



Standard Chartered Bank  
(Hong Kong) Limited

Unaudited Supplementary  
Financial Information

For the year ended 31 December 2008

## Unaudited supplementary financial information

These notes are supplementary to and should be read in conjunction with the 2008 consolidated financial statements. The consolidated financial statements and this unaudited supplementary financial information (“supplementary notes”) taken together comply with the Banking (Disclosure) Rules (“Rules”) under section 60A of the Banking Ordinance.

### 1 Basis of preparation

- (i) Except where indicated otherwise, the financial information contained in these supplementary notes has been prepared on a consolidated basis in accordance with Hong Kong Financial Reporting Standards. Some parts of these supplementary notes, however, are required by the Rules to be prepared on a different basis. In such cases, the Rules require that certain information is prepared on a basis which excludes some of the subsidiaries of the Bank. Further information regarding subsidiaries that are not included in the consolidation for regulatory purposes is set out in note 2(a) the supplementary notes.
- (ii) The accounting policies applied in preparing these supplementary notes are the same as those applied in preparing the consolidated financial statements for the year ended 31 December 2008 as set out on pages 11 to 21 of the 2008 consolidated financial statements.
- (iii) Certain comparative figures have not been provided where the current year is the first year of disclosure and the provision of comparative figures is impracticable.

### 2 Capital management

#### (a) Basis of consolidation and preparation

The consolidated capital adequacy and core capital ratios were calculated in accordance with the Banking (Capital) Rules of the Hong Kong Banking Ordinance.

The basis of consolidation for calculation of the capital ratios under the Capital Rules includes the Bank’s major subsidiaries but excludes certain subsidiaries including SCL Consulting (Shanghai) Company Limited, Standard Chartered Corporate Advisory Company Limited, SCOPE International (China) Company Limited and Standard Chartered Investment Services Limited. The investment cost of these subsidiaries is therefore deducted from capital.

In 2007, the Bank adopted the basic approach to calculate its credit risk capital requirement for non-securitisation exposures and the standardised (securitisation) approach for securitisation exposures.

The Hong Kong Monetary Authority (“HKMA”) formally approved the Bank’s use of the advanced internal ratings-based (“IRB”) approaches for calculating regulatory capital in 2007. Since 1 January 2008, the Bank has been using the advanced IRB approach for the measurement of credit risk capital and management of credit risk for the majority of its portfolios and the standardised (credit risk) approach for insignificant portfolios exempted from IRB.

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

The Bank applies the Internal Capital Adequacy Assessment Process (“ICAAP”) to assess its capital demand on a current, planned and stressed basis. The assessment covers the major risks faced by the Bank, in addition to credit, market and operational risks that are covered under the minimum capital requirements. The ICAAP has been approved by the Asset and Liability Committee (“ALCO”), the Executive Committee (“EXCO”) and the Board of Directors (“the Board”).

Further information regarding capital management is set out in note 36(g) on page 78 of the 2008 consolidated financial statements.

**(b) Capital adequacy ratio and capital base**

	<i>Consolidated</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Core capital:		
Paid up ordinary share capital	97	97
Share premium	12,477	12,477
Reserves	13,306	8,157
Current year profit	5,837	7,425
Minority interests	5	–
Deduct:		
Goodwill	(729)	(611)
Other intangible assets	(206)	(172)
Deferred tax assets	(262)	(43)
	<u>30,525</u>	<u>27,330</u>
Deductions from core capital	<u>(3,317)</u>	<u>(1,536)</u>
Core capital after deductions	<u><u>27,208</u></u>	<u><u>25,794</u></u>
Supplementary capital:		
Available-for-sale investment reserve and others	115	627
Regulatory reserve	36	914
Collective impairment allowances for impaired assets	85	328
Term subordinated debt	6,180	6,234
	<u>6,416</u>	<u>8,103</u>
Deductions from supplementary capital	<u>(3,317)</u>	<u>(1,536)</u>
Supplementary capital after deductions	<u><u>3,099</u></u>	<u><u>6,567</u></u>
Total capital base before deductions	36,941	35,433
Deductions from total capital base	<u>(6,634)</u>	<u>(3,072)</u>
Total capital base	<u><u>30,307</u></u>	<u><u>32,361</u></u>
Capital adequacy ratio as at 31 December	<u>13.1%</u>	<u>13.2%</u>
Core capital ratio as at 31 December	<u>11.7%</u>	<u>10.5%</u>

**(c) Capital requirements for credit risk**

The Bank and its subsidiaries' capital requirement for credit risk is summarised as follows:

	<i>Consolidated capital requirement 2008 HK\$'M</i>
<b>Subject to IRB approach:</b>	
Corporate exposures	6,880
Sovereign exposures	44
Bank exposures	1,780
Residential mortgages to individuals and property-holding shell companies	782
Qualifying revolving retail exposures	1,327
Other retail exposures to individuals	454
Other exposures	809
Securitisation positions	17
Equity exposures	—
<b>Total capital requirement for credit risk under IRB approach</b>	<u>12,093</u>
<b>Subject to standardised approach:</b>	
Sovereign exposures	—
Public sector entity exposures	—
Multilateral development bank exposures	—
Bank exposures	11
Securities firm exposures	—
Corporate exposures	692
Collective investment scheme exposures	—
Cash items	—
Regulatory retail exposures	274
Residential mortgage loans	251
Other exposures which are not past due	214
Past due exposures	224
<b>Total capital requirement for credit risk under standardised approach</b>	<u>1,666</u>
<b>Total capital requirement for credit risk</b>	<u><u>13,759</u></u>
	<i>Consolidated capital requirement 2007 HK\$'M</i>
Non-securitisation exposures under the basic approach	17,055
Securitisation exposures under the standardised (securitisation) approach	45
<b>Total capital requirement for credit risk</b>	<u><u>17,100</u></u>

### 3 Corporate governance

The Bank is committed to high standards of corporate governance, and has fully complied throughout the year with the guideline on “Corporate Governance of Locally Incorporated Authorised Institutions” under the Supervisory Policy Manual issued by the HKMA.

#### (a) *The Board of Directors (“the Board”)*

The Board is responsible for overseeing the management of the business and affairs of the Bank including the determination and approval of the Bank’s financial objectives and strategic plan. It oversees the Bank’s compliance with statutory and regulatory obligations, its capital and corporate structure and ensures a sound system of internal control and risk management. The Board also reviews performance in light of the Bank’s strategy, objectives, corporate and business plans and budgets and determines appropriate levels for the Bank’s capital and liquidity positions. The Board delegates day-to-day management of the Bank’s risks to a number of committees. Risk profiles and capital related matters are reviewed by the Board on a regular basis.

#### (b) *Executive Committee (“EXCO”)*

Ultimate responsibility for setting the Bank’s risk appetite and for the effective management of risk rests with the Board. Executive responsibility for risk management is delegated to the EXCO. The EXCO operates under the direct authority of the Board and meets regularly in relation to the day to day management, operation and control of the business. It also sub-delegates to various committees certain aspects of the conduct of the business as detailed below. The EXCO includes the Chief Executive Officer, the Chief Financial Officer and the heads of various business functions.

#### (c) *Asset and Liability Committee (“ALCO”)*

The ALCO, appointed by the EXCO and with authority derived from the Board, is responsible for the management of capital ratios and the establishment of, and compliance with, policies relating to balance sheet management, including management of the Bank’s liquidity, capital adequacy and structural foreign exchange and interest rate risks. The members of the ALCO include the Chief Executive Officer, the Chief Financial Officer and key business and risk management heads.

#### (d) *Risk Committee (“RC”)*

The RC, through its authority delegated by the Board, is responsible for the management of all other risks, including the establishment of, and compliance with, policies relating to credit risk, country risk, market risk, operational risk, regulatory risk and reputational risk. It also ensures that processes and procedures that are in place for monitoring and controlling risk meet the Group’s internal standards and external regulatory requirements. The Committee meets regularly and comprises the Chief Risk Officer (“CRO”), the Chief Financial Officer, heads of Credit and representatives from other relevant units. It has appointed various subcommittees to supervise and review specific areas of risk, including the Portfolio Management Committee, the Early Alert Committee, the Group Special Asset Management Committee, the Excess Approval Committee, the Country Operational Risk Group (“CORG”), the Model Assessment Committee (“MAC”) and the Stress Testing Working Group (“STWG”).

#### (e) *Audit Committee*

The Audit Committee meets regularly with Internal Audit and the external auditors to review and discuss the Bank’s internal financial controls, internal controls, compliance and risk management systems. The Committee also discusses matters raised by the internal and external auditors and ensures that audit recommendations are implemented appropriately. The Committee comprises of 5 non-executive directors, the majority of whom are independent.

**(f) Group Internal Audit**

Group Internal Audit is a separate function that reports to the Standard Chartered PLC Group Chief Executive and the Chairman of the Group Audit and Risk Committee. It provides independent confirmation that Bank and business standards, policies and procedures are being complied with. Where necessary, it will recommend corrective action to restore or maintain such standards.

**4 Credit risk exposure management**

The Bank has in place a risk management framework, as outlined on page 57 of the 2008 consolidated financial statements. As part of risk management, stress testing and scenario analysis are used to assess the financial and management capability of the Bank to continue to operate effectively under extreme but plausible trading conditions. The STWG, which is led by the Risk function, with participation from Group Treasury, has a primary objective to ensure the Bank understands the earnings and capital implications of specific stress scenarios.

In view of recent market turbulence, stress testing activity has been intensified and has taken into consideration possible future scenarios that would arise as a result of the development of market conditions.

**(a) IRB approach to credit risk**

Since 1 January 2008, the Bank has been using the advanced IRB approach for the measurement of credit risk capital and management of credit risk for the majority of its portfolios. The following exposures are subject to the IRB approach:

- Corporate exposures including exposures to small and medium-sized enterprises and other corporates.
- Sovereign exposures including exposures to sovereign governments and sovereign foreign public sector entities.
- Bank exposures including exposures to banks and regulated securities firms.
- Retail exposures including residential mortgages, qualifying revolving retail exposures and other retail exposures to individuals.
- Other exposures including notes and coins, premises, plant and equipment and other fixed assets.

Under the advanced or retail IRB approach, the Bank is permitted to use its own internal estimates of probability of default ("PD"), exposure at default ("EAD") and loss given default ("LGD") to determine an asset's risk weighting:

- the PD of an obligor is the likelihood, expressed as a percentage, of a default event in a one-year time horizon.
- EAD is the expected amount of exposure at the time of default.
- LGD is an estimate of the severity of the loss that the Bank is likely to incur in the event that the obligor defaults, expressed as a percentage of the EAD.

The internal estimates of PD, EAD and LGD are supported by sophisticated risk measurement models developed to support the credit decision making process. These models are approved by the RC, on the recommendation of the MAC.

Risk-weighted assets ("RWA") under the IRB approach are determined by regulatory specified formulae dependent on the Bank's estimates of PD, EAD and LGD. The development, use and governance of models under the IRB approach is covered in more detail in note 6 to the supplementary notes.

**(b) Standardised approach to credit risk**

The standardised approach to credit risk measures credit risk pursuant to fixed risk weights and is less sophisticated than the IRB approach. The risk weighting applied under the standardised approach is provided by the HKMA and is based on the asset class to which the exposure is assigned.

## 5 Risk Grade Profile

### (a) Structure of rating systems

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. Lower credit grades are indicative of a lower likelihood of default. Credit grades 1 to 12 are assigned to performing customers or accounts, while higher credit grades are assigned to 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 also typically poorly rated under the Bank's internal credit grades.

Credit grades for the majority of consumer accounts are based on a probability of default calculated using 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.

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.

Standard Chartered makes use of internal risk estimates of PD, LGD and EAD extensively in the areas of:

- Credit Approval and Decision – The level of authority required for the sanctioning of credit requests and the decision made is based on a combination of PD, LGD and EAD of the obligor;
- Pricing – In Wholesale Banking, a pre-deal pricing calculator is used which takes into consideration PD, LGD and EAD in the calculation of expected loss and economic capital for the proposed transactions to ensure appropriate return. In Consumer Banking, a scorecard approach is used to assess the level of risk using PD, LGD and EAD;
- Limit Setting – In Wholesale Banking, concentration limits for some portfolios, as well as counterparty limits are determined by PD, LGD and EAD. The limits operate on a sliding scale to ensure that the Bank does not have over concentration of low credit quality assets. This process operates similarly in Consumer Banking;
- Provisioning – Portfolio Impairment Provisions ('PIP') are raised as described in note 6(h) to the supplementary notes;
- Risk Appetite – PD, LGD and EAD models provide some of the key inputs into the risk-based methodologies used in the assessment of business and market variables which in turn are key components in the approach taken to Risk Appetite; and
- Economic Capital – PD, EAD and LGD are key components of the model used to calculate Economic Capital, which is in turn used in strategic planning, budgeting, pricing and performance measurement processes at business unit, portfolio and client relationship level.

**(b) Risk assessment for exposures under IRB approach**

The following tables set out analyses of EAD, LGD, average risk weight and PD by internal credit grading and Basel II asset classes.

	Grades 1-5	Grades 6-8	Grades 9-11	Grade 12	Defaulted	Unrated	Total
<b>Total EAD (HK\$ million)</b>							
Corporates	88,436	55,089	19,429	198	1,619	–	164,771
Sovereigns	26,908	–	–	–	–	–	26,908
Banks	262,018	7,522	116	–	181	–	269,837
Residential mortgages to individuals and property-holding shell companies	96,167	10,595	1,171	64	161	–	108,158
Qualifying revolving retail exposures	35,643	7,645	5,413	1,385	80	–	50,166
Other retail exposures to individuals	694	2,119	1,679	202	10	–	4,704
Other exposures	–	–	–	–	–	38,890	38,890
Securitisation exposures	2,418	–	–	–	–	–	2,418
Equity exposures	–	–	–	–	–	–	–
	<u>512,284</u>	<u>82,970</u>	<u>27,808</u>	<u>1,849</u>	<u>2,051</u>	<u>38,890</u>	<u>665,852</u>

	Grades 1-5	Grades 6-8	Grades 9-11	Grade 12	Defaulted	Unrated	Total
<b>Exposure-weighted average LGD (%)</b>							
Corporates	56.36	45.55	31.65	43.22	60.05	–	49.85
Sovereigns	26.20	–	–	–	–	–	26.20
Banks	29.00	39.68	38.82	–	26.20	–	29.30
Residential mortgages to individuals and property-holding shell companies	20.63	25.27	24.97	28.00	27.23	–	21.15
Qualifying revolving retail exposures	92.06	92.06	92.06	92.06	80.22	–	92.04
Other retail exposures to individuals	98.48	97.87	98.53	98.54	87.59	–	98.20

	Grades 1-5	Grades 6-8	Grades 9-11	Grade 12	Defaulted	Unrated	Total
<b>Exposure-weighted average risk weight (%)</b>							
Corporates	28.53	74.17	62.18	225.84	154.84	–	49.24
Sovereigns	1.93	–	–	–	–	–	1.93
Banks	6.43	46.08	89.97	–	312.67	–	7.78
Residential mortgages to individuals and property-holding shell companies	5.23	27.48	72.85	158.54	205.91	–	8.53
Qualifying revolving retail exposures	6.49	35.39	129.31	256.62	93.09	–	31.19
Other retail exposures to individuals	55.07	94.45	149.09	230.62	52.94	–	113.90
Other exposures	–	–	–	–	–	24.53	24.53
Securitisation exposures	8.90	–	–	–	–	–	8.90
Equity exposures	–	–	–	–	–	–	–

	Grades 1-5	Grades 6-8	Grades 9-11	Grade 12	Defaulted	Unrated	Total
<b>Exposure-weighted average PD (%)</b>							
Corporates	0.20	1.01	7.09	33.00	100.00	–	2.30
Sovereigns	0.01	–	–	–	–	–	0.01
Banks	0.05	0.81	3.65	–	100.00	–	0.14
Residential mortgages to individuals and property-holding shell companies	0.10	0.85	4.31	24.92	100.00	–	0.38
Qualifying revolving retail exposures	0.13	1.04	6.75	26.61	100.00	–	1.87
Other retail exposures to individuals	0.33	1.01	5.85	25.66	100.00	–	3.90

The following table set out an analysis of the amount of undrawn commitments and EAD for corporate, sovereign, bank and equity exposures:

	Undrawn commitments HK\$'M	EAD HK\$'M
Corporates	2,575	410
Sovereigns	–	–
Banks	–	–
Equity exposures	–	–
	<u>2,575</u>	<u>410</u>

## 6 Internal ratings-based models

### (a) Model governance

Models are developed by analytics teams within Standard Chartered PLC Group Risk and the Consumer Banking and Wholesale Banking risk functions. The model development process is conducted and documented in line with specific criteria setting out the minimum standards for model development. All IRB models are validated annually by a model validation team reporting to the Group Chief Credit Officer, thereby maintaining independence from the model build processes. Model validation findings are presented to the Hong Kong Model Assessment Committee which in turn makes approval recommendations to the Hong Kong Risk Committee. These decision making bodies are comprised of divisional senior management whose role is to challenge model assumptions and performance and agree on appropriate model use and deployment for business decision making. The Hong Kong Risk Committee and Group Internal Audit periodically review overall model performance.

The model validation process involves a qualitative and quantitative assessment of the model, data, systems and governance. This would typically include an assessment of the:

- Model assumptions;
- Validity of the technical approach used;
- Statistical and empirical measures of performance;

- Appropriateness of intended model use;
- Model application and infrastructure;
- Data integrity and history;
- Model response to changes in internal and external environment: i.e., the extent to which the model provides point in time or through the cycle measures of risk;
- Model monitoring standards and triggers; and
- Levels of conservatism applied.

Statistical testing is used to determine a model's discriminatory power, predicted versus actual performance and stability over time with pre-defined thresholds for passing such tests. The model development teams also conduct annual model reviews, which are informed by regular monitoring, to ascertain whether the model is fit for purpose and performing within acceptable boundaries or whether there are potential improvements in performance to be made.

#### **(b) PD Model Development**

SCB Group employs a variety of techniques to develop its PD models. The appropriate approach is dictated by the availability and relevance of both internal and external data. The general approaches fall into three broad categories:

Default History Based ("Good-Bad") – where a sufficient number of defaults are available, the Group deploys a variety of statistical methods to determine the likelihood of default on existing exposures. These methods afford very high discriminatory power by identifying exposure characteristics that have a significant predictive ability. The majority of the Group's consumer and corporate exposures are rated under such an approach.

Shadow Rating Approach – if it is determined that the Group's internal data does not provide sufficient default history (so called "low default portfolios"), then the Group develops models which are designed to reflect ratings made by established external credit assessment institutions, which have access to large databases of defaults on a variety of credit obligations. These external ratings are customised to develop the Group's own customer rating systems.

Constrained Expert Judgement – for certain types of exposures there is little or no internal or external default history, and therefore no reliable external ratings. In such rare cases, the Group develops quantitative frameworks which include the expert opinions of the Group's credit risk management personnel. These frameworks are called 'knowledge based systems' and are regularly reviewed with respect to historical outcomes.

#### **(c) LGD Model Development**

SCB Group develops LGD models by assessing unsecured recoveries, the forced sale value of collateral, the economic costs in securing these recoveries, and the timing with which such cash flows occur. All such cash flows are then measured at net present value using a suitable discount rate to derive a recovery rate. Loss given default is therefore the EAD less these estimated recoveries.

Unsecured recoveries are estimated based upon empirical experience, which has shown that factors such as customer segment, product and geography have predictive content.

All LGD models are conservatively calibrated to a 'downturn' – with lower assumed collateral values and lower recoveries on unsecured exposures than would normally prevail.

**(d) EAD Model Development**

An EAD model is developed for uncertain exposure products such as lines of credit, credit cards, overdrafts and other commitments. Based on the Group's experience (and supplemented by external data), EAD models assess changes to limits and the likely draw-down of committed and uncommitted limits as an exposure approaches default. The factor generated by the model and applied to the undrawn limit is referred to as the credit conversion factor ("CCF").

**(e) Model Use**

In addition to supporting credit decisions, IRB models also support risk-based pricing methodologies and measures used to assess business performance such as Economic Capital, Economic Revenue and Economic Profit.

The use of models is governed by a suite of policies:

- Each model is governed by a separate policy and procedure which defines the applicability of that model and details the procedure for use;
- The model review policy governs the regular review of models and specifies statistical thresholds and other triggers which determine when models need to be redeveloped.
- The model override policy sets the conditions and approval authority required to override model output.
- The parental support policy, for Wholesale Banking, determines the extent to which parental support may be utilised to adjust the credit grade of corporates' and financial institutions' subsidiaries.

**(f) Wholesale Banking Model Results**

The following table sets out actual PD, LGD and EAD compared to IRB model predictions.

The Bank was incorporated on 1 July, 2004. In order to compute the long run actual realisations of LGD and EAD, IRB model development data was used prior to the incorporation date.

	PD		LGD		Conversion Factor*	
	Actual Default		Actual	Estimate	Actual	Estimate
	Rate	Estimate				
	%	%	%	%	%	%
<b>IRB Exposure Class</b>						
Corporates	0.78	1.33	55.16	49.85	14.55	16.05
Sovereigns	0.00	0.01	0.00	26.20	–	–
Banks	0.00	0.07	0.00	29.30	–	–

\* Conversion factor is the estimate used when estimating EAD

Wholesale Banking models have been developed from a dataset which runs to over a decade, including default and recovery experience from the Asian financial crisis. These data have been used to calibrate estimates of PD to a long run experience. Actual ("point in time") default rates will typically differ from this "through the cycle" experience as economies move above or below cyclical norms.

IRB PD estimates computed as of 1 January 2008 have been compared with default observations as at 31 December 2008. The actual observed default rates for corporate, sovereign and bank exposures were maintained below IRB model predictions.

The recovery process on defaults in 2008 is too immature to compute meaningful actual versus realised outcomes as it takes a number of years for a workout process to complete. To obviate this difficulty, the Bank's estimate of LGD is based on the most recently deployed model outputs as of 31 December 2008 which have been compared with long run actual realisations of LGD, including downturn periods, since 1995. LGD estimates take into account the impact of risk mitigation and netting. LGD estimates for corporate exposures are lower compared with actual due to the change in product mix over the years with more emphasis on lower risk products today.

To be consistent with the approach taken for LGD, the estimated EAD is computed based on model outputs as of 31 December 2008. Actual EADs are similarly based on long run realisations of EAD since 1995.

**(g) Consumer Banking Model Results**

Seven years of performance data is held for the majority of Consumer Banking portfolios and this history has been used to develop the IRB model suite. These data include "credit bubbles" as well as stress that arose during the SARS outbreak. This experience therefore features in the calibration of the models.

The comparisons of predicted against actual outcomes are shown at an asset class level for each of the PD, LGD and EAD model suites. For LGD, the predicted value reflects estimates of LGD for defaults over the period 2006 and 2007, compared with realised LGDs in 2008 when the recoveries' process was terminated.

The results below comprise many individual portfolios which during the year were affected by a number of influencing factors including changes in underwriting policies, business mix, economic conditions and modelling approach.

	<i>PD</i>		<i>LGD</i>		<i>EAD</i>	
	<i>Actual</i> <i>PD%</i> <i>2008</i>	<i>Predicted</i> <i>PD%</i> <i>2007</i>	<i>Actual</i>	<i>Predicted</i>	<i>Actual</i> <i>EAD</i> <i>HK\$'M</i>	<i>Predicted</i> <i>EAD</i> <i>HK\$'M</i>
			<i>Exposure- weighted</i> <i>LGD%</i> <i>2008</i>	<i>Exposure- weighted</i> <i>LGD%</i> <i>2008</i>		
<b>IRB Exposure Class</b>						
Residential mortgages	0.12	0.26	12.12	25.18	100	102
Qualifying revolving retail exposures	0.65	1.78	64.26	85.98	385	429
Other retail exposures to individuals	2.22	6.34	49.28	85.72	49	92

Across the various asset classes, the actual default rate experienced during the 12 months from December 2007 is lower than the predicted rate (PD). With any rating system, there is a tendency to over predict or under predict based on different economic conditions. Economic conditions in 2008 were not as severe as the long run average that the Group has used to calibrate its models. A measure of conservatism is also built into rating systems where empirical default histories are insufficient to satisfy the Group's statistical measures of accuracy. This conservatism together with prevailing economic conditions in 2008 resulted in over-estimating the default rate.

Actual LGDs are lower than predicted values as the model LGDs use "Downturn" parameter settings. This is most evident in the mortgage portfolios where the predicted LGDs include both a significant assumed reduction in property values in addition to the application of the regulatory minimum LGD floor of 10%.

Actual EAD is lower than predicted mainly due to the level of conservatism assigned to the predicted values.

#### **(h) Problem Credit Management and Provisioning**

##### *Consumer Banking*

Within Consumer Banking, an account is considered to be delinquent when payment is not received on the due date. For delinquency reporting purposes, the Bank follows industry standards, measuring delinquency as of 1, 30, 60, 90, 120 and 150 days past due. Accounts that are overdue by more than 30 days are more closely monitored and are subject to specific collection processes.

The process used for raising individual impairment provisions (“IIPs”) is dependent on the product. For unsecured products and loans secured by automobiles, individual provisions are raised for the entire outstanding amount at 150 days past due. For mortgages, IIPs are generally raised at 150 days past due based on the difference between the outstanding amount of the loan, and the present value of the estimated future cash flows which includes the realisation of collateral. For other secured loans (excluding those secured by mortgages and automobiles), IIPs are raised at 90 days past due based on the forced sale value of the collateral without further discounting, as the collateral value is typically realised in less than 12 months. For all products, there are certain situations where the individual impairment provisioning process is accelerated, such as in cases involving bankruptcy, fraud and death.

A portfolio impairment provision (“PIP”) is held to cover the inherent risk of losses which, although not specifically identified, are known through experience to be present in the loan portfolio. PIP is calculated with reference to past flow-rate and recovery rate experience, and is adjusted to take account of current market conditions. These include the economic and business environment in the Bank’s markets, and trends in a range of portfolio indicators such as portfolio loss severity, collections and recovery performance trends.

The procedures for managing problem credits for the Medium Enterprises in the SME segment of Consumer Banking are similar to those adopted in Wholesale Banking. For unsecured loans to Small Businesses within the SME segment, the problem credit management process is similar to that of other unsecured products in Consumer Banking.

##### *Wholesale Banking*

Loans are classified as impaired and considered non-performing where analysis and review indicates that full payment of either interest or principal is questionable, or as soon as payment of interest or principal is 90 days overdue. Impaired accounts are managed by Group Special Assets Management, the Bank’s recovery unit, which is separate from the main businesses of the Bank. Where any amount is considered irrecoverable, an individual impairment provision is raised, being the difference between the loan carrying amount and the present value of estimated future cash flows.

Future cash flows are estimated by taking into account the individual circumstances of each customer and can arise from operations, sales of assets or subsidiaries, realisation of collateral, or payments under guarantees. Cash flows from all available sources are considered. In any decision relating to the raising of provisions, the Bank attempts to balance economic conditions, local knowledge and experience, and the results of independent asset reviews.

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

As with Consumer Banking, a PIP is held to cover the inherent risk of losses which, although not identified, are known through experience to be present in any loan portfolio. In Wholesale Banking, the PIP is set with reference to past experience using loss rates, and judgemental factors such as the economic environment and the trends in key portfolio indicators.

The following sets out the actual losses for the year 2007 and 2008 and the regulatory expected loss as at 31 December 2007.

<i>Exposure Class</i>	<i>Actual loss for the year of</i>		<i>Regulatory expected loss at</i>
	<i>2008</i>	<i>2007</i>	<i>31 December 2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Corporates	668	48	795
Sovereigns	–	–	–
Banks	2	–	70
Residential mortgages	(30)	(21)	70
Qualifying revolving retail exposures	295	316	1,155
Other retail exposures to individuals	67	14	273
	<u>1,002</u>	<u>357</u>	<u>2,363</u>

It should be noted that the actual loss and the regulatory expected loss numbers are not directly comparable as they have been calculated using different methodologies. The regulatory expected loss is calculated by risk models using a through-the-cycle methodology based on risk parameters and observations over a period of time, as set out in note 6 to the supplementary notes. The actual loss is the net individual impairment charge recognised in the income statement during the reporting period which has been made in accordance with the Bank's accounting policy.

**(i) Credit risk mitigation ("CRM")**

Potential credit losses from any given account, customer or portfolio are mitigated using a range of tools such as collateral, credit insurance, 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.

Where guarantees are used as CRMs the creditworthiness is assessed and established using the credit approval process for the guarantor in addition to that of the obligor or main counterparty. The main types of guarantors include bank guarantees, insurance companies, parent companies and shareholders.

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.

Certain credit exposures are mitigated using credit default insurance.

The Bank uses bilateral and multilateral netting to reduce pre-settlement and settlement counterparty risk. Pre-settlement risk exposures are normally netted using the bilateral netting documentation in legally approved jurisdictions. Settlement exposures are generally netted using Delivery Vs Payments or Payment Vs Payments systems.

#### *Wholesale Banking*

The process of managing and recognising credit risk mitigation is governed by policies which set out the eligibility criteria that must be met. The credit risk mitigation policy sets out clear criteria that must be satisfied if the mitigation is to be considered effective:

- Excessive exposure to any particular risk mitigants or counterparties should be avoided. Collateral concentration mitigation standards are maintained at both the portfolio and counterparty level;
- Risk mitigants should not be correlated with the underlying assets such that default would coincide with a lowering of the Forced Sale Value ('FSV') of the collateral;
- Where there is a currency mismatch, haircuts should be applied to protect against currency fluctuations;
- Legal opinions and documentation must be in place; and
- Ongoing review and controls exist where there is a maturity mismatch between the collateral and exposure.

For all CRMs that meet the policy criteria, a clear set of procedures is applied to ensure that the value of the underlying collateral is appropriately recorded and updated regularly.

#### *Consumer Banking*

The effective use of collateral is a key tool by which credit risk is mitigated in Consumer Banking. All eligible collateral accepted by Consumer Banking is covered by a product proposal approved by senior credit officers delegated with the relevant authority. New collateral types have to be vetted through a stringent 'New Business Approval' process and approved by the Consumer Banking Risk Committee.

In order to be recognised as security and for the loan to be classified as secured, all items pledged must be valued and there must exist an active secondary resale market for the collateral. Documentation must be held to enable Consumer Banking to realise the asset without the cooperation of the asset owner in the event that this is necessary.

Detailed procedures over collateral management must be in place for each business at the country level.

The following table discloses the amount of exposure in the IRB portfolio that is covered by guarantees. For the IRB portfolios, there is no requirement to disclose the value of collateral by asset class.

	<i>EAD covered by guarantees HK\$'M</i>
<b>IRB Exposure Class</b>	
Corporate exposures	2,445
Sovereign exposures	–
Bank exposures	287
Residential mortgages to individuals and property-holding shell companies	–
Qualifying revolving retail exposures	–
Other retail exposures to individuals	–
Other exposures	–
Securitisation positions	–
Equity exposures	–
	<u>2,732</u>

The table below identifies the effect of credit risk mitigation on total exposures for the portfolios under the standardised approach.

	<i>Total exposures before the effect of CRM* HK\$'M</i>	<i>Total exposures covered by recognised collateral HK\$'M</i>	2008		<i>Risk weighted amounts</i>	
			<i>Total exposures after the effect of CRM</i>			
			<i>Rated HK\$'M</i>	<i>Unrated HK\$'M</i>	<i>Rated HK\$'M</i>	<i>Unrated HK\$'M</i>
<b>Standardised Exposure Class</b>						
Sovereigns	–	–	–	–	–	–
Public sector entities	–	–	–	–	–	–
Multilateral development banks	482	–	–	482	–	–
Banks	641	13	–	628	–	133
Securities firms	–	–	–	–	–	–
Corporates	9,468	820	–	8,648	–	8,648
Collective investment schemes	–	–	–	–	–	–
Cash items	–	–	–	–	–	–
Regulatory retail	4,901	334	–	4,567	–	3,425
Residential mortgage loans	3,837	–	–	3,837	–	3,139
Other exposures which are not past due	3,819	1,141	–	2,678	–	2,678
Past due exposures	1,865	–	–	1,865	–	2,798
	<u>25,013</u>	<u>2,308</u>	<u>–</u>	<u>22,705</u>	<u>–</u>	<u>20,821</u>
Exposures deducted from capital base	<u>–</u>					

\* Principal amount or credit equivalent amount, as applicable, net of specific provisions.

There are no exposures under the standardised approach which are covered by recognised guarantees or credit derivative contracts.

There are immaterial credit and market risks concentrations within the credit risk mitigants (recognised collateral and guarantees) used by the Bank.

## 7 Market risk

For the calculation of its capital requirement for market risk, the Bank uses an internal models approach for two guaranteed retirement funds and the standardised (market risk) approach for other exposures.

The Bank's capital requirement for market risk is summarised as follows:

	<i>Consolidated capital requirement</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
<b>Subject to standardised approach:</b>		
Interest rate exposures	230	542
Foreign exchange exposures	48	19
	<u>278</u>	<u>561</u>
<b>Subject to internal models approach:</b>		
Guaranteed retirement funds	31	28
	<u>309</u>	<u>589</u>
<b>Total capital requirement for market risk</b>	<u><u>309</u></u>	<u><u>589</u></u>

The capital requirement for the Bank's guaranteed retirement funds is based on the potential shortfall between the estimated returns from the funds and the guaranteed returns. The projected returns are estimated using a simulation approach with a 99% confidence level. The model is back-tested against actual results.

## 8 Operational risk

The Bank adopts the standardised (operational risk) approach for assessing capital requirements for 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 Bank's capital requirement for operational risk is summarised as follows:

	<i>Consolidated capital requirement</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Standardised (operational risk) approach	<u>2,161</u>	<u>1,876</u>

CORG is appointed by the Risk Committee to review the Bank's operational risk profile with the objective of providing a forum for the management oversight of country and business level operational risk ("OR") trends and issues arising from control lapses/failures, regulatory breaches, policy non-compliance, as well as exceptions and weaknesses identified through the self-assessment processes, risk toolkits, compliance and business reviews, internal and external audits and external developments/changes. CORG will deliberate the root causes of risk issues, the appropriateness of risk ratings, as well as the adequacy and effectiveness of remedial actions.

Further information regarding operational risk governance and management is set out in note 36(f) on pages 77 to 78 of the 2008 consolidated financial statements.

## 9 Other annual financial disclosure

### (a) Counterparty credit risk exposures

The Bank's regulatory capital requirements for counterparty credit risk arising from OTC derivative transactions booked in the banking or trading book (referred to as "relevant transactions" in this section), is calculated in accordance with the Banking (Capital) rules. In 2008, the Bank has adopted the IRB approach to calculate the counterparty credit risk exposures whilst the Basic Approach was used in 2007. The capital requirement for credit risk relating to the relevant transactions is made by multiplying the risk-weighted amounts derived from the IRB or Basic approach by 8%.

Credit risk arising from all financial derivatives is managed as part of the overall lending limits to banks and corporate customers. Where collateral is deemed a necessary or desirable mitigant to the exposure, the Bank will seek to negotiate Credit Support Annexes ("CSA") with counterparties on a case by case basis. The credit terms of the CSA are specific to each legal document and determined by the credit risk approval unit responsible for the counterparty. The nature of the collateral will be specified in the legal document and will typically be cash or highly liquid securities. The Bank further reduces its credit exposures to counterparties by entering into contractual netting agreements which result in a single amount owed by or to the counterparty through netting the sum of the positive (amounts owed by the counterparty) and negative (amounts owed by the Bank) mark to market values of these transactions. Exposures are however presented on a gross basis in the financial statements as such transactions are not intended to be settled net in the ordinary course of business.

The following table summarises the Bank's credit exposure arising from OTC derivative transactions. As at 31 December 2008 and 2007, the Bank did not have any outstanding repo-style transactions or credit derivative contracts.

	<i>Consolidated</i>	
	<i>2008</i>	<i>2007</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross total positive fair value	1,815	2,039
Credit equivalent amount	7,185	19,241
Recognised collateral held		
– Cash	50	55
Credit equivalent amounts net of recognised collateral held	7,135	19,186
Risk weighted amounts	<u>954</u>	<u>4,704</u>

An analysis of the notional amounts, credit equivalent amounts and the risk-weighted amounts for OTC derivatives by counterparty type is summarised as follows:

	Consolidated	
	2008 HK\$'M	2007 HK\$'M
Notional amounts:		
– Banks	532,495	750,362
– Corporates	17,891	63,033
	<u>550,386</u>	<u>813,395</u>
Credit equivalent amounts:		
– Banks	6,563	18,103
– Corporates	622	1,138
	<u>7,185</u>	<u>19,241</u>
Risk-weighted amounts:		
– Banks	522	3,621
– Corporates	432	1,083
	<u>954</u>	<u>4,704</u>

**(b) Asset securitisation**

In 2008, the Bank has adopted the IRB approach to calculate the credit risk for asset securitisations in which it is an investing institution. In 2007, the Bank had used the standardised (securitisation) approach to calculate the credit risk for securitisation exposures in which it was an investing institution. There was no asset securitisation for which the Bank was an originating institution.

The Bank uses the following external credit assessment institutions to calculate the capital adequacy requirements: Standard & Poor's Ratings Services and Moody's Investors Service.

	Consolidated 2008			Exposures deducted from capital	
	Outstanding amounts HK\$'M	Risk- weighted amount HK\$'M	Capital requirements HK\$'M	Core Capital HK\$'M	Supplementary Capital HK\$'M
Residential mortgages					
Risk weight					
7%	2,157	160	13		
15%	170	27	2		
20%	76	16	1		
75%	15	12	1		
	<u>2,418</u>	<u>215</u>	<u>17</u>	<u>26</u>	<u>26</u>
	Consolidated 2007			Exposures deducted from capital	
	Outstanding amounts HK\$'M	Risk- weighted amount HK\$'M	Capital requirements HK\$'M	Core Capital HK\$'M	Supplementary Capital HK\$'M
Residential mortgages	<u>2,586</u>	<u>561</u>	<u>45</u>	<u>39</u>	<u>39</u>

**(c) Equity exposure in the banking book**

Investments in equity shares which are intended to be held on a continuing basis, but which do not comprise investments in associates, jointly controlled entities or subsidiaries, are classified as available-for-sale securities and are reported in the balance sheet as "Investment securities". Available-for-sale securities are measured at fair value as described in Notes 2(i) of the 2008 consolidated financial statements. Included within this category are investments made by the Bank for strategic purposes, which are subject to additional internal procedures and approvals to ensure that the investment is in accordance with the Bank's strategy and to ensure compliance with all relevant regulatory and legal restrictions. In some cases, additional investments may be made later such that the investee becomes an associate, jointly controlled entity or subsidiary, at which point the investment is reclassified in accordance with the Bank's accounting policies.

	2008 HK\$M	2007 HK\$M
Cumulative realised gains on disposal	41	180
Unrealised gains:		
– recognised in reserves but not through the income statement	57	1,396
– included in supplementary capital for capital adequacy ratio purpose	26	628

**(d) Interest rate exposure in the banking book**

As at the balance sheet date, the variation in the Bank's earnings for a 200 basis points interest rate increase, broken down by currency, is shown as follows (in HK\$ million):

	HKD	USD	CNY	EUR	JPY
2008	(641)	8	(3)	(14)	90
	HKD	USD	AUD	EUR	JPY
2007	(432)	184	(24)	(13)	(61)

The above analysis is based on the methodology as set out by the HKMA in the completion instructions for the "Return of Interest Rate Risk Exposure".

**(e) Analysis of fee and commission income**

The products constituting not less than 10% of the total amount of fee and commission income are as follows:

	2008 HK\$'M	2007 HK\$'M
Credit cards	567	1,042
Trade products	822	795
Global market products	1,279	1,313
Investment services	826	1,321
Insurance services	560	350

**(f) Cross border claims**

Cross border claims are on-balance sheet exposures of counterparties based on the location of those counterparties after taking into account the transfer of risk. For a claim guaranteed by a party situated in a country different from the counterparty, risk will be transferred to the country of the guarantor. For a claim on the branch of a bank or other financial institution, the risk will be transferred to the country where its head office is situated. Claims on individual countries or area, after risk transfer, amounting to 10% or more of the aggregate cross border claims are shown as follows:

	<i>Consolidated</i>			
	<i>2008</i>			
	<i>Banks and other financial institutions HK\$'M</i>	<i>Public sector entities HK\$'M</i>	<i>Other HK\$'M</i>	<i>Total HK\$'M</i>
Asia Pacific excluding Hong Kong	42,027	–	24,778	66,805
Western Europe				
– United Kingdom	89,560	–	3,261	92,821
– Others	80,950	–	709	81,659
	<u>170,510</u>	<u>–</u>	<u>3,970</u>	<u>174,480</u>
	<i>Consolidated</i>			
	<i>2007</i>			
	<i>Banks and other financial institutions HK\$'M</i>	<i>Public sector entities HK\$'M</i>	<i>Other HK\$'M</i>	<i>Total HK\$'M</i>
Asia Pacific excluding Hong Kong	30,862	–	10,080	40,942
Western Europe				
– United Kingdom	80,564	–	3,196	83,760
– Others	49,990	518	1,947	52,455
	<u>130,554</u>	<u>518</u>	<u>5,143</u>	<u>136,215</u>

**(g) Advances to customers analysed by industry sector**

The analysis of gross advances to customers by industry sector is based on the categories used by the HKMA.

	<i>Consolidated and Bank</i>		<i>% of</i>	
	<i>2008</i>	<i>% of</i>	<i>2007</i>	<i>% of</i>
	<i>HK\$'M</i>	<i>advances</i>	<i>HK\$'M</i>	<i>advances</i>
		<i>covered by</i>		<i>covered by</i>
		<i>collateral</i>		<i>collateral</i>
		<i>or other</i>		<i>or other</i>
		<i>securities</i>		<i>securities</i>
Gross advances for use in Hong Kong				
<i>Industrial, commercial and financial</i>				
– Property development	4,125	10%	3,612	33%
– Property investment	22,619	89%	17,756	92%
– Financial concerns	21,081	26%	9,773	40%
– Stockbrokers	2,422	–	1,939	38%
– Wholesale and retail trade	4,554	28%	4,214	27%
– Manufacturing	10,844	19%	8,369	25%
– Transport and transport equipment	1,805	12%	2,047	3%
– Recreational activities	41	33%	166	38%
– Information technology	1,370	–	878	30%
– Others	5,400	11%	6,315	17%
<i>Individuals</i>				
– Advances for the purchase of flats in the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	1,328	99%	1,406	100%
– Advances for the purchase of other residential properties	87,673	99%	82,682	99%
– Credit card advances	8,378	–	9,003	–
– Others	13,337	17%	8,219	–
Total gross advances for use in Hong Kong	184,977		156,379	
Trade finance	19,598	12%	15,834	28%
Trade bills	3,381	–	2,852	–
Gross advances for use outside Hong Kong	7,290	7%	5,221	–
Gross advances to customers	215,246	57%	180,286	67%

Advances to customers by geographical area are classified according to the location of the counterparties after taking into account the transfer of risk. As at 31 December 2008 and 31 December 2007, over 90 per cent of the Bank's and its subsidiaries' advances to customers were classified under the area of Hong Kong.

The above balances do not include inter-company loans and advances.

The amount of impaired and overdue advances to customers and individually and collectively assessed impairment allowances for industry sectors which constitute not less than 10% of the Bank's and its subsidiaries' total advances to customers are as follows:

	<i>Impaired advances to customers</i>	<i>Overdue advances to customers</i>	<i>Individually assessed impairment allowances</i>	<i>Collectively assessed impairment allowances</i>	<i>New provision charge</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
<u>As at 31 December 2008</u>					
Advances for the purchase of other residential properties	117	32	48	9	9
Property investment	8	35	4	61	–
<u>As at 31 December 2007</u>					
Advances for the purchase of other residential properties	219	88	74	11	28

**(h) Overdue and rescheduled assets**

**(i) Overdue advances to customers**

	<i>Consolidated</i>			
	<i>2008</i>	<i>% of gross advances</i>	<i>2007</i>	<i>% of gross advances</i>
	<i>HK\$'M</i>		<i>HK\$'M</i>	
Gross advances to customers which have been overdue with respect to either principal or interest for periods of:				
– 6 months or less but over 3 months	479	0.2%	176	0.1%
– 1 year or less but over 6 months	165	0.1%	69	–
– over 1 year	438	0.2%	339	0.2%
	<u>1,082</u>	<u>0.5%</u>	<u>584</u>	<u>0.3%</u>
			<i>2008</i>	<i>2007</i>
			<i>HK\$'M</i>	<i>HK\$'M</i>
Fair value of collateral held against the covered portion of overdue advances to customers			<u>260</u>	<u>178</u>
Covered portion of overdue advances to customers			101	86
Uncovered portion of overdue advances to customers			<u>981</u>	<u>498</u>

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

The collateral held in respect of the overdue advances consists of cash, properties and securities.

	2008 HK\$'M	2007 HK\$'M
Individually assessed impairment charges against overdue advances to customers	696	389

As at 31 December 2008 and 31 December 2007, there were no advances to banks and other financial institutions which were overdue for more than 3 months.

(ii) *Rescheduled advances to customers*

	2008		Consolidated 2007	
	HK\$'M	% of gross advances	HK\$'M	% of gross advances
Rescheduled advances	456	0.2%	498	0.3%

Rescheduled advances are those advances, which have been restructured or renegotiated because of a deterioration in the financial position of the borrowers, or the inability of the borrowers to meet the original repayment schedule and for which the revised repayment terms are non-commercial to the Bank. Rescheduled advances to customers are stated net of any advances that have subsequently become overdue for over 3 months and reported as overdue advances in note 9 (h)(i) above.

There were no rescheduled advances to banks and other financial institutions as at 31 December 2008 and 31 December 2007.

(i) **Non-bank Mainland China exposure**

	On-balance sheet exposure HK\$'M	Off-balance sheet exposure HK\$'M	Total HK\$'M	Individually assessed impairment allowances HK\$'M
<u>As at 31 December 2008</u>				
Mainland China entities	6,326	7,293	13,619	17
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	4,889	16,578	21,467	46
Other counterparties where the exposure is considered by the Bank to be non-bank Mainland China exposure	60	598	658	–
<u>As at 31 December 2007</u>				
Mainland China entities	2,850	6,431	9,281	122
Companies and individuals outside Mainland China where the credit is granted for use in Mainland China	3,050	14,862	17,912	3
Other counterparties where the exposure is considered by the Bank to be non-bank Mainland China exposure	14	102	116	–

The off-balance sheet exposure represents the amount at risk should the contract be fully drawn upon and the client defaults. As the facilities may expire without being drawn upon, the contractual amounts do not represent expected future cash flows.

**(j) Liquidity ratio**

	<i>Bank</i>
	<i>2007</i>
	<i>(restated)</i>
	<i>%</i>
Average liquidity ratio for the year	41.2%
	33.1%

The average liquidity ratio is computed as the simple average of each calendar month's average ratio and is in accordance with the Fourth Schedule to the Hong Kong Banking Ordinance.