



Standard Chartered Bank
(Hong Kong) Limited

Directors' Report and
Consolidated Financial
Statements

For the year ended 31 December 2008

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 2008.

Principal place of business

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

Principal activities

The Bank is a licensed bank registered under the Hong Kong Banking Ordinance. The Bank's principal activities are the provision of banking and related financial services. The principal activities and other particulars of the Bank's principal subsidiaries are set out in note 17 to the financial statements.

Financial statements

The profit of the Bank and its subsidiaries for the year ended 31 December 2008 and the state of the Bank's and its subsidiaries' affairs as at that date are set out in the financial statements on pages 5 to 90.

During the year ended 31 December 2008, the directors had declared and paid a special dividend of HK\$0.60 (2007: HK\$0.61) per 'A' ordinary share and 'B' ordinary share totalling HK\$1,162 million (2007: HK\$1,181 million).

Other movements in reserves are set out in note 32 to the financial statements.

Charitable donations

Charitable donations made by the Bank and its subsidiaries during the year amounted to HK\$9 million (2007: HK\$13 million).

Fixed assets

Details of the movements in the fixed assets are set out in note 19 to the financial statements.

Share capital

Details of the movements in the share capital of the Bank during the year are set out in note 31 to the financial statements.

Directors

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

Executive directors

Benjamin Hung Pi Cheng (appointed on 1 January 2008)

Julian Fong Loong Choon

Non-executive directors

Chow Chung Kong*, Chairman
Jaspal Singh Bindra (appointed on 13 February 2008)
Nicholas Robert Sallnow-Smith
Stefano Paolo Bertamini (appointed on 19 September 2008)
Olga Louise Zoutendijk (appointed on 28 May 2008)
Tan Siew Boi (appointed on 2 January 2009)
Raymond Kwok Ping Luen*
Ma Xuezheng*
Norman Lyle*
Chan Wing Kin*
Michael Bernard DeNoma (resigned on 1 June 2008)

** Independent non-executive directors*

Mr Stefano Paolo Bertamini, Ms Olga Louise Zoutendijk and Ms Tan Siew Boi will retire in accordance with Article 109 of the Bank's Articles of Association at the forthcoming annual general meeting and being eligible, offer themselves for re-election.

Directors' service contracts

The independent non-executive directors were appointed by the board of directors for a term of 3 years. Their remuneration is determined by the shareholders at the general meeting.

Directors' interests in Share Option Schemes

Certain directors of the Bank have been granted options under various share option schemes of Standard Chartered PLC, the ultimate holding company of the Bank. During the year, Jaspal Singh Bindra, Benjamin Hung Pi Cheng, Julian Fong Loong Choon, Nicholas Robert Sallnow-Smith, Stefano Paolo Bertamini, Olga Louise Zoutendijk and Michael Bernard DeNoma were granted options under these schemes.

Directors' rights to acquire shares

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

Directors' interests in contracts

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

Auditors

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

On behalf of the Board

Sir C K Chow
Chairman

Hong Kong, 3 March 2009

Auditors' report to the shareholders of Standard Chartered Bank (Hong Kong) Limited

(Incorporated in Hong Kong SAR with limited liability)

We have audited the consolidated financial statements of Standard Chartered Bank (Hong Kong) Limited (the "Bank") set out on pages 5 to 90, which comprise the consolidated and the Bank balance sheets as at 31 December 2008, and the consolidated income statement, the consolidated statement of recognised income and expense and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors of the Bank are responsible for the preparation and the true and fair presentation of these financial statements in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board and Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

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

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Bank and of the consolidated state of affairs of the Bank and its subsidiaries as at 31 December 2008 and of the consolidated profit and cash flows of the Bank and its subsidiaries for the year then ended in accordance with International Financial Reporting Standards and Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

KPMG

Certified Public Accountants

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

3 March 2009

Consolidated income statement

For the year ended 31 December 2008

(Expressed in millions of Hong Kong dollars)

	Note	2008 HK\$'M	2007 HK\$'M
Interest income	3(a)	16,593	21,618
Interest expense	3(b)	(6,564)	(11,513)
Net interest income		<u>10,029</u>	<u>10,105</u>
Fee and commission income		5,430	6,080
Fee and commission expense		(600)	(974)
Net fee and commission income	3(c)	4,830	5,106
Net trading income	3(d)	925	543
Net losses from financial instruments designated at fair value	3(e)	(200)	(326)
Net gains from disposal of available-for-sale securities	5	100	238
Other operating income	3(f)	131	482
		<u>5,786</u>	<u>6,043</u>
Total operating income		15,815	16,148
Staff costs		(3,960)	(3,493)
Premises and equipment expense		(956)	(890)
Others		(2,669)	(2,665)
Operating expenses	3(g)	<u>(7,585)</u>	<u>(7,048)</u>
Operating profit before impairment		8,230	9,100
Impairment charges on advances to banks and customers	4(a)	(1,160)	(227)
Other impairment charges	4(b)	(136)	(51)
Operating profit after impairment		6,934	8,822
Share of profit of associates		23	12
Profit before taxation		6,957	8,834
Taxation	6(a)	<u>(1,209)</u>	<u>(1,464)</u>
Profit after taxation		<u>5,748</u>	<u>7,370</u>
Attributable to:			
Equity shareholders of the Bank	32(a)	5,743	7,368
Minority interests	32(d)	5	2
Profit after taxation		<u>5,748</u>	<u>7,370</u>

The notes on pages 11 to 90 form part of these financial statements.

Consolidated balance sheet as at 31 December 2008*(Expressed in millions of Hong Kong dollars)*

	Note	2008 HK\$'M	2007 HK\$'M
Assets			
Cash and balances with banks and other financial institutions	9	15,378	8,216
Placements with banks and other financial institutions	10(a)	136,463	114,724
Hong Kong SAR Government certificates of indebtedness	11	24,001	22,321
Trading assets	12	17,241	24,616
Advances to customers	13(a)	213,539	179,380
Amounts due from immediate holding company	16	60,996	53,331
Amounts due from fellow subsidiaries	16	25,278	20,126
Investment securities	15	90,501	45,023
Interest in associates	18	3,401	1,132
Fixed assets	19	2,946	3,173
Goodwill and intangible assets	20	935	783
Deferred tax assets	26	172	43
Other assets	21	7,820	8,858
		<u>598,671</u>	<u>481,726</u>
Liabilities			
Hong Kong SAR currency notes in circulation	11	24,001	22,321
Deposits and balances of banks and other financial institutions		6,914	8,746
Deposits from customers	23	476,796	365,875
Trading liabilities	27	15,620	16,536
Financial liabilities designated at fair value	25	5,306	4,439
Debt securities in issue	24	3,420	1,408
Amounts due to immediate holding company	16	7,162	7,524
Amounts due to fellow subsidiaries	16	4,826	2,193
Current tax liabilities		272	579
Deferred tax liabilities	26	37	398
Other liabilities	28	14,698	15,447
Subordinated liabilities	30	6,180	6,234
		<u>565,232</u>	<u>451,700</u>
Equity			
Share capital	31	97	97
Reserves	32(a)	33,337	29,929
Shareholders' equity		33,434	30,026
Minority interests	32(d)	5	–
		<u>33,439</u>	<u>30,026</u>
		<u>598,671</u>	<u>481,726</u>

Approved and authorised for issue by the Board of Directors on 3 March 2009.

Sir C K Chow
Chairman

Hung Pi Cheng Benjamin
Director

Julian Fong Loong Choon
Director

Lai Wing Nga
Company Secretary

The notes on pages 11 to 90 form part of these financial statements.

Balance sheet as at 31 December 2008*(Expressed in millions of Hong Kong dollars)*

	Note	2008 HK\$'M	2007 HK\$'M
Assets			
Cash and balances with banks and other financial institutions	9	15,320	8,193
Placements with banks and other financial institutions	10(a)	136,463	114,722
Hong Kong SAR Government certificates of indebtedness	11	24,001	22,321
Trading assets	12	17,241	24,616
Advances to customers	13(a)	213,539	179,380
Amounts due from immediate holding company	16	60,969	53,330
Amounts due from fellow subsidiaries	16	24,061	20,118
Amounts due from subsidiaries of the Bank	16	1,855	759
Investment securities	15	89,774	43,087
Investments in subsidiaries of the Bank	17	255	208
Interest in associates	18	2,764	1,117
Fixed assets	19	2,936	3,167
Goodwill and intangible assets	20	935	783
Deferred tax assets	26	172	43
Other assets	21	7,570	8,843
		<u>597,855</u>	<u>480,687</u>
Liabilities			
Hong Kong SAR currency notes in circulation	11	24,001	22,321
Deposits and balances of banks and other financial institutions		6,914	8,746
Deposits from customers	23	476,796	365,875
Trading liabilities	27	15,620	16,536
Financial liabilities designated at fair value	25	5,306	4,439
Debt securities in issue	24	3,420	1,408
Amounts due to immediate holding company	16	6,793	7,519
Amounts due to fellow subsidiaries	16	4,226	2,038
Amounts due to subsidiaries of the Bank	16	693	466
Current tax liabilities		246	580
Other liabilities	28	14,432	15,408
Subordinated liabilities	30	6,180	6,234
		<u>564,627</u>	<u>451,570</u>
Equity			
Share capital	31	97	97
Reserves	32(b)	33,131	29,020
Shareholders' equity		<u>33,228</u>	<u>29,117</u>
		<u>597,855</u>	<u>480,687</u>

Approved and authorised for issue by the Board of Directors on 3 March 2009.

Sir C K Chow
Chairman

Hung Pi Cheng Benjamin
Director

Julian Fong Loong Choon
Director

Lai Wing Nga
Company Secretary

The notes on pages 11 to 90 form part of these financial statements.

Consolidated statement of recognised income and expense
For the year ended 31 December 2008

(Expressed in millions of Hong Kong dollars)

	2008 HK\$'M	2007 HK\$'M
Effective portion of changes in fair value of cash flow hedges	10	48
Changes in fair value transferred to the income statement on termination of hedging derivatives	(2)	–
Exchange difference	74	70
Changes in fair value of available-for-sale securities	(1,008)	1,518
Changes in fair value transferred to the income statement on disposal of available-for-sale securities	(100)	(238)
Adjustment on acquisition of an associate	158	–
Actuarial (losses)/gains on defined benefit plan	(770)	7
Deferred tax recognised directly in reserves	465	(396)
Disposal of a subsidiary	–	(53)
	<hr/>	<hr/>
Income and expense recognised directly in reserves	(1,173)	956
Profit after taxation	5,748	7,370
	<hr/>	<hr/>
Total recognised income and expense for the year	4,575	8,326
	<hr/> <hr/>	<hr/> <hr/>
Attributable to:		
Shareholders of the Bank	4,570	8,377
Minority interest	5	(51)
	<hr/>	<hr/>
	4,575	8,326
	<hr/> <hr/>	<hr/> <hr/>

The notes on pages 11 to 90 form part of these financial statements.

Consolidated cash flow statement

For the year ended 31 December 2008

(Expressed in millions of Hong Kong dollars)

	<i>Note</i>	<i>2008</i> <i>HK\$'M</i>	<i>2007</i> <i>HK\$'M</i>
Operating activities			
Profit before taxation		6,957	8,834
Adjustments for:			
Impairment charges on advances to banks and customers		1,160	227
Advances written off net of recoveries		(376)	(862)
Unwinding of discount on loan impairment charges		(32)	(34)
Other impairment charges		136	51
Losses on disposal of fixed assets		–	5
Depreciation		197	168
Amortisation of intangible assets		46	59
Gain on disposal of merchant acquiring business		–	(86)
Recognition of profit on Visa shares		(53)	(316)
Share of profit of associates		(23)	(12)
Interest expense on subordinated liabilities		232	268
Fair value gains transferred from reserves on cash flow hedges		(2)	–
Exchange translation on subordinated liabilities		(33)	11
		<u>8,209</u>	<u>8,313</u>
(Increase)/decrease in operating assets:			
Placements with banks and other financial institutions			
with original maturity beyond three months		(36,919)	(14,350)
Trading assets		10,370	(7,659)
Investment securities		(37,044)	8,594
Gross advances to customers		(29,860)	(9,672)
Amounts due from immediate holding company			
and fellow subsidiaries		(12,518)	(14,697)
Other assets		1,219	(1,132)
Increase/(decrease) in operating liabilities:			
Deposits and balances of banks and other financial institutions		(1,924)	3,476
Deposits from customers		94,421	75,558
Debt securities in issue		2,012	(1,299)
Financial liabilities designated at fair value		867	(5,075)
Amounts due to immediate holding company and fellow subsidiaries		2,638	2,885
Trading liabilities		(1,072)	4,533
Other liabilities		(2,231)	6,283
		<u>(1,832)</u>	<u>55,758</u>
Cash (used in)/generated from operations		(1,832)	55,758
Income tax paid		(1,541)	(1,424)
Net cash (used in)/generated from operating activities		(3,373)	54,334

	Note	2008 HK\$'M	2007 HK\$'M
Investing activities			
Dividend received from an associate		79	–
Cash and cash equivalents from purchase of business, net of purchase consideration		529	–
Payment for purchase of an associate		(1,647)	(158)
Payment for purchase of fixed assets		(97)	(133)
Payment for purchase of intangible assets		(96)	(129)
Proceeds from disposal of merchant acquiring business		–	153
Proceeds from disposal of intangible assets		16	50
Proceeds from disposal of a subsidiary		–	55
Proceeds from disposal of fixed assets		–	37
Net cash used in investing activities		<u>(1,216)</u>	<u>(125)</u>
Financing activities			
Repurchase of share capital		–	(7,020)
Issuance of subordinated liabilities		–	2,377
Repurchase of subordinated liabilities		(74)	–
Interest paid on subordinated liabilities		(251)	(239)
Dividends paid		(1,162)	(1,181)
Net cash used in financing activities		<u>(1,487)</u>	<u>(6,063)</u>
Net (decrease)/increase in cash and cash equivalents		(6,076)	48,146
Cash and cash equivalents at 1 January		<u>120,106</u>	<u>71,960</u>
Cash and cash equivalents at 31 December	33	<u><u>114,030</u></u>	<u><u>120,106</u></u>
Cash flows from operating activities include:			
Interest received		16,368	21,310
Interest paid		6,331	11,466
Dividends received		19	10

The notes on pages 11 to 90 form part of these financial statements.

Notes to the financial statements

(Expressed in millions of Hong Kong dollars)

1 Principal activities

The principal activities of Standard Chartered Bank (Hong Kong) Limited (the “Bank”) and its subsidiaries 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 and Interpretations issued by the International Accounting Standards Board (“IASB”), these financial statements also comply with IFRSs.

(b) Basis of preparation of the financial statements

(i) Basis of Preparation

The consolidated financial statements comprise the accounts of the Bank and its subsidiaries made up to 31 December 2008.

(ii) Consolidated Financial Statements

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

(iii) New and revised HKFRSs/IFRSs

The HKICPA and IASB have issued certain new and revised HKFRSs and IFRSs that are first effective for the current accounting period of the Bank and its subsidiaries. Details of the impact of the new and revised HKFRSs and IFRSs are outlined in note 42.

(c) Subsidiaries

Subsidiaries are entities over which the Bank has the power to directly or indirectly govern the financial and operating policies, generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which the Bank effectively obtains control. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Bank. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, together with costs directly attributable to the acquisition. Identifiable net assets and contingent liabilities acquired are fair valued at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Bank's share of the identifiable net assets and contingent liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets and contingent liabilities of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between the Bank and its subsidiaries are eliminated in the consolidated financial statements. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred.

In the Bank's balance sheet, investments in subsidiaries are stated at cost less any impairment and dividends from pre-acquisition profits received, if any.

(d) Associates

Associates are entities in respect of which the Bank has significant influence, but not control, over the financial and operating policies and procedures. Investments in associates are accounted for using the equity method of accounting in the consolidated financial statements and are initially recognised at cost.

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

Unrealised gains on transactions between the Bank and its associates are eliminated to the extent of the Bank's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

In the Bank's balance sheet, the investment in an associate is stated at cost less any impairment and dividends from pre-acquisition profits received, if any.

(e) Intangible assets

(i) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Bank's share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition.

Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses, if any. Goodwill is allocated to cash-generating units for the purpose of impairment testing.

(ii) Computer software

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Costs associated with the development of software are capitalised where it is probable that it will generate future economic benefits in excess of its cost. Computer software costs are amortised on the basis of expected useful lives (two to five years). Costs associated with maintaining computer software programmes 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 balance sheet at depreciated cost less impairment. Investment properties are depreciated over their estimated useful lives on a straight-line basis.

(g) Other property, plant and equipment

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

The Government of the Hong Kong SAR owns all the land in Hong Kong and permits its use under leasehold arrangements. Where the cost of land is known or can be reliably determined at the inception of the lease, the Bank records its interest in leasehold land and land use rights separately as operating leases. These leases are recorded at original cost and amortised over the term of the lease. Where the cost of the land is unknown, or cannot be reliably determined, the land and buildings are accounted for together as "Buildings and leasehold land held for own use".

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

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

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

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

(h) Leases

Where the Bank is the lessee

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

Where the Bank is the lessor

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

(i) Financial assets and liabilities (excluding derivatives)

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

(i) Financial assets and liabilities 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.

(iii) Available-for-sale securities

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 or equity prices.

Initial recognition

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

Subsequent measurement

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

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

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

The fair values of quoted financial assets or financial liabilities in active markets are based on current prices. If the market for a financial asset or financial liability is not active, and for unlisted securities, the Bank and its subsidiaries 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.

Reclassification

Reclassifications of financial assets, other than as disclosed below, or of financial liabilities between 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 loan and receivables category, where they are no longer held for the purpose of selling or repurchasing in the near term and they would have met the definition of a loan and receivable on initial recognition and the Bank and its subsidiaries have the intent and ability to hold the assets for the foreseeable future or until maturity.

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

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

Pursuant to these amendments, the Bank reclassified certain non-derivative financial assets. Details of the impact of these reclassifications are outlined in note 42.

Renegotiated loans

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

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank 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 expires.

(j) Derivative financial instruments and hedge accounting

A derivative contract is initially recognised at fair value on the date on which it is entered into and is subsequently re-measured at its 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 options pricing models, as appropriate. All derivatives are carried as assets when their fair values are positive and as liabilities when their fair values are negative.

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

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Bank 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 Bank 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 Bank also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

(i) Fair value hedge

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

(ii) Cash flow hedge

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

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

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

Derivatives that do not qualify for hedge accounting

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

(k) Impairment of financial assets

Assets carried at amortised cost

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

The Bank 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 Bank 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 income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Bank may measure impairment on the basis of an instrument's fair value using observable market price.

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

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

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

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

Available-for-sale assets

A significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence 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 profit or loss) is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

(l) Offsetting financial transactions

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

(m) Fiduciary activities

The Bank 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 of the Bank.

(n) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including: cash and balances with banks and other financial institutions, placements with banks and other financial institutions, and treasury bills.

(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 at fair value through profit or loss excluding derivatives is recognised in the income statement using the effective interest rate method.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank 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.

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. Loan syndication fees are recognised as revenue when the syndication has been completed and the Bank 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.

(iii) Other income from financial assets and liabilities

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

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

Dividends on available-for-sale equity instruments are recognized in the income statement when the Bank'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 balance sheet date and 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, is credited or charged directly to equity and is subsequently recognised in the income statement together with the current or deferred gain or loss.

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

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

(q) Provisions

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

(r) 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) Pension obligations

The Bank has defined contribution plans and a defined benefit plan.

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

For the defined benefit plan, the liability recognised in the balance sheet represents the excess of the present value of the defined benefit obligations over the fair value of plan assets at the balance sheet date. The defined benefit obligations are calculated annually by independent actuaries using the projected unit 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 high-quality corporate 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 statement of recognised income and expense 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 unwinding of the discount on plan liabilities, offset by the expected return on plan assets, are charged to operating expenses.

(iii) Share-based compensation

The Standard Chartered PLC Group operates equity-settled share-based compensation plans in which the Bank'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 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.

(s) Translation of foreign currencies

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

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

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

- assets and liabilities for each balance sheet presented are translated at the closing rate at the balance sheet date.
- income and expenses for each income statement are translated at average exchange rates or at rates on the date of the transaction where exchange rates fluctuate significantly; and
- 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 shareholders' equity. Such exchange differences arising are separately identified within equity. When a foreign operation is sold they are recognised in the income statement as part of the gain or loss on disposal.

(t) Related parties

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

3 Operating profit

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

	2008 HK\$'M	2007 HK\$'M
(a) Interest income		
Interest income on listed securities	141	132
Interest income on unlisted securities	1,929	2,355
Other interest income	14,523	19,131
	<u>16,593</u>	<u>21,618</u>
Amount shown in the income statement	16,593	21,618
Less: Interest income arising from trading assets	(452)	(1,057)
	<u>16,141</u>	<u>20,561</u>
Total interest income on financial assets that are not measured at fair value through profit or loss	<u>16,141</u>	<u>20,561</u>

Other interest income includes interest income on unwinding of discounts on loan impairment charges of HK\$32 million (note 14) (2007: HK\$34 million), and fair value gains of HK\$2 million transferred from reserves on cash flow hedges (note 32(a)) (2007: HK\$ Nil).

	2008 HK\$'M	2007 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	6,332	11,245
Interest expense on subordinated liabilities	232	268
	<u>6,564</u>	<u>11,513</u>
Amount shown in the income statement	6,564	11,513
Less: Interest expense arising from trading liabilities	(258)	(613)
Less: Interest expense arising from financial liabilities designated at fair value	(19)	–
	<u>(277)</u>	<u>(613)</u>
Total interest expense on financial liabilities that are not measured at fair value through profit or loss	<u>6,287</u>	<u>10,900</u>
(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	1,366	1,130
– fee and commission expense	273	288
	<u>1,093</u>	<u>842</u>
Net fee income from trust and other fiduciary activities where the Bank holds or invests assets on behalf of its customers		
– fee and commission income	378	499
– fee and commission expense	76	104
	<u>302</u>	<u>395</u>
(d) Net trading income		
Gains less losses from dealing in foreign currencies	741	358
Gains less losses from trading securities	163	202
Gains/(losses) from other dealing activities	21	(17)
	<u>925</u>	<u>543</u>
Amount shown in the income statement	925	543
Add: interest income arising from trading assets	452	1,057
Less: interest expense arising from trading liabilities	(258)	(613)
	<u>1,119</u>	<u>987</u>
Net income from trading instruments	<u>1,119</u>	<u>987</u>
(e) Net losses from financial instruments designated at fair value		
Net losses as shown in the income statement	(200)	(326)
Less: interest expense arising from financial liabilities designated at fair value	(19)	–
	<u>(219)</u>	<u>(326)</u>

	2008 HK\$'M	2007 HK\$'M
(f) Other operating income		
Dividend income from listed available-for-sale securities	3	3
Dividend income from unlisted available-for-sale securities	16	7
Net gains on disposal of financial instruments measured at amortised cost	–	17
Losses on disposal of fixed assets	–	(5)
Gain on disposal of merchant acquiring business	–	86
Recognition of profit on Visa shares	53	316
Others	59	58
	<u>131</u>	<u>482</u>
(g) Operating expenses		
Staff costs		
– contributions to defined contribution plans	106	82
– expense in respect of the defined benefits plan (note 29(d))	27	35
– equity-settled share-based payment expenses	106	84
– salaries and other staff costs	3,721	3,292
Depreciation (note 19(a))	197	168
Premises and equipment expense, excluding depreciation		
– rental of premises	506	428
– others	253	294
Amortisation		
– other intangible assets (note 20)	46	59
Auditors' remuneration	11	9
Others	2,612	2,597
	<u>7,585</u>	<u>7,048</u>
4 Impairment charges		
(a) Impairment charges on advances to banks and customers		
Individual impairment provisions (note 14)		
– additions	1,480	756
– releases	(162)	(259)
– recoveries	(225)	(247)
	<u>1,093</u>	<u>250</u>
Portfolio impairment charges/(releases) (note 14)	<u>67</u>	<u>(23)</u>
	<u>1,160</u>	<u>227</u>
(b) Other impairment charges		
Impairment (releases)/charges on other financial assets measured at amortised cost	(2)	37
Provision for contingent liabilities	126	14
Impairment charges on equity shares	12	–
	<u>136</u>	<u>51</u>

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

	2008 HK\$'M	2007 HK\$'M
Net gains transferred from reserves (note 32(a))	100	238

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

	2008 HK\$'M	2007 HK\$'M
<i>Current tax</i>		
Hong Kong profits tax	1,158	1,458
Overseas taxation	28	–
Under/(over) provision in respect of prior years	48	(10)
	<u>1,234</u>	<u>1,448</u>
<i>Deferred tax (note 26)</i>		
Reversal of temporary differences	(30)	1
Effect on deferred tax balances at 1 January resulting from a change in tax rate	5	–
Under-provision in respect of prior years	–	15
	<u>(25)</u>	<u>16</u>
	<u>1,209</u>	<u>1,464</u>

In February 2008, the Hong Kong Government announced a decrease in the Profits Tax rate from 17.5% to 16.5% which is applicable to the Group's operations in Hong Kong for the year ended 31 December 2008. This decrease is taken into account in the preparation of the Group's and the Bank's 2008 financial statements. Accordingly, the provision for Hong Kong Profits Tax for 2008 is calculated at 16.5% (2007: 17.5%) of the estimated assessable profits for the year and the opening balance of deferred tax has been re-estimated accordingly. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant jurisdictions.

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

	2008 HK\$'M	2007 HK\$'M
Profit before taxation	6,957	8,834
Notional tax on profit before taxation, calculated at Hong Kong profits tax rate of 16.5% (2007: 17.5%)	1,148	1,546
Tax effect of non-deductible expenses	73	44
Tax effect of non-taxable revenue	(81)	(134)
Effect on deferred tax balances at 1 January resulting from a change in tax rate	5	–
Under-provision in prior years	48	5
Tax effect of different tax rates of subsidiaries operating in other jurisdictions	13	5
Others	3	(2)
Actual tax expense	<u>1,209</u>	<u>1,464</u>

7 Directors' remuneration

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

	<i>Bank</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Fees	2	2
Salaries and other emoluments	45	19
	<u>47</u>	<u>21</u>

8 Segmental reporting

	<i>Consumer banking</i>		<i>Wholesale banking</i>		<i>Corporate items not allocated</i>		<i>Consolidated Total</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</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>
Total operating income	7,917	9,000	7,898	7,062	–	86	15,815	16,148
Total operating expenses	(4,059)	(3,851)	(3,526)	(3,197)	–	–	(7,585)	(7,048)
Operating profit	3,858	5,149	4,372	3,865	–	86	8,230	9,100
Impairment (charges)/releases	(629)	(314)	(667)	36	–	–	(1,296)	(278)
Share of profit of associates	–	–	–	–	23	12	23	12
Profit before taxation	<u>3,229</u>	<u>4,835</u>	<u>3,705</u>	<u>3,901</u>	<u>23</u>	<u>98</u>	<u>6,957</u>	<u>8,834</u>
Segment assets	132,119	123,202	462,979	357,349	172	43	595,270	480,594
Interest in associates	–	–	–	–	3,401	1,132	3,401	1,132
Total assets	<u>132,119</u>	<u>123,202</u>	<u>462,979</u>	<u>357,349</u>	<u>3,573</u>	<u>1,175</u>	<u>598,671</u>	<u>481,726</u>
Segment liabilities	<u>231,462</u>	<u>190,824</u>	<u>333,461</u>	<u>259,899</u>	<u>309</u>	<u>977</u>	<u>565,232</u>	<u>451,700</u>
Depreciation and amortisation for the year	(194)	(132)	(49)	(95)	–	–	(243)	(227)
Capital expenditure incurred during the year	(308)	(214)	(3)	(48)	–	–	(311)	(262)

The Bank and its subsidiaries comprise two main business segments: Consumer Banking which provides financial services to customers including lending and deposit taking activities, credit card facilities and investment services; and Wholesale Banking which provides financial services to corporations and institutions, including lending and deposit taking activities, structured finance products, syndicated loans, cash management, investment advice, distributing fixed income and equity investments, interbank and capital market activities and foreign exchange transactions.

The Bank and its subsidiaries comprise only one geographical segment as over 90% of the business is based in Hong Kong.

9 Cash and balances with banks and other financial institutions

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Cash in hand	1,370	1,242	1,370	1,219
Balances with central bank	3,999	3,854	3,999	3,854
Balances with banks and other financial institutions	10,009	3,120	9,951	3,120
	<u>15,378</u>	<u>8,216</u>	<u>15,320</u>	<u>8,193</u>

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

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross placements with banks and other financial institutions				
– maturing within one month	59,017	89,737	59,017	89,735
– maturing between one month to one year	76,619	24,869	76,619	24,869
– maturing between one year to five years	829	107	829	107
– maturing after five years	–	11	–	11
	<u>136,465</u>	<u>114,724</u>	<u>136,465</u>	<u>114,722</u>
Less: impairment charges individually assessed (note 14(b))	(2)	–	(2)	–
	<u>136,463</u>	<u>114,724</u>	<u>136,463</u>	<u>114,722</u>

(b) Impaired placements with banks and other financial institutions

	<i>Consolidated and Bank</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross impaired advances to banks	177	–
Impairment charges – individually assessed	(2)	–
	<u>175</u>	<u>–</u>
Gross impaired advances to banks as a % of gross advances to banks	0.13%	–

There is no collateral held against impaired advances to banks.

11 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.

12 Trading assets

	<i>Consolidated and Bank</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Trading securities	16,473	23,855
Positive fair values of derivatives	768	761
	<u>17,241</u>	<u>24,616</u>
Trading securities:		
Treasury bills (including Exchange Fund Bills)	8,562	9,789
Certificates of deposit held	–	3,252
Debt securities	7,911	10,814
	<u>16,473</u>	<u>23,855</u>
Issued by:		
Central governments and central banks	15,661	16,120
Banks and other financial institutions	682	5,694
Corporate entities	130	2,041
	<u>16,473</u>	<u>23,855</u>
By place of listing:		
Listed in Hong Kong	6,594	6,330
Listed outside Hong Kong	–	275
	<u>6,594</u>	<u>6,605</u>
Unlisted	9,879	17,250
	<u>16,473</u>	<u>23,855</u>

13 Advances to customers**(a) Advances to customers**

	<i>Consolidated and Bank</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross advances to customers	211,865	177,434
Trade bills	3,381	2,852
	<u>215,246</u>	<u>180,286</u>
Less : Impairment charges		
– individually assessed (note 14(a))	(1,276)	(578)
– collectively assessed (note 14(a))	(431)	(328)
	<u>213,539</u>	<u>179,380</u>

(b) Impaired advances to customers

	<i>Consolidated and Bank</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross impaired advances to customers	1,936	1,166
Impairment charges – individually assessed	<u>(1,276)</u>	<u>(578)</u>
	<u>660</u>	<u>588</u>
Gross impaired advances to customers as a % of gross advances to customers	<u>0.90%</u>	<u>0.65%</u>
Fair value of collateral held against the covered portion of impaired advances to customers	<u>273</u>	<u>317</u>
Covered portion of impaired advances to customers	160	240
Uncovered portion of impaired advances to customers	<u>1,776</u>	<u>926</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.

(c) Net investment in finance leases

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

	<i>Consolidated and Bank</i>					
	<i>2008</i>			<i>2007</i>		
	<i>Present</i>	<i>Interest</i>	<i>Total</i>	<i>Present</i>	<i>Interest</i>	<i>Total</i>
	<i>value of</i>	<i>income</i>	<i>minimum</i>	<i>value of</i>	<i>income</i>	<i>minimum</i>
	<i>the minimum</i>	<i>relating</i>	<i>lease</i>	<i>the minimum</i>	<i>relating</i>	<i>lease</i>
	<i>payments</i>	<i>to future</i>	<i>payments</i>	<i>payments</i>	<i>to future</i>	<i>payments</i>
	<i>receivable</i>	<i>periods</i>	<i>periods</i>	<i>receivable</i>	<i>periods</i>	<i>periods</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>
Within 1 year	34	3	37	65	8	73
After 1 year but within 5 years	24	1	25	71	6	77
After 5 years	<u>2</u>	<u>1</u>	<u>3</u>	<u>5</u>	<u>1</u>	<u>6</u>
	<u>60</u>	<u>5</u>	<u>65</u>	<u>141</u>	<u>15</u>	<u>156</u>
Impairment charges:						
– individually assessed	<u>–</u>			<u>–</u>		
Net investment in finance leases	<u>60</u>			<u>141</u>		

14 Movement in impairment charges on advances to banks and customers**(a) Advances to customers****Consolidated and Bank**

	<i>Individually assessed HK\$'M</i>	<i>2008 Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2008	578	328	906
Amounts written off	(601)	–	(601)
Recoveries of advances written off in previous years	225	–	225
Net charge to the income statement (note 4(a))	1,091	67	1,158
Unwind of discount on loan impairment charges (note 3(a))	(32)	–	(32)
Others	15	36	51
	<u>1,276</u>	<u>431</u>	<u>1,707</u>

Consolidated and Bank

	<i>Individually assessed HK\$'M</i>	<i>2007 Collectively assessed HK\$'M</i>	<i>Total HK\$'M</i>
At 1 January 2007	1,224	351	1,575
Amounts written off	(1,109)	–	(1,109)
Recoveries of advances written off in previous years	247	–	247
Net charge/(release) to the income statement (note 4(a))	250	(23)	227
Unwind of discount on loan impairment charges (note 3(a))	(34)	–	(34)
	<u>578</u>	<u>328</u>	<u>906</u>

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

	<i>Individually assessed</i>	
	<i>2008 HK\$'M</i>	<i>2007 HK\$'M</i>
At 1 January	–	–
Charge to the income statement (note 4(a))	2	–
	<u>2</u>	<u>–</u>
At 31 December (note 10(a))	<u>2</u>	<u>–</u>

15 Investment securities

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Available-for-sale securities				
Treasury bills (including Exchange Fund Bills)	23,650	14,457	23,650	14,457
Certificates of deposit held	15,212	960	15,212	960
Debt securities	45,807	25,217	45,807	24,980
Equity shares	281	2,160	281	461
Less: impairment charges	(17)	(5)	(17)	(5)
	<u>84,933</u>	<u>42,789</u>	<u>84,933</u>	<u>40,853</u>
Loans and receivables – Debt securities	5,601	2,277	4,874	2,277
Less: impairment charges	(33)	(43)	(33)	(43)
	<u>90,501</u>	<u>45,023</u>	<u>89,774</u>	<u>43,087</u>
Issued by:				
Central governments and central banks	24,456	15,898	24,456	15,898
Public sector entities	4,515	4,175	4,515	4,175
Banks and other financial institutions	55,778	21,500	55,778	19,778
Corporate entities	5,752	3,450	5,025	3,236
	<u>90,501</u>	<u>45,023</u>	<u>89,774</u>	<u>43,087</u>
By place of listing:				
Listed in Hong Kong	828	939	828	939
Listed outside Hong Kong	6,243	4,294	6,243	2,572
	<u>7,071</u>	<u>5,233</u>	<u>7,071</u>	<u>3,511</u>
Unlisted	83,430	39,790	82,703	39,576
	<u>90,501</u>	<u>45,023</u>	<u>89,774</u>	<u>43,087</u>

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

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

(i) Consolidated

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

	<i>Immediate holding company</i>		<i>Fellow subsidiaries</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Income	2,085	1,571	698	950
Expenses	788	927	379	681

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

	<i>2008</i>		<i>2007</i>	
	<i>Immediate holding company</i>	<i>Fellow subsidiaries</i>	<i>Immediate holding company</i>	<i>Fellow subsidiaries</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Assets				
Unlisted available-for-sale debt securities	–	2,418	2,343	2,586
Positive fair values of trading derivatives	1,144	–	1,490	–
Positive fair values of hedging derivatives	182	–	63	–
Liabilities				
Other debt securities in issue, measured at amortised cost	–	928	–	892
Negative fair values of trading derivatives	1,869	–	1,413	–
Negative fair values of hedging derivatives	64	–	15	–

(ii) *The Bank*

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

	<i>Immediate holding company</i>		<i>Fellow subsidiaries</i>		<i>Subsidiaries of the Bank</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</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>
Income	<u>2,085</u>	<u>1,571</u>	<u>698</u>	<u>950</u>	<u>72</u>	<u>34</u>
Expenses	<u>788</u>	<u>927</u>	<u>379</u>	<u>681</u>	<u>–</u>	<u>1</u>

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

	<i>2008</i>			<i>2007</i>	
	<i>Immediate holding company</i>	<i>Fellow subsidiaries</i>	<i>Subsidiaries of the Bank</i>	<i>Immediate holding company</i>	<i>Fellow subsidiaries</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Assets					
Unlisted available-for-sale debt securities	–	2,418	–	2,343	2,586
Unlisted debt securities, designated at fair value	–	–	996	–	–
Positive fair values of trading derivatives	1,144	–	–	1,490	–
Positive fair values of hedging derivatives	<u>182</u>	<u>–</u>	<u>–</u>	<u>63</u>	<u>–</u>
Liabilities					
Other debt securities in issue, measured at amortised cost	–	928	–	–	892
Negative fair values of trading derivatives	1,722	–	–	1,413	–
Negative fair values of hedging derivatives	<u>64</u>	<u>–</u>	<u>–</u>	<u>15</u>	<u>–</u>

17 Investments in subsidiaries of the Bank

	<i>Bank</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Unlisted shares, at cost less impairment charges, if any	<u>255</u>	<u>208</u>

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 and securities</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

18 Interest in associates***Consolidated***

	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Share of net assets	1,773	1,132
Goodwill	<u>1,628</u>	<u>–</u>
	<u>3,401</u>	<u>1,132</u>

Bank

	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Unlisted investments, at cost less impairment losses, if any	1,520	1,117
Listed investment, at cost less impairment losses, if any	<u>1,244</u>	<u>–</u>
	<u>2,764</u>	<u>1,117</u>

The associated companies of the Bank and its subsidiaries are:

<i>Name of associate</i>	<i>Place of establishment and operation</i>	<i>Particulars of issued and paid up capital</i>	<i>Proportion of ownership interest</i>	<i>Principal activity</i>
Asia Commercial Joint Stock Bank ("ACB")	Vietnam	635,578,195 ordinary shares of VND 10,000 each	15%	Provision of banking and related financial services
China Bohai Bank Company Limited ("Bohai")	The People's Republic of China	5,000,000,000 ordinary shares of RMB1 each	20%	Provision of banking and related financial services
Merchant Solutions Private Limited ("MS")	Singapore	560,000 "A" shares and 440,000 "B" shares	44%	Credit card merchant acquiring business

Shareholdings in associated companies include a listed investment of HK\$1,793 million (2007: HK\$Nil). At the balance sheet date, the fair value of the investment, based on quoted market prices was HK\$1,181 million (2007: HK\$Nil). Testing on the investment has been carried out and this demonstrates that there is no impairment.

On 2 July 2008, the Bank acquired a further 6.16% equity stake in ACB (including convertible bonds) for HK\$1,647 million (VND3,489 billion) to bring the total shareholding to 15%. The investment in ACB has been accounted for as an associate, as the Bank has representation on the Board of Directors and also through a Technical Support and Assistance Agreement, which includes the secondment of staff to ACB, is able to exercise significant influence over the company's management, financial and operating policies.

In respect of the year ended 31 December 2008, the share of the results of MS and ACB was included in these financial statements based on accounts drawn up to 30 September 2008, but taking into account any changes in the subsequent period from 1 October 2008 to 31 December 2008 that would materially affect the results. Bohai's result was included in the financial statements based on accounts drawn up to 30 November 2008. The Group has taken advantage of the provision contained in HKAS 28 'Investment 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 must be no greater than three months.

Summary of financial information of associates

	<i>Assets HK\$'M</i>	<i>Liabilities HK\$'M</i>	<i>Equity HK\$'M</i>	<i>Revenue HK\$'M</i>	<i>Profit HK\$'M</i>
2008					
100 per cent	111,501	101,717	9,784	1,573	200
Group's effective interest	19,873	18,100	1,773	320	23
	<i>Assets HK\$'M</i>	<i>Liabilities HK\$'M</i>	<i>Equity HK\$'M</i>	<i>Revenue HK\$'M</i>	<i>Profit HK\$'M</i>
2007					
100 per cent	35,236	29,666	5,570	666	63
Group's effective interest	7,100	5,968	1,132	137	12

(b) Bank

	2008				
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost:					
At 1 January 2008	2,665	517	3,182	644	3,826
Additions	58	29	87	–	87
Disposals	(15)	(97)	(112)	–	(112)
Reclassifications	(46)	46	–	–	–
Acquisition of business (note 22)	–	5	5	–	5
Transfer to property held for resale	–	–	–	(143)	(143)
At 31 December 2008	<u>2,662</u>	<u>500</u>	<u>3,162</u>	<u>501</u>	<u>3,663</u>
Accumulated depreciation:					
At 1 January 2008	327	311	638	21	659
Charge for the year	89	89	178	13	191
Written back on disposals	(15)	(97)	(112)	–	(112)
Transfer to property held for resale	–	–	–	(11)	(11)
At 31 December 2008	<u>401</u>	<u>303</u>	<u>704</u>	<u>23</u>	<u>727</u>
Net book value:					
At 31 December 2008	<u>2,261</u>	<u>197</u>	<u>2,458</u>	<u>478</u>	<u>2,936</u>
	2007				
	<i>Buildings and leasehold land held for own use HK\$'M</i>	<i>Equipment, furniture & fixtures HK\$'M</i>	<i>Sub-total HK\$'M</i>	<i>Investment properties HK\$'M</i>	<i>Total fixed assets HK\$'M</i>
Cost:					
At 1 January 2007	2,431	469	2,900	886	3,786
Additions	79	47	126	–	126
Disposals	(53)	(33)	(86)	–	(86)
Reclassifications	208	34	242	(242)	–
At 31 December 2007	<u>2,665</u>	<u>517</u>	<u>3,182</u>	<u>644</u>	<u>3,826</u>
Accumulated depreciation:					
At 1 January 2007	247	268	515	21	536
Charge for the year	86	69	155	12	167
Written back on disposals	(18)	(26)	(44)	–	(44)
Reclassifications	12	–	12	(12)	–
At 31 December 2007	<u>327</u>	<u>311</u>	<u>638</u>	<u>21</u>	<u>659</u>
Net book value:					
At 31 December 2007	<u>2,338</u>	<u>206</u>	<u>2,544</u>	<u>623</u>	<u>3,167</u>

Buildings and leasehold land held for own use:

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Leasehold in Hong Kong, at cost				
– medium-term leases	2,164	2,224	2,164	2,224
– short-term leases	99	114	97	114
	<u>2,263</u>	<u>2,338</u>	<u>2,261</u>	<u>2,338</u>

Investment properties:

	<i>Consolidated and Bank</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Leasehold in Hong Kong, at cost		
– medium-term leases	–	135
Freehold outside Hong Kong	478	488
	<u>478</u>	<u>623</u>

The investment property is stated at depreciated cost less impairment. The fair value of the investment property outside Hong Kong was HK\$1,590 million (2007: HK\$786 million). The valuation of the investment property located outside Hong Kong was carried out by an independent firm 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.

As of 31 December 2008, the previous investment property located in Hong Kong was reclassified to assets held for resale included in "Other assets".

20 Goodwill and intangible assets

	<i>Consolidated and Bank 2008</i>		
	<i>Capitalised software and other intangible assets HK\$'M</i>	<i>Goodwill HK\$'M</i>	<i>Total HK\$'M</i>
Cost:			
At 1 January 2008	284	611	895
Additions	96	118	214
Disposals	(93)	–	(93)
	<u>287</u>	<u>729</u>	<u>1,016</u>
At 31 December 2008	287	729	1,016
Accumulated amortisation:			
At 1 January 2008	112	–	112
Charge for the year (note 3(g))	46	–	46
Written back on disposal	(77)	–	(77)
	<u>81</u>	<u>–</u>	<u>81</u>
At 31 December 2008	81	–	81
Carrying amount:			
At 31 December 2008	<u>206</u>	<u>729</u>	<u>935</u>
	<i>Consolidated and Bank 2007</i>		
	<i>Capitalised software and other intangible assets HK\$'M</i>	<i>Goodwill HK\$'M</i>	<i>Total HK\$'M</i>
Cost:			
At 1 January 2007	330	611	941
Additions	129	–	129
Disposals	(175)	–	(175)
	<u>284</u>	<u>611</u>	<u>895</u>
At 31 December 2007	284	611	895
Accumulated amortisation:			
At 1 January 2007	178	–	178
Charge for the year (note 3(g))	59	–	59
Written back on disposal	(125)	–	(125)
	<u>112</u>	<u>–</u>	<u>112</u>
At 31 December 2007	112	–	112
Carrying amount:			
At 31 December 2007	<u>172</u>	<u>611</u>	<u>783</u>

Impairment tests for cash-generating units containing goodwill

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

	2008 HK\$'M	2007 HK\$'M
Lending	611	611
Private Banking	118	–
	<u>729</u>	<u>611</u>

The recoverable amounts of the CGU are determined based on value in use calculations. The key assumptions and approach to determining value in use calculations, as set out below, are solely estimates for the purpose of assessing impairment on acquired goodwill. These calculations use cash flow projections based on budgets and forecasts approved by management covering one year and extrapolated for a further 18 years using steady growth rates.

In assessing impairment of goodwill, the Bank assumed growth at a steady rate in line with long-term forecast GDP growth. A discount rate of 13.7 per cent (2007: 11.5 per cent) was used.

21 Other assets

	<i>Consolidated</i>		<i>Bank</i>	
	2008 HK\$'M	2007 HK\$'M	2008 HK\$'M	2007 HK\$'M
Prepayments and accrued income	3,730	4,667	3,730	4,655
Acceptances and endorsements	3,005	3,002	3,005	3,002
Positive fair values of hedging derivatives	25	–	25	–
Property held for resale	132	–	132	–
Others	928	1,189	678	1,186
	<u>7,820</u>	<u>8,858</u>	<u>7,570</u>	<u>8,843</u>

22 Business combinations

On 1 July 2008, the Bank acquired 100 per cent of the assets and liabilities of American Express Bank Limited Hong Kong Branch ("AEB"), a financial services entity. If the acquisition had occurred on 1 January 2008, the operating income of the Group would have been approximately HK\$16,043 million and profit before taxation would have been approximately HK\$6,970 million.

The assets and liabilities arising from the acquisition of AEB at the date of acquisition were as follows:

	AEB	
	<i>Fair value</i> HK\$'M	<i>Acquiree's carrying amount</i> HK\$'M
Advances to customers	5,024	5,036
Amounts due from immediate holding company	11,238	11,238
Fixed assets	5	10
Other assets	1,000	1,002
Total assets	17,267	17,286
Deposits from customers	16,500	16,500
Other liabilities	787	786
Total liabilities	17,287	17,286
Net liabilities acquired	(20)	–
Purchase consideration settled in cash	(98)	
Cash and cash equivalents in business acquired	627	
Cash inflow on acquisition	529	
Purchase consideration:		
– cash paid	98	
– direct costs relating to the acquisition	–	
Total purchase consideration	98	
Fair value of net liabilities acquired	20	
Goodwill	118	
Contribution from acquisition to 31 December 2008:		
Operating income	80	
Loss before taxation	(92)	

Goodwill arising on the acquisition of AEB is attributable to the significant synergies expected to arise from development within the Bank and to those intangibles which are not separately identifiable.

23 Deposits from customers

	<i>Consolidated and Bank</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Current accounts	41,248	40,332
Savings accounts	196,769	158,843
Time, call and notice deposits	229,299	159,409
Deposits and balances of central banks	9,480	7,291
	<u>476,796</u>	<u>365,875</u>

24 Debt securities in issue

	<i>Consolidated and Bank</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Certificates of deposit, measured at amortised cost	<u>3,420</u>	<u>1,408</u>

25 Financial liabilities designated at fair value

	<i>Consolidated and Bank</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Structured customer deposits	5,270	3,301
Debt securities issued	<u>36</u>	<u>1,138</u>
	<u>5,306</u>	<u>4,439</u>

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

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

At 31 December 2008, the carrying amount of these financial liabilities exceeded the contractual amount payable at maturity by HK\$113 million (2007: HK\$43 million). This change is attributable to changes in market rates.

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

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

Consolidated

	<i>Depreciation allowances in excess of related depreciation HK\$'M</i>	<i>Impairment losses on financial assets HK\$'M</i>	<i>Others HK\$'M</i>	<i>Total HK\$'M</i>
	2008			
Deferred tax arising from:				
At 1 January 2008	(16)	(57)	428	355
Effect on deferred tax balances at				
1 January resulting from a change in tax rate	1	3	(2)	2
Charge/(release) to income statement (note 6(a))	10	(11)	(29)	(30)
Credit to reserves (note 32(a))	—	—	(462)	(462)
At 31 December 2008	<u>(5)</u>	<u>(65)</u>	<u>(65)</u>	<u>(135)</u>
	2007			
At 1 January 2007	2	(61)	26	(33)
Charge to income statement (note 6(a))	6	4	6	16
Charge to reserves (note 32(a))	—	—	396	396
Disposal of a subsidiary	(24)	—	—	(24)
At 31 December 2007	<u>(16)</u>	<u>(57)</u>	<u>428</u>	<u>355</u>

Bank

	<i>Depreciation allowances in excess of related depreciation HK\$'M</i>	<i>Impairment losses on financial assets HK\$'M</i>	<i>Others HK\$'M</i>	<i>Total HK\$'M</i>
2008				
Deferred tax arising from:				
At 1 January 2008	(16)	(57)	30	(43)
Effect on deferred tax balances at				
1 January resulting from a change in tax rate	1	3	(2)	2
Charge/(release) to income statement	10	(11)	(29)	(30)
Credit to reserves (note 32(b))	—	—	(101)	(101)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
At 31 December 2008	<u> </u> <u> </u>	<u> </u> <u> </u>	<u> </u> <u> </u>	<u> </u> <u> </u>
2007				
At 1 January 2007	(21)	(61)	26	(56)
Charge to income statement	5	4	6	15
Credit to reserves (note 32(b))	—	—	(2)	(2)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
At 31 December 2007	<u> </u> <u> </u>	<u> </u> <u> </u>	<u> </u> <u> </u>	<u> </u> <u> </u>
	<i>Consolidated</i>		<i>Bank</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Analysed by:				
Net deferred tax asset recognised on the balance sheet	(172)	(43)	(172)	(43)
Net deferred tax liability recognised on the balance sheet	37	398	—	—
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	<u> </u> <u> </u>	<u> </u> <u> </u>	<u> </u> <u> </u>	<u> </u> <u> </u>

27 Trading liabilities

	<i>Consolidated and Bank</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Short positions in securities	15,389	16,047
Negative fair values of derivatives	231	489
	<u>15,620</u>	<u>16,536</u>

28 Other liabilities

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Accruals and deferred income	3,047	2,423	2,973	2,405
Provision for liabilities and charges	217	30	218	30
Negative fair values of hedging derivatives	71	–	71	–
Acceptance and endorsements	3,005	3,002	3,005	3,002
Others	8,358	9,992	8,165	9,971
	<u>14,698</u>	<u>15,447</u>	<u>14,432</u>	<u>15,408</u>

29 Employee retirement benefits

The Bank makes contributions to a defined benefit retirement scheme (the "Scheme") which covers 26% (2007: 30%) of the Bank's employees. The Scheme is administered by a trustee, with the assets held separately from those of the Bank.

(a) The amounts recognised in the consolidated balance sheet are as follows:

	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Fair value of plan assets	1,467	1,980
Present value of wholly or partly funded obligations	<u>(1,890)</u>	<u>(1,666)</u>
Net (liability)/asset recognised in the balance sheet (included in "Other liabilities"/ "Other assets")	<u>(423)</u>	<u>314</u>

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

	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
At the beginning of the year	1,666	1,458
Current service cost	97	90
Interest cost	56	55
Benefits paid	(76)	(107)
Actuarial losses	147	170
	<u>1,890</u>	<u>1,666</u>

(c) Movements in the fair value of assets:

	2008 HK\$'M	2007 HK\$'M
At the beginning of the year	1,980	1,719
Contributions	60	81
Expected return on assets	126	110
Benefits paid	(76)	(107)
Actuarial (losses)/gains on plan assets	(623)	177
	<u>1,467</u>	<u>1,980</u>

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

	2008 HK\$'M	2007 HK\$'M
At the beginning of the year	314	261
Contributions	60	81
Expense recognised in the income statement (note 3(g))	(27)	(35)
Actuarial (losses)/gains to pension reserve (note 32(a))	(770)	7
	<u>(423)</u>	<u>314</u>
At the end of the year	<u>(423)</u>	<u>314</u>

As at 31 December 2008, the Scheme did not invest in the Bank's own financial instruments and properties (2007: HK\$Nil). The Bank expects to contribute approximately HK\$111 million to the Scheme in 2009.

(e) The expense recognised in the consolidated income statement for the year is as follows:

	2008 HK\$'M	2007 HK\$'M
Current service cost	97	90
Interest cost	56	55
Actuarial expected return on plan assets	(126)	(110)
	<u>27</u>	<u>35</u>

The actual return on plan assets (taking into account all changes in the fair value of the plan assets excluding contributions paid and received) was a net loss of HK\$497 million (2007: net income of HK\$287 million).

(f) The principal actuarial assumptions used in the valuation are as follows:

	2008	2007
Discount rate	1.20%	3.45%
Expected rate of return on plan assets	6.50%	6.50%
Future salary increases	3.50%	4.50%

The expected return is based on market expectations at the beginning of the year, for the return net of administration costs, over the entire life of the related obligations.

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

	2008	2007
Equities	48%	53%
Bonds	51%	43%
Cash	1%	4%
	<u>100%</u>	<u>100%</u>

30 Subordinated liabilities

	<i>Consolidated and Bank</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
HK\$595 million (2007: HK\$670 million) Floating Rate Step-Up Notes 2014 ⁽¹⁾	596	670
HK\$500 million 3.5% Fixed/Floating Rate Step-Up Notes 2014 ⁽²⁾	508	496
US\$350 million 4.375% Fixed/Floating Rate Step-Up Notes 2014 ⁽³⁾	2,776	2,735
US\$300 million Floating Rate Step-Up Notes 2017 ⁽⁴⁾	2,300	2,333
	<u>6,180</u>	<u>6,234</u>

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

- (1) Interest rate at three month HIBOR plus 0.37 per cent, payable quarterly, to the call option date on 4 December 2009. Thereafter, it will be reset to three-month HIBOR plus 0.87 per cent, payable quarterly.
- (2) Interest rate at 3.5 per cent per annum, payable semi-annually, to the call option date on 4 December 2009. Thereafter, it will be reset to three-month HIBOR plus 0.87 per cent, payable quarterly.
- (3) Interest rate at 4.375 per cent per annum, payable semi-annually, to the call option date on 4 December 2009. Thereafter, it will be reset to three-month US dollar LIBOR plus 0.86 per cent, payable quarterly.
- (4) Interest rate at three-month US dollar LIBOR plus 0.25 per cent, payable quarterly, to the call option date on 13 April 2012. Thereafter, it will be reset to three-month US dollar LIBOR plus 0.75 per cent, payable quarterly.

32 Reserves**(a) Consolidated**

	Share premium HK\$'M	Capital redemption reserve HK\$'M	Property revaluation reserve HK\$'M	Cash flow hedge reserve HK\$'M	Available- for-sale investment reserve HK\$'M	Pension reserve HK\$'M	Exchange reserve HK\$'M	Retained profits HK\$'M	Total HK\$'M
At 1 January 2008	12,477	3,804	–	36	985	141	104	12,382	29,929
Effect on deferred tax balances at 1 January resulting from a change in tax rate	–	–	–	–	1	2	–	–	3
Available-for-sale securities:									
– changes in fair value	–	–	–	–	(1,008)	–	–	–	(1,008)
– transfer to income statement (note 5)	–	–	–	–	(100)	–	–	–	(100)
– deferred tax released (note 26)	–	–	–	–	338	–	–	–	338
Adjustment on acquisition of an associate	–	–	–	–	–	–	–	158	158
Cash flow hedge:									
– effective portion of changes in fair value	–	–	–	10	–	–	–	–	10
– transfer to income statement upon termination (note 3(a))	–	–	–	(2)	–	–	–	–	(2)
– deferred tax charged (note 26)	–	–	–	(1)	–	–	–	–	(1)
Exchange differences	–	–	–	–	–	–	74	–	74
Actuarial losses on defined benefits plan (note 29(d))	–	–	–	–	–	(770)	–	–	(770)
Tax on actuarial losses on defined benefits plan (note 26)	–	–	–	–	–	125	–	–	125
Dividend paid	–	–	–	–	–	–	–	(1,162)	(1,162)
Profit for the year attributable to shareholders	–	–	–	–	–	–	–	5,743	5,743
At 31 December 2008	12,477	3,804	–	43	216	(502)	178	17,121	33,337
At 1 January 2007	12,477	–	3	(4)	97	130	34	13,212	25,949
Available-for-sale securities:									
– changes in fair value	–	–	–	–	1,518	–	–	–	1,518
– transfer to income statement on disposal (note 5)	–	–	–	–	(238)	–	–	–	(238)
– deferred tax charged (note 26)	–	–	–	–	(392)	–	–	–	(392)
Cash flow hedge:									
– effective portion of changes in fair value	–	–	–	48	–	–	–	–	48
– deferred tax charged (note 26)	–	–	–	(8)	–	–	–	–	(8)
Capitalisation of reserve	–	3,804	–	–	–	–	–	(7,020)	(3,216)
Exchange differences	–	–	–	–	–	–	70	–	70
Transfer of reserve	–	–	(3)	–	–	–	–	3	–
Actuarial gains on defined benefits plan (note 29(d))	–	–	–	–	–	7	–	–	7
Tax on actuarial gains on defined benefits plan (note 26)	–	–	–	–	–	4	–	–	4
Dividend paid	–	–	–	–	–	–	–	(1,181)	(1,181)
Profit for the year attributable to shareholders	–	–	–	–	–	–	–	7,368	7,368
At 31 December 2007	12,477	3,804	–	36	985	141	104	12,382	29,929

(b) Bank

	Share premium HK\$'M	Capital redemption reserve HK\$'M	Property revaluation reserve HK\$'M	Cash flow hedge reserve HK\$'M	Available- for-sale investment reserve HK\$'M	Pension reserve HK\$'M	Retained profits HK\$'M	Total HK\$'M
At 1 January 2008	12,477	3,804	–	36	55	141	12,507	29,020
Effect on deferred tax balances at 1 January resulting from a change in tax rate	–	–	–	–	1	2	–	3
Available-for-sale securities:								
– changes in fair value	–	–	–	–	327	–	–	327
– transfer to income statement	–	–	–	–	(100)	–	–	(100)
– deferred tax charged (note 26)	–	–	–	–	(23)	–	–	(23)
Cash flow hedge:								
– effective portion of changes in fair value	–	–	–	10	–	–	–	10
– transfer to income statement upon termination	–	–	–	(2)	–	–	–	(2)
– deferred tax (note 26)	–	–	–	(1)	–	–	–	(1)
Actuarial losses on defined benefits plan	–	–	–	–	–	(770)	–	(770)
Tax on actuarial losses on defined benefits plan (note 26)	–	–	–	–	–	125	–	125
Dividend paid	–	–	–	–	–	–	(1,162)	(1,162)
Profit for the year attributable to shareholders	–	–	–	–	–	–	5,704	5,704
At 31 December 2008	<u>12,477</u>	<u>3,804</u>	<u>–</u>	<u>43</u>	<u>260</u>	<u>(502)</u>	<u>17,049</u>	<u>33,131</u>
At 1 January 2007	12,477	–	3	(4)	98	130	13,261	25,965
Available-for-sale securities:								
– changes in fair value	–	–	–	–	189	–	–	189
– transfer to income statement on disposal	–	–	–	–	(238)	–	–	(238)
– deferred tax released (note 26)	–	–	–	–	6	–	–	6
Cash flow hedge:								
– effective portion of changes in fair value	–	–	–	48	–	–	–	48
– deferred tax charged (note 26)	–	–	–	(8)	–	–	–	(8)
Capitalisation of reserve	–	3,804	–	–	–	–	(7,020)	(3,216)
Transfer of reserve	–	–	(3)	–	–	–	3	–
Actuarial gains on defined benefits plan	–	–	–	–	–	7	–	7
Tax on actuarial gains on defined benefits plan (note 26)	–	–	–	–	–	4	–	4
Dividend paid	–	–	–	–	–	–	(1,181)	(1,181)
Profit for the year attributable to shareholders	–	–	–	–	–	–	7,444	7,444
At 31 December 2007	<u>12,477</u>	<u>3,804</u>	<u>–</u>	<u>36</u>	<u>55</u>	<u>141</u>	<u>12,507</u>	<u>29,020</u>

The consolidated profit attributable to equity shareholders of the Bank includes a profit of HK\$5,704 million (2007: HK\$7,444 million) which has been included in the financial statements of the Bank.

During the year ended 31 December 2008, the directors had declared and paid a special dividend of HK\$0.60 (2007: HK\$0.61) per each 'A' and 'B' ordinary share totalling HK\$1,162 million (2007: HK\$1,181 million).

(c) Nature and purpose of reserves

(i) Share premium

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

(ii) Capital redemption reserve

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

(iii) Available-for-sale investment reserve

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

(iv) Cash flow hedge reserve

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

(v) Pension reserve

The pension reserve comprises the cumulative net effect of the actuarial gains and losses for the defined benefits plan.

(vi) Exchange reserve

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

The HKMA requires the Bank to maintain a minimum level of impairment allowances which is in excess of the impairment allowances required under Hong Kong Financial Reporting Standards. Of the retained earnings as at 31 December 2008, an amount of HK\$1,383 million (2007: HK\$914 million) has been reserved for this purpose.

(d) Minority interests

	<i>Consolidated</i>	
	<i>2008</i> <i>HK\$'M</i>	<i>2007</i> <i>HK\$'M</i>
At 1 January	–	51
Profit after taxation	5	2
Disposal of a subsidiary	–	(53)
	<u>5</u>	<u>–</u>
At 31 December	<u><u>5</u></u>	<u><u>–</u></u>

33 Cash and cash equivalents

	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
(a) Components of cash and cash equivalents in the cash flow statement		
Cash and balances with banks and other financial institutions	15,348	8,180
Trading assets with original maturity within three months	3,909	1,305
Placements with banks and other financial institutions with original maturity within three months	67,827	83,005
Investment securities with original maturity within three months	14,123	4,178
Amounts due from immediate holding company and fellow subsidiaries with original maturity within three months	12,823	23,438
	<u>114,030</u>	<u>120,106</u>
	<u><u>114,030</u></u>	<u><u>120,106</u></u>
(b) Reconciliation with the consolidated balance sheet		
Cash and balances with banks and other financial institutions	15,378	8,216
Placements with banks and other financial institutions	136,463	114,724
Trading securities	16,473	23,855
Investment securities	90,501	45,023
Amounts due from immediate holding company and fellow subsidiaries	86,274	73,457
Overdrafts included in “deposits and balances of banks and other financial institutions”	(30)	(36)
Overdrafts included in “amounts due to immediate holding company”	(18)	(461)
	<u>345,041</u>	<u>264,778</u>
Less: amounts with an original maturity of beyond three months	(231,011)	(144,672)
	<u><u>114,030</u></u>	<u><u>120,106</u></u>
Cash and cash equivalents in the consolidated cash flow statement	<u><u>114,030</u></u>	<u><u>120,106</u></u>

34 Derivatives

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

(a) *Notional amounts of derivatives*

Derivatives are contracts whose value depends on the value of one or more underlying financial instruments, interest or exchange rates or indices. 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 Bank and its subsidiaries:

Consolidated

	2008			
	<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	–	618	445,821	446,439
Options purchased	–	103,932	289	104,221
Options written	–	105,884	289	106,173
Interest rate contracts				
Forwards	–	4,459	–	4,459
Swaps	19,336	2,197	1,164	22,697
Options purchased	–	317	–	317
Options written	–	1,307	–	1,307
Other derivatives	–	238	405	643
	<u>19,336</u>	<u>218,952</u>	<u>447,968</u>	<u>686,256</u>
2007				
Exchange rate contracts				
Forwards	–	114	423,012	423,126
Options purchased	–	185,321	–	185,321
Options written	–	184,368	–	184,368
Interest rate contracts				
Forwards	–	6,578	–	6,578
Swaps	12,395	19,508	58	31,961
Options purchased	–	336	–	336
Options written	–	864	–	864
Other derivatives	–	144	–	144
	<u>12,395</u>	<u>397,233</u>	<u>423,070</u>	<u>832,698</u>

Bank

	2008			
	Qualifying for hedge accounting HK\$'M	Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$'M	Others, including held for trading HK\$'M	Total HK\$'M
Exchange rate contracts				
Forwards	–	618	445,821	446,439
Options purchased	–	103,932	289	104,221
Options written	–	105,884	289	106,173
Interest rate contracts				
Forwards	–	4,459	–	4,459
Swaps	19,336	2,197	–	21,533
Options purchased	–	317	–	317
Options written	–	1,307	–	1,307
Other derivatives	–	238	405	643
	<u>19,336</u>	<u>218,952</u>	<u>446,804</u>	<u>685,092</u>
2007				
Exchange rate contracts				
Forwards	–	114	423,012	423,126
Options purchased	–	185,321	–	185,321
Options written	–	184,368	–	184,368
Interest rate contracts				
Forwards	–	6,578	–	6,578
Swaps	12,395	19,508	58	31,961
Options purchased	–	336	–	336
Options written	–	864	–	864
Other derivatives	–	144	–	144
	<u>12,395</u>	<u>397,233</u>	<u>423,070</u>	<u>832,698</u>

(b) Fair values and credit risk weighted amounts of derivatives

	Consolidated					
	2008			2007		
	Fair value assets HK\$'M	Fair value liabilities HK\$'M	Credit risk weighted amount HK\$'M	Fair value assets HK\$'M	Fair value liabilities HK\$'M	Credit risk weighted amount HK\$'M
Exchange rate contracts	1,502	1,819	853	2,141	1,744	4,449
Interest rate contracts	572	384	68	170	168	255
Other derivatives	45	32	33	3	5	–
	<u>2,119</u>	<u>2,235</u>	<u>954</u>	<u>2,314</u>	<u>1,917</u>	<u>4,704</u>

	Bank					
	2008			2007		
	Fair value assets HK\$'M	Fair value liabilities HK\$'M	Credit risk weighted amount HK\$'M	Fair value assets HK\$'M	Fair value liabilities HK\$'M	Credit risk weighted amount HK\$'M
Exchange rate contracts	1,502	1,819	853	2,141	1,744	4,449
Interest rate contracts	572	237	67	170	168	255
Other derivatives	45	32	33	3	5	–
	<u>2,119</u>	<u>2,088</u>	<u>953</u>	<u>2,314</u>	<u>1,917</u>	<u>4,704</u>

Credit risk weighted amount refers to the amount as computed in accordance with the Banking (Capital) Rules issued by the HKMA which became effective on 1 January 2007. The amount calculated is dependent upon the status of the counterparty and maturity characteristics of each type of contract.

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

In 2007, the Bank used the Basic approach to calculate its credit risk for non-securitization exposures. In 2008, the Bank has used the Advanced Internal Ratings-Based approach and Standardized approach to calculate its credit risk for non-securitization exposures. As there are significant differences between the approaches to calculate credit risk, the credit risk weighted amounts for 2008 and 2007 are not directly comparable.

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

The following is a summary of the fair values of derivatives held for hedging purposes by product type entered into by the Bank and its subsidiaries as at 31 December 2008:

	Consolidated and Bank	
	Assets (Included in Other assets and Amounts due from immediate holding company) HK\$'M	Liabilities (Included in Other liabilities and Amounts due to immediate holding company) HK\$'M
Interest rate contracts	<u>207</u>	<u>135</u>

The following is a summary of the fair values of derivatives held for hedging purposes by product type entered into by the Bank and its subsidiaries as at 31 December 2007:

	Consolidated and Bank	
	Assets (Included in Amounts due from immediate holding company) HK\$'M	Liabilities (Included in Amounts due to immediate holding company) HK\$'M
Interest rate contracts	<u>63</u>	<u>15</u>

Fair value hedges

The fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of certain fixed rate liabilities due to movements in market interest rates. At 31 December 2008, the net fair value of interest rate swaps held as fair value hedges was HK\$33 million (2007: HK\$5 million) comprising assets of HK\$95 million (2007: HK\$8 million) and liabilities of HK\$62 million (2007: HK\$3 million). The gains on the hedging instruments were HK\$28 million (2007: HK\$90 million). The losses on the hedged item attributable to the hedged risk were HK\$28 million (2007: HK\$90 million).

Cash flow hedges

The cash flow hedges principally consist of interest rate swaps that are used to hedge against the variability in cash flows of certain floating rate assets and liabilities. At 31 December 2008, the net fair value of interest rate swaps held as cash flow hedges was HK\$39 million (2007: HK\$43 million) comprising assets of HK\$112 million (2007: HK\$55 million) and liabilities of HK\$73 million (2007: HK\$12 million). The interest rate swaps will mature within 5 years (2007: within 3 years) from the balance sheet date. During the year, there was no ineffectiveness recognised in the income statement that arose from cash flow hedges (2007: HK\$ Nil).

35 Contingent liabilities and commitments

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

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2008</i>	<i>2007</i>	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Direct credit substitutes	35,633	12,219	35,633	12,219
Transaction-related contingencies	12,087	11,400	12,087	11,400
Trade-related contingencies	19,819	18,720	19,819	18,720
Forward asset purchases	14	144	14	144
Forward forward deposits placed	25	597	25	597
Other commitments:				
which are not unconditionally cancellable:				
with original maturity of not more than one year	5,971	2,206	5,971	2,206
with original maturity of more than one year	10,338	10,816	10,338	10,816
which are unconditionally cancellable	179,100	177,487	179,100	177,487
	<u>262,987</u>	<u>233,589</u>	<u>262,987</u>	<u>233,589</u>
Credit risk weighted amount	<u>22,477</u>	<u>19,124</u>	<u>22,477</u>	<u>19,124</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.

In 2007, the Bank used the Basic approach to calculate its credit risk for non-securitization exposures. In 2008, the Bank has used the Advanced Internal Ratings-Based approach and Standardized approach to calculate its credit risk for non-securitization exposures. As there are significant differences between the approaches to calculate credit risk, the credit risk weighted amounts for 2008 and 2007 are not directly comparable.

(b) Capital commitments

Capital commitments outstanding at 31 December not provided for in the financial statements were as follows:

	<i>Consolidated and Bank</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Contracted for	25	31
Authorised but not contracted for	39	63
	<u>64</u>	<u>94</u>

(c) Lease commitments

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

	<i>Consolidated and Bank</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Within 1 year	537	397
After 1 year but within 5 years	831	751
After 5 years	4	2
	<u>1,372</u>	<u>1,150</u>

(d) Contingencies

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

36 Risk management

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

Risk management framework

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

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

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

- **Balancing risk and reward:** risk is taken in support of the requirements of the Bank's stakeholders, in line with the Bank's strategy and within its risk appetite;
- **Responsibility:** it is the responsibility of all employees to ensure that risk-taking is disciplined and focused. The Bank takes account of its social, environmental and ethical responsibilities in taking risk to produce a return;
- **Accountability:** risk is taken only within agreed authorities and where there is appropriate infrastructure and resource. All risk-taking must be transparent, controlled and reported;
- **Anticipation:** the Bank looks to anticipate future risks and maximise awareness of all risks; and
- **Competitive advantage:** the Bank seeks competitive advantage through efficient and effective risk management and control.

(a) Credit Risk

Credit risk is the risk that the counterparty to a financial transaction will fail to discharge an obligation, resulting in financial loss to the Bank. Credit exposures may arise from both the banking book and the trading book.

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

Group-wide credit policies and standards are considered and approved by the Group Risk Committee ("GRC"), which also oversees the delegation of credit approval and loan impairment provisioning authorities. The GRC is responsible for the management of all risks, including the establishment of, and compliance with, policies relating to credit risk, country risk, market risk, operational risk, regulatory risk and reputational risk. The GRC is also responsible for defining the SCB Group's overall risk management framework.

Policies and procedures that are specific to each business are established by authorised risk committees within Wholesale and Consumer Banking. These are consistent with the Group-wide credit policies, but are more detailed and adapted to reflect the different risk environments and portfolio characteristics. The Group chief risk officer ('GCRO') chairs the GRC and is a member of the SCB Group Management Committee. Chief risk officers for both the Wholesale and Consumer Banking businesses have their primary reporting lines into the GCRO. Country chief risk officers take overall responsibility for risk within the SCB Group's principal countries including Hong Kong.

Based on the policies and standards approved by the GRC, in Hong Kong the Bank has put in place a credit control structure and effective credit risk management tools to ensure proper management of the quality of its credit portfolio. The Bank's credit policies and procedures define credit extension criteria, credit approval authorities delegated from the Board, credit monitoring processes, the loan grading system and provisioning policy. It also takes into account the requirements of the Hong Kong Banking Ordinance and the guidelines issued by the HKMA with respect to large exposures and provisioning requirements. The Bank's policy is not to have significant concentrations of exposure to individual counterparties or individual overseas countries.

The Risk function performs the following core activities:

- informs and challenges business strategy in order to encourage rigour, quality, optimisation and transparency in relation to the deployment of risk capital;
- controls the risk management processes independently of the businesses and seeks to ensure discipline and consistency with risk standards, policy and appetite;
- advises on risk management frameworks, the structuring of products and transactions and on the assessment and measurement of risk;
- facilitates and manages risk processes and seeks to ensure operational efficiency, effectiveness and best practice; and
- communicates with stakeholders to demonstrate compliance with requirements in relation to risk management.

Credit rating and measurement

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

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

There is no direct relationship between the SCB Group's internal credit grades and those used by external rating agencies. The Group's credit grades are not intended to replicate external credit grades although, as the factors used to grade a borrower may be similar, a borrower rated poorly by an external rating agency is typically rated in the lower rank of the Bank's internal credit grades.

Credit grades for the majority of consumer accounts are based on a probability of default calculated using advanced IRB models. These models are based on application and behavioural scorecards which make use of credit bureau information as well as the Bank's own data. For Consumer Banking portfolios where IRB models have not yet been developed, the probability of default is calculated using historical portfolio delinquency flow rates and expert judgement, where applicable.

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

Risk measurement models are approved by the responsible risk committee, on the recommendation of the SCB Group Model Assessment Committee ('MAC'). The MAC supports risk committees in ensuring risk identification and measurement capabilities are objective and consistent, so that risk control and risk origination decisions are properly informed. Prior to review by the MAC, all 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 a detailed review at least annually. Such reviews are also triggered if the performance of a model deteriorates materially.

Credit Approval

The Bank has been locally incorporated since 1st July 2004. Since then, the approval process reflects that strategic decisions are being made by the Bank's personnel in accordance with their delegated authorities and the terms of reference of the appropriate committees. It is recognised that as a major part of the SCB Group, all significant risk decisions emanating from Hong Kong will have an impact to the SCB Group, be it regulatory, concentration, strategic, etc. It is therefore recognised that it is essential for the SCB Group to consider such transactions to ensure that these SCB Group issues are included as part of the decision making process. Delegated authorities are given by the CEO of the Bank to the key risk managers to ensure that all risk decisions are made within the Bank. Where proposals fall outside of the individual's authorities, the advice and guidance of the SCB Group is sought. In such cases, the relevant SCB Group entity, whether an individual or a committee (including but not limited to the GRC), will review the proposal from a SCB Group perspective and give their recommendation. On receipt of such recommendation, the Bank's Excess Approval Committee, being a sub-committee of the Risk Committee, will meet to consider such advice and reach a suitable decision. All the credit applications approved by the Excess Approval Committee will be reported at each Risk Committee meeting for noting.

Concentration Risk

Concentration risk in the Wholesale Banking loan portfolio is managed through the Risk Committee which is chaired by the Chief Risk Officer and comprises members of senior management from Credit and Business. Various concentration measures are evaluated including industry sector, geographical spread, credit rating and customer segment.

Credit concentration risk is managed within concentration caps set by counterparty or groups of related counterparties, industry sector and country in Wholesale Banking; and by product and country in Consumer Banking. Additional targets are set and monitored for concentrations by credit rating.

Credit monitoring

The Group regularly monitors credit exposures and external trends which may impact risk management outcomes.

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

In Wholesale Banking, accounts or portfolios are placed on Early Alert when they display signs of weakness or financial deterioration, for example where there is a decline in the customer's position within the industry, a breach of covenants, non-performance of an obligation, or there are issues relating to ownership or management.

Such accounts and portfolios are subjected to a dedicated process overseen by Group Special Assets Management ('GSAM'), the specialist recovery unit. Account plans are re-evaluated and remedial actions are agreed and monitored. Remedial actions include, but are not limited to, exposure reduction, security enhancement, exit of the account or immediate movement of the account into the control of GSAM.

In Consumer Banking, portfolio delinquency trends are monitored continuously at a detailed level. Individual customer behaviour is also tracked and informs lending decisions. Accounts which are past due are subject to a collections process, managed independently by the Risk function. Charged-off accounts are managed by a specialist recovery team. In some countries, aspects of collections and recovery functions are outsourced. Medium Enterprise and Private Banking past due accounts are managed by GSAM.

The SME business is managed within Consumer Banking in two distinct segments: Small Businesses, and Medium Enterprises, differentiated by the annual turnover of the counterparty. Medium Enterprise accounts are monitored in line with Wholesale Banking procedures, while Small Business accounts are monitored in line with other Consumer Banking accounts.

Credit mitigation

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

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

Collateral is valued in accordance with the SCB Group's risk mitigation policy, which prescribes the frequency of valuation for different collateral types. The valuation frequency is driven by the level of price volatility of each type of collateral and the nature of the underlying product or risk exposure. Collateral held against impaired loans is maintained at fair value.

Traded Products

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

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

For derivative contracts, the Group limits its exposure to credit losses in the event of default by entering into master netting agreements with certain counterparties. As required by IAS 32, exposures are not presented net in the financial statements as in the ordinary course of business they are not intended to be settled net.

In addition, the Group enters into Credit Support Annexes ('CSA') with counterparties where collateral is deemed a necessary or desirable mitigant to the exposure. Under a variation margin process, additional collateral is called from the counterparty if total uncollateralised mark-to-market exposure exceeds the threshold and minimum transfer amount specified in the CSA.

Maximum exposure to credit risk

The maximum exposures to credit risk of balance sheet and off-balance sheet financial instruments, before taking account of any collateral or other credit enhancements, are as follows:

Consolidated

	2008 HK\$'M	2007 HK\$'M
Balances with banks and other financial institutions	14,008	6,974
Placements with banks and other financial institutions	136,463	114,724
Hong Kong SAR Government certificates of indebtedness	24,001	22,321
Trading assets	17,241	24,616
Advances to customers	213,539	179,380
Amounts due from immediate holding company	60,996	53,331
Amounts due from fellow subsidiaries	25,278	20,126
Investment securities	90,501	45,023
Other assets	7,688	8,858
Financial guarantees and other credit related contingent liabilities	67,539	42,339
Loan commitments and other credit related commitments	16,348	13,763
	<u>673,602</u>	<u>531,455</u>

Bank

	2008 HK\$'M	2007 HK\$'M
Balances with banks and other financial institutions	13,950	6,974
Placements with banks and other financial institutions	136,463	114,722
Hong Kong SAR Government certificates of indebtedness	24,001	22,321
Trading assets	17,241	24,616
Advances to customers	213,539	179,380
Amounts due from immediate holding company	60,969	53,330
Amounts due from fellow subsidiaries	24,061	20,118
Amounts due from subsidiaries of the Bank	1,855	759
Investment securities	89,774	43,087
Other assets	7,438	8,843
Financial guarantees and other credit related contingent liabilities	67,539	42,339
Loan commitments and other credit related commitments	16,348	13,763
	<u>673,178</u>	<u>530,252</u>

For on-balance sheet instruments, the maximum exposure to credit risk is the carrying amount reported on the balance sheet. For off-balance sheet instruments, the maximum exposure to credit risk represents the contractual nominal amounts.

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

	2008		2007	
	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M
Loans and advances				
– neither past due nor impaired	210,312	136,288	175,819	114,724
– past due but not impaired	2,998	–	3,301	–
– impaired, net of individually assessed impairment charges	660	175	588	–
Less: collectively assessed impairment charges	(431)	–	(328)	–
	<u>213,539</u>	<u>136,463</u>	<u>179,380</u>	<u>114,724</u>
Fair value of collateral held against:				
– impaired advances	160	–	240	–
– past due but not impaired advances	1,900	–	2,282	–

Bank

	2008		2007	
	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M	<i>Advances to customers</i> HK\$'M	<i>Advances to banks</i> HK\$'M
Loans and advances				
– neither past due nor impaired	210,312	136,288	175,819	114,722
– past due but not impaired	2,998	–	3,301	–
– impaired, net of individually assessed impairment charges	660	175	588	–
Less: collectively assessed impairment charges	(431)	–	(328)	–
	<u>213,539</u>	<u>136,463</u>	<u>179,380</u>	<u>114,722</u>
Fair value of collateral held against:				
– impaired advances	160	–	240	–
– past due but not impaired advances	1,900	–	2,282	–

The following tables set out an analysis of the internal credit gradings for advances which are not past due and for which no individual impairment provision has been raised. The credit gradings set out in the tables below are based on a probability of default measure as set out on page 59.

Consolidated

	2008		2007	
	Advances to customers	Advances to banks	Advances to customers	Advances to banks
	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Credit grades:				
1 to 5	127,782	133,976	108,138	112,070
6 to 8	49,550	2,301	42,018	2,654
9 to 11	31,822	11	25,316	–
12	1,158	–	347	–
	<u>210,312</u>	<u>136,288</u>	<u>175,819</u>	<u>114,724</u>

Bank

	2008		2007	
	Advances to customers	Advances to banks	Advances to customers	Advances to banks
	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Credit grades:				
1 to 5	127,782	133,976	108,138	112,070
6 to 8	49,550	2,301	42,018	2,652
9 to 11	31,822	11	25,316	–
12	1,158	–	347	–
	<u>210,312</u>	<u>136,288</u>	<u>175,819</u>	<u>114,722</u>

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

Consolidated

	2008		2007	
	Advances to customers	Advances to banks	Advances to customers	Advances to banks
	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Past due				
– up to 30 days	2,508	–	2,867	–
– 31-60 days	286	–	277	–
– 61-90 days	101	–	96	–
– 91-120 days	73	–	25	–
– 121-150 days	30	–	36	–
	<u>2,998</u>	<u>–</u>	<u>3,291</u>	<u>–</u>

Bank

	2008		2007	
	Advances to customers	Advances to banks	Advances to customers	Advances to banks
	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Past due				
– up to 30 days	2,508	–	2,867	–
– 31-60 days	286	–	277	–
– 61-90 days	101	–	96	–
– 91-120 days	73	–	25	–
– 121-150 days	30	–	36	–
	<u>2,998</u>	<u>–</u>	<u>3,291</u>	<u>–</u>

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

Consolidated

	2008			
	Treasury bills	Debt securities	Equity shares	Total
	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Impaired securities	–	33	22	55
Impairment provisions	–	(33)	(17)	(50)
Net impaired securities	–	–	5	5
Securities neither past due nor impaired	32,212	76,916	259	109,387
	2007			
	Treasury bills	Debt securities	Equity shares	Total
	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Impaired securities	–	43	6	49
Impairment provisions	–	(43)	(5)	(48)
Net impaired securities	–	–	1	1
Securities neither past due nor impaired	24,246	47,406	2,154	73,806

Bank

	2008			
	Treasury bills	Debt securities	Equity shares	Total
	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Impaired securities	–	33	22	55
Impairment provisions	–	(33)	(17)	(50)
Net impaired securities	–	–	5	5
Securities neither past due nor impaired	32,212	77,185	259	109,656
	2007			
	Treasury bills	Debt securities	Equity shares	Total
	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Impaired securities	–	43	6	49
Impairment provisions	–	(43)	(5)	(48)
Net impaired securities	–	–	1	1
Securities neither past due nor impaired	24,246	47,169	455	71,870

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

Consolidated

	2008		2007	
	Treasury bills	Debt securities	Treasury bills	Debt securities
	HK\$'M	HK\$'M	HK\$'M	HK\$'M
AAA	–	5,822	–	6,643
AA - to AA +	32,212	56,951	24,246	28,365
A - to A +	–	4,743	–	8,025
Lower than A-	–	504	–	2,057
Unrated	–	8,896	–	2,316
	<u>32,212</u>	<u>76,916</u>	<u>24,246</u>	<u>47,406</u>

Bank

	2008		2007	
	Treasury bills	Debt securities	Treasury bills	Debt securities
	HK\$'M	HK\$'M	HK\$'M	HK\$'M
AAA	–	5,822	–	6,643
AA - to AA +	32,212	56,951	24,246	28,365
A - to A +	–	4,743	–	8,025
Lower than A-	–	504	–	2,034
Unrated	–	9,165	–	2,102
	<u>32,212</u>	<u>77,185</u>	<u>24,246</u>	<u>47,169</u>

Reposessed Collateral

During the year, the Bank obtained assets by taking possession of collateral held as security, as follows:

	<i>Consolidated and Bank</i>	
	2008 HK\$'M	2007 HK\$'M
Property, plant and equipment	51	27
Others	–	–
	<u>51</u>	<u>27</u>

As at 31 December 2008, the reposessed assets amounted to HK\$7 million (2007: HK\$7 million).

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

Renegotiated loans

There were no renegotiated loans and advances to banks which were neither past due nor impaired (2007: HK\$ Nil).

Renegotiated advances to customers which were neither past due nor impaired amounted to HK\$106 million (2007: HK\$386 million).

(b) Market risk management**Market risk**

The Bank recognises market risk as the risk of loss resulting from changes in market prices and rates. The Bank is exposed to market risk arising principally from customer driven transactions. The objective of the Bank's market risk policies and processes is to obtain the best balance of risk and return whilst meeting customers' requirements.

The Bank transacts in the money market, foreign exchange markets and capital markets giving rise to market risk exposures. Financial instruments transacted include debt and other securities and certain derivative financial instruments. Derivative instruments are contracts whose characteristics and value are derived from underlying financial instruments, interest and exchange rates or indices. They include futures, forwards, swaps, and options transactions in the foreign exchange and interest rate markets. Derivative contracts entered into by the Bank are primarily over-the-counter derivatives.

The Bank has established market risk management policies and framework, including limits setting, monitoring and reporting and control procedures, which are reviewed regularly by the Risk Committee. Market risk limits are proposed by the business within the terms of agreed policy. Market Risk department 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 Value at Risk ("VaR") as risk management tools. For example, interest rate sensitivity is measured in terms of exposure to a one basis point increase in yields.

Value at risk

VaR, in general, is a quantitative measure of market risk which applies recent historic 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 of the Bank is calculated for expected movements over one business day and to a confidence level of 97.5 per cent. This confidence level suggests that potential daily losses, in excess of the VaR measure, are likely to be experienced six times per year.

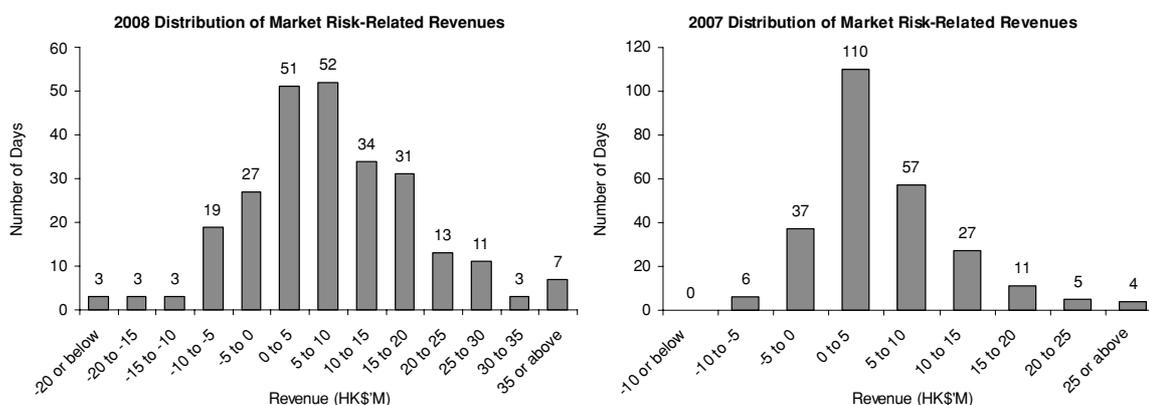
The Bank uses historic simulation as its VaR methodology with an observation period of one year. Historic simulation involves the revaluation of all unmatured contracts to reflect the effect of historically observed changes in market risk factors on the valuation of the current portfolio.

Stress testing

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

VaR is complemented by regular stress testing of market risk exposures to highlight potential risk that may arise from extreme market events that are rare but plausible. Stress testing is an integral part of the market risk management framework and considers both historical market events and forward looking scenarios. A consistent stress testing methodology is applied to trading and non-trading books.

Stress scenarios are regularly updated to reflect changes in risk profile and economic events. The Risk Committee reviews stress test results on a regular basis. The stress testing methodology assumes that scope for management action would be limited during a stress event, reflecting the decrease in liquidity that often occurs. Ad hoc scenarios are also prepared reflecting specific market conditions and for particular concentrations of risk that arise within the business.



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

Value at risk (HK\$'M):

	2008				2007			
	Average	High	Low	Actual [^]	Average	High	Low	Actual [^]
Interest rate risk	45.9	64.7	33.8	47.9	29.1	36.8	24.3	35.4
Foreign exchange risk	1.5	3.8	0.2	0.6	1.1	3.5	0.2	0.9
Total*	45.6	63.9	34.0	48.1	29.2	37.1	24.4	35.5

Trading (VaR at 97.5%, 1 day)

Value at risk (HK\$'M):

	2008				2007			
	Average	High	Low	Actual [^]	Average	High	Low	Actual [^]
Interest rate risk	8.0	14.9	3.0	9.5	10.7	15.5	5.7	8.1
Foreign exchange risk	1.5	3.8	0.2	0.6	1.1	3.5	0.2	0.9
Total *	8.0	14.4	3.3	8.4	10.7	16.0	5.5	8.2

* The total VaR shown in the table above is not a sum of the component risks due to offsets between them.

[^] This represents the actual one day VaR as at 31 December.

The highest and lowest VaR are independent and could have occurred on different days.

	2008 HK\$'M	2007 HK\$'M
<i>The average daily income earned from market risk related activities is as follows:</i>		
Interest rate risk	1.2	0.9
Foreign exchange risk	7.7	4.5
Total	<u>8.9</u>	<u>5.4</u>

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

<i>Value at risk (HK\$'M):</i>	2008				2007			
	<i>Average</i>	<i>High</i>	<i>Low</i>	<i>Actual [^]</i>	<i>Average</i>	<i>High</i>	<i>Low</i>	<i>Actual [^]</i>
Interest rate risk	<u>40.1</u>	<u>62.4</u>	<u>24.9</u>	<u>46.0</u>	<u>20.4</u>	<u>25.7</u>	<u>17.4</u>	<u>25.7</u>

[^] This represents the actual one day VaR as at 31 December.

	2008 HK\$'M	2007 HK\$'M
<i>The average daily income earned from non-trading market risk related activities is as follows:</i>		
Interest rate risk	<u>3.8</u>	<u>2.1</u>

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

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

Structural foreign exchange risks are not included within the VaR and arise from net investments in non-HKD currency entities. These are managed separately under the ALCO by Group Treasury.

(c) Foreign exchange risk

The Bank's foreign exchange positions arise from foreign exchange trading and commercial banking operations. Foreign exchange trading exposures are principally derived from customer driven transactions. Market Risk department approves foreign exchange limits within delegated authorities and monitors exposures against these limits. The Bank's application in using VaR methodology for measuring and monitoring foreign exchange risk is discussed under "Market Risk".

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

	2008 HK\$'M	2007 HK\$'M
US dollars exposure		
Spot assets	209,139	158,055
Spot liabilities	(179,746)	(124,741)
Forward purchases	206,303	229,941
Forward sales	(236,755)	(263,945)
	<u>(1,059)</u>	<u>(690)</u>
Net short non-structural position	<u>(1,059)</u>	<u>(690)</u>
Pound sterling exposure		
Spot assets	10,650	4,199
Spot liabilities	(5,610)	(4,009)
Forward purchases	956	1,093
Forward sales	(5,844)	(1,215)
	<u>152</u>	<u>68</u>
Net long non-structural position	<u>152</u>	<u>68</u>
Australian dollars exposure		
Spot assets	14,864	12,009
Spot liabilities	(14,485)	(11,867)
Forward purchases	2,113	6,214
Forward sales	(2,349)	(6,360)
	<u>143</u>	<u>(4)</u>
Net long/(short) non-structural position	<u>143</u>	<u>(4)</u>
New Zealand dollars exposure		
Spot assets	5,419	1,592
Spot liabilities	(4,331)	(1,706)
Forward purchases	498	857
Forward sales	(1,446)	(682)
	<u>140</u>	<u>61</u>
Net long non-structural position	<u>140</u>	<u>61</u>

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

	2008 HK\$'M	2007 HK\$'M
Chinese Renminbi	960	960
United Arab Emirates Dirham	478	488
Vietnamese Dong	2,063	1,324
	<u>3,501</u>	<u>2,772</u>

(d) Interest rate risk

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

The Bank has established principles, policies and techniques for managing interest rate risk. Interest rate risk management is governed by the ALCO. The Bank's application in using VaR methodology for measuring and monitoring interest rate risk is discussed under "Market Risk".

(e) Liquidity risk

The Bank defines liquidity risk as the risk that it either does not have sufficient financial resources available to meet all its obligations and commitments as they fall due, or can only secure them at excessive cost.

The Bank has established standards, principles, policies and techniques for managing liquidity risk. Liquidity risk management is governed by the ALCO. It is the policy of the Bank to maintain adequate liquidity at all times and hence to be in a position to meet all obligations as they fall due. The tools used for the management of liquidity risk range from key balance sheet ratios and medium-term funding requirements for ensuring balance sheets are not developing structural imbalances, to short term cash flow limits, controls on borrowing in the wholesale markets and guidelines on commitments. They are supplemented by the establishment of regular stress test on liquidity positions and a liquidity crisis contingency plan.

The Bank has significant levels of marketable securities, principally government securities and bank paper, which can be realised in the event that there is a need for liquidity in a crisis. The Bank also prescribes a liquidity stress scenario that assumes accelerated withdrawal of deposits over a period of time and needs to ensure that cash inflows exceed outflows under such scenario. The liquidity crisis management plan lays out trigger points and actions in the event of a liquidity crisis to ensure that there is an effective response by senior management in case of such an event.

Financial Markets is responsible for the day-to-day management of all the liquidity risk in the Bank, executing liquidity directives and operating within the liquidity policy and approved limits. Liquidity risk management is centralised in Financial Markets and liquidity profile of the products is transferred to Financial Markets at an appropriate price by means of the funds transfer pricing mechanism. Liquidity limits are regularly monitored by a Market Risk function that is independent from the business. Liquidity profiles are reviewed by the ALCO on a regular basis.

Customer deposits form a significant part of the Bank's overall funding. Its composition has remained relatively diversified and stable. The ALCO monitors trends in the balance sheet and ensures that any concerns that might impact the stability of these deposits are addressed effectively. The ALCO also reviews balance sheet plans to ensure that asset growth plans are matched by growth in the stable funding base. Moreover, professional markets are accessed for the purposes of providing additional funding, maintaining a presence in local money markets and optimising asset and liability maturities.

(i) Analysis of assets and liabilities by remaining maturity

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

Consolidated

	2008							Total HK\$'M
	Repayable on demand HK\$'M	Due within 1 month HK\$'M	Due between 1 month to 3 months HK\$'M	Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M	Undated HK\$'M	
Assets								
Cash and balances with banks and other financial institutions	15,378	-	-	-	-	-	-	15,378
Placements with banks and other financial institutions	235	58,782	26,938	49,681	829	-	(2)	136,463
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	24,001	24,001
Trading assets	-	2,495	6,664	2,322	4,346	1,414	-	17,241
Advances to customers	7,286	29,293	20,595	25,815	61,041	71,216	(1,707)	213,539
Investment securities	727	13,332	22,140	39,996	13,878	197	231	90,501
Amounts due from group companies	1,438	25,793	44,000	4,218	7,194	3,631	-	86,274
Others	105	1,906	4,959	796	172	-	7,336	15,274
Total Assets	25,169	131,601	125,296	122,828	87,460	76,458	29,859	598,671
Liabilities								
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	24,001	24,001
Deposits and balances of banks and other financial institutions	5,409	1,106	162	237	-	-	-	6,914
Deposits from customers	240,867	164,746	52,239	18,930	14	-	-	476,796
Trading liabilities	-	15,485	77	58	-	-	-	15,620
Financial liabilities designated at fair value	-	681	641	2,218	1,571	195	-	5,306
Debt securities in issue	-	1,203	770	1,437	10	-	-	3,420
Amounts due to group companies	1,862	1,453	5,437	1,975	327	934	-	11,988
Subordinated liabilities	-	-	-	-	-	6,180	-	6,180
Others	5,613	1,258	4,721	2,849	101	8	457	15,007
Total Liabilities	253,751	185,932	64,047	27,704	2,023	7,317	24,458	565,232

Consolidated

	2007							Total HK\$'M
	Repayable on demand HK\$'M	Due within 1 month HK\$'M	Due between 1 month to 3 months HK\$'M	Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M	Undated HK\$'M	
Assets								
Cash and balances with banks and other financial institutions	8,216	-	-	-	-	-	-	8,216
Placements with banks and other financial institutions	87	89,650	19,781	5,088	118	-	-	114,724
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	22,321	22,321
Trading assets	-	1,148	6,474	9,913	5,988	1,093	-	24,616
Advances to customers	6,108	38,801	21,994	17,293	31,490	64,600	(906)	179,380
Investment securities	409	7,010	9,983	18,779	6,687	-	2,155	45,023
Amounts due from group companies	7,453	20,717	28,405	10,401	3,879	2,602	-	73,457
Others	88	6,161	1,816	298	172	-	5,454	13,989
Total Assets	22,361	163,487	88,453	61,772	48,334	68,295	29,024	481,726
Liabilities								
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	22,321	22,321
Deposits and balances of banks and other financial institutions	8,450	287	9	-	-	-	-	8,746
Deposits from customers	200,140	15,134	143,854	6,696	51	-	-	365,875
Trading liabilities	-	16,047	37	401	39	12	-	16,536
Financial liabilities designated at fair value	-	723	799	1,012	1,700	205	-	4,439
Debt securities in issue	-	-	210	1,138	30	30	-	1,408
Amounts due to group companies	3,051	5,375	41	64	278	908	-	9,717
Subordinated liabilities	-	-	-	-	-	6,234	-	6,234
Others	5,760	5,699	1,047	873	468	-	2,577	16,424
Total Liabilities	217,401	43,265	145,997	10,184	2,566	7,389	24,898	451,700

Bank

	2008							Total HK\$'M
	Repayable on demand HK\$'M	Due within 1 month HK\$'M	Due between 1 month to 3 months HK\$'M	Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M	Undated HK\$'M	
Assets								
Cash and balances with banks and other financial institutions	15,320	–	–	–	–	–	–	15,320
Placements with banks and other financial institutions	235	58,782	26,938	49,681	829	–	(2)	136,463
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	–	24,001	24,001
Trading assets	–	2,495	6,664	2,322	4,346	1,414	–	17,241
Advances to customers	7,286	29,293	20,595	25,815	61,041	71,216	(1,707)	213,539
Investment securities	–	13,332	22,140	39,996	13,878	197	231	89,774
Amounts due from group companies	1,438	25,793	44,779	4,218	8,190	2,467	–	86,885
Others	105	1,906	4,863	643	172	–	6,943	14,632
Total Assets	24,384	131,601	125,979	122,675	88,456	75,294	29,466	597,855
Liabilities								
Hong Kong SAR currency notes in circulation	–	–	–	–	–	–	24,001	24,001
Deposits and balances of banks and other financial institutions	5,409	1,106	162	237	–	–	–	6,914
Deposits from customers	240,867	164,746	52,239	18,930	14	–	–	476,796
Trading liabilities	–	15,485	77	58	–	–	–	15,620
Financial liabilities designated at fair value	–	681	641	2,218	1,571	195	–	5,306
Debt securities in issue	–	1,203	770	1,437	10	–	–	3,420
Amounts due to group companies	1,897	1,414	5,390	1,897	180	934	–	11,712
Subordinated liabilities	–	–	–	–	–	6,180	–	6,180
Others	5,613	1,254	4,721	2,635	8	–	447	14,678
Total Liabilities	253,786	185,889	64,000	27,412	1,783	7,309	24,448	564,627

Bank

	2007							Total HK\$'M
	Repayable on demand HK\$'M	Due within 1 month HK\$'M	Due between 1 month to 3 months HK\$'M	Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M	Undated HK\$'M	
Assets								
Cash and balances with banks and other financial institutions	8,193	-	-	-	-	-	-	8,193
Placements with banks and other financial institutions	85	89,650	19,781	5,088	118	-	-	114,722
Hong Kong SAR Government certificates of indebtedness	-	-	-	-	-	-	22,321	22,321
Trading assets	-	1,148	6,474	9,913	5,988	1,093	-	24,616
Advances to customers	6,108	38,801	21,994	17,293	31,490	64,600	(906)	179,380
Investment securities	409	7,010	9,960	18,779	6,473	-	456	43,087
Amounts due from group companies	7,506	20,717	28,405	11,098	3,879	2,602	-	74,207
Others	88	6,157	1,839	293	145	-	5,639	14,161
Total Assets	22,389	163,483	88,453	62,464	48,093	68,295	27,510	480,687
Liabilities								
Hong Kong SAR currency notes in circulation	-	-	-	-	-	-	22,321	22,321
Deposits and balances of banks and other financial institutions	8,450	287	9	-	-	-	-	8,746
Deposits from customers	200,140	15,134	143,854	6,696	51	-	-	365,875
Trading liabilities	-	16,047	37	401	39	12	-	16,536
Financial liabilities designated at fair value	-	723	799	1,012	1,700	205	-	4,439
Debt securities in issue	-	-	210	1,138	30	30	-	1,408
Amounts due to group companies	3,373	5,375	41	64	278	892	-	10,023
Subordinated liabilities	-	-	-	-	-	6,234	-	6,234
Others	5,760	5,679	1,047	874	70	-	2,558	15,988
Total Liabilities	217,723	43,245	145,997	10,185	2,168	7,373	24,879	451,570

Bank

	2008						
	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	Total HK\$'M
Deposits and balances of banks and other financial institutions	5,409	1,272	246	–	–	–	6,927
Deposits from customers	240,892	217,326	19,147	14	–	–	477,379
Trading liabilities	6	292,291	162,356	1,332	8	–	455,993
Financial liabilities designated at fair value	–	1,304	2,168	1,568	154	–	5,194
Debt securities in issue	–	1,988	1,463	12	–	–	3,463
Amounts due to group companies	1,897	5,611	1,436	55	1,550	–	10,549
Subordinated liabilities	–	34	237	1,256	6,857	–	8,384
Others	5,613	5,307	2,725	–	–	24,448	38,093
	<u>253,817</u>	<u>525,133</u>	<u>189,778</u>	<u>4,237</u>	<u>8,569</u>	<u>24,448</u>	<u>1,005,982</u>
	2007						
Deposits and balances of banks and other financial institutions	9,134	6,893	12	–	–	–	16,039
Deposits from customers	199,456	153,281	6,836	52	–	–	359,625
Trading liabilities	6	313,949	199,355	11,816	11	–	525,137
Financial liabilities designated at fair value	–	1,535	1,036	1,784	266	–	4,621
Debt securities in issue	–	225	1,159	37	1,592	–	3,013
Amounts due to group companies	3,347	3,983	49	300	23	–	7,702
Subordinated liabilities	–	40	256	1,362	7,326	–	8,984
Others	5,760	6,747	874	69	–	24,173	37,623
	<u>217,703</u>	<u>486,653</u>	<u>209,577</u>	<u>15,420</u>	<u>9,218</u>	<u>24,173</u>	<u>962,744</u>

(f) Operational risk

Operational risk is the risk of direct or indirect loss due to an event or action resulting from the failure of internal processes, people, and systems, or from external events. The Bank seeks to ensure that key operational risks are managed in a timely and effective manner through a framework of policies, procedures and tools to identify, assess, monitor, control, and report such risks.

The Country Operational Risk Group (“CORG”) has been established to supervise and direct the management of operational risks across the Bank. CORG is also responsible for ensuring adequate and appropriate policies and procedures are in place for the identification, assessment, monitoring, control and reporting of operational risks.

An operational risk function, independent from the businesses is responsible for establishing and maintaining the overall operational risk framework, and for monitoring the Bank’s key operational risk exposures. This unit is supported by Wholesale Banking and Consumer Banking Operational Risk units. These units are responsible for ensuring compliance with policies and procedures in the business, monitoring key operational risk exposures, and the provision of guidance to the respective business areas on operational risk.

Compliance with operational risk policies and procedures is the responsibility of all managers. The CORG has in-country governance responsibility for ensuring that an appropriate and robust risk management framework is in place to monitor and manage operational risk.

(g) Capital management

The HKMA sets and monitors capital requirements for the Bank and certain of its subsidiaries specified by the HKMA. In implementing current capital requirements, the HKMA requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. The Bank calculated its consolidated capital adequacy ratios as at 31 December 2008 in accordance with the Banking (Capital) Rules of the Hong Kong Banking Ordinance which became effective on 1 January 2007.

In addition to meeting the regulatory requirements, the Bank'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 Bank actively and regularly reviews and manages its capital structure to maintain a balance between the higher shareholder returns that might otherwise be possible with greater gearing and the advantages and security afforded by a sound capital position, and makes adjustments to the capital structure in light of changes in economic conditions.

The process of allocating capital to specific operations and activities is undertaken by the Asset and Liability Committee and is reviewed regularly by the Board of Directors.

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

The Bank and its individually regulated subsidiary have complied with all externally imposed capital requirements throughout the years ended 31 December 2008 and 2007.

For the capital ratios as at 31 December 2007, the Bank used the basic approach and standardized (securitization) approach to calculate its credit risk for non-securitization exposures and credit risk for securitization exposures respectively.

For the capital ratios as at 31 December 2008, the Bank uses the advanced internal ratings-based approach and standardized approach to calculate its credit risk for non-securitization exposures. The Bank adopts the internal ratings-based (securitization) approach to calculate its credit risk for securitization exposures.

For the calculation of its capital charge for market risk, the Bank uses an internal models approach for two guaranteed funds and the standardized (market risk) approach for other exposures. In addition, the Bank adopts the standardized (operational risk) approach for operational risk. This was unchanged from 2007.

As there are significant differences between the approaches to calculate credit risk in 2008 and 2007, the capital adequacy ratios are not directly comparable.

The Bank's consolidated capital as at 31 December 2008 consists of core capital after deductions of HK\$27,208 million (2007: HK\$25,794 million) and supplementary capital after deductions of HK\$3,099 million (2007: HK\$6,567 million). Supplementary capital includes subordinated debt, available-for-sale investment reserve and collective impairment allowances for impaired assets.

37 Fair value information

(a) Fair value

All financial instruments are stated at fair value or carried at amounts not materially different from their fair values as at 31 December 2008 and 2007.

(b) Estimation of fair values

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

Cash and balances with banks and other financial institutions

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

Placements with banks and other financial institutions

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

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. Expected cash flows are discounted at current market rates to determine fair value.

Investment securities

Investment securities with observable market prices, including debt and equity securities, are fair valued using that information. Debt securities that do not have observable market data are fair valued by either discounting cash flows using the prevailing market rates for debts with a similar credit risk and remaining maturity, or using quoted market prices for securities with similar credit, maturity and yield characteristics.

Deposits by banks 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 discounting 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 related yield curve appropriate for the remaining term to maturity.

38 Assets pledged as security for liabilities

The Bank maintains pledged cash and securities accounts with financial institutions to secure any borrowings or other obligations resulting from the Bank's use of clearing systems and to cover short positions. As at 31 December 2008, the Bank did not have borrowings due to the financial institutions and had securities amounting to HK\$15,389 million (2007: HK\$16,047 million) to cover short positions.

39 Material related party transactions

In addition to the transactions and balances disclosed elsewhere in these financial statements, the Bank and its subsidiaries entered into the following material related party transactions. The transactions of the Bank are materially the same as for those appearing in the consolidated financial statements in 2008 and 2007.

(a) Key management personnel remuneration

Remuneration for key management personnel, including amounts paid to the Bank's directors as disclosed in note 7 is as follows:

	<i>Consolidated</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Short-term employee benefits	101	69
Post-employment benefits	5	4
Equity compensation benefits	26	18
	<u>132</u>	<u>91</u>

Total remuneration is included in staff costs (see note 3(g)).

(b) Credit facilities and loans to key management personnel

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

	<i>Consolidated</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Loan balances:		
At 1 January	<u>341</u>	<u>1,391</u>
At 31 December	<u>853</u>	<u>341</u>
Average balance during the year	<u>802</u>	<u>870</u>
Income earned	<u>21</u>	<u>38</u>

(c) Share based payments

The Standard Chartered PLC Group (the "Group") operates a number of share based payment schemes for its directors and employees.

1997/2006 Restricted Share Scheme

The Group operates a discretionary Restricted Share Scheme for high performing and high potential staff at any level of the organisation whom the Group wishes to motivate and retain. Except upon appointment when an executive director may be granted an award of restricted shares, the Restricted Share Scheme is not applicable to executive directors, as it has no performance conditions attached to it. Fifty per cent of the award vests two years after the date of grant and the balance after three years. The awards can be exercised within seven years of the grant date. The value of shares awarded in any year to any individual may not exceed two times their base salary.

2000 Executive Share Option Scheme

The 2000 scheme is designed to be internationally competitive and focus executive directors and their senior management teams on delivering long-term performance. An EPS performance criterion needs to 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.

2001 Performance Share Plan

The Performance Share Plan is designed to be an intrinsic part of total remuneration for the Group's executive directors and for a small number of the Group's most senior executives. It is an internationally competitive long-term incentive plan that focuses executives on meeting and exceeding the long-term performance targets of the Group. Awards of nil price options to acquire shares are granted to the executives and will normally be exercisable between three and ten years after the date of grant if the individual is still employed by the Group. There is provision for earlier exercise in certain limited circumstances.

All Employee Sharesave Schemes

Under the Sharesave schemes, employees have the choice of opening a three-year or five-year savings contract. Within a period of six months after the third or fifth anniversary, 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 all the employee sharesave schemes.

2007 Supplementary Restricted Share Scheme

The Group operates a Supplementary Restricted Share Scheme which can be used to defer part of an employee's annual bonus in shares. The plan is principally used for employees in the global markets area and is similar to the Restricted Share Scheme outlined above except for three important factors: executive directors are specifically prohibited from the plan; no new shares can be issued to satisfy awards; and there is no individual annual limit.

2004 Deferred Bonus Plan

Under the 2004 Deferred Bonus Plan, shares are conditionally awarded instead of all or part of the executive directors' and certain senior executives' annual cash bonus.

1994 Executive Share Option Scheme (closed)

No awards have been made under this scheme since August 1999 as the scheme was replaced by the 2000 Executive Share Option Scheme. Executive share options to purchase ordinary shares in the Group are exercisable after the third, but before the tenth anniversary of the date of grant. The exercise price is the share price at the date of grant and options can only be exercised if EPS increases by at least 15 per cent over three consecutive years.

2000 Executive Share Option Scheme

No options under the 2000 Executive Share Option Scheme were granted in 2008 and 2007.

A reconciliation of option movements for the year ended 31 December 2008 is shown below:

	2008		2007	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	1,504,950	£8.09	2,919,609	£8.22
Additional shares for rights issue*	187,245	£7.14	—	—
Lapsed	(3,348)	£6.91	(193,045)	£7.20
Exercised	(186,999)	£7.60	(1,221,614)	£8.54
Outstanding at 31 December	1,501,848	£7.14	1,504,950	£8.09
Exercisable at 31 December	1,501,848	£7.14	1,504,950	£8.09

* For grants awarded prior to the announcement of the rights issue on 24 November 2008 which have not been exercised, the number of shares granted have been increased by 14.2 per cent and the exercise prices have been decreased accordingly to ensure option holders were compensated for the dilutive impact of the rights issue.

Range of exercise price	2008			2007		
	Weighted average exercise price	No. of shares	Weighted average contractual life	Weighted average exercise price	No. of shares	Weighted average contractual life
£6.905/£10.395	£7.14	1,501,848	3.5 years	£8.09	1,504,950	4.5 years

2001 Performance Share Plan**Valuation**

For awards, the fair value is based on the market value less an adjustment to take into account the expected dividends over the vesting period.

Grant Date	2008			2007	
	16 September	24 April	11 March	17 September	12 March
Share price at grant date	£13.86	£17.82	£16.26	£14.69	£14.51
Shares granted	14,196	2,824	180,144	34,805	202,247
Vesting period (years)	3	3	3	3	3
Expected dividends (yield) (%)	2.6	2.6	2.6	2.9	2.8
Fair value (EPS) (£)	12.83	16.50	15.06	6.74	6.68
Fair value (TSR) (£)	5.04	6.49	5.89	2.92	2.89

The expected dividend yield is based on the historical dividend yield over the last three years or the three years prior to grant. The EPS and TSR fair value relates to certain performance criteria to be satisfied. The TSR fair value is derived by discounting 50 per cent of the award which is subject to the TSR condition by the loss of expected dividends over the performance period, and the likelihood of meeting the TSR condition which is calculated by the area under the TSR vesting schedule curve. The EPS fair value is derived by discounting 50 per cent of the award by the loss of expected dividends over the performance period and is adjusted for actual performance as appropriate.

A reconciliation of movements for the year ended 31 December 2008 is shown below:

	2008		2007	
	No. of shares		No. of shares	
Outstanding at 1 January	470,761		382,618	
Granted	197,164		237,052	
Additional shares for rights issue*	83,639		–	
Lapsed	(11,536)		(48,292)	
Exercised	(69,170)		(100,617)	
Outstanding at 31 December	670,858		470,761	
Weighted average contractual life	8.25 years		8.5 years	
Exercisable at 31 December	20,470		6,763	

* For grants awarded prior to the announcement of the rights issue on 24 November 2008 which have not been exercised, the number of shares granted have been increased by 14.2 per cent to ensure option holders were compensated for the dilutive impact of the rights issue.

1997/2006 Restricted Share Scheme

Valuation

For awards, the fair value is based on the market value less an adjustment to take into account the expected dividends over the vesting period.

Grant Date	2008			2007	
	16 September	24 April	11 March	17 September	12 March
Share price at grant date	£17.82	£13.86	£16.26	£14.69	£14.51
Shares granted	29,910	39,359	159,940	64,461	291,256
Vesting period (years)	3	3	3	2/3	2/3
Expected dividends (yield) (%)	2.4	2.4	2.4	2.9	2.8
Fair value (£)	8.25	8.25	8.25	13.49	13.36

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

A reconciliation of movements for the year ended 31 December 2008 is shown below:

	2008	2007
	<i>No. of shares</i>	<i>No. of shares</i>
Outstanding at 1 January	993,893	992,302
Granted	229,209	400,757
Additional shares for rights issue*	131,875	–
Lapsed	(38,944)	(102,478)
Exercised	(258,260)	(296,688)
Outstanding at 31 December	1,057,773	993,893
Weighted average contractual life	4.71 years	4.4 years
Exercisable at 31 December	291,273	299,570

* For grants awarded prior to the announcement of the rights issue on 24 November 2008 which have not been exercised, the number of shares granted have been increased by 14.2 per cent to ensure option holders were compensated for the dilutive impact of the rights issue.

2007 Supplementary Restricted Share Scheme

Valuation

For awards, the fair value is based on the market value less an adjustment to take into account the expected dividends over the vesting period.

<i>Grant Date</i>	2008	
	<i>16 September</i>	<i>11 March</i>
Share price at grant date	£13.86	£16.26
Shares granted	31,144	182,144
Vesting period (years)	3	3
Expected dividends (yield) (%)	2.4	2.4
Fair value (£)	13.06	12.41

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

A reconciliation of movements for the year to 31 December 2008 is shown below:

	2008	
	<i>No. of shares</i>	<i>Weighted average exercise price</i>
Outstanding at 1 January	–	–
Granted	213,258	–
Additional shares for rights issue*	29,054	–
Lapsed	(7,947)	–
Exercised	(1,329)	–
Outstanding at 31 December	233,036	–
Weighted average contractual life	6.27 years	–
Exercisable at 31 December	–	–

* For grants awarded prior to the announcement of the rights issue on 24 November 2008 which have not been exercised, the number of shares granted have been increased by 14.2 per cent to ensure option holders were compensated for the dilutive impact of the rights issue.

2004 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:

Grant Date	2008	2007
	3 October	1 October
Share price at grant date	£14.52	£15.88
Exercise price	£11.62	£12.43
Shares granted	960,282	813,838
Vesting period (years)	3/5	3/5
Expected volatility (%)	40-49	21-24
Expected option life (years)	3.33-5.33	3.33/5.33
Risk free rate (%)	2.3-2.5	4.9-5.0
Expected dividends (yield) (%)	2.5-2.7	2.9-3.3
Fair value (£)	3.0	4.4-4.9

The expected volatility is based on historical volatility over the last three to five years or three to five years prior to grant. The expected life is the average expected period to exercise. The risk free rate of return is the yield on zero-coupon UK government bonds of a term consistent with the assumed option life. The expected dividend yield is based on historical dividend yield over the last three years or three years prior to grant. Where two amounts are shown for volatility, risk free rates, expected dividend yield and fair values, the first relates to a three years vesting period and the second to a five years vesting period.

A reconciliation of option movements for the year ended 31 December 2008 is shown below:

	2008		2007	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	2,170,055	£10.96	1,863,709	£9.60
Granted	960,282	£11.62	813,838	£12.43
Additional shares for rights issue*	286,044	£8.64	–	–
Lapsed	(1,053,178)	£11.62	(188,748)	£9.84
Exercised	(68,922)	£7.61	(318,744)	£7.45
Outstanding at 31 December	2,294,281	£9.66	2,170,055	£10.96
Exercisable at 31 December	583,448	£8.64	69,036	£7.43

* For grants awarded prior to the announcement of the rights issue on 24 November 2008 which have not been exercised, the number of shares granted have been increased by 14.2 per cent and the exercise prices have been decreased accordingly to ensure option holders were compensated for the dilutive impact of the rights issue.

Range of exercise price	2008			2007		
	Weighted average exercise price	No. of shares	Weighted average contractual life	Weighted average exercise price	No. of shares	Weighted average contractual life
£7.43/£12.43	£9.66	2,294,281	1.8 years	£10.96	2,170,055	2.7 years

2004 Deferred Bonus Plan

Under this plan, shares are issued directly to participants upon vesting.

A reconciliation of share movements for the year ended 31 December 2008 and 2007 is shown below:

	<u>2008</u>	<u>2007</u>
	<i>No. of shares</i>	<i>No. of shares</i>
Outstanding at 1 January	17,365	14,506
Shares vested	(16,555)	(13,194)
Shares awarded	20,622	17,476
Additional shares for rights issue*	3,053	–
Shares lapsed	–	(1,423)
Outstanding at 31 December	<u>24,485</u>	<u>17,365</u>

* For grants awarded prior to the announcement of the rights issue on 24 November 2008 which have not been exercised, the number of shares granted have been increased by 14.2 per cent to ensure option holders were compensated for the dilutive impact of the rights issue.

1994 Executive Share Option Scheme

Awards made under this scheme are not subject to the valuation criteria of HKFRS 2 as all awards were granted prior to 7 November 2002 and were all vested as at that date.

A reconciliation of option movements for the years ended 31 December 2008 and 2007 is shown below:

	<u>2008</u>		<u>2007</u>	
	<i>No. of shares</i>	<i>Weighted average exercise price</i>	<i>No. of shares</i>	<i>Weighted average exercise price</i>
Outstanding at 1 January	–	–	106,365	£8.68
Lapsed	–	–	(5,000)	£8.50
Exercised	–	–	(101,365)	£8.69
Outstanding at 31 December	–	–	–	–
Exercisable at 31 December	–	–	–	–

(d) Loans to officers

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

	<u>2008</u>	<u>2007</u>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Aggregate amount of relevant loans by the Bank outstanding at 31 December	<u>46</u>	<u>32</u>
Maximum aggregate amount of relevant loans by the Bank outstanding during the year	<u>50</u>	<u>46</u>

(e) Related party transactions with associates

During the year, the Bank and its subsidiaries entered into transactions with associates in the ordinary course of its banking business. The amounts of material transactions during the year are set out below:

	2008 HK\$'M	2007 HK\$'M
Amounts due from associates	425	–
Deposits from associates	99	–
Interest income	9	–

40 Ultimate holding company

The Bank's ultimate holding company is Standard Chartered PLC, a company registered in England and Wales. Standard Chartered PLC has dual primary listings on the London Stock Exchange and the Stock Exchange of Hong Kong.

41 Comparative figures

In 2008, all balances relating to transactions with SCB Group plc counterparties have been classified on the balance sheets in "Amounts due from/(to) immediate holding company", "Amounts due from/(to) fellow subsidiaries" and "Amounts due from/(to) subsidiaries of the Bank" as appropriate. These include debt securities issued from and to SCB Group plc counterparties and mark-to-market balances relating to derivative contracts with SCB Group plc counterparties. The corresponding amounts in the 2007 balance sheets have been reclassified to conform to the current year presentation. In 2008, deposits and balances of central banks have been classified as "Deposits from customers". An amount of HK\$7,291 million in respect of 2007 was therefore reclassified from "Deposits and balances of banks and other financial institutions" to "Deposits from customers". These reclassifications provide a better reflection of the underlying transactions.

42 Changes in accounting policies

The IASB has issued a number of new and revised IFRSs and Interpretations that are first effective for the current accounting period commencing 1 January 2008 or are available for early adoption. The equivalent new and revised HKFRSs and Interpretations consequently issued by HKICPA have the same effective date as those issued by the IASB and are in all material respects identical to the pronouncements issued by the IASB. There have been no other material changes to HKFRSs.

The Bank has adopted the amendments to HKAS 39 Financial Instruments: Recognition and Measurement and HKFRS 7 Financial Instruments: Disclosures, which was effective from 1 July 2008.

Reclassification of financial assets

The Bank has reclassified certain financial assets classified as held for trading into the available-for-sale category as these were no longer considered to be held for the purpose of selling or repurchasing in the near time. At the time of transfer, the Group identified the rare circumstances permitting such a transfer as the impact of the ongoing credit crisis in financial markets, particularly in the third quarter of 2008, which significantly impacted liquidity in certain markets. The Bank has also reclassified certain financial assets from trading to loans and receivables.

The following table provides details of the assets reclassified in 2008 as at and up to the date of reclassification:

	<i>Consolidated and Bank 2008</i>				<i>Estimated amounts of cash flows expected to be recovered HK\$'M</i>
	<i>Amount reclassified HK\$'M</i>	<i>Fair value gain/(loss) recognised in income in current year HK\$'M</i>	<i>Fair value gain recognised in income in prior year HK\$'M</i>	<i>Effective interest rate %</i>	
Reclassifications:					
From trading to available-for-sale	2,390	4	3	3.08	2,484
From trading to loans and receivables	449	(6)	–	4.59	461

The following table provides details of the reclassified assets from the date of reclassification until 31 December 2008:

	<i>Consolidated and Bank 2008</i>			
	<i>Carrying amounts at 31 December 2008 HK\$'M</i>	<i>Fair value at 31 December 2008 HK\$'M</i>	<i>Fair value gain/ (loss) which would have been recognised in income statement HK\$'M</i>	<i>Income recognised in income statement HK\$'M</i>
For assets reclassified:				
From trading to available-for-sale	1,769	1,769	16	7
From trading to loans and receivables	449	438	(11)	6

43 Significant accounting estimates and judgements

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

Pensions

Actuarial assumptions are made in valuing future pension obligations as set out in note 29 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.

Impairment of financial assets

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

44 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2008

Up to the date of issue of the financial statements, the IASB and HKICPA have issued a number of amendments, new standards and interpretations which are not yet effective for the accounting year ended 31 December 2008 and which have not been adopted in these financial statements.

These include:

- HKFRS 2 Amendment Share-based Payment Vesting Condition and Cancellations
- HKFRS 3 (Revised) Business Combinations
- HKFRS 8 Operating Segments
- HKAS 1 (Revised) Presentation of Financial Statements
- HKAS 23 (Revised) Borrowing Costs
- HKAS 27 (Revised) Consolidated and Separate Financial Statements
- HKAS 32 Amendment and HKAS 1 Amendment Puttable Financial Instruments and Obligations Arising on Liquidation
- HK(IFRIC) – Int 13 Customer Loyalty Programmes

The Bank and its subsidiaries are in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application.

So far, it has concluded that the adoption of them is unlikely to have a significant impact on the Bank and its subsidiaries' results and financial positions.

45 Post-Balance Sheet Event

On 13 November 2008, Standard Chartered Bank (Hong Kong) Limited entered into an agreement to acquire 100 per cent of Cazenove Asia Limited ("Cazenove Asia"), a leading Asian equity capital markets, corporate finance and institutional brokerage business, from JPMorgan Cazenove. The acquisition was completed on 30 January 2009 for a consideration of approximately HK\$613 million.