 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 39 to the financial statements.

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

Loans past due or impaired

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

	2017		2016	
	<i>Advances to customers</i>	<i>Advances to banks</i>	<i>Advances to customers</i>	<i>Advances to banks</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Estimated fair value of collateral (Note):				
Held against impaired advances	1,064	–	934	–
Held against past due but not impaired advances	1,445	–	2,101	–
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

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

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(a) Credit risk (continued)***(i) Loans and advances (continued)**Repossessed Collateral*

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

	<i>2017</i>	<i>2016</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Property, plant and equipment	<u>138</u>	<u>298</u>

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.

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

	2017		2016	
	<i>Advances to customers HK\$'M</i>	<i>Advances to banks HK\$'M</i>	<i>Advances to customers HK\$'M</i>	<i>Advances to banks HK\$'M</i>
Loans and advances				
– neither past due nor impaired	476,473	149,241	435,229	154,359
– past due but not impaired	2,266	1,015	3,100	2,391
– impaired, net of individually assessed impairment provision	2,371	–	2,256	–
Less: collectively assessed impairment provision	(243)	–	(563)	–
	480,867	150,256	440,022	156,750

The following table sets out an analysis of the internal credit gradings for advances which are not past due and for which no individual impairment provision has been raised. The credit gradings set out in the table below are based on a probability of default measure as set out on page 79 to 80.

	2017		2016	
	<i>Advances to customers HK\$'M</i>	<i>Advances to banks HK\$'M</i>	<i>Advances to customers HK\$'M</i>	<i>Advances to banks HK\$'M</i>
Credit grades:				
1 to 5	337,496	144,507	323,671	149,015
6 to 8	108,131	4,652	85,214	5,287
9 to 11	30,055	82	25,449	57
12	791	–	895	–
	476,473	149,241	435,229	154,359

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

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

	2017		2016	
	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M
Past due				
– up to 30 days	1,988	1,015	2,695	2,391
– 31 - 60 days	153	–	280	–
– 61 - 90 days	41	–	54	–
– 91 - 120 days	53	–	35	–
– 121 - 150 days	31	–	36	–
	<u>2,266</u>	<u>1,015</u>	<u>3,100</u>	<u>2,391</u>

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

	2017			
	<i>Treasury bills</i> HK\$'M	<i>Debt securities</i> HK\$'M	<i>Equity shares</i> HK\$'M	<i>Total</i> HK\$'M
Impaired securities	–	–	–	–
Impairment provisions	–	–	–	–
Net impaired securities	–	–	–	–
Securities neither past due nor impaired	<u>90,895</u>	<u>135,313</u>	<u>701</u>	<u>226,909</u>
	2016			
	<i>Treasury bills</i> HK\$'M	<i>Debt securities</i> HK\$'M	<i>Equity shares</i> HK\$'M	<i>Total</i> HK\$'M
Impaired securities	–	–	12	12
Impairment provisions	–	–	(6)	(6)
Net impaired securities	–	–	6	6
Securities neither past due nor impaired	<u>64,738</u>	<u>157,109</u>	<u>472</u>	<u>222,319</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(a) Credit risk (continued)**Credit quality (continued)*(ii) Analysis of debt securities (including certificates of deposit), equity shares and treasury bills (continued)*

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

	2017		2016	
	<i>Treasury bills</i> HK\$'M	<i>Debt securities</i> HK\$'M	<i>Treasury bills</i> HK\$'M	<i>Debt securities</i> HK\$'M
AAA	848	38,356	–	60,818
AA - to AA +	79,022	35,819	56,958	27,813
A - to A +	11,025	52,256	7,780	64,374
Lower than A -	–	7,403	–	2,651
Unrated	–	1,479	–	1,453
	<u>90,895</u>	<u>135,313</u>	<u>64,738</u>	<u>157,109</u>

(b) Country risk

The Group defines Country Risk as the potential for default 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.

Policies and procedures are developed and deployed to put in place standards and controls that all countries must follow 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.

The ERC is responsible for the establishment of policies, setting and maintaining of 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, relating to Country Risk.

Decision making and approval authorities are guided by reference levels for countries. Reference levels are guidelines to set country limits in respect Country Risk.

Monitoring and reporting is included in the policy and procedures and covers the monitoring of exposures relative to risk appetite thresholds and limits, and the reporting of material exposures to internal committees and externally. The ERC 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.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(c) Market risk management

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 providing 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 market risk related activities is primarily driven by the volume of client activity rather than risk-taking. Market risk also arises in the non-trading book from the requirement to hold a large liquid assets buffer of high-quality liquid debt securities and from the translation of foreign currency denominated assets, liabilities and earnings.

The primary categories of market risk for the Group are:

- interest rate risk: arising from changes in yield curves, credit spreads and implied volatilities on interest rate options;
- currency exchange rate risk: arising from changes in exchange rates and implied volatilities on foreign exchange options.

Market risk governance

The Group sets the Group's risk appetite for market risk. Subject to the risk appetite set for market risk, the ERC approves the Group's overall market risk VaR and stress loss triggers taking account of market volatility, the range of products and asset classes, business volumes and transaction sizes. The ERC is responsible for setting business and desk level VaR, and stress loss triggers for market risk. The ERC is also responsible for policies and other standards for the control of market risk and overseeing their effective implementation. These policies cover both trading and non-trading books of the Group.

The Market and Traded Credit Risk function ("MTCR") approves the limits within delegated authorities and monitors exposures against these limits. Additional limits are placed on specific instruments and position concentrations where appropriate. Sensitivity measures are used in addition to VaR as risk management tools. For example, interest rate sensitivity is measured in terms of exposure to a one basis point increase in yields.

Value at Risk

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 per cent. This confidence level suggests that potential daily losses in excess of the VaR measure are likely to be experienced six times per year.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(c) Market risk management (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 VaR.
- 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

Losses beyond the 97.5 per cent confidence interval are not captured by a VaR calculation, therefore VaR calculation gives no indication of the size of unexpected losses in these situations.

MTCR complements the VaR measurement by weekly stress testing of market risk exposures to highlight the potential risk that may arise from extreme market events that are rare but plausible.

Stress testing is an integral part of the market risk management framework and considers both historical market events and forward-looking scenarios. A consistent stress testing methodology is applied to trading and non-trading books. The stress testing methodology assumes that scope for management action would be limited during a stress event, reflecting the decrease in market liquidity that often occurs.

Stress scenarios are regularly updated to reflect changes in risk profile and economic events. MTCR reviews stress exposures and, where necessary, enforces reductions in overall market risk exposure. The ERC 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, and exchange rates. This covers all asset classes in the Financial Markets banking 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 these non-trading book exposures in the same way as for the trading book, including available-for-sale securities. Securities classed as Loans and Receivables or Held to Maturity are not reflected in VaR or stress tests since they are accounted on an amortised cost basis, so market price movements have limited effect on either profit and loss or reserves.

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

Structural foreign exchange currency risks are managed by ALCO, and are not included within VaR. Otherwise, the non-trading book does not run open foreign exchange positions.

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

<i>Value at risk:</i>	2017				2016			
	<i>Average</i>	<i>High**</i>	<i>Low**</i>	<i>Actual*</i>	<i>Average</i>	<i>High**</i>	<i>Low**</i>	<i>Actual*</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>HK\$'M</i>	<i>HK\$'M</i>
Interest rate risk [^]	47.4	72.0	32.1	38.1	57.5	74.4	42.9	56.1
Foreign exchange risk	4.1	10.2	1.3	5.0	5.5	17.7	1.9	7.7
Total ^{^^}	48.1	74.5	31.9	41.0	56.3	73.6	41.6	55.9

Trading (VaR at 97.5%, 1 day)

<i>Value at risk:</i>	2017				2016			
	<i>Average</i>	<i>High**</i>	<i>Low**</i>	<i>Actual*</i>	<i>Average</i>	<i>High**</i>	<i>Low**</i>	<i>Actual*</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>HK\$'M</i>	<i>HK\$'M</i>
Interest rate risk	9.7	17.5	5.0	5.0	11.8	24.7	5.3	11.0
Foreign exchange risk	4.1	10.2	1.3	5.0	5.5	17.7	1.9	7.7
Total ^{^^}	11.7	22.0	5.8	6.6	13.4	25.6	6.6	16.8

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

<i>Value at risk:</i>	2017				2016			
	<i>Average</i>	<i>High**</i>	<i>Low**</i>	<i>Actual*</i>	<i>Average</i>	<i>High**</i>	<i>Low**</i>	<i>Actual*</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>HK\$'M</i>	<i>HK\$'M</i>
Interest rate risk [^]	45.0	70.7	30.3	37.5	54.2	72.6	37.8	57.2

* Actual one day VaR at period end date.

** Highest and lowest VaR for each risk factor are independent and usually occur on different days.

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

^{^^} The total VaR shown in the tables above is not a sum of the component risks due to offsets between them.

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

The foreign exchange positions of the Group arise from foreign exchange trading and commercial banking operations. 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>2017</i>	<i>2016</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
US dollars exposure		
Spot assets	339,429	364,096
Spot liabilities	(328,208)	(324,498)
Forward purchases	1,378,261	995,460
Forward sales	(1,385,414)	(1,031,735)
Net option position	—	—
	<u>4,068</u>	<u>3,323</u>
Net long non-structural position	<u>4,068</u>	<u>3,323</u>
	<i>2017</i>	<i>2016</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Chinese Renminbi exposure		
Spot assets	53,737	57,399
Spot liabilities	(45,149)	(61,396)
Forward purchases	581,943	605,830
Forward sales	(590,659)	(602,494)
Net option position	—	—
	<u>(128)</u>	<u>(661)</u>
Net short non-structural position	<u>(128)</u>	<u>(661)</u>

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

	<i>2017</i>	<i>2016</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Chinese Renminbi	11,639	9,167
US dollars	3,263	2,283
	<u>14,902</u>	<u>11,450</u>

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(e) Interest rate risk in the banking book

Earnings Risk is evolving. Currently interest rate re-pricing risk in the banking book is managed centrally by Treasury Markets within market risk limits. The governance of Earnings Risk will develop through 2018 in line with regulatory guidelines for interest rate risk in the banking book.

(f) Liquidity and funding risk

Liquidity and Funding Risk is the potential that the Group does not have sufficient financial resources or stable sources of funding in the medium or long term, to meet its obligations as they fall due, or can access these financial resources only at excessive cost.

The Group's liquidity and funding risk framework requires the Group to ensure that it operates within predefined liquidity limits and remain in compliance with the liquidity policies and practices, as well as local regulatory requirements.

This is achieved through a combination of setting risk appetite and associated limits, policy formation, risk measurement and monitoring, prudential and internal stress testing, governance and review.

The liquidity position of the Group remained strong in 2017 and the Group continued to maintain good access to wholesale markets.

Primary sources of funding

The Group's funding strategy is largely driven by its policy to maintain adequate liquidity at all times 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, which aligns with the Group's 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.

Liquidity and funding risk management

The Treasury Risk and Finance Functions are responsible for developing a risk framework for liquidity risk and complying with regulatory requirements in Hong Kong. The Treasury Risk and Finance Functions provide independent challenge and oversight of the first line risk management activities in respect to liquidity risk.

The Group develops and adopts policies to address the material liquidity risks and aims to constrain the risk profile within risk appetite. The Group also maintains a recovery plan which is a live document to be used by management in a liquidity or solvency crisis. The recovery plan includes a broad set of Recovery Indicators, an escalation framework and a set of management actions that could be effectively implemented in the event of a liquidity stress.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(f) Liquidity and funding risk (continued)****Liquidity and funding risk management (continued)**

The Group implements various business-as-usual and stress risk measures and monitors these against transparently set limits. This ensures that the Group maintains an adequate and well-diversified liquidity buffer and stable funding base.

Liquidity and funding risk governance

The Board approves the Group's Risk Appetite for liquidity and funding risk along with supporting metrics. The oversight under the liquidity and funding framework resides with the ALCO, and supported by Treasury Markets so to ensure the Group operates within predefined liquidity limits and remains in compliance with liquidity policies and practices, as well as local regulatory requirements.

Monitoring

On a day to day basis the management of liquidity is performed at the business level. 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 with appropriate escalation processes in place for the breach of limits.

Internal risk management reports covering the balance sheet and liquidity position of the Group are presented to ALCO. 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.

Liquidity and funding risk metrics

The Group monitors key liquidity metrics regularly. The following Liquidity & 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 minimum advances to deposits.

Liquidity Coverage Ratio

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(f) Liquidity and funding risk (continued)****Stress Coverage**

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

The Group's approach to managing liquidity and funding 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. 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 is a Board Risk Appetite metric. This scenario assumes both a Standard Chartered-specific and a 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 a firm's credit rating.

Stress testing results show that a positive surplus was maintained under all scenarios at 31 December 2017 i.e. the Group is able to survive for a period of time as defined under each scenario. The Combined scenario at 31 December 2017 showed the Group maintained liquidity resources to survive greater than 60 days, as per the Group's Board Risk Appetite.

The Group's credit ratings as at 31 December 2017 were A+ with stable outlook (S&P) and A1 with stable outlook (Moody's). A downgrade in credit rating 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.

External wholesale borrowing

A Board risk limit prevents excessive reliance on wholesale borrowing. As at the reporting date the Group remained within Board Risk Appetite.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 Risk management (continued)****(f) Liquidity and funding risk (continued)****Advances-to-deposits ratio**

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

	<i>2017</i>	<i>2016</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Advances to customers	480,867	440,022
Deposits from customers	833,899	778,242
Advances to deposits ratio	58%	57%

Net stable funding ratio (NSFR)

With effect from 1 January 2018, the Group monitors and reports the NSFR in line with the Banking (Liquidity) Rules issued by the HKMA.

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 available-for-sale are used by the Group principally for liquidity management purposes.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 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	2017				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	18,350	-	-	-	-	-	-	18,350
Placements with banks and other financial institutions	1,201	62,784	50,389	29,987	5,175	720	-	150,256
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	42,341	42,341
Trading assets	-	615	4,354	6,044	3,452	8,018	-	22,483
Financial assets designated at fair value	-	-	-	-	-	336	-	336
Advances to customers	14,439	89,300	30,550	54,506	113,466	178,606	-	480,867
Investment securities	236	38,921	67,801	39,841	53,887	6,540	701	207,927
Amounts due from immediate holding company	6,693	14,976	16,295	19,946	735	430	-	59,075
Amounts due from fellow subsidiaries	2,408	11,457	2,524	4,235	3,584	-	-	24,208
Others	870	2,035	8,637	1,045	858	6	55,755	69,206
Total Assets	44,197	220,088	180,550	155,604	181,157	194,656	98,797	1,075,049
Liabilities								
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	42,341	42,341
Deposits and balances of banks and other financial institutions	18,404	88	2	920	199	-	-	19,613
Deposits from customers	654,100	76,683	52,069	47,721	3,100	226	-	833,899
Trading liabilities	-	6,941	137	565	638	20	-	8,301
Financial liabilities designated at fair value	-	696	503	2,603	2,825	4,847	-	11,474
Debt securities in issue	-	1,712	156	1,198	-	-	-	3,066
Amounts due to immediate holding company	2,124	8,209	19,146	7,582	477	6,708	-	44,246
Amounts due to fellow subsidiaries	7,130	549	1,272	514	12	-	-	9,477
Subordinated liabilities	-	-	-	-	6,003	-	-	6,003
Others	6,617	5,132	7,238	2,165	763	-	286	22,201
Total Liabilities	688,375	100,010	80,523	63,268	14,017	11,801	42,627	1,000,621

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

	2016							Total HK\$'M
	Repayable on demand HK\$'M	Due	Due	Due	Due	Due	Undated HK\$'M	
		within 1 month HK\$'M	between 1 month to 3 months HK\$'M	between 3 months to 1 year HK\$'M	between 1 year to 5 years HK\$'M	between 5 years after HK\$'M		
Assets								
Cash and balances with banks, central banks and other financial institutions	15,332	-	-	-	-	-	-	15,332
Placements with banks and other financial institutions	863	63,795	54,503	32,597	4,078	914	-	156,750
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	42,211	42,211
Trading assets	116	795	1,533	6,157	3,787	3,242	4	15,634
Financial assets designated at fair value	-	-	-	-	-	370	-	370
Advances to customers	16,238	75,695	32,585	38,453	102,136	176,915	(2,000)	440,022
Investment securities	234	24,702	55,787	64,802	51,685	9,787	474	207,471
Amounts due from immediate holding company	3,652	14,145	15,680	11,607	809	1,540	(912)	46,521
Amounts due from fellow subsidiaries	1,661	3,684	1,442	4,246	5,204	-	91	16,328
Others	1,192	1,401	5,773	6,054	752	10	50,201	65,383
Total Assets	39,288	184,217	167,303	163,916	168,451	192,778	90,069	1,006,022
Liabilities								
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	42,211	42,211
Deposits and balances of banks and other financial institutions	18,760	2	1	-	911	-	-	19,674
Deposits from customers	613,902	47,772	63,511	50,413	2,429	215	-	778,242
Trading liabilities	-	7,900	300	57	29	3	-	8,289
Financial liabilities designated at fair value	-	156	247	4,011	1,444	3,710	-	9,568
Debt securities in issue	-	7	14	1,041	1,111	-	-	2,173
Amounts due to immediate holding company	1,253	4,447	16,171	11,386	883	8,142	-	42,282
Amounts due to fellow subsidiaries	10,067	9	354	1,502	-	-	-	11,932
Subordinated liabilities	-	-	-	-	6,088	-	-	6,088
Others	6,540	2,625	5,781	3,993	550	130	232	19,851
Total Liabilities	650,522	62,918	86,379	72,403	13,445	12,200	42,443	940,310

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

(i) Contractual maturity of assets and liabilities (continued)

	Repayable on demand	2017					Undated	Total
		Due within 1 month	Due between 1 month to 3 months	Due between 3 months to 1 year	Due between 1 year to 5 years	Due after 5 years		
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	
Of which:								
Certificates of deposit held								
- included in Trading assets	-	257	106	19	42	-	-	424
- included in Investment securities as available-for-sale securities	-	4,616	5,440	7,362	1,960	-	-	19,378
	-	4,873	5,546	7,381	2,002	-	-	19,802
Treasury bills								
- included in Trading assets	-	116	3,583	588	-	-	-	4,287
- included in Investment securities as available-for-sale securities	-	23,604	45,529	17,475	-	-	-	86,608
	-	23,720	49,112	18,063	-	-	-	90,895
Debt securities								
- included in Trading assets	-	31	346	3,885	1,661	8,005	-	13,928
- included in Financial assets designated at fair value	-	-	-	-	-	336	-	336
- included in Investment securities classified as:								
- available-for-sale securities	-	10,701	16,832	14,176	49,680	4,801	-	96,190
- loans and receivables	236	-	-	828	2,247	1,739	-	5,050
	236	10,732	17,178	18,889	53,588	14,881	-	115,504

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

(i) Contractual maturity of assets and liabilities (continued)

	Repayable on demand	2016					Undated	Total
		Due within 1 month	Due between 1 month to 3 months	Due between 3 months to 1 year	Due between 1 year to 5 years	Due after 5 years		
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	
Of which:								
Certificates of deposit held								
- included in Trading assets	-	646	844	431	206	-	-	2,127
- included in Investment securities as available-for-sale securities	-	1,318	2,592	21,221	160	-	-	25,291
	-	1,964	3,436	21,652	366	-	-	27,418
Treasury bills								
- included in Trading assets	-	-	71	4,274	-	-	-	4,345
- included in Investment securities as available-for-sale securities	-	12,583	40,104	7,706	-	-	-	60,393
	-	12,583	40,175	11,980	-	-	-	64,738
Debt securities								
- included in Trading assets	-	77	85	1,252	3,361	3,233	-	8,008
- included in Financial assets designated at fair value	-	-	-	-	-	370	-	370
- included in Investment securities classified as:								
- available-for-sale securities	-	10,801	12,703	34,681	47,073	7,978	-	113,236
- loans and receivables	234	-	388	1,195	4,451	1,809	-	8,077
	234	10,878	13,176	37,128	54,885	13,390	-	129,691

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(f) Liquidity and funding risk (continued)**

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

The cash flows presented in note 37(f)(i) reflect the cash flows which will be contractually payable over the residual maturity of the instruments. 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. Such behavioural adjustments are identified and managed through analysis of the historical balances.

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

The following tables analyse 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 statement of financial position as the tables incorporate all contractual cash flows, on an undiscounted basis, relating to both principal and interest payments.

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

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

	2017						Total HK\$'M
	Repayable on demand HK\$'M	Due within 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	
Deposits and balances of banks and other financial institutions	18,404	90	1,008	209	–	–	19,711
Deposits from customers	654,100	129,169	48,209	3,212	226	–	834,916
Trading liabilities	–	6,327	–	–	–	–	6,327
Financial liabilities designated at fair value	–	1,209	2,656	2,945	4,847	–	11,657
Debt securities in issue	–	1,868	1,240	–	–	–	3,108
Amounts due to immediate holding company	2,124	27,421	7,784	1,553	7,784	–	46,666
Amounts due to fellow subsidiaries	7,130	1,821	514	12	–	–	9,477
Subordinated liabilities	–	–	352	6,534	–	–	6,886
Others	6,140	9,276	1,986	763	–	42,627	60,792
	<u>687,898</u>	<u>177,181</u>	<u>63,749</u>	<u>15,228</u>	<u>12,857</u>	<u>42,627</u>	<u>999,540</u>
	2016						Total HK\$'M
	Repayable on demand HK\$'M	Due within 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	
Deposits and balances of banks and other financial institutions	18,760	3	–	968	–	–	19,731
Deposits from customers	613,902	111,694	50,836	2,468	215	–	779,115
Trading liabilities	–	7,728	–	–	–	–	7,728
Financial liabilities designated at fair value	–	406	4,068	1,465	3,710	–	9,649
Debt securities in issue	–	22	1,093	1,154	–	–	2,269
Amounts due to immediate holding company	1,253	20,679	11,548	1,750	9,226	–	44,456
Amounts due to fellow subsidiaries	10,067	363	1,502	–	–	–	11,932
Subordinated liabilities	–	–	374	6,982	–	–	7,356
Others	6,282	8,141	3,982	551	128	42,443	61,527
	<u>650,264</u>	<u>149,036</u>	<u>73,403</u>	<u>15,338</u>	<u>13,279</u>	<u>42,443</u>	<u>943,763</u>

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

(iv) Derivative financial instruments on an undiscounted basis

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

	2017				Total HK\$'M		
	<i>Due within 3 months HK\$'M</i>	<i>Due between 3 months to 1 year HK\$'M</i>	<i>Due between 1 year to 5 years HK\$'M</i>	<i>Due after 5 years HK\$'M</i>			
	Derivative financial instruments	1,818,464	985,133	18,697		3,338	2,825,632
		<u>1,818,464</u>	<u>985,133</u>	<u>18,697</u>		<u>3,338</u>	<u>2,825,632</u>
	2016				Total HK\$'M		
	<i>Due within 3 months HK\$'M</i>	<i>Due between 3 months to 1 year HK\$'M</i>	<i>Due between 1 year to 5 years HK\$'M</i>	<i>Due after 5 years HK\$'M</i>			
	Derivative financial instruments	1,295,346	743,224	11,163		3,667	2,053,400
		<u>1,295,346</u>	<u>743,224</u>	<u>11,163</u>		<u>3,667</u>	<u>2,053,400</u>

(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 provides oversight of operational risk management across the Group. It is supported by the Operational Risk Committee ("CORC") along with its sub-committees including the Financial Crime Risk Committee ("FCRC"), Data Governance Committee ("DGC"), and Third Party Risk Management Committee ("TPRMC"), which oversee operational risks arising from businesses and functions, financial crime compliance, data quality management, and third party risk 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.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***37 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

External Rules & Regulations	Potential for actual or opportunity loss due to failure to comply with laws or regulations, or as a result of changes in laws or regulations or in their interpretation or application
Liability	Potential for loss or sanction due to a legal claim against any part of the Group or individuals within the Group
Legal enforceability	Potential for loss due to failure to protect legally the Group's interests or from difficulty in enforcing the Group's rights
Damage or loss of physical assets	Potential for loss or damage or denial of use of property or other physical assets
Safety & security	Potential for loss or damage relating to health and safety or physical security
Internal fraud or dishonesty	Potential for loss due to action by staff who is intended to defraud, or to circumvent the law or company policy
External fraud	Potential for loss due to criminal acts by external parties such as fraud or theft of financial assets
Information security	Potential for loss due to unauthorised access, use, disclosure, disruption, modification or destruction of information. This risk sub-type excludes data privacy regulatory risk.
Processing failure	Potential for loss due to failure of an established process or to a process design weakness
Model	Potential for loss or adverse impact due to incorrectly designed or misused models Potential for regulatory breach due to a significant discrepancy between the output of financial crime client risk scoring, financial crime transaction monitoring models and actual experience

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

The Group defines Reputational Risk as the potential for damage to the franchise, resulting in loss of earnings or adverse impact on market capitalisation as a result of stakeholders taking a negative view of the organization, its actions or inactions – leading stakeholders to change their behaviour.

The ERC and its sub-committee, the Reputational Risk committee, provide Group-wide oversight on reputational risk, set policy and monitor material risks. The Reputational Risk Committee ensures the effective management of Reputational Risk across the Group. The Reputational Risk Committee's remit is to challenge, constrain and if required stop business activities where risks are not aligned with the approved risk appetite; to make decisions on Reputational Risk matters assessed as high or very high based on the Group's Reputational Risk Materiality Assessment Matrix, and matters escalated from the Regions or Client Businesses; and to provide oversight of material Reputational Risk and/or thematic issues arising from the potential failure of other risk types.

The Reputational Risk Committee 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's risk appetite, and any limits and policies set by authorised bodies of the Group. Matters considered at the Reputational Risk Committee are still subject to other relevant risk approvals for other risk types.

(i) Compliance

The Group defines Compliance Risk as the potential for regulatory sanctions or loss from a failure on its 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.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(j) Conduct**

The Group defines Conduct Risk as the potential regulatory sanctions or loss from a failure on its part to abide by the Group Code of Conduct.

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 Management Policy 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.

(k) Information and Cyber Security**Information and cyber security risk**

The Group defines Information and cyber security risk 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.

During 2017 the Group introduced the Chief Information Security Officer function and announced a revised operating model to address information and cyber security as a business risk and incorporate it into its overall risk management strategy. The combined functions of Chief Information Security Officer and Technical Information Security Team are referred to as Information Security with the Chief Information Security Officer function having responsibility for the overall management of the information and cyber security risk and the Technical Information Security Team having responsibility for application of technical information security controls in the Group.

The Chief information Security Officer as second line of defence has overall responsibility for the information and cyber security risk and provides oversight and challenge to the First Line, business units who own the information assets and systems. In addition, the Chief Information Security Officer sets both the strategy and policy framework through which information assets and systems must be protected.

The Chief Information Security Officer function was introduced into the Group during 2017. Monitoring capability is under development and will be enhanced during 2018 as information and cyber security becomes a principle risk managed under a refreshed model. Currently monitoring is performed through a range of roles and activities in both the Chief Information Security Office and Technical Information Security Team.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)**(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 FCRC which is appointed by and reports into the CORC. The FCRC is concerned with ensuring the effective management of operational risk relating to Financial Crime Compliance throughout the Group in support of the Group's strategy and in line with the Group's Risk Appetite, Enterprise Risk Management Framework and Operational Risk Procedures.

Metrics and tolerances covering the operation of key Processes in support of Financial Crime have been documented. Metrics are subject to periodic review and performance against them is regularly reported to the FCRC.

(m) Capital management

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

In addition to meeting the regulatory requirements, the 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 ALCO and is reviewed regularly by the Board.

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 requirements during 2017.

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 internal ratings-based (securitization) approach to calculate its credit risk for securitization exposures.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(m) Capital management (continued)

For market risk, the Group adopts the standardised (market risk) approach for the majority of its exposures and uses an internal models approach for two guaranteed funds. In addition, the Group adopts the standardised (operational risk) approach for operational risk.

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.

The Group's consolidated capital as at 31 December 2017 consists of tier 1 capital after deduction of HK\$57,666 million (2016: HK\$51,890 million) and tier 2 capital after deductions of HK\$12,535 million (2016: HK\$13,682 million). Tier 2 capital includes subordinated debt and collective impairment allowances for impaired assets.

38 Financial instruments

(a) Valuation of financial instruments carried at fair value

Valuation of financial assets and liabilities held at fair value are subject to a review independent of the business by Valuation Control. For those financial assets and liabilities whose fair value is determined by reference to externally quoted prices or market observable pricing inputs to valuation models, an assessment is made against external market data and consensus services. Financial instruments held at fair value in the 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, and the types of instruments classified into each level within that hierarchy, is set out below:

	Level 1	Level 2	Level 3
Fair value determined using:	Unadjusted quoted price in an active market for identical assets and liabilities	Directly or indirectly observable inputs other than unadjusted quoted prices included within Level 1 that are observable (note 1)	Significant inputs for the asset or liability that are not based on observable market data (unobservable inputs) (see note 38 (a) (i))
Types of financial assets	Actively traded government, agency and other securities Listed equities Quoted derivative instruments	Asset backed securities Corporate and other government bonds and loans Over-the-counter derivatives	Asset backed securities in illiquid markets Corporate bonds and loans in illiquid markets Unlisted equities Over-the-counter derivatives with unobservable inputs
Types of financial liabilities	Short positions in actively traded government and agency securities Short positions in listed equities Quoted derivative instruments	Structured bank and customer deposits Debt securities in issue Over-the-counter derivatives	Structured bank and customer deposits Debt securities issued Over-the-counter derivatives with unobservable inputs

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

(Note 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.

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

	2017			Total HK\$'M
	Level 1 HK\$'M	Level 2 HK\$'M	Level 3 HK\$'M	
Trading assets				
– Trading securities	8,045	10,573	24	18,642
– Advances to customers	–	2,649	–	2,649
– Positive fair values of trading derivatives	1	1,191	–	1,192
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	44	22,169	–	22,213
– Positive fair values of hedging derivatives	–	596	–	596
– Debt securities	–	7	–	7
Amounts due from fellow subsidiaries				
– Positive fair values of trading derivatives	–	712	–	712
– Positive fair values of hedging derivatives	–	–	–	–
Financial assets designated at fair value				
– Debt securities	–	336	–	336
Available-for-sale securities				
– Treasury bills	86,608	–	–	86,608
– Certificates of deposit held	37	19,341	–	19,378
– Debt securities	36,843	59,347	–	96,190
– Equity shares, net of impairment	–	–	701	701
Total assets measured at fair value	131,578	116,921	725	249,224
Trading liabilities				
– Short positions in securities	3,274	2,539	–	5,813
– Negative fair values of trading derivatives	3	2,485	–	2,488
Financial liabilities designated at fair value				
– Structured bank and customer deposits	–	3,940	–	3,940
– Debt securities issued	–	6,370	1,164	7,534
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	32	23,147	–	23,179
– Negative fair values of hedging derivatives	–	396	–	396
Amounts due to fellow subsidiaries				
– Negative fair values of trading derivatives	2	584	–	586
– Negative fair values of hedging derivatives	–	405	–	405
Total liabilities measured at fair value	3,311	39,866	1,164	44,341

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

	2016			Total HK\$'M
	Level 1 HK\$'M	Level 2 HK\$'M	Level 3 HK\$'M	
Trading assets				
– Trading securities	6,023	8,461	–	14,484
– Advances to customers	–	116	–	116
– Positive fair values of trading derivatives	–	1,034	–	1,034
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	61	21,998	24	22,083
– Positive fair values of hedging derivatives	–	1,567	–	1,567
Amounts due from fellow subsidiaries				
– Positive fair values of trading derivatives	–	54	–	54
– Positive fair values of hedging derivatives	–	7	–	7
Financial assets designated at fair value				
– Debt securities	–	370	–	370
Available-for-sale securities				
– Treasury bills	60,393	–	–	60,393
– Certificates of deposit held	449	24,842	–	25,291
– Debt securities	55,277	57,939	20	113,236
– Equity shares, net of impairment	7	–	467	474
Total assets measured at fair value	122,210	116,388	511	239,109
Trading liabilities				
– Short positions in securities	1,954	5,756	–	7,710
– Negative fair values of trading derivatives	–	579	–	579
Financial liabilities designated at fair value				
– Structured bank and customer deposits	–	3,420	–	3,420
– Debt securities issued	–	4,462	1,686	6,148
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	34	22,609	–	22,643
– Negative fair values of hedging derivatives	–	1,108	–	1,108
Amounts due to fellow subsidiaries				
– Negative fair values of trading derivatives	–	10	–	10
– Negative fair values of hedging derivatives	–	–	–	–
Total liabilities measured at fair value	1,988	37,944	1,686	41,618

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

(i) Valuation of financial instruments with significant unobservable inputs

The movements during the year for level 3 financial assets and liabilities are as follows:

	2017			Total level 3 assets HK\$'M
	Trading securities HK\$'M	Amounts due from immediate holding company HK\$'M	Available- for-sale securities HK\$'M	
Financial assets				
At 1 January 2017	–	24	487	511
Total gains recognised in the consolidated income statement				
– Net trading income	–	20	–	20
– Net gains from disposal of available-for-sale securities	–	–	–	–
Sales	–	–	(32)	(32)
Total gains recognised in the available-for-sale investment reserve	–	–	258	258
Purchases	24	–	8	32
Settlements	–	(44)	(20)	(64)
At 31 December 2017	<u>24</u>	<u>–</u>	<u>701</u>	<u>725</u>
Total gains recognised in the consolidated income statement relating to assets held at 31 December 2017				
– Net trading income	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>

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

	<i>Financial liabilities designated at fair value HK\$'M</i>
Financial liabilities At 1 January 2017	1,686
Total gains recognised in the consolidated income statement	
– Net gains from financial instruments designated at fair value through profit or loss	(48)
Issuances	1,224
Settlements	(1,698)
	<hr/>
At 31 December 2017	1,164
	<hr/> <hr/>
Total gains recognised in the consolidated income statement relating to liabilities held at 31 December 2017	
– Net gains from financial instruments designated at fair value through profit or loss	(48)
	<hr/> <hr/>

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

	<i>Amounts due from immediate holding company HK\$'M</i>	<i>2016 Available- for-sale securities HK\$'M</i>	<i>Total level 3 assets HK\$'M</i>
Financial assets			
At 1 January 2016	471	752	1,223
Total gains recognised in the consolidated income statement			
– Net trading income	4	–	4
– Net gains from disposal of available-for-sale securities	–	54	54
Sales	–	(237)	(237)
Total losses recognised in the available-for-sale investment reserve	–	(53)	(53)
Purchases	–	91	91
Settlements	–	(120)	(120)
Transferred out of level 3 (note)	(451)	–	(451)
	<u>24</u>	<u>487</u>	<u>511</u>
At 31 December 2016			
Total gains recognised in the consolidated income statement relating to assets held at 31 December 2016			
– Net trading income	<u>4</u>	<u>–</u>	<u>4</u>

(note) Transfers out of level 3 during the year relate to financial instruments where the valuation parameters became observable during the year.

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

	<i>Financial liabilities designated at fair value</i> HK\$'M	<i>Amounts due to immediate holding company</i> HK\$'M	<i>Total level 3 liabilities</i> HK\$'M
Financial liabilities			
At 1 January 2016	1,824	12	1,836
Total gains recognised in the consolidated income statement			
– Net gains from financial instruments designated at fair value through profit or loss	(129)	–	(129)
Issuances	404	–	404
Settlements	(404)	(1)	(405)
Transferred out of Level 3 (note)	(9)	(11)	(20)
	<u>1,686</u>	<u>–</u>	<u>1,686</u>
At 31 December 2016			
Total gains recognised in the consolidated income statement relating to liabilities held at 31 December 2016			
– Net gains from financial instruments designated at fair value through profit or loss	(129)	–	(129)

(note) Transfers out of level 3 during the year relate to financial instruments where the valuation parameters became observable during the year.

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

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

<u>Type of instruments</u>	<u>Principal valuation technique</u>	<u>Significant unobservable inputs</u>	<u>Range (Note 1)</u>	<u>Weighted average (Note 2)</u>
Debt securities	Discounted cash flows	Price/Yield	5% (2016: 0.4%)	5% (2016: 0.4%)
Debt securities in issue	Discounted cash flows	Credit spreads	0.9% to 4.0% (2016: 2.0% to 4.0%)	2.6% (2016: 2.4%)
Derivative financial Instruments	Internal pricing model	Equity-equity correlation	Nil (2016: Nil)	Nil (2016: Nil)
		Equity-foreign exchange correlation	Nil (2016: 40% to 63%)	Nil (2016: Nil)
	Discounted cash flows	Credit spreads	Nil (2016: 4.0%)	Nil (2016: 4.0%)

(Note 1) The ranges of values shown represent the highest and lowest levels used in the valuation of the level 3 financial instruments as at 31 December 2017 and 2016. 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.

(Note 2) Weighted average for non-derivative financial instruments have been calculated by weighting inputs by the relative fair value. Weighted average for derivatives has been provided by weighting inputs by the risk relevant to that variable.

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

Yield

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

Correlation

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

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

Credit spreads represent the additional yield that a market participant would demand for taking exposures to the credit risk of an instrument.

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

	2017					
	<i>Held at fair value through profit or loss</i>			<i>Available-for-sale securities</i>		
	<i>Net</i>	<i>Favourable</i>	<i>Unfavourable</i>	<i>Net</i>	<i>Favourable</i>	<i>Unfavourable</i>
	<i>exposure</i>	<i>changes</i>	<i>changes</i>	<i>exposure</i>	<i>changes</i>	<i>changes</i>
<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	
Amounts due from immediate holding company	–	–	–	–	–	–
Debt securities	24	25	23	–	–	–
Equity securities	–	–	–	701	771	631
Debt securities issued	(1,164)	(1,088)	(1,180)	–	–	–
	<u>(1,140)</u>	<u>(1,063)</u>	<u>(1,157)</u>	<u>701</u>	<u>771</u>	<u>631</u>

	2016					
	<i>Held at fair value through profit or loss</i>			<i>Available-for-sale securities</i>		
	<i>Net</i>	<i>Favourable</i>	<i>Unfavourable</i>	<i>Net</i>	<i>Favourable</i>	<i>Unfavourable</i>
	<i>exposure</i>	<i>changes</i>	<i>changes</i>	<i>exposure</i>	<i>changes</i>	<i>changes</i>
<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	
Amounts due from immediate holding company	24	32	11	–	–	–
Debt securities	–	–	–	20	20	20
Equity securities	–	–	–	467	514	421
Debt securities issued	(1,686)	(1,623)	(1,710)	–	–	–
	<u>(1,662)</u>	<u>(1,591)</u>	<u>(1,699)</u>	<u>487</u>	<u>534</u>	<u>441</u>

Where the fair value of financial instruments are measured using valuation techniques that incorporate one or more significant inputs which are based on unobservable market data, the Group applies a 10 per cent increase or decrease on the values of these unobservable parameter inputs, to generate a range of reasonably possible alternative valuations in accordance with the requirements of HKFRS 7/IFRS 7. The percentage shift is determined by statistical analyses performed on a set of reference prices, which included certain equity indices, credit indices and volatility indices, based on the composition of 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)***38 Financial instruments (continued)****(a) Valuation of financial instruments carried at fair value (continued)**

As of 31 December 2017, these reasonably possible alternatives could have increased the net fair values of financial instruments held at fair value through profit or loss by HK\$77 million (2016: HK\$71 million) or decreased them by HK\$17 million (2016: HK\$37 million); and increased the fair values of available-for-sale securities by HK\$70 million (2016: HK\$47 million) or decreased them by HK\$70 million (2016: HK\$46 million).

<i>Financial instruments</i>	<i>Fair value changes</i>	<i>2017 HK\$'M</i>	<i>2016 HK\$'M</i>
Trading assets	Possible increase	1	8
	Possible decrease	1	13
Financial assets designated at fair value	Possible increase	76	63
	Possible decrease	16	24
Investment securities	Possible increase	70	47
	Possible decrease	70	46

(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 2017 and 2016, 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>2017</i>			<i>2016</i>		
	<i>Carrying amount HK\$'M</i>	<i>Fair value Level 1 HK\$'M</i>	<i>Fair value Level 2 HK\$'M</i>	<i>Carrying amount HK\$'M</i>	<i>Fair value Level 1 HK\$'M</i>	<i>Fair value Level 2 HK\$'M</i>
Subordinated liabilities – US\$750 million						
5.875% Fixed Rate Notes 2020 (Note 31)	<u>6,003</u>	<u>6,263</u>	<u>–</u>	<u>6,088</u>	<u>6,298</u>	<u>–</u>
Subordinated liabilities – US\$800 million						
4.30% Fixed Rate debt 2026 (Note 18)	<u>6,252</u>	<u>–</u>	<u>6,316</u>	<u>6,204</u>	<u>–</u>	<u>6,204</u>

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) and note 2(j), respectively.

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

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

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

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>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
Collateral pledged against repurchase agreements		
On balance sheet		
Cash	–	–
Investment securities	–	2,051
Off balance sheet		
Repledged collateral received	–	–
	<u>–</u>	<u>2,051</u>
Balance sheet liabilities – repurchase agreements		
Deposits from customers	–	2,006
	<u>–</u>	<u>2,006</u>

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

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

	2017					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	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Positive fair values of derivative financial instruments	24,713	–	24,713	(23,083)		1,630
Reverse repos, securities borrowing and similar agreements	36,352	–	36,352	(36,294)		58
	<u>61,065</u>	<u>–</u>	<u>61,065</u>	<u>(59,377)</u>		<u>1,688</u>
Liabilities	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Negative fair values of derivative financial instruments	27,054	–	27,054	(23,989)		3,065
Repos and similar agreements	–	–	–	–		–
	<u>27,054</u>	<u>–</u>	<u>27,054</u>	<u>(23,989)</u>		<u>3,065</u>

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

	2016				Net amount HK\$'M
	Gross amounts of recognised financial liabilities offset in the consolidated statement of financial assets HK\$'M	Net amounts of financial assets presented in the consolidated statement of financial position HK\$'M	Related amounts not offset in the consolidated statement of financial position HK\$'M		
Assets					
Positive fair values of derivative financial instruments	24,745	–	24,745	(23,927)	818
Reverse repos, securities borrowing and similar agreements	22,689	–	22,689	(22,504)	185
	<u>47,434</u>	<u>–</u>	<u>47,434</u>	<u>(46,431)</u>	<u>1,003</u>
Liabilities					
Negative fair values of derivative financial instruments	24,340	–	24,340	(23,916)	424
Repos and similar agreements	2,006	–	2,006	(2,006)	–
	<u>26,346</u>	<u>–</u>	<u>26,346</u>	<u>(25,922)</u>	<u>424</u>

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***38 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.

39 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 2017, the Group had securities amounting to HK\$5,813 million (2016: HK\$7,710 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>2017</i>	<i>2016</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Consolidated statement of financial position assets - reverse repos and securities borrowing		
Placements with banks and other financial institutions	18,912	14,295
Advances to customers	–	3,741
Amounts due from immediate holding company	17,440	4,653
	<u>36,352</u>	<u>22,689</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>2017</i>	<i>2016</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Securities and collateral that can be repledged or sold (at fair value)	36,966	22,925
Thereof repledged/transferred to others under repos (at fair value)	–	–
	<u>36,966</u>	<u>22,925</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)***40 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.

(a) Key management personnel remuneration

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

	2017 HK\$'M	2016 HK\$'M
Short-term employee benefits	66	69
Post-employment benefits	2	2
Equity compensation benefits	10	5
Termination benefits	5	1
	<u>83</u>	<u>77</u>

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

(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.

	2017 HK\$'M	2016 HK\$'M
Loan balances:		
At 1 January	<u>65</u>	<u>1,468</u>
At 31 December	<u>34</u>	<u>65</u>
Average balance during the year	<u>41</u>	<u>1,184</u>
Income earned	<u>1</u>	<u>24</u>

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Material related party transactions (continued)**(c) Share based payments**

SCPLC 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 SCPLC's main share plan. Since approval, it has been used to deliver various types of share awards:

Long Term Incentive Plan ('LTIP')

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.

Performance shares

Awards of performance shares vest after a three-year period and are subject to a combination of three performance measures, TSR, Earning per share (EPS) and RoRWA. The three performance measures are equally weighted with one third of the award depending on each measure, assessed independently. Performance share awards form part of the variable compensation awarded to executive directors. In line with regulatory requirements, discretionary variable compensation for executive directors will not exceed 200 per cent of fixed pay.

Deferred share awards/Restricted shares

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 SCPLC to meet regulatory requirements relating to deferral levels, and is in line with market practice.

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 SCPLC 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.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Material related party transactions (continued)**(c) Share based payments (continued)****1997/2006 Restricted Share Scheme (2006 RSS)/ 2007 Supplementary Restricted Share Scheme (2007 SRSS)**

SCPLC's previous plans for delivering restricted shares were the 2006 RSS and 2007 SRSS, both of which are now replaced by the 2011 Plan. There are vested awards outstanding under these plans. Awards will generally be in the form of nil cost options and do not have any performance conditions. Generally deferred restricted share awards vest equally over three years and for non-deferred awards half vests two years after the date of grant and the balance after three years. No further awards will be granted under the 2006 RSS and 2007 SRSS.

2000 Executive Share Option Scheme (2000 ESOS)

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

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

2001 Performance Share Plan (2001 PSP)

SCPLC's previous plan for delivering performance shares was the 2001 PSP. Although the 2001 PSP was replaced in 2011, there are still outstanding vested awards under the plan.

Under the 2001 PSP, half the award is dependent upon TSR performance and the balance is subject to a target of defined EPS growth. Both measures use the same three-year period and are assessed independently. No further awards can be granted under the plan.

All Employee Sharesave Plan (2004 International Sharesave, 2004 UK Sharesave and 2013 Sharesave)

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

The 2013 Sharesave Plan was approved by Shareholders in May 2013 and since then all Sharesave invitations have been made under this plan.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)****2011 Standard Chartered Share Plan (the 2011 plan)****Management Long Term Incentive Plan “MLTIP”****Valuation**

The vesting of awards granted in both 2016 and 2017 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.

<i>Grant Date</i>	<i>2017</i>		<i>2016</i>	
	<i>13 March</i>	<i>15 June</i>	<i>4 May</i>	<i>11 March</i>
Share price at grant date (£)	7.43	5.05	5.08	4.68
Vesting period (years)	3.7	3	3.7	3
Expected dividends (yield) (%)	N/A	N/A	N/A	N/A
Fair value (RoE) (£)	2.48	1.68	1.69	1.56
Fair value (TSR) (£)	1.81, 1.38	1.24	1.25, 1.12	1.15
Fair value (Strategic) (£)	2.48	1.68	1.69	1.56

Dividend equivalents accrue on these awards during the vesting period, so no discount is applied.

Deferred Share Awards**Valuation**

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

<i>Grant Date</i>	<i>2017</i>			<i>2016</i>				
	<i>3 October</i>	<i>15 June</i>	<i>13 March</i>	<i>30 November</i>	<i>4 October</i>	<i>15 June</i>	<i>4 May</i>	<i>11 March</i>
Share price at grant date (£)	7.56	7.69	7.43	6.41	6.50	5.05	5.08	4.68
Vesting period (years)	1-3	1-3	1-3, 1-5, 3-7	1-3	1-3	1-3	1-3	1-3
Expected dividends yield (%)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Fair value (£)	7.56	7.69	7.43	6.41	6.50	5.05	5.08	4.68

Deferred awards accrue dividend equivalent payments during the vesting period.

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

Valuation

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

Grant Date	2017											
	29 November		3 October		15 June		13 March					
	Share price at grant date (£)		7.43		7.56		7.69		7.43			
Vesting Period	Expected dividend yield (%)		Fair value (£)		Expected dividend yield (%)		Fair value (£)		Expected dividend yield (%)		Fair value (£)	
	6 months	-	-	-	-	-	-	-	-	0.0	7.43	
1 year	0.0	7.43	0.0	7.56	0.0	7.69	0.0	7.69	0.0	7.43		
2 years	0.0	7.43	0.0	7.56	0.5	7.61	0.5	7.61	0.5	7.35		
2-3 years	-	-	-	-	-	-	-	-	1.9	7.08		
3 years	1.6	7.08	1.6	7.21	2.1	7.23	2.1	7.23	2.1	6.99		
4 years	2.2	6.80	2.2	6.92	2.5	6.96	2.5	6.96	2.5	6.72		
5 years	2.4	6.58	2.4	6.70	-	-	-	-	-	-		
6 years	2.6	6.36	2.6	6.47	-	-	-	-	-	-		

Grant Date	2016											
	30 November		4 October		15 June		4 May		11 March			
	Share price at grant date (£)		6.41		6.50		5.05		5.08		4.68	
Vesting Period	Expected dividend yield (%)		Fair value (£)		Expected dividend yield (%)		Fair value (£)		Expected dividend yield (%)		Fair value (£)	
	1 year	0	6.41	0	6.50							
2 years	2.4	6.11	2.4	6.20								
2-3 years	2.5	6.03	2.5	6.11	3.6	4.62	3.6	4.65	3.5	4.30		
3 years	3.0	5.87	3.0	5.95			3.4	4.60				
2-4 years							3.8	4.65				
1-4 years									3.5	4.30		
4 years			3.1	5.76			3.4	4.44				

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)***40 Material related party transactions (continued)****(c) Share based payments (continued)****Sharesave (2004 International Sharesave, 2004 UK Sharesave and 2013 Sharesave)**

Valuation

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

<i>Grant Date</i>	<i>2017</i>	<i>2016</i>
	<i>3 October</i>	<i>4 October</i>
Share price at grant date (£)	7.71	6.50
Exercise price (£)	6.20	5.30
Vesting period (years)	3	3
Expected volatility (%)	34.9	34.2
Expected option life (years)	3.33	3.33
Risk free rate (%)	0.47	0.13
Expected dividends (yield) (%)	1.87	3.04
Fair value (£)	2.32	1.71

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 historical dividend yield for three years prior to grant.

Reconciliation of share award movements for the year to 31 December 2017

	<i>2011 Plan</i>						<i>Weighted average Sharesave exercise price (£)</i>	<i>2013 Sharesave</i>	<i>Weighted average Sharesave exercise price (£)</i>
	<i>LTIP</i>	<i>Deferred/ Restricted shares</i>	<i>PSP</i>	<i>RSS</i>	<i>SRSS</i>	<i>Sharesave</i>			
Outstanding at 1 January 2017	2,611,407	3,476,340	468,389	67,267	3,818	8,408	10.14	1,045,315	6.33
Granted	104,329	1,232,489	-	-	-	-	-	188,180	6.20
Lapsed	(284,429)	(261,827)	(449,953)	(19,797)	(1,647)	(8,408)	10.14	(247,999)	8.10
Exercised	-	(1,346,960)	(10,807)	(31,655)	(2,171)	-	-	(3,731)	5.53
Outstanding at 31 December 2017	2,431,307	3,100,042	7,629	15,815	-	-	-	981,765	5.86
Exercisable at 31 December 2017	-	589,676	7,629	15,815	-	-	-	55,543	9.38
Range of exercise prices (£)	-	-	-	-	-	-	-	5.30-9.38	
Weighted average contractual remaining life (years)	8.24	8.05	3.62	0.19	-	-	-	1.90	

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***40 Material related party transactions (continued)****(c) Share based payments (continued)****Reconciliation of share award movements for the year to 31 December 2016**

	2011 Plan					Sharesave	Weighted average Sharesave exercise price (£)	2013 Sharesave	Weighted average Sharesave exercise price (£)
	LTIP	Deferred/ Restricted shares	PSP	RSS	SRSS				
Outstanding at 1 January 2016	-	3,529,703	1,186,275	125,526	32,494	119,828	10.76	1,414,173	6.73
Granted	2,822,977	1,276,135	-	-	-	-	-	187,414	5.30
Additional shares for Notional Dividend	-	26,181	-	-	-	-	-	-	-
Lapsed	(211,570)	(472,656)	(701,503)	(12,645)	(3)	(111,420)	10.81	(556,114)	7.01
Exercised	-	(883,023)	(16,383)	(45,614)	(28,673)	-	-	(158)	5.58
Outstanding at 31 December 2016	2,611,407	3,476,340	468,389	67,267	3,818	8,408	10.14	1,045,315	6.33
Exercisable at 31 December 2016	-	780,398	20,932	67,267	3,818	8,408	10.14	55,773	11.21
Range of exercise prices (£)	-	-	-	-	-	10.1367	-	5.30-11.2122	-
Weighted average contractual remaining life (years)	9.20	8.18	7.10	0.79	0.19	0.41	-	2.35	-

(d) Loans to directors

Loans to directors 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:

	2017 HK\$'M	2016 HK\$'M
Aggregate amount of relevant loans by the Group outstanding at 31 December	11	26
Maximum aggregate amount of relevant loans by the Group outstanding during the year	25	31

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

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

	<i>2017</i> <i>HK\$'M</i>	<i>2016</i> <i>HK\$'M</i>
Amounts due from associates and joint ventures	9	3
Deposits from associates and joint ventures	174	58
Debt securities issued to associates and joint ventures	120	111
Operating income	35	17

41 Ultimate and immediate holding company

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

The Group's immediate holding company is Standard Chartered Bank, a company registered in England and Wales.

42 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 30 and are updated periodically.

Taxes

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

Fair value of financial instruments

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

42 Significant accounting estimates and judgements (continued)*Impairment of financial assets*

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

Goodwill impairment

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

Fair value hedge

Historically, the Group has applied fair value hedge accounting to the fixed interest rate risk element arising from the future rental receivables under the operating leases on its portfolio of aircraft and vessels which were being economically hedged by interest rate swaps. The hedge accounting treated the fixed interest rate risk element of the future rental receivables as a firm commitment. During the year, the Group adopted an alternative hedging strategy and discontinued hedge accounting. As a result, the Group unwound all the related interest rate swaps and terminated the hedging relationships, giving rise to a net loss of HK\$31 million in trading income. During the course of the strategy review, the Group also concluded that the previous hedge accounting was not appropriate. The Group considered the materiality of applying such a change in accounting treatment retrospectively in accordance with HKAS8/IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, and concluded that the impact is not material to the Group's consolidated financial statements and a restatement is therefore not required. Should the Group apply the change in accounting treatment retrospectively, the Group's consolidated total operating income and profit before taxation would increase by HK\$612 million for the year ended 31 December 2016 and the consolidated total assets would reduce by HK\$31 million as at 31 December 2016.

43 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2017

Up to the date of issue of the consolidated financial statements, the HKICPA/IASB has issued a number of amendments and new standards which are not yet effective for the accounting year ended 31 December 2017 and which have not been adopted in these financial statements.

These include:

- HKFRS 9/IFRS 9, *Financial instruments* (effective on 1 January 2018)
- HKFRS 15/IFRS 15, *Revenue from contracts with customers* (effective on 1 January 2018)
- HKFRS 16/IFRS 16, *Leases* (effective on 1 January 2019)
- HKFRS 17/IFRS 17, *Insurance contracts* (effective on 1 January 2021)
- Amendments to HKAS 40/IAS 40, *Investment property* (effective on 1 January 2018)
- Amendments to HKAS 28/IAS 28, *Investments in associates and joint ventures* and HKFRS 10/IFRS 10, *Consolidated financial statements* (effective date-to be determined)

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

43 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2017 (continued)

- Amendments to HKFRS 4/IFRS 4, *Insurance contracts* (effective on 1 January 2018)
- Amendments to HKFRS 2/IFRS 2, *Share-based payment* (effective on 1 January 2018)
- HK(IFRIC)22, *Foreign currency transactions and advance consideration* (effective on 1 January 2018)
- HK(IFRIC)23, *Uncertainty over income tax treatments* (effective on 1 January 2019)

The Group is in the process of making an assessment of what the impact of these amendments and new standards is expected to be in the period of initial application. So far the Group has identified some aspects of the new standards which may have a significant impact on the consolidated financial statements. Further details of the expected impact is discussed below. 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 and which transitional approach to take, where there are alternative approaches allowed under the new standards.

HKFRS 9/IFRS 9, Financial instruments

On 1 January 2018, the Group adopted HKFRS 9/IFRS 9 Financial Instruments. In October 2017, the HKICPA/IASB issued Prepayment Features with Negative Compensation (Amendments to HKFRS 9/IFRS 9). This amendment is effective for annual periods beginning on or after 1 January 2019, with early adoption permitted.

HKFRS 9/IFRS 9 replaces a number of elements of HKAS 39/IAS 39 Financial Instruments: Recognition and Measurement and introduces new requirements for the classification and measurement of financial instruments; the recognition and measurement of credit impairment provisions; and providing for a simplified approach to hedge accounting. The Group has elected to continue hedge accounting in line with the HKAS 39/IAS 39 requirements and has not therefore applied the HKFRS 9/IFRS 9 hedging requirements. Comparative information will not be restated, as it is not permitted to do so if it cannot be done without the use of hindsight.

The changes in measurements arising on the initial adoption of HKFRS 9/IFRS 9 will be incorporated through an adjustment to the opening reserves position as at 1 January 2018. This adjustment is estimated to reduce shareholders' equity by approximately HK\$715 million, the majority of which relates to the adoption of the expected credit loss provisioning requirements.

The Group continues to refine its expected credit loss models and embed its operational processes which may change the actual impact on adoption.

Detailed transition disclosures setting out the impact of initial adoption of HKFRS 9/IFRS 9 will be provided in the Group's 2018 consolidated financial statements in addition to the disclosure requirements set out in HKFRS 7/IFRS 7.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

43 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2017 (continued)**(a) Classification and measurement of financial assets****HKAS 39/IAS 39:**

There are four asset classifications: fair value through profit or loss ('FVTPL'), incorporating trading and instruments designated at FVTPL; loans and receivables; held to maturity; and available-for-sale ('AFS'). The classification of assets into these categories was determined based on a mix of management intent and product characteristics. Only the AFS category has no restrictions on classification.

In respect of hybrid financial assets, the embedded derivative component must be separated and measured at fair value, unless closely related to the host contract. If this is not possible, the entire instrument can be designated at FVTPL.

Other instruments may be designated at FVTPL if they are managed on a fair value basis or where the designation would eliminate or significantly reduce an accounting mismatch.

HKFRS 9/IFRS 9:

There are three measurement classifications under IFRS 9: amortised cost, fair value through profit or loss ('FVTPL') and, for financial assets, fair value through other comprehensive income ('FVOCI'). The existing HKAS 39/IAS 39 financial asset categories are removed.

Financial assets are classified into these measurement classifications on the basis of the business model within which they are held, and their contractual cash flow characteristics. The business model reflects how groups of financial assets are managed to achieve a particular business objective. Financial assets can only be held at amortised cost if the instruments are held in order to collect the contractual cash flows ('hold to collect'), and where those contractual cash flows are solely payments of principal and interest ('SPPI'). Principal represents the fair value of the instrument at the time of initial recognition. Interest in this context represents compensation for the time value of money and associated credit risks together with compensation for other basic lending risks and costs and a profit margin. This requires an assessment at initial recognition of the contractual terms to determine whether it contains a term that could change the timing or amount of cash flows in a way that is inconsistent with the SPPI criteria.

Assets may be sold out of hold to collect portfolios where there is an increase in credit risk. Disposals for other reasons are permitted but such sales should be insignificant in value or infrequent in nature.

Financial asset debt instruments where the business model objectives are achieved either by collecting the contractual cash flows or by selling the assets ('hold to collect and sell') are held at FVOCI, with unrealised gains or losses deferred in reserves until the asset is derecognised. In certain circumstances, non-trading equity instruments can be irrevocably designated as FVOCI but both unrealised and realised gains or losses are recognised in reserves and no amounts other than dividends are recognised in the income statement.

All other financial assets will mandatorily be held at FVTPL.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

43 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2017 (continued)**(a) Classification and measurement of financial assets (continued)****HKFRS 9/IFRS 9: (continued)**

There has been no change to the classification and measurement of financial liabilities. The Group adopted the changes related to the presentation of fair value changes on own credit for the current accounting period commencing 1 January 2017.

The derecognition requirements have also been carried forward unchanged from HKAS 39/IAS 39.

Transition impact:

The Group has assessed the business models that it operates. In its assessment, the Group considered the objectives of the business model, how performance is measured and how staff are remunerated amongst other factors.

Where the objective of a business is to manage financial assets on a fair value basis, the instruments within that business model are measured at FVTPL. This includes the Group's trading portfolios.

Most of the Group's loans to banks and customers are held within a "hold to collect" business model. Investment debt securities held by Treasury Markets are held within a 'hold to collect and sell' portfolio.

For hold to collect portfolios, the level of sales and the reason for those sales is also monitored to ensure they are consistent with the characteristics of a hold to collect business model.

Where the assets are held within a 'hold to collect' or 'hold to collect and sell' business model, a further assessment has been undertaken to determine whether the cash flows of the assets are deemed to be solely payments of principal and interest (SPPI).

Where the instruments have SPPI cash flows, the instruments are measured at amortised cost (for hold to collect business models) or FVOCI (for hold to collect and sell business models).

Instruments that do not meet the SPPI criteria are measured at FVTPL regardless of the business model in which they are held. Other than hybrid financial assets, this primarily arises from prepayment clauses in certain loan contracts. While prepayment clauses are common across the Group's loan portfolio, prepayment penalties are not considered to meet the SPPI criteria if the prepayment penalty received by the Bank is not considered to be reasonable compensation from a HKFRS 9/IFRS 9 perspective for early termination of the contract. This has impacted a small number of products in Retail Banking and a small number of contracts within the Corporate Lending portfolios.

Non-trading equity investments are measured at FVTPL except for a small portfolio of strategic equity investments which are irrevocably designated at FVOCI.

Assets designated at FVTPL under HKAS 39/IAS 39 that are not as a result of an accounting mismatch have been de-designated and mandatorily classified as FVTPL either because they are managed on a fair value basis or cash flows are maximised through sale or part of a broader trading business or are hybrid financial assets. There is no impact on the measurement of these instruments.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

43 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2017 (continued)**(a) Classification and measurement of financial assets (continued)****Transition impact: (continued)**

Certain equity and debt securities classified as available-for-sale securities and loan and receivables respectively under HKAS 39/IAS 39 have been de-designated and recognised as FVTPL as a result of business model assessment. In addition, certain loans to customers which do not meet SPPI testing have been de-designated from an amortised cost basis and recognised as FVTPL.

(b) Impairment of financial assets not held at FVTPL**HKAS 39/IAS 39:**

For debt instruments held at amortised cost or available-for-sale, specific loss allowances are only recognised where there is objective evidence of an incurred loss. For instruments held at amortised cost, where losses are known to have been incurred but have not been separately identified, a portfolio impairment provision is recognised.

A portfolio impairment provision is not, however, recognised for available-for-sale instruments. Impairment loss allowances are also not recognised for loan commitments and financial guarantees

Where there is objective evidence of impairment for available-for-sale debt instruments, the entire unrealised loss held in reserves is transferred to the income statement and recognised as impairment.

Equity shares classified as available-for-sale are considered impaired when there is a significant or prolonged decline in their value compared to initial recognition. On impairment, the entire unrealised loss held in reserves is transferred to the income statement and recognised as impairment.

HKFRS 9/IFRS 9:

Expected credit losses ('ECL') are recognised for all financial debt instruments, loan commitments and financial guarantees that are classified as hold to collect/hold to collect and sell and have cash flows that are solely payments of principal and interest.

An ECL allowance is recognised at the time of initial recognition for all financial assets that are in the scope of ECL in respect of default events that may occur over the next 12 months (so-called "stage 1 assets" with allowances equivalent to 12-months ECL). ECL continues to be determined on this basis until there is either a significant increase in credit risk ("SICR") or the asset becomes credit impaired.

If a financial asset (or portfolio of financial assets) experiences a SICR since initial recognition, an expected credit loss provision is recognised for default events that may occur over the lifetime of the asset (so-called "stage 2 assets" with provisions equivalent to lifetime ECL). SICR is assessed in the context of an increase in the risk of a default occurring over the life of the financial instrument when compared to that expected at the time of initial recognition. It is not assessed in the context of an increase in the expected credit loss.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

43 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2017 (continued)**(b) Impairment of financial assets not held at FVTPL (continued)****HKFRS 9/IFRS 9: (continued)**

The Group uses a number of qualitative and quantitative measures in assessing SICR. Quantitative measures relate to the relative and absolute changes in the lifetime PD compared to those expected at initial recognition. Qualitative factors include placement of loans on non-purely precautionary early alert, classification as higher risk (CG12) or where principal and/or interest payments are 30 days or more past due.

An asset is only considered credit impaired, and lifetime expected credit losses recognised, if there is observed objective evidence of impairment. These factors are similar to the indicators of objective evidence of impairment under HKAS 39/IAS 39. This includes, amongst other factors, assets in default, experiencing significant financial difficulty or subject to forbearance actions, or are otherwise credit-impaired (so-called “stage 3 assets”).

To the extent that assets are credit-impaired at the point of initial recognition, they are classified as purchased or originated credit-impaired (‘POCI’). An expected credit loss allowance is not recognised at initial recognition. Any changes in lifetime expected losses after initial recognition are charged or credited to the income statement through ‘Impairment’.

The measurement of ECL across all stages is required to reflect an unbiased and probability weighted amount that is determined by evaluating a range of reasonably possible outcomes using reasonable and supportable information about past events, current conditions and forecasts of future economic conditions.

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. The period considered when measuring expected credit loss is the shorter of the expected life and the contractual term of the financial asset. The expected life may be impacted by prepayments and the maximum contractual term by extension options. For certain revolving portfolios, including credit cards, the expected life is assessed over the period that the Group is exposed to credit risk (which is based on the length of time it takes for credit facilities to be withdrawn) rather than the contractual term.

For stage 3 financial assets, the determination of lifetime expected credit losses will be similar to the HKAS 39/IAS 39 approach; for example, loan loss allowances within Corporate & Institutional Banking will be based on the present value of estimated future cash flows for individual clients. The estimated cash flows will, however, be based on a probability range of scenarios. Where the cash flows include realisable collateral, the values used will incorporate forward looking information.

For assets measured at amortised cost, the balance sheet amount reflects the gross asset less the allowance for ECL. For debt instruments held at FVOCI, the balance sheet amount reflects the instrument’s fair value, with the expected credit loss held as a separate reserve within other comprehensive income. Expected credit loss allowances for off-balance sheet instruments are held as liability provisions to the extent they can be separately identified. Otherwise they will be reported against the drawn component.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

43 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2017 (continued)**(b) Impairment of financial assets not held at FVTPL (continued)****HKFRS 9/IFRS 9: (continued)****Impact:**

The estimated initial adoption of the ECL approach would reduce retained earnings by approximately \$794 million. Approximately \$645 million of this related to loans and advances to customers, \$8 million to loans and advances to banks, \$33 million to debt securities and \$108 million to off-balance sheet exposures.

(c) Impact on capital planning

The introduction of HKFRS 9/IFRS 9 has an insignificant impact on the Group's capital ratios.

For IRB portfolios, the impact on capital will be mitigated to the extent that there is a current deduction of regulatory reserve in CET1 capital. Where the HKFRS 9/IFRS 9 accounting provisions exceed regulatory expected losses (EL), the excess accounting provisions will reduce the required deduction of regulatory reserve. The excess accounting provisions will reduce the capital base only when the required regulatory reserve becomes zero. From a total capital perspective, if there is an excess of accounting provisions over regulatory EL, this is added back to the Tier 2 capital base but only up to a limit of 0.6 per cent of credit risk-weighted assets (RWAs).

For standardised portfolios, there will be a direct flow through to capital for any increase in provisions as there is no shortfall of regulatory EL to offset the increase. Risk weights will not be adjusted.

HKFRS 15/IFRS 15, Revenue from contracts with customers

HKFRS 15/IFRS 15 is effective from 1 January 2018. The standard provides a more detailed principles-based approach for income recognition that the current standard HKAS 18/IAS 18 *Revenue*, with revenue being considered as or when promised services are transferred to customers. The standard applies to "Fees and commission income" but does not apply to financial instruments or lease contracts. HKFRS 15/IFRS 15 will not have a material impact on the Group's consolidated financial statements and there will not be an adjustment to retained earnings in respect of adoption.

HKFRS 16/IFRS 16, Leases

The effective date of HKFRS 16/IFRS 16 is 1 January 2019. HKFRS 16/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 16/IFRS 16 substantially carries forward the lessor accounting requirements in HKAS 17/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. The work to assess the impact of the standard is ongoing. It is not yet practicable to quantify the effect of HKFRS 16/IFRS 16 on these consolidated financial statements. The Group will have a balance sheet increase in lease liabilities and right of use assets on adoption of HKFRS 16/IFRS 16.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***44 Statement of financial position as at 31 December 2017**

	2017 HK\$'M	2016 HK\$'M
Assets		
Cash and balances with banks, central banks and other financial institutions	18,347	15,289
Placements with banks and other financial institutions	150,249	156,744
Hong Kong SAR Government certificates of indebtedness	42,341	42,211
Trading assets	22,483	15,634
Financial assets designated at fair value	336	370
Investment securities	207,927	207,471
Advances to customers	478,138	438,182
Amounts due from immediate holding company	57,633	45,569
Amounts due from fellow subsidiaries	23,929	16,047
Amounts due from subsidiaries of the Bank	41,380	40,445
Investments in subsidiaries of the Bank	769	886
Interest in associate	3,168	3,168
Property, plant and equipment	2,984	3,046
Goodwill and intangible assets	1,206	1,118
Current tax assets	–	107
Deferred tax assets	219	268
Other assets	12,770	10,917
	<u>1,063,879</u>	<u>997,472</u>
Liabilities		
Hong Kong SAR currency notes in circulation	42,341	42,211
Deposits and balances of banks and other financial institutions	19,613	19,674
Deposits from customers	833,899	778,242
Trading liabilities	7,787	8,289
Financial liabilities designated at fair value	11,474	9,568
Debt securities in issue	3,066	2,173
Amounts due to immediate holding company	44,132	42,204
Amounts due to fellow subsidiaries	9,476	11,932
Amounts due to subsidiaries of the Bank	1,828	1,477
Current tax liabilities	436	–
Other liabilities	19,755	18,233
Subordinated liabilities	6,003	6,088
	<u>999,810</u>	<u>940,091</u>
Equity		
Share capital	20,256	20,256
Reserves	41,861	37,125
	<u>62,117</u>	<u>57,381</u>
Shareholders' equity	62,117	57,381
Other equity instruments	1,952	–
	<u>1,063,879</u>	<u>997,472</u>

Approved and authorised for issue by the Board of Directors on 27 February 2018.

Huen Wai Yi Mary
Director

Yee Mann Hau
Director

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***45 Statement of changes in equity for the year ended 31 December 2017**

	Share capital HK\$'M	Own Credit adjustment reserve ² HK\$'M	Cash flow hedge reserve HK\$'M	Available- for-sale investment reserve HK\$'M	Retained profits HK\$'M	Share option equity reserve HK\$'M	Capital contribution reserve ¹ HK\$'M	Other equity instruments ³ HK\$'M	Total HK\$'M
At 1 January 2016	20,256	-	18	(77)	37,182	223	-	-	57,602
Total comprehensive income	-	-	(210)	(201)	6,707	-	-	-	6,296
Dividend paid	-	-	-	-	(6,392)	-	-	-	(6,392)
Movement in respect of share-based compensation plans	-	-	-	-	-	(125)	-	-	(125)
At 31 December 2016	<u>20,256</u>	<u>-</u>	<u>(192)</u>	<u>(278)</u>	<u>37,497</u>	<u>98</u>	<u>-</u>	<u>-</u>	<u>57,381</u>
Transfer of own credit risk adjustment, net of taxation	-	363	-	-	(363)	-	-	-	-
Total comprehensive income	-	(381)	210	395	7,596	-	-	-	7,820
Dividend paid	-	-	-	-	(3,368)	-	-	-	(3,368)
Other equity instruments issued, net of expenses	-	-	-	-	-	-	-	1,952	1,952
Movement in respect of share- based compensation plans	-	-	-	-	-	130	-	-	130
Effect of transfer of a subsidiary to a commonly controlled entity	-	-	-	-	-	-	154	-	154
At 31 December 2017	<u>20,256</u>	<u>(18)</u>	<u>18</u>	<u>117</u>	<u>41,362</u>	<u>228</u>	<u>154</u>	<u>1,952</u>	<u>64,069</u>

¹ The capital contribution reserve arose as a result of the transfer of a wholly-owned subsidiary, GBS, to Standard Chartered Bank, which is an entity under the common control of SCPLC. The reserve represents the difference between the consideration received and the cost of investment by the Bank (Note 2(b)(i)).

² The Bank early adopted HKFRS 9/IFRS 9 Financial Instruments to present own credit adjustments within other comprehensive income (rather than net trading income).

³ On 13 December 2017, the Bank issued US\$250 million 5 per cent fixed rate perpetual non-cumulative subordinated capital securities as Additional Tier 1 capital under the Banking (Capital) Rules.

During the year ended 31 December 2017, the directors had declared and paid an ordinary dividend of HK\$1.61276 (2016: HK\$3.17479) per each 'A' and 'B' ordinary share totalling HK\$3,124 million (2016: HK\$6,150 million). A total dividend of HK\$244 million (2016: HK\$242 million) was paid in respect of the US\$500 million 6.25% perpetual non-cumulative convertible preference shares classified as equity.

Notes to the consolidated financial statements (continued)*(Expressed in millions of Hong Kong dollars)***46 Assets held for sale**

In 2016, the Group's interest in Asia Commercial Joint Stock Bank ("ACB") was reclassified to assets held for sale.

In accordance with HKFRS 5/IFRS 5, when an interest in an associate is reclassified to assets held for sale, it is measured at the lower of its carrying amount and fair value less cost to sell.

On 24 November 2017, the Group ceased to have significant influence over ACB as the Group relinquished its representative on the Board of ACB which triggered a deemed disposal of the Group's entire interest in ACB in accordance with HKAS 28/IAS 28. Together with the recycling of ACB's related reserves, a net loss of HK\$240 million was recognised in the consolidated income statement upon the deemed disposal. The investment in ACB at the date when significant influence was lost was recognised as a financial asset designated at fair value through profit or loss.

Analysis of the result of assets held-for-sale up to the date the Group ceased to have significant influence over ACB is as follows:

	<i>2017</i>	<i>2016</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
(a) Share of the associate's net asset classified as held for sale	–	1,020
(b) Share of the associate's profits classified as held for sale	41	61
(c) Cumulative currency translation movement and other reserves movement recognised during the year in other comprehensive income relating to the interest in associate held for sale	7	(12)

On 9 January 2018, the sale of the Group's interest in ACB which was classified as assets held for sale as of 31 December 2017 was completed with a consideration of HK\$1,076 million.

Appendix I: corporate governance report

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the 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 Hong Kong Monetary Authority (“HKMA”) throughout the year ended 31 December 2017.

Organisational and governance structure and policies

Board Composition

Chairman

Hung Pi Cheng Benjamin

Executive Directors

Huen Wai Yi Mary (re-designated as an executive director on 1 March 2017)

Hau Yee Mann (appointed on 1 April 2017)

Tan Siew Boi (resigned on 1 March 2017)

Ling Fou Tsong (resigned on 1 April 2017)

Non-executive Directors

Edward Martin Williams

Anna Elizabeth Marrs (resigned on 7 February 2018)

Lee Cheuk Kuen Gloria (appointed on 26 May 2017)

Michael Andres Gorriz (appointed on 7 February 2018)

Independent Non-executive Directors

Fong Ching

Stephen Robert Eno

Cheng Edward Wai Sun

Tung Lieh Cheung Andrew

Hung Pi Cheng Benjamin

Chairman, Non-Executive Director

Mr. Hung was appointed to the Board in January 2008, becoming the Chairman in May 2014.

Mr. Hung is the Regional CEO for Greater China and North Asia and the CEO of Retail Banking business globally for Standard Chartered Bank. He sits on the Standard Chartered Group’s Management Team and is also the chairman of Standard Chartered Bank (China) Limited and Standard Chartered Bank (Taiwan) Limited.

Mr. Hung joined Standard Chartered Group in 1992 and has held a number of senior management positions spanning corporate, commercial and retail banking in the UK and Hong Kong. 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)*****Hung Pi Cheng Benjamin (continued)**

Mr. Hung is a member of the Financial Services Development Council. He sits on the Exchange Fund Advisory Committee and is a member of the General Committee of the Hong Kong General Chamber of Commerce and HKTDC Belt and Road Committee. He was previously the chairman of the Hong Kong Association of Banks, a board member of the Hong Kong Airport Authority, 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.

Huen Wai Yi Mary***Executive Director and Chief Executive Officer***

Ms. Huen was appointed to the Board in September 2016, becoming the Chief Executive Officer in March 2017.

Prior to the current role, Ms. Huen was Regional Head of Retail Banking, Greater China & North Asia, responsible for setting the strategic agenda for retail operations in the region and supporting the countries execute their strategy to deliver performance. Previously, she was Head of Retail Banking, Hong Kong. She led the Retail Banking business in Hong Kong to become 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 a board member of the Hong Kong Interbank Clearing Limited, Vice Chairman of the Hong Kong Association of Banks, and Vice President of the council of the Hong Kong Institute of Bankers. She is also a member of the Banking Advisory Committee and the Exchange Fund Advisory Committee Financial Infrastructure and Market Development Sub-Committee of the Hong Kong Monetary Authority and a council member of the Treasury Markets Association.

Ms. Huen received a Bachelor of Arts degree from the University of Hong Kong.

Hau Yee Mann***Executive Director and Chief Financial Officer***

Ms. Hau was appointed to the Board in April 2017, becoming the Chief Financial Officer at the same time.

Prior to her current role, Ms. Hau was Chief Financial Officer, Standard Chartered Bank (China) Limited. Ms. Hau joined the Bank 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.

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)*****Hau Yee Mann (continued)**

Ms. Hau is a chartered accountant with the Institute of Chartered Accountants in England and Wales, and Hong Kong Institute of Certified Public Accountants.

Edward Martin Williams*Non-Executive Director*

Mr. Williams was appointed to the Board in August 2015.

Mr. Williams is currently Chairman of the Madison Pacific Group, a specialized provider of trust, custody, agency and other related services. Prior to 2017, Mr. Williams was the Deputy Group Chief Risk Officer for Standard Chartered Group and responsible for risk governance for a number of the Group's major operating subsidiaries. He was also responsible for approvals and the oversight of Standard Chartered Group's largest and most complex transactions and counterparty 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 Standard Chartered Group for over 16 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 the Massachusetts Institute of Technology, and a Bachelor of Science degree in Aerospace Engineering from Princeton University.

Lee Cheuk Kuen Gloria*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 Science 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 responsible for the banking operations, 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 CIO 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 14 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 is currently the Chairman of the Process Review Panel in relation to the Regulation of Mandatory Provident Fund Intermediaries. 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 also 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 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.

Cheng Edward Wai Sun

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. He is an independent non-executive director of Orient Overseas (International) 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 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.

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 Silver 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)*****Tung Lieh Cheung Andrew***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 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 the Chief Executive Officer and Senior Managing Director of OOCL since 1 July 2012. 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.

Tan Siew Boi*Former Executive Director and Chief Executive Officer*

Ms. Tan was appointed to the Board in January 2009, becoming the Chief Executive Officer in July 2014, and resigned as both Director and Chief Executive Officer in March 2017.

As Chief Executive Officer before leaving the Bank, Ms. Tan was responsible for developing the equities and investment banking businesses, and expanding the geographical footprint of the Asian operations.

Before joining the Bank, Ms. Tan had held positions in PwC, London and then joined Cazenove in 1983, in which she worked in the Hong Kong office in research, sales and corporate finance. Ms. Tan became Chief Executive of Cazenove Asia in 1993 and a Partner of Cazenove & Co. in 1995.

Ms. Tan holds dual degree in economics and accounting from the University of Sheffield, United Kingdom. Ms. Tan is a UK Chartered Accountant.

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)*****Ling Fou Tsong**

Former Executive Director and Chief Financial Officer

Mr. Ling was appointed to the Board as Chief Financial Officer in April 2012, and resigned as both Director and Chief Financial Officer in April 2017.

Mr. Ling was responsible for leading the finance function in Hong Kong. Prior to his role of Regional Chief Financial Officer, Hong Kong & Greater China, Mr. Ling had held various roles in Standard Chartered Group including Senior Manager, Group Treasury in London, UK; Chief Financial Officer in Malaysia; Global Account Manager, Wholesale Bank in London, UK; Group Chief Accountant in London, UK; and Chief Financial Officer in Taiwan.

Mr. Ling is a Chartered Accountant of the Institute of Chartered Accountants England and Wales.

Anna Elizabeth Marrs

Former Non-Executive Director

Ms. Marrs was appointed to the Board in September 2015 and resigned in February 2018.

Ms. Marrs is the Regional CEO of Standard Chartered Group's Association of South East Asian Nations (ASEAN) and South Asia and the CEO of Commercial and Private Banking globally. She joined Standard Chartered Bank as Group Head of Strategy and Corporate Development in January 2012.

Prior to joining Standard Chartered Group, she was a Partner in McKinsey & Company's Banking Practice. Before joining McKinsey in 2003, Ms. Marrs was the CEO of a financial information company based in London. She started her career at D. E. Shaw, a New York-based investment firm.

Ms. Marrs holds an MBA from London Business School and an undergraduate degree from Northwestern University in Chicago.

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. The Board has held four scheduled meetings and one ad-hoc meeting in 2017.

(b) Executive Committee (“EXCO”)

The EXCO operates under the direct authority of the Board and meets regularly in relation to the day to day management, operation and control of the business. It also sub-delegates to various committees certain aspects of the conduct of the business as detailed below. The EXCO includes the Chief Executive Officer (“CEO”), the Chief Financial Officer (“CFO”) and the heads of various business functions. During the year, eleven EXCO meetings have been held.

(c) Board Audit and Risk Committee (“A&R”)

The A&R has been demerged into two separate committees, Audit Committee and Board Risk Committee, with effect from 1 January 2018.

Prior to the demerger, the A&R meets regularly with Internal Audit and the external auditors to review and discuss the Bank’s internal financial controls, other internal controls, compliance and risk management systems as well as to consider the Bank’s overall appetite for risk and to review the appropriateness and effectiveness of the Bank’s risk management systems and controls. The A&R also discusses matters raised by Internal Audit and external auditors and ensures that audit recommendations are implemented appropriately.

The A&R comprises 4 independent non-executive directors (“INEDs” or “INED”) and 1 non-executive director (“NED”) namely Fong Ching (INED), Stephen Robert Eno (INED), Cheng Wai Sun Edward (INED), Tung Lieh Cheung Andrew (INED) and Edward Martin Williams (NED).

During the year, 4 A&R meetings have been held.

(d) Nomination Committee (“NomCo”)

The NomCo is responsible for identifying and nominating candidates for the approval of the Board to fill any board vacancies. It makes recommendations to the Board on appointment, re-appointment or removal of directors and succession planning for directors, in particular the Chairman and the Chief Executive. It reviews the structure, size and composition of the Board and makes recommendations to the Board with regard to any adjustments that are deemed necessary. It also reviews the efficiency and effectiveness of the functioning of the Board by implementing a process for the evaluation of the performance and effectiveness of the Board.

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) Nomination Committee (“NomCo”) (continued)

The NomCo comprises 4 INEDs and 1 NED namely Fong Ching (INED), Stephen Robert Eno (INED), Cheng Wai Sun Edward (INED) and Tung Lih Cheung Andrew (INED) and Hung Pi Cheng Benjamin (NED).

During the year, two NomCo meetings have been held.

Sub-committees of Exco

(a) Asset and Liability Committee (“ALCO”)

The ALCO, appointed by the EXCO, is responsible for the implementation of, and compliance with, balance sheet management policies, including management of the Bank’s liquidity, capital adequacy, leverage, interest rate risk and basis risk. The ALCO comprises of the CEO, CFO and CRO as members, with attendance from key business and risk management heads. During the year, twenty ALCO meetings have been convened.

(b) Executive Risk Committee (“ERC”)

The ERC, through its authority delegated by the EXCO, is responsible for the management of all risks other than those delegated to ALCO and the Country Pensions Committee (“CPC”). The ERC oversees effective application of the Bank’s Enterprise Risk Management Framework, recommends risk appetite for approval by the Board, approves and reviews risk control parameters including policies, risk exposure limits, or other control levers. The ERC is chaired by the CRO with members including the CEO, the CFO, and the key business and risk management heads. There were in total eleven standing ERC meetings held in 2017.

Risk appetite

The details of the Group’s risk appetite are disclosed in note 37 to the consolidated financial statements.

Major share ownership and voting rights

The Bank is 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) hold 49% and 51% of the voting rights in the Bank respectively. Each of SCPLC and SCHL is a company incorporated in England and Wales whereas SCB is a company incorporated in England by Royal Charter.

Related party transactions

All related party transactions during the year ended 31 December 2017 are disclosed in notes 18 and 40 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 19 to the consolidated financial statements.

Appendix II: unaudited supplementary financial information

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

Pursuant to section 3 of CG-5 on Guideline on a Sound Remuneration System of the Supervisory Policy manual issued by the HKMA and the Pillar 3 disclosure requirements for remuneration by the Basel Committee on Banking Supervision (“BCBS”), the following disclosures are made:

- a) Information relating to the governance structure of the remuneration system
- b) Information relating to the design and structure of the remuneration processes
- c) Description of the ways in which current and future risks are taken into account in the remuneration processes
- d) Description of the ways in which the Bank seeks to link performance during a performance measurement period with levels of remuneration
- e) Description of the ways in which the Bank seeks to adjust remuneration to take account of longer-term performance
- f) Description of the different forms of variable remuneration that the Bank utilises and the rationale for using these different forms
- g) Number of meetings held by the Board Remuneration Committee during the financial year and remuneration paid to the staff

The Bank adopts the remuneration policy and systems of SCPLC. Please refer to the Directors’ Remuneration Report in the Annual Report of SCPLC for details of the Board Remuneration Committee, the major characteristics of the remuneration system, and how risks are taken into account in the remuneration processes.

- h) Aggregate quantitative information on remuneration for Senior Management and Key Personnel (note 1) for the year ended 31 December 2017 and 31 December 2016 are as follows:

Analysis of remuneration split between fixed and variable compensation

	2017		2016	
	Senior Management HK\$’000	Key Personnel HK\$’000	Senior Management HK\$’000	Key Personnel HK\$’000
Fixed compensation	31,606	51,592	21,686	47,125
Variable compensation				
– Up front cash	8,357	14,985	5,349	15,606
– Up front shares	6,498	6,151	2,144	5,000
– Deferred cash	9,981	5,848	1,110	3,102
– Deferred shares:				
– Restricted shares	10,891	6,676	1,829	2,686
– Performance shares	–	–	13,792	18,960
Total	<u>67,333</u>	<u>85,252</u>	<u>45,910</u>	<u>92,479</u>
Number of staff at 31 December	<u>8</u>	<u>18</u>	<u>8</u>	<u>18</u>

Appendix II: unaudited supplementary financial information (continued)**Disclosure on Remuneration for CG-5 Guideline on a Sound Remuneration System issued by the HKMA (continued)****Analysis of deferred remuneration (note 2)**

	2017		2016	
	Senior Management HK\$'000	Key Personnel HK\$'000	Senior Management HK\$'000	Key Personnel HK\$'000
At 1 January	24,062	43,645	25,600	38,214
Awarded during the year	20,872	12,524	16,731	24,748
Paid out during the year	(3,273)	(5,071)	(9,003)	(7,599)
Vested and lapsed during the year	–	–	–	–
Not vested due to performance adjustment	(2,893)	(2,447)	(3,690)	(4,161)
At 31 December	<u>38,768</u>	<u>48,651</u>	<u>29,638</u>	<u>51,202</u>
Vested during the year	<u>2,133</u>	<u>8,498</u>	<u>5,898</u>	<u>9,984</u>

Analysis of total amount of outstanding deferred remuneration

	2017		2016	
	Senior Management HK\$'000	Key Personnel HK\$'000	Senior Management HK\$'000	Key Personnel HK\$'000
At 31 December				
– Vested	2,273	12,817	3,226	10,518
– Not-vested	<u>36,495</u>	<u>35,833</u>	<u>26,412</u>	<u>40,684</u>
	<u>38,768</u>	<u>48,650</u>	<u>29,638</u>	<u>51,202</u>
At 31 December				
– Cash	10,792	8,806	2,396	5,703
– Shares	<u>27,976</u>	<u>39,844</u>	<u>27,242</u>	<u>45,499</u>
	<u>38,768</u>	<u>48,650</u>	<u>29,638</u>	<u>51,202</u>
Total amount of remuneration exposed to ex post explicit and/ or implicit adjustments (note 3)				
– Deferred remuneration (outstanding)	38,768	48,650	29,638	51,202
– Retained remuneration	2,613	3,459	–	2,982

Appendix II: unaudited supplementary financial information (continued)**Disclosure on Remuneration for CG-5 Guideline on a Sound Remuneration System issued by the HKMA (continued)****Analysis of adjustments of deferred remuneration**

	2017		2016	
	Senior Management HK\$'000	Key Personnel HK\$'000	Senior Management HK\$'000	Key Personnel HK\$'000
Total amount of adjustments during the financial year due to				
– ex post explicit adjustments	(2,893)	(2,447)	(3,690)	(4,161)
– ex post implicit adjustments	5,411	6,797	4,267	6,645

Analysis of guaranteed bonuses, sign-on awards and severance payments during the year

	2017		2016	
	Senior Management HK\$'000	Key Personnel HK\$'000	Senior Management HK\$'000	Key Personnel HK\$'000
Guaranteed bonuses awarded	2,400	–	–	–
Sign-on awards made	–	–	–	–
Severance payments awarded and made	–	–	–	–
Highest severance payments awarded	–	–	–	–
Number of beneficiaries of guaranteed bonuses awarded	1	–	–	–
Number of beneficiaries of sign-on awards made	–	–	–	–
Number of beneficiaries of severance payments awarded and made	–	–	–	–

Note 1: As defined in the CG-5 Guideline on a Sound Remuneration System issued by the HKMA, senior management are those who are responsible for oversight of either the Bank's company-wide strategy or activities or those of the Bank's material business lines. Key Personnel are individual employees whose duties or activities in the course of their employment involve the assumption of material risk or the taking on of material exposures on behalf of the Bank.

Note 2: The population of Senior Management and Key Personnel in 2017 differs from that of 2016.

Note 3: Ex post adjustments are adjustments made after the awards are granted.

Appendix III: 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 2018:

Sami ABDELKAFI
 Sanjeev AGRAWAL
 * Nigel ANTON
 * Garry BURKE
 * Peter William BURNETT
 * Paul Stuart CHAMBERS
 * CHEN Poonis Annie
 * CHEUNG Wai Hing
 * CHEUNG Yup Fan
 * CHUNG Byung Ho
 * Kieran CORR
 * Christopher John DANIELS
 Jeremy EAST
 * Jean FERNANDES
 * HAU Yee Mann
 Sridhar KANTHADAI
 * Jonathan Davey HOWARD
 * Guy Roland ISHERWOOD
 KONG Pik Tung
 * Nils Kristian KOVDAL
 * Dinesh KUMAR
 LAI Darcy Tat-Sze
 * LAI Yan Hong
 * LAM Hui Yip
 * LAW Heung Yee, Nita
 LEE Hoi Keung
 LIM Han Siang Peter
 LING Fou Tsong
 * MAI Wai Lam
 * Shikkoh MALIK
 * William MCCALLUM
 * Peter MOYLAN
 Peter NAGLE
 * Barnaby Joel NELSON
 * NG Chau Shing Dantes
 * NG Chi Ming
 * Ivo Laurence PHILIPPS
 Wayne Robert PORRITT
 * Amit Kumar PURI
 * Xiaomin RONG
 * SZETO Ho Yin Jeffrey
 * TAN Ming Kin John
 TAN Siew Boi
 * Amit Kishorchandra TANNA
 *^ Tiara Ltd
 * Sam VILO
 * Jim WANG

Alternate director

^ Corporate director

* Directors serving the Board as at 27 February 2018