



Standard Chartered Bank  
(Hong Kong) Limited

Directors' Report and  
Consolidated Financial  
Statements

For the year ended 31 December 2009

**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 2009.

### **Principal place of business**

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

### **Principal activities**

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

### **Financial statements**

The profit of the Bank and its subsidiaries for the year ended 31 December 2009 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 107.

No dividends were declared or paid during 2009. During the year ended 31 December 2008, the directors had declared and paid a special dividend of HK\$0.60 per 'A' ordinary share and 'B' ordinary share totalling HK\$1,162 million.

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

### **Charitable donations**

Charitable donations made by the Bank and its subsidiaries during the year amounted to HK\$8 million (2008: HK\$9 million).

### **Fixed assets**

Details of the movements in the fixed assets are set out in note 21 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 33 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  
Julian Fong Loong Choon  
Tan Siew Boi

## **Report of the directors (continued)**

### *Non-executive directors*

Chow Chung Kong\*, Chairman

Jaspal Singh Bindra

Katherine Tsang King Suen (appointed on 2 September 2009)

Michael Thomas Pratt (appointed on 1 February 2010)

Olga Louise Zoutendijk

Raymond Kwok Ping Luen\*

Ma Xuezheng\*

Norman Lyle\*

Chan Wing Kin\*

Stefano Paolo Bertamini (resigned on 1 February 2010)

Nicholas Robert Sallnow-Smith (resigned on 31 July 2009)

### *\* Independent non-executive directors*

Ms Katherine Tsang King Suen and Mr Michael Thomas Pratt 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, Katherine Tsang King Suen, Benjamin Hung Pi Cheng, Julian Fong Loong Choon, Stefano Paolo Bertamini, Olga Louise Zoutendijk and Nicholas Robert Sallnow-Smith, were granted options under these schemes.

### **Directors' rights to acquire shares**

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

### **Directors' interests in contracts**

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

## **Report of the directors (continued)**

### **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 2010

## **Independent 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 107, which comprise the consolidated and the Bank balance sheets as at 31 December 2009, and the consolidated income statement, the consolidated statement of comprehensive income, consolidated and the Bank statements of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory 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 2009 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 2010

## Consolidated income statement

### For the year ended 31 December 2009

(Expressed in millions of Hong Kong dollars)

	Note	2009 HK\$'M	2008 HK\$'M
Interest income	4(a)	12,219	16,593
Interest expense	4(b)	(2,514)	(6,564)
<b>Net interest income</b>		<u>9,705</u>	<u>10,029</u>
Fee and commission income		5,448	5,430
Fee and commission expense		(619)	(600)
Net fee and commission income	4(c)	4,829	4,830
Net trading income	4(d)	1,594	925
Net losses from financial instruments designated at fair value	4(e)	(1)	(200)
Net gains from disposal of available-for-sale securities	5	172	100
Other operating income	4(f)	44	131
		<u>6,638</u>	<u>5,786</u>
<b>Total operating income</b>		16,343	15,815
Staff costs		(4,582)	(3,960)
Premises and equipment		(1,077)	(956)
Others		(3,337)	(2,669)
Operating expenses	4(g)	(8,996)	(7,585)
<b>Operating profit before impairment</b>		7,347	8,230
Impairment charges on advances to banks and customers	6(a)	(901)	(1,160)
Other impairment charges	6(b)	(1,010)	(136)
<b>Operating profit after impairment</b>		5,436	6,934
Share of profit of associates		164	23
<b>Profit before taxation</b>		5,600	6,957
Taxation	7(a)	(689)	(1,209)
<b>Profit after taxation</b>		<u>4,911</u>	<u>5,748</u>
Attributable to:			
Equity shareholders of the Bank		4,889	5,743
Minority interests		22	5
<b>Profit after taxation</b>		<u>4,911</u>	<u>5,748</u>

The notes on pages 13 to 107 form part of these financial statements.

**Consolidated balance sheet as at 31 December 2009***(Expressed in millions of Hong Kong dollars)*

	Note	2009 HK\$'M	2008 HK\$'M
<b>Assets</b>			
Cash and balances with banks and other financial institutions	10	8,871	15,378
Placements with banks and other financial institutions	11(a)	144,968	136,463
Hong Kong SAR Government certificates of indebtedness	12	26,461	24,001
Trading assets	13	32,654	17,241
Advances to customers	14(a)	226,236	213,539
Amounts due from immediate holding company	18	54,406	59,400
Amounts due from fellow subsidiaries	18	18,508	25,278
Investment securities	16	145,472	90,501
Interest in associates	20	3,595	3,547
Fixed assets	21	2,883	2,946
Goodwill and intangible assets	22	1,230	935
Deferred tax assets	28	488	172
Other assets	23	8,382	7,820
		<u>674,154</u>	<u>597,221</u>
<b>Liabilities</b>			
Hong Kong SAR currency notes in circulation	12	26,461	24,001
Deposits and balances of banks and other financial institutions		19,952	6,914
Deposits from customers	25	524,050	476,796
Trading liabilities	29	29,036	15,620
Financial liabilities designated at fair value	27	7,566	5,306
Debt securities in issue	26	1,063	3,420
Amounts due to immediate holding company	18	8,847	7,162
Amounts due to fellow subsidiaries	18	2,819	4,826
Current tax liabilities		311	272
Deferred tax liabilities	28	39	37
Other liabilities	30	12,954	13,102
Subordinated liabilities	32	2,306	6,180
		<u>635,404</u>	<u>563,636</u>
<b>Equity</b>			
Share capital	33	97	97
Reserves	34	38,626	33,483
Shareholders' equity		38,723	33,580
Minority interests		27	5
		<u>38,750</u>	<u>33,585</u>
		<u>674,154</u>	<u>597,221</u>

Approved and authorised for issue by the Board of Directors on 3 March 2010.

**Sir C K Chow**  
Chairman

**Hung Pi Cheng Benjamin**  
Director

**Julian Fong Loong Choon**  
Director

**Lai Wing Nga**  
Company Secretary

The notes on pages 13 to 107 form part of these financial statements.

**Balance sheet as at 31 December 2009***(Expressed in millions of Hong Kong dollars)*

	Note	2009 HK\$'M	2008 HK\$'M
<b>Assets</b>			
Cash and balances with banks and other financial institutions	10	8,871	15,320
Placements with banks and other financial institutions	11(a)	144,947	136,463
Hong Kong SAR Government certificates of indebtedness	12	26,461	24,001
Trading assets	13	32,701	17,241
Advances to customers	14(a)	226,236	213,539
Amounts due from immediate holding company	18	54,267	59,373
Amounts due from fellow subsidiaries	18	17,101	24,061
Amounts due from subsidiaries of the Bank	18	1,947	1,855
Investment securities	16	143,069	89,774
Investments in subsidiaries of the Bank	19	2,808	255
Interest in associates	20	2,724	2,764
Fixed assets	21	2,852	2,936
Goodwill and intangible assets	22	921	935
Deferred tax assets	28	488	172
Other assets	23	8,041	7,570
		<u>673,434</u>	<u>596,259</u>
<b>Liabilities</b>			
Hong Kong SAR currency notes in circulation	12	26,461	24,001
Deposits and balances of banks and other financial institutions		19,952	6,914
Deposits from customers	25	524,050	476,796
Trading liabilities	29	29,036	15,620
Financial liabilities designated at fair value	27	7,566	5,306
Debt securities in issue	26	1,063	3,420
Amounts due to immediate holding company	18	8,468	6,793
Amounts due to fellow subsidiaries	18	2,384	4,226
Amounts due to subsidiaries of the Bank	18	1,042	693
Current tax liabilities		247	246
Other liabilities	30	12,532	12,836
Subordinated liabilities	32	2,306	6,180
		<u>635,107</u>	<u>563,031</u>
<b>Equity</b>			
Share capital	33	97	97
Reserves	34	38,230	33,131
Shareholders' equity		<u>38,327</u>	<u>33,228</u>
		<u>673,434</u>	<u>596,259</u>

Approved and authorised for issue by the Board of Directors on 3 March 2010.

**Sir C K Chow**  
Chairman

**Hung Pi Cheng Benjamin**  
Director

**Julian Fong Loong Choon**  
Director

**Lai Wing Nga**  
Company Secretary

The notes on pages 13 to 107 form part of these financial statements.

## Consolidated statement of comprehensive income

### For the year ended 31 December 2009

(Expressed in millions of Hong Kong dollars)

	2009 HK\$'M	2008 HK\$'M
<b>Profit after taxation</b>	4,911	5,748
<b>Other comprehensive income:</b>		
Defined benefit plan:		
– Actuarial gains/(losses)	462	(770)
– Related tax effect	(71)	127
Available-for-sale securities:		
– Changes in fair value recognised during the year	109	(1,008)
– Changes in fair value transferred to the income statement on disposal of available-for-sale securities	(172)	(100)
– Related tax effect	37	339
Cash flow hedges:		
– Effective portion of changes in fair value of cash flow hedges	(95)	10
– Changes in fair value transferred to the income statement on termination of hedging derivatives	(23)	(2)
– Related tax effect	19	(1)
Exchange difference	(12)	74
Adjustment on acquisition of an associate	–	304
	<u>254</u>	<u>(1,027)</u>
Other comprehensive income/(losses) for the year, net of tax		
	<u>254</u>	<u>(1,027)</u>
<b>Total comprehensive income for the year</b>	<u>5,165</u>	<u>4,721</u>
<b>Attributable to:</b>		
Shareholders of the Bank	5,143	4,716
Minority interest	22	5
	<u>5,165</u>	<u>4,721</u>

The notes on pages 13 to 107 form part of these financial statements.

## Consolidated statement of changes in equity

### For the year ended 31 December 2009

(Expressed in millions of Hong Kong dollars)

	Share capital HK\$'M	Share premium HK\$'M	Capital redemption reserve HK\$'M	Cash flow hedge reserve HK\$'M	Available- for-sale investment reserve HK\$'M	Revaluation reserve HK\$'M	Pension reserve HK\$'M	Exchange reserve HK\$'M	Retained profits HK\$'M	Minority interests HK\$'M	Total HK\$'M
At 1 January 2008	97	12,477	3,804	36	985	–	141	104	12,382	–	30,026
Total comprehensive income	–	–	–	7	(769)	146	(643)	74	5,901	5	4,721
Dividends paid	–	–	–	–	–	–	–	–	(1,162)	–	(1,162)
At 31 December 2008	97	12,477	3,804	43	216	146	(502)	178	17,121	5	33,585
Total comprehensive income	–	–	–	(99)	(26)	–	391	(12)	4,889	22	5,165
At 31 December 2009	97	12,477	3,804	(56)	190	146	(111)	166	22,010	27	38,750

The notes on pages 13 to 107 form part of these financial statements.

**Statement of changes in equity**  
**For the year ended 31 December 2009**

(Expressed in millions of Hong Kong dollars)

	Share capital HK\$'M	Share premium HK\$'M	Capital redemption reserve HK\$'M	Cash flow hedge reserve HK\$'M	Available- for-sale investment reserve HK\$'M	Pension reserve HK\$'M	Retained profits HK\$'M	Total HK\$'M
At 1 January 2008	97	12,477	3,804	36	55	141	12,507	29,117
Total comprehensive income	-	-	-	7	205	(643)	5,704	5,273
Dividends paid	-	-	-	-	-	-	(1,162)	(1,162)
At 31 December 2008	97	12,477	3,804	43	260	(502)	17,049	33,228
Total comprehensive income	-	-	-	(99)	(69)	359	4,908	5,099
At 31 December 2009	97	12,477	3,804	(56)	191	(143)	21,957	38,327

No dividends were declared and paid in 2009. During the year ended 31 December 2008, the directors had declared and paid a special dividend of HK\$0.60 per each 'A' and 'B' ordinary share totalling HK\$1,162 million.

The notes on pages 13 to 107 form part of these financial statements.

## Consolidated cash flow statement

### For the year ended 31 December 2009

(Expressed in millions of Hong Kong dollars)

	Note	2009 HK\$'M	2008 HK\$'M
<b>Operating activities</b>			
Profit before taxation		5,600	6,957
Adjustments for:			
Impairment charges on advances to banks and customers		901	1,160
Advances written off net of recoveries		(951)	(376)
Unwinding of discount on loan impairment charges		(42)	(32)
Other impairment charges		1,010	136
Depreciation		217	197
Amortisation of intangible assets		75	46
Recognition of profit on Visa shares		–	(53)
Share of profit of associates		(164)	(23)
Gain on disposal of investment in an associate		(7)	–
Interest expense on subordinated liabilities		168	232
Fair value gains transferred from reserves on cash flow hedges		(23)	(2)
Exchange translation on subordinated liabilities		3	(33)
		<u>6,787</u>	<u>8,209</u>
(Increase)/decrease in operating assets:			
Placements with banks and other financial institutions			
with original maturity beyond three months		(8,039)	(36,919)
Trading assets		(17,485)	10,370
Investment securities		(67,889)	(37,044)
Gross advances to customers		(12,599)	(29,860)
Amounts due from immediate holding company			
and fellow subsidiaries		7,973	(10,922)
Other assets		(375)	1,219
Increase/(decrease) in operating liabilities:			
Deposits and balances of banks and other financial institutions		13,052	(1,924)
Deposits from customers		47,254	94,421
Debt securities in issue		(2,357)	2,012
Financial liabilities designated at fair value		2,260	867
Amounts due to immediate holding company and fellow subsidiaries		(1,296)	2,638
Trading liabilities		13,416	(1,072)
Other liabilities		(999)	(3,827)
		<u>(20,297)</u>	<u>(1,832)</u>
<b>Cash used in operations</b>		(20,297)	(1,832)
Income tax paid		(979)	(1,541)
		<u>(21,276)</u>	<u>(3,373)</u>
<b>Net cash used in operating activities</b>		(21,276)	(3,373)

	Note	2009 HK\$'M	2008 HK\$'M
<b>Investing activities</b>			
Dividend received from an associate		74	79
Payment for purchase of subsidiary, net of cash and cash equivalents acquired		(341)	529
Payment for purchase of an associate		–	(1,647)
Payment for purchase of fixed assets		(151)	(97)
Payment for purchase of intangible assets		(59)	(96)
Proceeds from disposal of investment in an associate		31	–
Proceeds from disposal of intangible assets		11	16
Proceeds from disposal of fixed assets		7	–
<b>Net cash used in investing activities</b>		<u>(428)</u>	<u>(1,216)</u>
<b>Financing activities</b>			
Repurchase of subordinated liabilities		(3,810)	(74)
Interest paid on subordinated liabilities		(197)	(251)
Dividends paid		–	(1,162)
<b>Net cash used in financing activities</b>		<u>(4,007)</u>	<u>(1,487)</u>
<b>Net decrease in cash and cash equivalents</b>		(25,711)	(6,076)
<b>Cash and cash equivalents at 1 January</b>		<u>114,030</u>	<u>120,106</u>
<b>Cash and cash equivalents at 31 December</b>	35	<u><u>88,319</u></u>	<u><u>114,030</u></u>
Cash flows from operating activities include:			
Interest received		12,789	16,368
Interest paid		2,620	6,331
Dividends received		17	19

The notes on pages 13 to 107 form part of these financial statements.

## Notes to the financial statements

(Expressed in millions of Hong Kong dollars)

### 1 Principal activities

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

### 2 Significant accounting policies

#### (a) Statement of compliance

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

#### (b) Basis of preparation of the financial statements

##### (i) Basis of Preparation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries made up to 31 December 2009.

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

The preparation of financial statements in conformity with adopted HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank and its subsidiaries’ accounting policies.

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

##### (ii) Consolidated Financial Statements

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

**Notes to the financial statements (continued)**

(Expressed in millions of Hong Kong dollars)

**2 Significant accounting policies (continued)****(c) Subsidiaries and minority interests**

Subsidiaries are entities controlled by the Bank and its subsidiaries. Control exists when the Bank and its subsidiaries have the power to directly or indirectly govern the financial and operating policies so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

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

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

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

In the Bank's balance sheet, its investments in subsidiaries are stated at cost less impairment losses, if any (see note 19).

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

**Notes to the financial statements (continued)**

(Expressed in millions of Hong Kong dollars)

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

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

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 prior to 1 January 2009, if any.

**(e) Intangible assets****(i) Goodwill**

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

Goodwill included in "Goodwill and intangible assets" is tested annually for impairment and carried at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units for the purpose of impairment testing.

**(ii) Acquired intangibles**

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

**(iii) Computer software**

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Costs associated with the development of software are capitalised where it is probable that it will generate future economic benefits in excess of its cost. Computer software costs are amortised on the basis of expected useful life (2 to 5 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.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***2 Significant accounting policies (continued)****(g) Other property, plant and equipment**

Property, plant and equipment is stated at cost less accumulated depreciation and impairment, if any. Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the 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 leased to customers under finance leases, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method (before tax), which reflects a constant periodic rate of return ignoring tax cash flows.

## Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

### 2 Significant accounting policies (continued)

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

Financial assets are classified in the following categories: financial assets held at fair value through profit or loss, loans and receivables, and available-for-sale financial assets. Financial liabilities are classified either held 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 held at fair value through profit or loss

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

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

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

##### (ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

##### (iii) Available-for-sale assets

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

#### Initial recognition

Purchases and sales of financial assets and liabilities held 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.

**Notes to the financial statements (continued)**

(Expressed in millions of Hong Kong dollars)

**2 Significant accounting policies (continued)****(i) Financial assets and liabilities (excluding derivatives) (continued)***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 establish fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

*Reclassifications*

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

*Renegotiated loans*

Loans and receivables with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank 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.

**Notes to the financial statements (continued)**

(Expressed in millions of Hong Kong dollars)

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

Derivatives are categorised as trading unless they are designated as hedging instruments:

Derivative contracts are initially recognised at fair value on the date on which they are entered into and are subsequently re-measured at their fair value. Fair values are obtained from market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and 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 or derecognition.

**Notes to the financial statements (continued)**

(Expressed in millions of Hong Kong dollars)

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

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow 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 affects profit or loss.

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

*Derivatives that do not qualify for hedge accounting*

Certain derivative transactions do not qualify for hedge accounting. Changes in the fair value of any derivative 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.

**Notes to the financial statements (continued)**

(Expressed in millions of Hong Kong dollars)

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

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the 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 historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

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

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

*Available-for-sale assets*

A significant or prolonged decline in the fair value of an equity security below its cost is considered in determining whether the equity security is impaired. Where objective evidence of impairment exists for available-for-sale financial assets, the cumulative loss (measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in 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.

**Notes to the financial statements (continued)**

(Expressed in millions of Hong Kong dollars)

**2 Significant accounting policies (continued)****(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 held at fair value through profit or loss excluding derivatives is recognised in the income statement using the effective interest rate method.

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

**Notes to the financial statements (continued)**

(Expressed in millions of Hong Kong dollars)

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

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

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

Dividends on equity instruments are recognised in the income statement when the Bank'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 that are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

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

Current and deferred tax relating to items which are charged or credited directly to equity, 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 a legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Bank and its subsidiaries 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.

**Notes to the financial statements (continued)**

(Expressed in millions of Hong Kong dollars)

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

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

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

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

**(ii) Pension obligations**

The Bank has defined contribution and defined benefit plans.

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 funded defined benefit plans, the net asset recognised in the balance sheet represents the excess of the fair value of plan assets over the present value of the defined benefit obligations 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 consolidated statement of other comprehensive income in the period they arise. Past service costs are recognised immediately to the extent that benefits are vested and are otherwise recognised over the average period until benefits are vested on a straight-line basis. Current service costs and any past service costs, together with the unwinding of the discount on plan liabilities, offset by the expected return on plan assets where applicable, are charged to operating expenses.

**(iii) Share-based compensation**

The Standard Chartered PLC Group (the "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.

**Notes to the financial statements (continued)**

(Expressed in millions of Hong Kong dollars)

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

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

**(s) Translation of foreign currencies**

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

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

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

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

**(t) Related parties**

For the purposes of these financial statements, parties are considered to be related to the Bank and its subsidiaries if the Bank and its subsidiaries have the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Bank and its subsidiaries and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities and include 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.

## Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

### 2 Significant accounting policies (continued)

#### (u) Segment reporting

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

### 3 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 2009 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.

On 1 January 2009, the Bank and its subsidiaries retrospectively adopted HKAS 1 "Presentation of Financial Statements" (revised 2007). As a result, in the Bank and its subsidiaries and the Bank's financial statements certain terminology has changed and the Bank and its subsidiaries and the Bank statement of changes in equity have been included as a primary statement.

On 1 January 2009, the Bank and its subsidiaries retrospectively adopted HKFRS 8 "Operating Segments". The required disclosures using the reportable segments which are presented internally to senior management are set out in note 9.

On 1 January 2009, the Bank and its subsidiaries retrospectively adopted HK(IFRIC) 13 "Customer Loyalty Programmes", HK(IFRIC) 16 "Hedges of a Net Investment in a Foreign Operation", amendments to HKFRS 2 "Share Based Payment: Vesting Conditions and Cancellations", HKAS 23 (revised) "Borrowing Costs" and an amendment to HKAS 32 "Financial Instruments: Presentation", none of which had a material impact on the financial statements.

On 1 January 2009, the Bank and its subsidiaries prospectively adopted an amendment to HKAS 27 "Consolidated and Separate Financial Statements" in respect of cost of investment in a subsidiary, jointly controlled entity or associate, which did not have a material impact on the financial statements.

On 1 January 2009, the Bank and its subsidiaries prospectively adopted amendments to HKFRS 7 "Financial Instruments: Disclosures" and the required disclosures are presented in note 38 and 39 to the financial statements.

On 1 January 2009, the Bank and its subsidiaries adopted Improvements to HKFRSs (2008), a collection of amendments to a number of HKFRSs. The amendments to HKFRS 5, HKAS 19, HKAS 20, HKAS 28, HKAS 31, HKAS 32 and HKAS 40 were applied on a prospective basis and the amendments to HKAS 1, HKAS 7, HKAS 16, HKAS 19, HKAS 23, HKAS 27, HKAS 29, HKAS 36, HKAS 38 and HKAS 39 were applied on a retrospective basis. None of these amendments has had a material impact on the financial statements.

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

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

	2009 HK\$'M	2008 HK\$'M
<b>(a) Interest income</b>		
Interest income on listed securities	288	141
Interest income on unlisted securities	2,124	1,929
Other interest income	9,807	14,523
	<u>12,219</u>	<u>16,593</u>
Amount shown in the income statement	12,219	16,593
Less: Interest income arising from trading assets	<u>(177)</u>	<u>(452)</u>
Total interest income on financial assets that are not measured at fair value through profit or loss	<u>12,042</u>	<u>16,141</u>
<p>Other interest income includes interest income on unwinding of discounts on loan impairment charges of HK\$42 million (note 15) (2008: HK\$32 million), and fair value gains of HK\$23 million transferred from reserves on cash flow hedges (2008: HK\$2 million).</p>		
<b>(b) Interest expense</b>		
Interest expense on customer deposits, deposits of banks, certificates of deposit issued, debt securities issued, trading liabilities and financial liabilities designated at fair value	2,346	6,332
Interest expense on subordinated liabilities	168	232
	<u>2,514</u>	<u>6,564</u>
Amount shown in the income statement	2,514	6,564
Less: Interest expense arising from trading liabilities	(158)	(258)
Less: Interest expense arising from financial liabilities designated at fair value	<u>(44)</u>	<u>(19)</u>
Total interest expense on financial liabilities that are not measured at fair value through profit or loss	<u>2,312</u>	<u>6,287</u>

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

	2009 HK\$'M	2008 HK\$'M
<b>(c) Net fee and commission income</b>		
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	1,588	1,366
– fee and commission expense	150	273
	<u>1,588</u>	<u>1,366</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	301	378
– fee and commission expense	106	76
	<u>301</u>	<u>378</u>
<b>(d) Net trading income</b>		
Gains less losses from dealing in foreign currencies	924	741
Gains less losses from trading securities	163	163
Gains from other dealing activities	507	21
	<u>924</u>	<u>741</u>
Amount shown in the income statement	1,594	925
Add: interest income arising from trading assets	177	452
Less: interest expense arising from trading liabilities	(158)	(258)
	<u>177</u>	<u>452</u>
	<u>(158)</u>	<u>(258)</u>
Net income from trading instruments	<u>1,613</u>	<u>1,119</u>
<b>(e) Net losses from financial instruments designated at fair value</b>		
Net losses as shown in the income statement	(1)	(200)
Less: interest expense arising from financial liabilities designated at fair value	(44)	(19)
	<u>(44)</u>	<u>(19)</u>
	<u>(45)</u>	<u>(219)</u>
<b>(f) Other operating income</b>		
Dividend income from listed available-for-sale securities	2	3
Dividend income from unlisted available-for-sale securities	15	16
Net loss on disposal of financial instruments measured at amortised cost	(43)	(19)
Gain on disposal of investment in an associate	7	–
Recognition of profit on Visa shares	–	53
Others	63	78
	<u>63</u>	<u>78</u>
	<u>44</u>	<u>131</u>

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

	2009 HK\$'M	2008 HK\$'M
<b>(g) Operating expenses</b>		
Staff costs		
– contributions to defined contribution plans	117	106
– expense in respect of the defined benefits plan (note 31(d))	30	27
– equity-settled share-based payment expenses	219	106
– salaries and other staff costs	4,216	3,721
Depreciation (note 21)	217	197
Premises and equipment expense, excluding depreciation		
– rental of premises	556	506
– others	304	253
Amortisation		
– other intangible assets (note 22)	75	46
Auditors' remuneration	11	11
Others	3,251	2,612
	<u>8,996</u>	<u>7,585</u>

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

	2009 HK\$'M	2008 HK\$'M
Net gains transferred from reserves	<u>172</u>	<u>100</u>

**6 Impairment charges**

	2009 HK\$'M	2008 HK\$'M
<b>(a) Impairment charges on advances to banks and customers</b>		
Individual impairment provisions (note 15)		
– additions	1,254	1,480
– releases	(118)	(162)
– recoveries	(225)	(225)
	<u>911</u>	<u>1,093</u>
Portfolio impairment (releases)/charges (note 15)	<u>(10)</u>	<u>67</u>
	<u>901</u>	<u>1,160</u>
<b>(b) Other impairment charges</b>		
Impairment releases on other financial assets		
measured at amortised cost	–	(2)
Provision for contingent liabilities	1,010	126
Impairment charges on equity shares	–	12
	<u>1,010</u>	<u>136</u>

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

	2009 HK\$'M	2008 HK\$'M
<i>Current tax</i>		
Hong Kong profits tax	968	1,158
Overseas taxation	54	28
(Over)/under-provision in respect of prior years	(4)	48
	<u>1,018</u>	<u>1,234</u>
<i>Deferred tax (note 28)</i>		
Reversal of temporary differences	(339)	(30)
Effect on deferred tax balances at 1 January resulting from a change in tax rate	–	5
Under-provision in respect of prior years	10	–
	<u>(329)</u>	<u>(25)</u>
	<u>689</u>	<u>1,209</u>

The provision of Hong Kong profit tax for 2009 is calculated at 16.5% (2008: 16.5%) of the estimated assessable profits for the year. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

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

	2009 HK\$'M	2008 HK\$'M
Profit before taxation	<u>5,600</u>	<u>6,957</u>
Notional tax on profit before taxation, calculated at		
Hong Kong profits tax rate of 16.5%	924	1,148
Tax effect of non-deductible expenses	55	73
Tax effect of non-taxable revenue	(67)	(81)
Effect on deferred tax balances at 1 January resulting from a change in tax rate	–	5
Under-provision in prior years	6	48
Tax effect of different tax rates of subsidiaries operating in other jurisdictions	27	13
Tax effect of structured investments	(305)	–
Others	49	3
Actual tax expense	<u>689</u>	<u>1,209</u>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***8 Directors' remuneration**

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

	<i>Bank</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Fees	3	2
Salaries and other emoluments	38	45
	<u>41</u>	<u>47</u>

**9 Segmental reporting**

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

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

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

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

**(a) Segment results, assets and liabilities**

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

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

	Consumer banking		Wholesale banking		Other banking		Inter-segment eliminations		Consolidated Total	
	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008
	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M	HK\$'M
Operating income										
– Net interest income	4,401	5,107	5,212	4,629	(24)	(494)			9,589	9,242
– Other operating income	3,005	3,149	4,793	3,959	34	129			7,832	7,237
	7,406	8,256	10,005	8,588	10	(365)			17,421	16,479
Operating expenses	(4,342)	(4,291)	(4,495)	(3,323)	36	114			(8,801)	(7,500)
Operating profit before impairment	3,064	3,965	5,510	5,265	46	(251)			8,620	8,979
Impairment charges	(593)	(602)	(327)	(595)	–	(77)			(920)	(1,274)
Share of losses of associates	–	–	–	–	(59)	(12)			(59)	(12)
Profit before taxation	2,471	3,363	5,183	4,670	(13)	(340)			7,641	7,693
Total assets	156,729	139,074	510,402	429,013	60,203	66,968	(35,359)	(33,145)	691,975	601,910
Segment liabilities	270,829	239,086	401,778	347,916	13,776	12,004	(35,359)	(33,145)	651,024	565,861

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

	Consolidated	
	2009 HK\$'M	2008 HK\$'M
Reportable segment revenue	17,421	16,479
Income relating to Financial Market products	(944)	(1,186)
Cost of free funds	187	813
Others	(321)	(291)
Total operating income	16,343	15,815

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

	<i>Consolidated</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
<b>Profit before taxation</b>		
Reportable segment profit before taxation	7,641	7,693
Income relating to Financial Market products	(944)	(1,186)
Cost of free funds	187	813
Reallocations of impairment charges	(1,010)	–
Others	(274)	(363)
	<u>5,600</u>	<u>6,957</u>

	<i>Consolidated</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
<b>Assets</b>		
Reportable segment assets	691,975	601,910
Assets of subsidiaries not included in consolidated total assets	(599)	(1,962)
Others	(17,222)	(2,727)
	<u>674,154</u>	<u>597,221</u>

	<i>Consolidated</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
<b>Liabilities</b>		
Reportable segment liabilities	651,024	565,861
Liabilities of subsidiaries not included in consolidated total liabilities	(665)	(1,591)
Others	(14,955)	(634)
	<u>635,404</u>	<u>563,636</u>

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

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

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

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2009</i>	<i>2008</i>	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Cash in hand	1,340	1,370	1,340	1,370
Balances with central bank	1,946	3,999	1,946	3,999
Balances with banks and other financial institutions	5,585	10,009	5,585	9,951
	<u>8,871</u>	<u>15,378</u>	<u>8,871</u>	<u>15,320</u>

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

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2009</i>	<i>2008</i>	<i>2009</i>	<i>2008</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	92,638	59,017	92,617	59,017
– maturing between one month to one year	51,608	76,619	51,608	76,619
– maturing between one year to five years	722	829	722	829
	<u>144,968</u>	<u>136,465</u>	<u>144,947</u>	<u>136,465</u>
Less: impairment charges individually assessed (note 15(b))	<u>–</u>	<u>(2)</u>	<u>–</u>	<u>(2)</u>
	<u>144,968</u>	<u>136,463</u>	<u>144,947</u>	<u>136,463</u>

**(b) Impaired placements with banks and other financial institutions**

	<i>Consolidated and Bank</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross impaired advances to banks	184	177
Impairment charges – individually assessed	<u>–</u>	<u>(2)</u>
	<u>184</u>	<u>175</u>
Gross impaired advances to banks as a % of gross advances to banks	<u>0.13%</u>	<u>0.13%</u>

There is no collateral held against impaired advances to banks.

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

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

**13 Trading assets**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2009</i> <i>HK\$'M</i>	<i>2008</i> <i>HK\$'M</i>	<i>2009</i> <i>HK\$'M</i>	<i>2008</i> <i>HK\$'M</i>
Trading securities	32,005	16,473	32,005	16,473
Placements with banks and other financial institutions	38	–	38	–
Advances to customers	136	–	136	–
Positive fair values of derivatives	475	768	522	768
	<u>32,654</u>	<u>17,241</u>	<u>32,701</u>	<u>17,241</u>
Trading securities:				
Treasury bills (including Exchange Fund Bills)	18,472	8,562	18,472	8,562
Certificates of deposit held	1,237	–	1,237	–
Debt securities	12,296	7,911	12,296	7,911
	<u>32,005</u>	<u>16,473</u>	<u>32,005</u>	<u>16,473</u>
Issued by:				
Central governments and central banks	30,118	15,661	30,118	15,661
Public sector entities	2	–	2	–
Banks and other financial institutions	1,601	682	1,601	682
Corporate entities	284	130	284	130
	<u>32,005</u>	<u>16,473</u>	<u>32,005</u>	<u>16,473</u>
By place of listing:				
Listed in Hong Kong	10,726	6,594	10,726	6,594
Listed outside Hong Kong	120	–	120	–
	<u>10,846</u>	<u>6,594</u>	<u>10,846</u>	<u>6,594</u>
Unlisted	21,159	9,879	21,159	9,879
	<u>32,005</u>	<u>16,473</u>	<u>32,005</u>	<u>16,473</u>

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

	<i>Consolidated and Bank</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross advances to customers	225,467	211,865
Trade bills	2,386	3,381
	<u>227,853</u>	<u>215,246</u>
Less : Impairment charges		
– individually assessed (note 15(a))	(1,196)	(1,276)
– collectively assessed (note 15(a))	(421)	(431)
	<u>226,236</u>	<u>213,539</u>

**(b) Impaired advances to customers**

	<i>Consolidated and Bank</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Gross impaired advances to customers	1,932	1,936
Impairment charges – individually assessed	(1,196)	(1,276)
	<u>736</u>	<u>660</u>
Gross impaired advances to customers as a % of gross advances to customers	<u>0.85%</u>	<u>0.90%</u>
Fair value of collateral held against the covered portion of impaired advances to customers	<u>234</u>	<u>273</u>
Covered portion of impaired advances to customers	170	160
Uncovered portion of impaired advances to customers	<u>1,762</u>	<u>1,776</u>

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

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***14 Advances to customers (continued)****(c) Net investment in finance leases**

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

	<i>Consolidated and Bank</i>					
	2009			2008		
	<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>receivable</i>	<i>receivable</i>	<i>periods</i>	<i>payments</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	14	1	15	34	3	37
After 1 year but within 5 years	6	1	7	24	1	25
After 5 years	2	–	2	2	1	3
	<u>22</u>	<u>2</u>	<u>24</u>	<u>60</u>	<u>5</u>	<u>65</u>
Impairment charges:						
– individually assessed	–			–		
Net investment in finance leases	<u>22</u>			<u>60</u>		

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

	2009		<i>Total</i>
	<i>Individually</i>	<i>Collectively</i>	
	<i>assessed</i>	<i>assessed</i>	<i>HK\$'M</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	
At 1 January 2009	1,276	431	1,707
Amounts written off	(1,176)	–	(1,176)
Recoveries of advances written off in previous years	225	–	225
Net charge to the income statement (note 6(a))	909	(10)	899
Unwind of discount on loan impairment charges (note 4(a))	(38)	–	(38)
At 31 December 2009 (note 14(a))	<u>1,196</u>	<u>421</u>	<u>1,617</u>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***15 Movement in impairment charges on advances to banks and customers (continued)****(a) Advances to customers (continued)****Consolidated and Bank**

	<i>Individually assessed HK\$'M</i>	<i>2008</i>		<i>Total HK\$'M</i>
		<i>Collectively assessed 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 6(a))	1,091	67		1,158
Unwind of discount on loan impairment charges (note 4(a))	(32)	–		(32)
Others	15	36		51
	<u>1,276</u>	<u>431</u>		<u>1,707</u>
At 31 December 2008 (note 14(a))	<u>1,276</u>	<u>431</u>		<u>1,707</u>

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

	<i>Individually assessed</i>	
	<i>2009 HK\$'M</i>	<i>2008 HK\$'M</i>
At 1 January	2	–
Charge to the income statement (note 6(a))	2	2
Unwind of discount on loan impairment charges (note 4(a))	(4)	–
	<u>–</u>	<u>2</u>
At 31 December (note 11(a))	<u>–</u>	<u>2</u>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***16 Investment securities**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2009</i> <i>HK\$'M</i>	<i>2008</i> <i>HK\$'M</i>	<i>2009</i> <i>HK\$'M</i>	<i>2008</i> <i>HK\$'M</i>
Available-for-sale securities				
Treasury bills (including Exchange Fund Bills)	49,895	23,650	49,895	23,650
Certificates of deposit held	11,807	15,212	11,807	15,212
Debt securities	77,044	45,807	77,044	45,807
Equity shares	110	281	80	281
Less: impairment charges	(17)	(17)	(17)	(17)
	<u>138,839</u>	<u>84,933</u>	<u>138,809</u>	<u>84,933</u>
Loans and receivables – Debt securities	6,666	5,601	4,293	4,874
Less: impairment charges	(33)	(33)	(33)	(33)
	<u>145,472</u>	<u>90,501</u>	<u>143,069</u>	<u>89,774</u>
Issued by:				
Central governments and central banks	54,887	24,456	54,887	24,456
Public sector entities	2,924	4,515	2,924	4,515
Banks and other financial institutions	78,568	55,778	76,807	55,778
Corporate entities	9,093	5,752	8,451	5,025
	<u>145,472</u>	<u>90,501</u>	<u>143,069</u>	<u>89,774</u>
By place of listing:				
Listed in Hong Kong	4,218	828	4,188	828
Listed outside Hong Kong	12,850	6,243	12,850	6,243
	<u>17,068</u>	<u>7,071</u>	<u>17,038</u>	<u>7,071</u>
Unlisted	128,404	83,430	126,031	82,703
	<u>145,472</u>	<u>90,501</u>	<u>143,069</u>	<u>89,774</u>

**17 Financial instruments reclassification summary**

In 2008, the Bank reclassified certain financial assets classified as held for trading into the available-for-sale (AFS) category as they were no longer considered to be held for the purpose of selling or repurchasing in the near term. At the time of transfer, the Bank identified the rare circumstances permitting such a transfer as the impact of the ongoing credit crisis in financial markets, particularly from the beginning of 2008, which significantly impacted the liquidity in certain markets. The Bank also reclassified certain eligible financial assets from the trading category to loans and receivables as set out below. No assets have been reclassified in 2009.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***17 Financial instruments reclassification summary (continued)**

The following tables provide details of the remaining balance of assets reclassified during 2008 as at 31 December 2008 and 31 December 2009:

	Consolidated and Bank 2009			
	Carrying amounts at 31 December 2009 HK\$'M	Fair value at 31 December 2009 HK\$'M	Fair value gain/(loss) which would have been recognised in the income statement from 1 January 2009 to 31 December 2009 HK\$'M	Income recognised in income statement HK\$'M
For assets reclassified:				
From trading to available-for-sale	110	110	(2)	29
From trading to loans and receivables	422	414	2	5

	Consolidated and Bank 2008			
	Carrying amounts at 31 December 2008 HK\$'M	Fair value at 31 December 2008 HK\$'M	Fair value gain/(loss) which would have been recognised in the income statement from 1 January 2008 to 31 December 2008 HK\$'M	Income recognised in income statement HK\$'M
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

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

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

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

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

	<i>Immediate holding company</i>		<i>Fellow subsidiaries</i>	
	<i>2009</i>	<i>2008</i>	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Income	1,047	1,947	97	504
Expenses	819	650	326	185

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

	<i>2009</i>		<i>2008</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>
<b>Assets</b>				
Unlisted available-for-sale debt securities	–	3,455	–	3,580
Positive fair values of trading derivatives	2,123	–	1,144	–
Positive fair values of hedging derivatives	74	–	182	–
<b>Liabilities</b>				
Other debt securities in issue, measured at amortised cost	–	974	–	928
Negative fair values of trading derivatives	1,021	–	1,869	–
Negative fair values of hedging derivatives	223	–	64	–

*(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>2009</i>	<i>2008</i>	<i>2009</i>	<i>2008</i>	<i>2009</i>	<i>2008</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	1,047	1,947	97	504	76	72
Expenses	819	650	326	185	–	–

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

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

	2009			2008		
	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M	<i>Subsidiaries of the Bank</i> HK\$'M	<i>Immediate holding company</i> HK\$'M	<i>Fellow subsidiaries</i> HK\$'M	<i>Subsidiaries of the Bank</i> HK\$'M
<b>Assets</b>						
Unlisted available-for-sale debt securities	–	2,292	908	–	2,418	–
Unlisted debt securities, designated at fair value	–	–	–	–	–	996
Subordinated loan	–	–	130	–	–	–
Positive fair values of trading derivatives	2,123	–	–	1,144	–	–
Positive fair values of hedging derivatives	74	–	–	182	–	–
<b>Liabilities</b>						
Other debt securities in issue, measured at amortised cost	–	974	–	–	928	–
Negative fair values of trading derivatives	757	–	–	1,722	–	–
Negative fair values of hedging derivatives	223	–	–	64	–	–

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

	<i>Bank</i>	
	<i>2009</i> <i>HK\$'M</i>	<i>2008</i> <i>HK\$'M</i>
Unlisted shares, at cost less impairment charges, if any	<u>2,808</u>	<u>255</u>

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

<i>Name of company</i>	<i>Place of incorporation</i>	<i>Particulars of issued and paid up capital 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
Standard Chartered Securities (Hong Kong) Limited	Hong Kong	10,000,000 ordinary shares of HK\$1 each	100%	Equity capital markets, corporate finance and institutional brokerage

**20 Interest in associates*****Consolidated***

	<i>2009</i> <i>HK\$'M</i>	<i>2008</i> <i>HK\$'M</i>
Share of net assets	1,878	1,813
Goodwill	<u>1,717</u>	<u>1,734</u>
	<u>3,595</u>	<u>3,547</u>

***Bank***

	<i>2009</i> <i>HK\$'M</i>	<i>2008</i> <i>HK\$'M</i>
Unlisted investments, at cost less impairment losses, if any	1,117	1,520
Listed investment, at cost less impairment losses, if any	<u>1,607</u>	<u>1,244</u>
	<u>2,724</u>	<u>2,764</u>

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

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	781,413,755 ordinary shares of VND10,000 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\$2,399 million (2008: HK\$1,939 million). At the balance sheet date, the fair value of the investment, based on quoted market prices was HK\$1,831 million (2008: HK\$1,181 million). Impairment testing on the investment has been carried out and this demonstrates that there is no impairment.

In respect of the year ended 31 December 2009, the share of ACB's result was included in these financial statements based on accounts drawn up to 30 September 2009, but taking into account any changes in the subsequent period from 1 October 2009 to 31 December 2009 that would materially affect the results. Bohai's result was included in the financial statements based on accounts drawn up to 30 November 2009. MS's result was included in the financial statements based on accounts drawn up to 31 December 2009. The Bank and its subsidiaries have taken advantage of the provision contained in HKAS 28 "Investments in Associates" whereby it is permitted to include the attributable share of associates' results based on accounts drawn up to a non-coterminous period and where the difference is not greater than three months.

**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>
<b>2009</b>					
100 per cent	198,225	187,983	10,242	7,880	1,137
Group's effective interest	<u>35,866</u>	<u>33,988</u>	<u>1,878</u>	<u>1,330</u>	<u>164</u>
	<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>
<b>2008</b>					
100 per cent	111,501	101,717	9,784	1,573	200
Group's effective interest	<u>19,913</u>	<u>18,100</u>	<u>1,813</u>	<u>320</u>	<u>23</u>





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

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2009</i>	<i>2008</i>	<i>2009</i>	<i>2008</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	2,104	2,164	2,104	2,164
– short-term leases	120	99	94	97
	<u>2,224</u>	<u>2,263</u>	<u>2,198</u>	<u>2,261</u>

*Investment properties:*

	<i>Consolidated and Bank</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Freehold outside Hong Kong	<u>484</u>	<u>478</u>

The investment property is stated at depreciated cost less impairment. The fair value of the investment property was HK\$592 million (2008: HK\$1,590 million). The valuation of the investment property 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.



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

	2009		
	<i>Capitalised software and other intangible assets</i> HK\$'M	<i>Goodwill</i> HK\$'M	<i>Total</i> HK\$'M
<b>Cost:</b>			
At 1 January 2009	287	729	1,016
Additions	59	–	59
Disposals	(58)	–	(58)
	<u>288</u>	<u>729</u>	<u>1,017</u>
At 31 December 2009	288	729	1,017
<b>Accumulated amortisation:</b>			
At 1 January 2009	81	–	81
Charge for the year	62	–	62
Written back on disposal	(47)	–	(47)
	<u>96</u>	<u>–</u>	<u>96</u>
At 31 December 2009	96	–	96
<b>Carrying amount:</b>			
At 31 December 2009	<u>192</u>	<u>729</u>	<u>921</u>
	2008		
	<i>Capitalised software and other intangible assets</i> HK\$'M	<i>Goodwill</i> HK\$'M	<i>Total</i> HK\$'M
<b>Cost:</b>			
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
<b>Accumulated amortisation:</b>			
At 1 January 2008	112	–	112
Charge for the year	46	–	46
Written back on disposal	(77)	–	(77)
	<u>81</u>	<u>–</u>	<u>81</u>
At 31 December 2008	81	–	81
<b>Carrying amount:</b>			
At 31 December 2008	<u>206</u>	<u>729</u>	<u>935</u>

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

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

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2009</i>	<i>2008</i>	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Lending	611	611	611	611
Private Banking	118	118	118	118
Standard Chartered Securities (Hong Kong) Limited	253	–	–	–
	<u>982</u>	<u>729</u>	<u>729</u>	<u>729</u>

The recoverable amounts of the CGUs are determined based on value in use calculations. The key assumptions and approach to determining value in use calculations, as set out below, are solely 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 19 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 13.9 per cent (2008: 13.7 per cent) was used.

**23 Other assets**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2009</i>	<i>2008</i>	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Prepayments and accrued income	3,546	3,730	3,334	3,730
Acceptances and endorsements	3,772	3,005	3,772	3,005
Positive fair values of hedging derivatives	50	25	3	25
Property held for sale	132	132	132	132
Others	882	928	800	678
	<u>8,382</u>	<u>7,820</u>	<u>8,041</u>	<u>7,570</u>

**24 Business combinations**

On 30 January 2009, the Bank acquired 100 per cent of the share capital of Standard Chartered Securities (Hong Kong) Limited (formerly known as "Cazenove Asia Limited"), a leading Asian equity capital markets, corporate finance and institutional brokerage business.

Goodwill of HK\$253 million was recognised and HK\$69 million of customer relationship intangibles identified.

If the acquisition had occurred on 1 January 2009 the operating income of the Bank and its subsidiaries would have been approximately HK\$16,345 million and profit before taxation would have been approximately HK\$5,570 million.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***24 Business combinations (continued)**

The assets and liabilities arising from the acquisition of Standard Chartered Securities (Hong Kong) Limited were as follows:

	<i>Fair value</i> <i>HK\$'M</i>	<i>Acquiree's</i> <i>carrying</i> <i>amount</i> <i>HK\$'M</i>
Placement with banks and other financial institutions	238	238
Investment securities	5	5
Intangibles other than goodwill	69	–
Fixed assets	10	10
Other assets	375	375
	<hr/>	<hr/>
Total assets	697	628
	<hr/>	<hr/>
Other liabilities	303	303
Accruals and deferred income	54	54
Net retirement benefit obligation	14	14
	<hr/>	<hr/>
Total liabilities	371	371
	<hr/>	<hr/>
Net assets acquired	326	257
	<hr/> <hr/>	<hr/> <hr/>
Purchase consideration settled in cash	(579)	
Cash and cash equivalents in subsidiary acquired	238	
	<hr/>	
Cash outflow on acquisition	(341)	
	<hr/> <hr/>	
Purchase consideration:		
– cash paid	569	
– direct costs relating to the acquisition	10	
	<hr/>	
Total purchase consideration	579	
Less: Fair value of net assets acquired	(326)	
	<hr/>	
Goodwill	253	
	<hr/> <hr/>	
Intangible assets acquired:		
Customer relationships	69	
	<hr/>	
Total	69	
	<hr/> <hr/>	
Contribution from acquisition to 31 December 2009:		
Operating income	303	
Loss before taxation	(21)	
	<hr/> <hr/>	

Goodwill arising on the acquisition is attributable to the synergies expected to arise from their integration with the Bank.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***24 Business combinations (continued)**

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:

	<i>Fair value</i> HK\$'M	<i>Acquiree's</i> <i>carrying</i> <i>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
	<hr/>	<hr/>
Total assets	17,267	17,286
	<hr/>	<hr/>
Deposits from customers	16,500	16,500
Other liabilities	787	786
	<hr/>	<hr/>
Total liabilities	17,287	17,286
	<hr/>	<hr/>
Net liabilities acquired	(20)	–
	<hr/>	<hr/>
Purchase consideration settled in cash	(98)	
Cash and cash equivalents in subsidiary acquired	627	
	<hr/>	
Cash inflow on acquisition	529	
	<hr/>	
Purchase consideration:		
– cash paid	98	
– direct costs relating to the acquisition	–	
	<hr/>	
Total purchase consideration	98	
Fair value of net liabilities acquired	20	
	<hr/>	
Goodwill	118	
	<hr/>	
Contribution from acquisition to 31 December 2008:		
Operating income	80	
Loss before taxation	(92)	
	<hr/>	

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.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***25 Deposits from customers**

	<i>Consolidated and Bank</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Current accounts	68,780	41,248
Savings accounts	286,310	196,769
Time, call and notice deposits	155,717	229,299
Deposits and balances of central banks	13,243	9,480
	<u>524,050</u>	<u>476,796</u>

**26 Debt securities in issue**

	<i>Consolidated and Bank</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Certificates of deposit, measured at amortised cost	<u>1,063</u>	<u>3,420</u>

**27 Financial liabilities designated at fair value**

	<i>Consolidated and Bank</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Structured customer deposits	7,566	5,270
Debt securities issued	<u>–</u>	<u>36</u>
	<u>7,566</u>	<u>5,306</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 2009, the carrying amount of these financial liabilities exceeded the contractual amount payable at maturity by HK\$49 million (2008: HK\$113 million). This change is attributable to changes in market rates.





**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***29 Trading liabilities**

	<i>Consolidated and Bank</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Short positions in securities	28,378	15,389
Negative fair values of derivatives	658	231
	<u>29,036</u>	<u>15,620</u>

**30 Other liabilities**

	<i>Consolidated</i>		<i>Bank</i>	
	<i>2009</i>	<i>2008</i>	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Accruals and deferred income	3,113	3,047	2,909	2,973
Provision for liabilities and charges	1,556	217	1,556	218
Negative fair values of hedging derivatives	14	71	14	71
Acceptance and endorsements	3,772	3,005	3,772	3,005
Others	4,499	6,762	4,281	6,569
	<u>12,954</u>	<u>13,102</u>	<u>12,532</u>	<u>12,836</u>

**31 Employee retirement benefits**

The Bank and its subsidiaries make contributions to two defined benefit retirement schemes, namely Standard Chartered Bank Hong Kong Retirement Scheme ("SCB Scheme") and Cazenove Hong Kong Retirement Scheme ("Cazenove Scheme") which covers 26% (2008: 26%) of the Bank and its subsidiaries' employees. The schemes are administered by trustees, with the assets held separately from those of the Bank and its subsidiaries.

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

	<i>SCB Scheme</i>		<i>Cazenove Scheme</i>
	<i>2009</i>	<i>2008</i>	<i>2009</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Fair value of plan assets	1,799	1,467	70
Present value of wholly or partly funded obligations	(1,712)	(1,890)	(54)
Net asset/(liability) recognised in the balance sheet (included in "Other assets"/"Other liabilities")	<u>87</u>	<u>(423)</u>	<u>16</u>

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

	<i>SCB Scheme</i>		<i>Cazenove Scheme</i>
	<i>2009</i>	<i>2008</i>	<i>2009</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
At the beginning of the year	1,890	1,666	–
Acquisition	–	–	66
Current service cost	94	97	11
Interest cost	21	56	1
Benefits paid	(124)	(76)	(5)
Actuarial (gains)/losses	(169)	147	(19)
At the end of the year	<u>1,712</u>	<u>1,890</u>	<u>54</u>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***31 Employee retirement benefits (continued)****(c) Movements in the fair value of assets:**

	SCB Scheme		Cazenove Scheme
	2009	2008	2009
	HK\$'M	HK\$'M	HK\$'M
At the beginning of the year	1,467	1,980	–
Acquisition	–	–	52
Contributions	102	60	6
Expected return on assets	93	126	4
Benefits paid	(124)	(76)	(5)
Actuarial gains/(losses) on plan assets	261	(623)	13
	<u>1,799</u>	<u>1,467</u>	<u>70</u>

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

	SCB Scheme		Cazenove Scheme
	2009	2008	2009
	HK\$'M	HK\$'M	HK\$'M
At the beginning of the year	(423)	314	–
Acquisition	–	–	(14)
Contributions	102	60	6
Expense recognised in the income statement (note 4(g))	(22)	(27)	(8)
Actuarial gains/(losses) to pension reserve	430	(770)	32
	<u>87</u>	<u>(423)</u>	<u>16</u>

As at 31 December 2009, the schemes did not invest in the Bank's own financial instruments and properties (2008: HK\$Nil). The Bank and its subsidiaries expect to contribute approximately HK\$115 million to the schemes in 2010.

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

	SCB Scheme		Cazenove Scheme from
	2009	2008	30 January 2009 to 31 December 2009
	HK\$'M	HK\$'M	HK\$'M
Current service cost	94	97	11
Interest cost	21	56	1
Actuarial expected return on plan assets	(93)	(126)	(4)
	<u>22</u>	<u>27</u>	<u>8</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 income of HK\$371 million (2008: net loss of HK\$497 million).

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***31 Employee retirement benefits (continued)****(f) The principal actuarial assumptions used in the valuation are as follows:**

	SCB Scheme		Cazenove Scheme
	2009	2008	2009
Discount rate	2.60%	1.20%	2.60%
Expected rate of return on plan assets	6.50%	6.50%	6.50%
Future salary increases	3.50%	3.50%	3.50%

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:**

	SCB Scheme		Cazenove Scheme
	2009	2008	2009
Equities	50%	48%	64%
Bonds	46%	51%	31%
Cash	4%	1%	5%
	<u>100%</u>	<u>100%</u>	<u>100%</u>

**32 Subordinated liabilities**

	Consolidated and Bank	
	2009	2008
	HK\$'M	HK\$'M
HK\$595 million Floating Rate Step-Up Notes 2014 <sup>(1)(5)</sup>	–	596
HK\$500 million 3.5% Fixed/Floating Rate Step-Up Notes 2014 <sup>(2)(5)</sup>	–	508
US\$350 million 4.375% Fixed/Floating Rate Step-Up Notes 2014 <sup>(3)(5)</sup>	–	2,776
US\$300 million Floating Rate Step-Up Notes 2017 <sup>(4)</sup>	2,306	2,300
	<u>2,306</u>	<u>6,180</u>

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

(1) Interest rate at three months HIBOR plus 0.37 per cent, payable quarterly, to the call option date on 4 December 2009. Thereafter, it will be reset to three-months 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-months 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-months US dollar LIBOR plus 0.86 per cent, payable quarterly.

(4) Interest rate at three-months 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-months US dollar LIBOR plus 0.75 per cent, payable quarterly.

(5) The Bank has exercised its option to redeem the Notes in whole on 4 December 2009.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***33 Share capital**

	<i>2009 and 2008</i>	
	<i>No. of shares in millions</i>	<i>HK\$'M</i>
<b>Authorised:</b>		
'A' ordinary shares of HK\$0.05 each	780	39
'B' ordinary shares of HK\$0.05 each	1,231	62
	<hr/>	<hr/>
	2,011	101
Preference shares of HK\$1.00 each	3,800	3,800
	<hr/>	<hr/>
	5,811	3,901
	<hr/> <hr/>	<hr/> <hr/>
	<i>2009 and 2008</i>	
	<i>No. of shares in millions</i>	<i>HK\$'M</i>
<b>Issued and fully paid:</b>		
'A' ordinary shares of HK\$0.05 each	706	35
'B' ordinary shares of HK\$0.05 each	1,231	62
	<hr/>	<hr/>
	1,937	97
Preference shares of HK\$1.00 each	—	—
	<hr/>	<hr/>
	1,937	97
	<hr/> <hr/>	<hr/> <hr/>

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

**34 Reserves*****Nature and purpose of reserves***

## (i) Share premium

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

## (ii) Capital redemption reserve

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

## (iii) Available-for-sale investment reserve

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

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***34 Reserves (continued)*****Nature and purpose of reserves (continued)***

## (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).

## (vii) Revaluation reserve

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

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 2009, an amount of HK\$1,041 million (2008: HK\$1,383 million) has been reserved for this purpose.

**35 Cash and cash equivalents**

	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
<b>(a) <i>Components of cash and cash equivalents in the cash flow statement</i></b>		
Cash and balances with banks and other financial institutions	8,855	15,348
Trading assets with original maturity within three months	1,837	3,909
Placements with banks and other financial institutions with original maturity within three months	68,053	67,827
Investment securities with original maturity within three months	1,263	14,123
Amounts due from immediate holding company and fellow subsidiaries with original maturity within three months	8,311	12,823
	<u>88,319</u>	<u>114,030</u>
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
<b>(b) <i>Reconciliation with the consolidated balance sheet</i></b>		
Cash and balances with banks and other financial institutions	8,871	15,378
Placements with banks and other financial institutions	144,968	136,463
Trading assets	32,654	17,241
Investment securities	145,472	90,501
Amounts due from immediate holding company and fellow subsidiaries	72,914	84,678
Overdrafts included in "deposits and balances of banks and other financial institutions"	(16)	(30)
Overdrafts included in "amounts due to immediate holding company"	(798)	(18)
	<u>404,065</u>	<u>344,213</u>
Less: amounts with an original maturity of beyond three months	<u>(315,746)</u>	<u>(230,183)</u>
Cash and cash equivalents in the consolidated cash flow statement	<u>88,319</u>	<u>114,030</u>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***36 Derivative financial instruments**

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

**(a) Notional amounts of derivatives**

Derivatives are financial instruments that derive their value in reference to changes in interest or exchange rates, credit risk, financial instrument prices and 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**

	2009			
	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
<b>Exchange rate contracts</b>				
Forwards	–	299	366,017	366,316
Cross currency swaps	1,793	–	1,128	2,921
Options purchased	–	9,717	–	9,717
Options written	–	13,608	–	13,608
<b>Interest rate contracts</b>				
Forwards	–	2,591	–	2,591
Swaps	31,706	7,720	2,118	41,544
Options purchased	–	38	–	38
Options written	–	6,612	–	6,612
<b>Other derivatives</b>	–	4	392	396
	<u>33,499</u>	<u>40,589</u>	<u>369,655</u>	<u>443,743</u>
2008				
<b>Exchange rate contracts</b>				
Forwards	–	618	445,821	446,439
Options purchased	–	10,250	289	10,539
Options written	–	12,186	289	12,475
<b>Interest rate contracts</b>				
Forwards	–	4,459	–	4,459
Swaps	19,336	2,197	1,164	22,697
Options purchased	–	317	–	317
Options written	–	1,307	–	1,307
<b>Other derivatives</b>	–	238	405	643
	<u>19,336</u>	<u>31,572</u>	<u>447,968</u>	<u>498,876</u>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***36 Derivative financial instruments (continued)****Bank**

	2009			Total HK\$'M
	Qualifying for hedge accounting HK\$'M	Managed in conjunction with financial instruments designated at fair value through profit or loss HK\$'M	Others, including held for trading HK\$'M	
<b>Exchange rate contracts</b>				
Forwards	–	299	366,017	366,316
Cross currency swaps	–	–	2,921	2,921
Options purchased	–	9,717	–	9,717
Options written	–	13,608	–	13,608
<b>Interest rate contracts</b>				
Forwards	–	2,591	–	2,591
Swaps	31,706	7,720	955	40,381
Options purchased	–	38	–	38
Options written	–	6,612	–	6,612
<b>Other derivatives</b>	–	4	392	396
	<u>31,706</u>	<u>40,589</u>	<u>370,285</u>	<u>442,580</u>
2008				
<b>Exchange rate contracts</b>				
Forwards	–	618	445,821	446,439
Options purchased	–	10,250	289	10,539
Options written	–	12,186	289	12,475
<b>Interest rate contracts</b>				
Forwards	–	4,459	–	4,459
Swaps	19,336	2,197	–	21,533
Options purchased	–	317	–	317
Options written	–	1,307	–	1,307
<b>Other derivatives</b>	–	238	405	643
	<u>19,336</u>	<u>31,572</u>	<u>446,804</u>	<u>497,712</u>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***36 Derivative financial instruments (continued)****(b) Fair values and credit risk weighted amounts of derivatives**

	Consolidated					
	Fair value assets HK\$'M	2009 Fair value liabilities HK\$'M	Credit risk weighted amount HK\$'M	Fair value assets HK\$'M	2008 Fair value liabilities HK\$'M	Credit risk weighted amount HK\$'M
Exchange rate contracts	2,274	1,347	550	1,502	1,819	853
Interest rate contracts	425	559	77	572	384	68
Other derivatives	23	10	24	45	32	33
	<u>2,722</u>	<u>1,916</u>	<u>651</u>	<u>2,119</u>	<u>2,235</u>	<u>954</u>

	Bank					
	Fair value assets HK\$'M	2009 Fair value liabilities HK\$'M	Credit risk weighted amount HK\$'M	Fair value assets HK\$'M	2008 Fair value liabilities HK\$'M	Credit risk weighted amount HK\$'M
Exchange rate contracts	2,274	1,347	550	1,502	1,819	853
Interest rate contracts	425	295	74	572	237	67
Other derivatives	23	10	24	45	32	33
	<u>2,722</u>	<u>1,652</u>	<u>648</u>	<u>2,119</u>	<u>2,088</u>	<u>953</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.

**(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 2009:

As 31 December 2009

	Consolidated	
	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
Exchange rate contracts	47	—
Interest rate contracts	77	237
	<u>124</u>	<u>237</u>

	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	77	237

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***36 Derivative financial instruments (continued)****(c) Fair value of derivative financial instruments designated as hedging instruments (continued)**

As 31 December 2008

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

## Fair value hedges

The fair value hedges principally consist of interest rate swaps and cross currency swaps. The interest rate swaps are used to protect against changes in the fair value of certain fixed rate assets and liabilities due to movements in market interest rates. The cross currency swaps are used to manage foreign exchange exposures. At 31 December 2009, the net negative fair value of derivatives held as fair value hedges was HK\$48 million (2008: positive HK\$33 million) comprising assets of HK\$95 million (2008: HK\$95 million) and liabilities of HK\$143 million (2008: HK\$62 million). The losses on the hedging instruments were HK\$81 million (2008: gains of HK\$28 million). The gains on the hedged item attributable to the hedged risk were HK\$79 million (2008: losses of HK\$28 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 2009, the net negative fair value of interest rate swaps held as cash flow hedges was HK\$65 million (2008: positive HK\$39 million) comprising assets of HK\$29 million (2008: HK\$112 million) and liabilities of HK\$94 million (2008: HK\$73 million). The interest rate swaps will mature within 5 years (2008: within 5 years) from the balance sheet date. During the year, there was no ineffectiveness recognised in the income statement that arose from cash flow hedges (2008: HK\$ Nil).

**37 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>2009 HK\$'M</i>	<i>2008 HK\$'M</i>	<i>2009 HK\$'M</i>	<i>2008 HK\$'M</i>
Direct credit substitutes	26,402	35,633	26,537	35,633
Transaction-related contingencies	13,994	12,087	13,994	12,087
Trade-related contingencies	20,518	19,819	20,518	19,819
Forward asset purchases	851	14	851	14
Forward deposits placed	3,791	25	3,791	25
Other commitments:				
which are not unconditionally cancellable:				
with original maturity of not more than one year	1,743	5,971	1,743	5,971
with original maturity of more than one year	10,127	10,338	10,127	10,338
which are unconditionally cancellable	247,745	179,100	247,745	179,100
	325,171	262,987	325,306	262,987
Credit risk weighted amount	29,109	22,477	29,311	22,477

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***37 Contingent liabilities and commitments (continued)****(a) The following is a summary of the contractual amounts of each significant contingent liability and commitment: (continued)**

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

**(b) Capital commitments**

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

	<i>Consolidated and Bank</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Contracted for	893	25
Authorised but not contracted for	13	39
	<u>906</u>	<u>64</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>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Within 1 year	592	537
After 1 year but within 5 years	808	831
After 5 years	40	4
	<u>1,440</u>	<u>1,372</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.

## Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

### 38 Risk management

The management of risk lies at the heart of the Bank's business. One of the principal risks the Bank incurs arises from extending credit to customers through its trading and lending operations. Beyond credit risk, the Bank is also exposed to a range of other risk types such as 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 seeks 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 and trading books.

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.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(a) Credit risk (continued)**

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 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 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 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 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 is responsible for upholding the integrity of the Group’s risk/return decisions, and in particular for ensuring that risks are properly assessed, that risk/return decisions are made transparently on the basis of this proper assessment, and are controlled in accordance with the Group’s standards. The Risk function is independent of the business functions to ensure that the necessary balance in risk/return decisions is not compromised by short-term pressures to generate revenues.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(a) Credit risk (continued)***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 the 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.

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 Group'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 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.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(a) Credit risk (continued)***Credit Approval*

The Bank has been locally incorporated since 1 July 2004. Since then, the approval process reflects 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 Group, all significant risk decisions emanating from Hong Kong will have an impact to the Group, be it regulatory, concentration, strategic, etc. It is therefore recognised that it is essential for the Group to consider such transactions to ensure that these Group issues are included as part of the decision making process. Delegated authorities 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 Group is sought. In such cases, the relevant Group entity, whether an individual or a committee (including but not limited to the GRC), will review the proposal from a 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*

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 Bank and its subsidiaries regularly monitor 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.

## Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

### 38 Risk management (continued)

#### (a) Credit risk (continued)

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. 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 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 Bank 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 Bank and its subsidiaries enter 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.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(a) Credit risk (continued)**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**

	2009 HK\$'M	2008 HK\$'M
Balances with banks and other financial institutions	7,531	14,008
Placements with banks and other financial institutions	144,968	136,463
Hong Kong SAR Government certificates of indebtedness	26,461	24,001
Trading assets	32,654	17,241
Advances to customers	226,236	213,539
Amounts due from immediate holding company	54,406	59,400
Amounts due from fellow subsidiaries	18,508	25,278
Investment securities	145,472	90,501
Other assets	8,250	7,688
Financial guarantees and other credit related contingent liabilities	61,366	67,539
Loan commitments and other credit related commitments	16,512	16,348
	<u>742,364</u>	<u>672,006</u>

**Bank**

	2009 HK\$'M	2008 HK\$'M
Balances with banks and other financial institutions	7,531	13,950
Placements with banks and other financial institutions	144,947	136,463
Hong Kong SAR Government certificates of indebtedness	26,461	24,001
Trading assets	32,701	17,241
Advances to customers	226,236	213,539
Amounts due from immediate holding company	54,267	59,373
Amounts due from fellow subsidiaries	17,101	24,061
Amounts due from subsidiaries of the Bank	1,947	1,855
Investment securities	143,069	89,774
Other assets	7,909	7,438
Financial guarantees and other credit related contingent liabilities	61,501	67,539
Loan commitments and other credit related commitments	16,512	16,348
	<u>740,182</u>	<u>671,582</u>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(a) Credit risk (continued)**

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 is the contractual nominal amounts.

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

	2009		2008	
	<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	223,955	144,784	210,312	136,288
– past due but not impaired	1,966	–	2,998	–
– impaired, net of individually assessed impairment charges	736	184	660	175
Less: collectively assessed impairment charges	(421)	–	(431)	–
	<u>226,236</u>	<u>144,968</u>	<u>213,539</u>	<u>136,463</u>
Fair value of collateral held against:				
– impaired advances (Note)	170	–	160	–
– past due but not impaired advances	1,483	–	1,900	–
	<u>1,653</u>	<u>–</u>	<u>2,060</u>	<u>–</u>

**Bank**

	2009		2008	
	<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	223,955	144,763	210,312	136,288
– past due but not impaired	1,966	–	2,998	–
– impaired, net of individually assessed impairment charges	736	184	660	175
Less: collectively assessed impairment charges	(421)	–	(431)	–
	<u>226,236</u>	<u>144,947</u>	<u>213,539</u>	<u>136,463</u>
Fair value of collateral held against:				
– impaired advances (Note)	170	–	160	–
– past due but not impaired advances	1,483	–	1,900	–
	<u>1,653</u>	<u>–</u>	<u>2,060</u>	<u>–</u>

Note: The fair value represents the covered portion of impaired advances to customers (Note 14(b)).

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(a) Credit risk (continued)***(i) Analysis of the loan portfolio (continued)*

The following tables set out an analysis of the internal credit gradings for advances which are not past due and for which no individual impairment provision has been raised. The credit gradings set out in the tables below are based on a probability of default measure as set out on page 68.

**Consolidated**

	2009		2008	
	<i>Advances to customers</i>	<i>Advances to banks</i>	<i>Advances to customers</i>	<i>Advances to banks</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Credit grades:				
1 to 5	136,552	143,199	127,782	133,976
6 to 8	58,823	1,509	49,550	2,301
9 to 11	27,519	51	31,822	11
12	1,061	25	1,158	–
	<u>223,955</u>	<u>144,784</u>	<u>210,312</u>	<u>136,288</u>

**Bank**

	2009		2008	
	<i>Advances to customers</i>	<i>Advances to banks</i>	<i>Advances to customers</i>	<i>Advances to banks</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Credit grades:				
1 to 5	136,552	143,178	127,782	133,976
6 to 8	58,823	1,509	49,550	2,301
9 to 11	27,519	51	31,822	11
12	1,061	25	1,158	–
	<u>223,955</u>	<u>144,763</u>	<u>210,312</u>	<u>136,288</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**

	2009	2008
	<i>Advances to customers</i>	<i>Advances to customers</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Past due		
– up to 30 days	1,710	2,508
– 31-60 days	130	286
– 61-90 days	35	101
– 91-120 days	44	73
– 121-150 days	47	30
	<u>2,066</u>	<u>3,008</u>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(a) Credit risk (continued)***(i) Analysis of the loan portfolio (continued)***Bank**

	2009	2008
	<i>Advances to customers HK\$'M</i>	<i>Advances to customers HK\$'M</i>
Past due		
– up to 30 days	1,710	2,508
– 31-60 days	130	286
– 61-90 days	35	101
– 91-120 days	44	73
– 121-150 days	47	30

There are no overdue advances to banks as at 31 December 2009 and 2008.

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

	2009			
	<i>Treasury bills HK\$'M</i>	<i>Debt securities HK\$'M</i>	<i>Equity shares HK\$'M</i>	<i>Total HK\$'M</i>
Impaired securities	–	33	22	55
Impairment provisions	–	(33)	(17)	(50)
Net impaired securities	–	–	5	5
Securities neither past due nor impaired	68,367	112,472	88	180,927

	2008			
	<i>Treasury bills HK\$'M</i>	<i>Debt securities HK\$'M</i>	<i>Equity shares HK\$'M</i>	<i>Total HK\$'M</i>
Impaired securities	–	33	22	55
Impairment provisions	–	(33)	(17)	(50)
Net impaired securities	–	–	5	5
Securities neither past due nor impaired	32,212	78,078	259	110,549

**Bank**

	2009			
	<i>Treasury bills HK\$'M</i>	<i>Debt securities HK\$'M</i>	<i>Equity shares HK\$'M</i>	<i>Total HK\$'M</i>
Impaired securities	–	33	22	55
Impairment provisions	–	(33)	(17)	(50)
Net impaired securities	–	–	5	5
Securities neither past due nor impaired	68,367	109,844	58	178,269

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(a) Credit risk (continued)**

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

**Bank (continued)**

	2008			
	<i>Treasury bills</i>	<i>Debt securities</i>	<i>Equity shares</i>	<i>Total</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Impaired securities	–	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

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**

	2009		2008	
	<i>Treasury bills</i>	<i>Debt securities</i>	<i>Treasury bills</i>	<i>Debt securities</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
AAA	–	12,867	–	5,822
AA - to AA +	68,367	79,836	32,212	56,951
A - to A +	–	12,868	–	4,743
Lower than A-	–	792	–	504
Unrated	–	6,109	–	10,058
	68,367	112,472	32,212	78,078

**Bank**

	2009		2008	
	<i>Treasury bills</i>	<i>Debt securities</i>	<i>Treasury bills</i>	<i>Debt securities</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
AAA	–	12,867	–	5,822
AA - to AA +	68,367	78,075	32,212	56,951
A - to A +	–	12,868	–	4,743
Lower than A-	–	792	–	504
Unrated	–	5,242	–	9,165
	68,367	109,844	32,212	77,185

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(a) Credit risk (continued)**Repossessed Collateral

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

	<i>Consolidated and Bank</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Property, plant and equipment	89	51

As at 31 December 2009, the repossessed assets amounted to HK\$60 million (2008: 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 (2008: HK\$ Nil).

Renegotiated advances to customers which were neither past due nor impaired amounted to HK\$91 million (2008: HK\$106 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 off-balance sheet ("derivative") financial instruments. Derivative instruments are contracts with characteristics and value derived from underlying financial instruments, interest and exchange rates or indices. They include futures, forwards, swaps, and options transactions in the foreign exchange and interest rate markets. The Bank only enters into derivative positions to meet customer demand or for hedging purposes. 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. The 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 VaR as risk management tools. For example, interest rate sensitivity is measured in terms of exposure to a one basis point increase in yields.

## Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

### 38 Risk management (continued)

#### (b) Market risk management (continued)

##### 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.

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

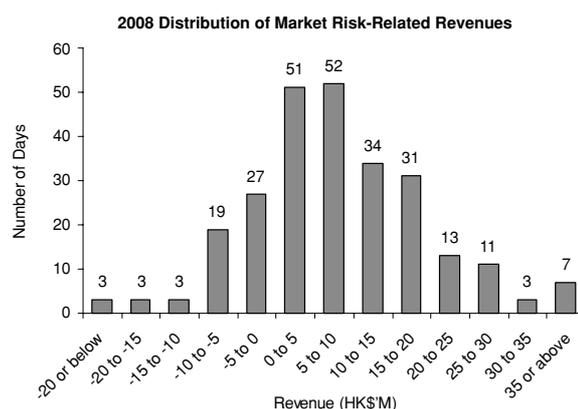
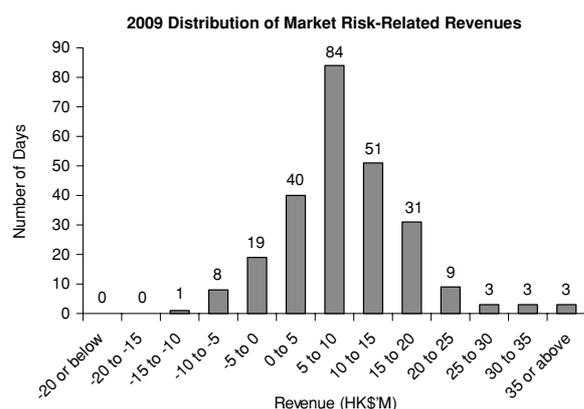
The Bank applies two VaR methodologies, historic simulation and monte carlo simulation, with an observation period of one year. Historic simulation is applied for general market risk factors. This approach involves the revaluation of all unmatured contracts to reflect the effect of historically observed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

##### Stress Testing

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

VaR 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.



**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(b) Market risk management (continued)**Trading and Non-trading (VaR at 97.5%, 1 day)

<i>Value at risk (HK\$'M):</i>	2009				2008			
	<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 ^	61.3	72.6	41.5	56.8	45.9	64.7	33.8
Foreign exchange risk	2.0	10.1	0.5	0.7	1.5	3.8	0.2	0.6
<b>Total ^^</b>	<b>61.3</b>	<b>72.6</b>	<b>41.6</b>	<b>56.8</b>	<b>45.6</b>	<b>63.9</b>	<b>34.0</b>	<b>48.1</b>

Trading (VaR at 97.5%, 1 day)

<i>Value at risk (HK\$'M):</i>	2009				2008			
	<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 ^	11.5	23.4	5.4	12.6	8.0	14.9	3.0
Foreign exchange risk	2.0	10.1	0.5	0.7	1.5	3.8	0.2	0.6
<b>Total ^^</b>	<b>11.8</b>	<b>24.3</b>	<b>5.5</b>	<b>13.3</b>	<b>8.0</b>	<b>14.4</b>	<b>3.3</b>	<b>8.4</b>

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

<i>Value at risk (HK\$'M):</i>	2009				2008			
	<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 ^	59.6	72.0	37.6	53.8	40.1	62.4	24.9

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

	2009 HK\$'M	2008 HK\$'M
<b>Trading</b>		
Interest rate risk	2.2	1.2
Foreign exchange risk	7.2	7.7
<b>Total</b>	<b>9.4</b>	<b>8.9</b>
<b>Non-Trading</b>		
Interest rate risk	7.7	3.8

## Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

### 38 Risk management (continued)

#### (b) Market risk management (continued)

The highest and lowest VaR are independent and usually occur on different days.

\* This represents the actual one day VaR as at 31 December.

^ Interest rate risk VaR includes credit spread risk arising from securities held by ALM.

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

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

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

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(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 had the following non-structural foreign currency positions which exceeded 10% of the net non-structural position in all foreign currencies:

	<i>2009</i> <i>HK\$'M</i>	<i>2008</i> <i>HK\$'M</i>
<b>US dollars exposure</b>		
Spot assets	228,051	209,139
Spot liabilities	(186,265)	(179,746)
Forward purchases	163,395	206,303
Forward sales	(204,926)	(236,755)
	<u>255</u>	<u>(1,059)</u>
Net long/(short) non-structural position		
<b>Euro exposure</b>		
Spot assets	49,527	21,181
Spot liabilities	(14,286)	(17,941)
Forward purchases	13,190	4,436
Forward assets	(48,341)	(7,680)
	<u>90</u>	<u>(4)</u>
Net long/(short) non-structural position		
<b>Australian dollars exposure</b>		
Spot assets	13,954	14,864
Spot liabilities	(14,177)	(14,485)
Forward purchases	5,460	2,113
Forward sales	(5,104)	(2,349)
	<u>133</u>	<u>143</u>
Net long non-structural position		

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(c) Foreign exchange risk (continued)**

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

	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Chinese Renminbi	1,196	1,146
United Arab Emirates Dirham	484	478
Vietnamese Dong	682	607
	<u>2,362</u>	<u>2,231</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.

**(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 testing of 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.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(e) Liquidity risk (continued)**

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 the 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.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(e) Liquidity risk (continued)****(i) Contractual maturity**

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

**Consolidated**

	2009						Undated HK\$'M	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		
<b>Assets</b>								
Cash and balances with banks and other financial institutions	8,871	–	–	–	–	–	–	8,871
Placements with banks and other financial institutions	234	92,404	15,246	36,362	722	–	–	144,968
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	–	26,461	26,461
Trading assets	–	1,293	9,918	12,686	6,874	1,883	–	32,654
Advances to customers	7,933	26,704	17,154	28,007	64,532	83,523	(1,617)	226,236
Investment securities	612	11,497	26,509	75,240	29,716	1,805	93	145,472
Amounts due from group companies	609	20,448	31,363	12,405	4,335	3,754	–	72,914
Others	208	2,262	5,053	502	–	47	8,506	16,578
<b>Total Assets</b>	<b>18,467</b>	<b>154,608</b>	<b>105,243</b>	<b>165,202</b>	<b>106,179</b>	<b>91,012</b>	<b>33,443</b>	<b>674,154</b>
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation	–	–	–	–	–	–	26,461	26,461
Deposits and balances of banks and other financial institutions	17,192	2,087	298	375	–	–	–	19,952
Deposits from customers	357,457	91,525	39,054	35,733	281	–	–	524,050
Trading liabilities	–	28,809	167	60	–	–	–	29,036
Financial liabilities designated at fair value	–	64	382	4,352	2,597	171	–	7,566
Debt securities in issue	–	–	50	1,013	–	–	–	1,063
Amounts due to group companies	2,515	3,444	3,981	221	249	1,256	–	11,666
Subordinated liabilities	–	–	–	–	–	2,306	–	2,306
Others	2,842	2,675	4,667	2,892	196	–	32	13,304
<b>Total Liabilities</b>	<b>380,006</b>	<b>128,604</b>	<b>48,599</b>	<b>44,646</b>	<b>3,323</b>	<b>3,733</b>	<b>26,493</b>	<b>635,404</b>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(e) Liquidity risk (continued)****(i) Contractual maturity (continued)****Consolidated (continued)**

	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	
<b>Assets</b>								
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	42,404	4,218	7,194	3,631	–	84,678
Others	105	1,906	4,959	796	172	–	7,482	15,420
<b>Total Assets</b>	<b>25,169</b>	<b>131,601</b>	<b>123,700</b>	<b>122,828</b>	<b>87,460</b>	<b>76,458</b>	<b>30,005</b>	<b>597,221</b>
<b>Liabilities</b>								
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	3,125	2,849	101	8	457	13,411
<b>Total Liabilities</b>	<b>253,751</b>	<b>185,932</b>	<b>62,451</b>	<b>27,704</b>	<b>2,023</b>	<b>7,317</b>	<b>24,458</b>	<b>563,636</b>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(e) Liquidity risk (continued)****(i) Contractual maturity (continued)****Bank**

	2009							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	
<b>Assets</b>								
Cash and balances with banks and other financial institutions	8,871	–	–	–	–	–	–	8,871
Placements with banks and other financial institutions	214	92,403	15,246	36,362	722	–	–	144,947
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	–	26,461	26,461
Trading assets	–	1,293	9,918	12,686	6,874	1,930	–	32,701
Advances to customers	7,933	26,704	17,154	28,007	64,532	83,523	(1,617)	226,236
Amounts due from group companies	609	20,448	32,020	12,405	4,335	3,498	–	73,315
Investment securities	–	11,497	26,509	75,240	29,716	44	63	143,069
Others	66	2,240	5,053	404	–	–	10,071	17,834
<b>Total Assets</b>	<b>17,693</b>	<b>154,585</b>	<b>105,900</b>	<b>165,104</b>	<b>106,179</b>	<b>88,995</b>	<b>34,978</b>	<b>673,434</b>
<b>Liabilities</b>								
Hong Kong SAR currency notes in circulation	–	–	–	–	–	–	26,461	26,461
Deposits and balances of banks and other financial institutions	17,192	2,087	298	375	–	–	–	19,952
Deposits from customers	357,457	91,525	39,054	35,733	281	–	–	524,050
Trading liabilities	–	28,809	167	60	–	–	–	29,036
Financial liabilities designated at fair value	–	64	382	4,352	2,597	171	–	7,566
Debt securities in issue	–	–	50	1,013	–	–	–	1,063
Amounts due to group companies	2,515	3,444	4,474	221	249	991	–	11,894
Subordinated liabilities	–	–	–	–	–	2,306	–	2,306
Others	2,842	2,675	4,430	2,799	14	–	19	12,779
<b>Total Liabilities</b>	<b>380,006</b>	<b>128,604</b>	<b>48,855</b>	<b>44,553</b>	<b>3,141</b>	<b>3,468</b>	<b>26,480</b>	<b>635,107</b>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(e) Liquidity risk (continued)****(i) Contractual maturity (continued)****Bank (continued)**

	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	
<b>Assets</b>								
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	43,183	4,218	8,190	2,467	–	85,289
Others	105	1,906	4,863	643	172	–	6,943	14,632
<b>Total Assets</b>	<b>24,384</b>	<b>131,601</b>	<b>124,383</b>	<b>122,675</b>	<b>88,456</b>	<b>75,294</b>	<b>29,466</b>	<b>596,259</b>
<b>Liabilities</b>								
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	3,125	2,635	8	–	447	13,082
<b>Total Liabilities</b>	<b>253,786</b>	<b>185,889</b>	<b>62,404</b>	<b>27,412</b>	<b>1,783</b>	<b>7,309</b>	<b>24,448</b>	<b>563,031</b>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(e) Liquidity risk (continued)****(ii) Behavioural maturity of financial liabilities on a discounted basis**

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

**Consolidated and Bank**

	2009				
	<i>Due within 3 months</i>	<i>Due between 3 months and 1 year</i>	<i>Due between 1 year and 5 years</i>	<i>Due after 5 years</i>	<i>Total</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>	<i>HK\$'M</i>
Deposits and balances of banks and other financial institutions	19,928	24	–	–	19,952
Deposits from customers	282,874	201,377	39,799	–	524,050
	<u>302,802</u>	<u>201,401</u>	<u>39,799</u>	<u>–</u>	<u>544,002</u>
<b>Total</b>	<b><u>302,802</u></b>	<b><u>201,401</u></b>	<b><u>39,799</u></b>	<b><u>–</u></b>	<b><u>544,002</u></b>



**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(e) Liquidity risk (continued)**

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

**Bank**

	Repayable on demand HK\$'M	Due within 3 months HK\$'M	2009			Undated HK\$'M	Total HK\$'M
			Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M		
Deposits and balances of banks and other financial institutions	17,192	2,385	377	–	–	–	19,954
Deposits from customers	357,457	130,878	36,014	289	–	–	524,638
Trading liabilities	–	28,378	–	–	–	–	28,378
Financial liabilities designated at fair value	–	434	4,319	2,609	154	–	7,516
Debt securities in issue	–	51	1,019	–	–	–	1,070
Amounts due to group companies	2,515	7,343	56	–	1,551	–	11,465
Subordinated liabilities	–	3	9	80	2,388	–	2,480
Others	2,842	6,739	2,799	–	–	26,480	38,860
	<u>380,006</u>	<u>176,211</u>	<u>44,593</u>	<u>2,978</u>	<u>4,093</u>	<u>26,480</u>	<u>634,361</u>

	Repayable on demand HK\$'M	Due within 3 months HK\$'M	2008			Undated HK\$'M	Total HK\$'M
			Due between 3 months to 1 year HK\$'M	Due between 1 year to 5 years HK\$'M	Due after 5 years HK\$'M		
Deposits and balances of banks and other financial institutions	5,409	1,272	246	–	–	–	6,927
Deposits from customers	240,892	217,326	19,147	14	–	–	477,379
Trading liabilities	–	15,389	–	–	–	–	15,389
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	3,711	2,725	–	–	24,448	36,497
	<u>253,811</u>	<u>246,635</u>	<u>27,422</u>	<u>2,905</u>	<u>8,561</u>	<u>24,448</u>	<u>563,782</u>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***38 Risk management (continued)****(e) Liquidity risk (continued)**

## (iv) Derivative financial instruments on an undiscounted basis

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

**Consolidated**

	<i>Due within 3 months HK\$'M</i>	<i>Due between 3 months to 1 year HK\$'M</i>	<i>Due between 1 year to 5 years HK\$'M</i>	<i>Due after 5 years HK\$'M</i>	<i>Undated HK\$'M</i>	<i>Total HK\$'M</i>
	2009					
Derivative financial instruments	243,503	119,947	2,136	1,905	–	367,491
	2008					
Derivative financial instruments	276,908	162,386	1,452	8	–	440,754

**Bank**

	<i>Due within 3 months HK\$'M</i>	<i>Due between 3 months to 1 year HK\$'M</i>	<i>Due between 1 year to 5 years HK\$'M</i>	<i>Due after 5 years HK\$'M</i>	<i>Undated HK\$'M</i>	<i>Total HK\$'M</i>
	2009					
Derivative financial instruments	243,503	119,921	2,003	1,782	–	367,209
	2008					
Derivative financial instruments	276,908	162,356	1,332	8	–	440,604

**Notes to the financial statements (continued)**

(Expressed in millions of Hong Kong dollars)

**38 Risk management (continued)****(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 management.

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 2009 and 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 Bank and its subsidiaries' ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, by pricing products and services commensurately with the level of risk and by securing access to finance at a reasonable cost. The Bank actively and regularly reviews and manages its capital structure to maintain a balance between the higher shareholder returns that might otherwise be possible with greater gearing and the advantages and security afforded by a sound capital position, and makes adjustments to the capital structure in light of changes in economic conditions.

The process of allocating capital to specific operations and activities is undertaken by 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 2009 and 2008.

## Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

### 38 Risk management (continued)

#### (g) Capital management (continued)

For the capital ratios as at 31 December 2009 and 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.

The Bank's consolidated capital as at 31 December 2009 consists of core capital after deductions of HK\$32,655 million (2008: HK\$27,208 million) and supplementary capital after deductions of HK\$Nil (2008: HK\$3,099 million). Supplementary capital includes subordinated debt, available-for-sale investment reserve and collective impairment allowances for impaired assets.

### 39 Fair value information

#### (a) Financial instruments carried at fair value

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

#### Valuation methodologies

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

	Level 1	Level 2	Level 3
Fair value determined using:	Unadjusted quoted price in an active market for identical assets and liabilities	Valuation models with directly or indirectly market observable inputs	Valuation models using significant non-market observable inputs
Types of financial assets	Actively traded government and agency securities Listed equities Quoted derivative instruments	Corporate and other government bonds and loans Over-the-counter derivatives	Asset backed securities Corporate bonds and loans in illiquid markets Unlisted equities
Types of financial liabilities	Quoted derivative instruments	Structured customer deposits Over-the-counter derivatives	

The tables below show the classification of financial instruments held at fair value into the valuation hierarchy set out above as at 31 December 2009.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***39 Fair value information (continued)****(a) Financial instruments carried at fair value (continued)****Consolidated**

	2009 HK\$M			
	Level 1	Level 2	Level 3	Total
Trading assets				
– Trading securities	30,118	1,887	–	32,005
– Placement with banks and other financial institutions	–	38	–	38
– Advances to customers	–	136	–	136
– Positive fair values of derivatives	–	475	–	475
Amount due from immediate holding company				
– Positive fair values of trading derivatives	7	2,116	–	2,123
– Positive fair values of hedging derivatives	–	74	–	74
Amount due from fellow subsidiaries				
– Unlisted available-for-sale debt securities	–	1,163	2,292	3,455
Available-for-sale securities				
– Treasury bills (including Exchange Fund Bills)	49,895	–	–	49,895
– Certificates of deposit held	–	11,807	–	11,807
– Debt securities	10,928	66,063	53	77,044
– Equity shares, net of impairment	55	–	38	93
Other assets				
– Positive fair values of hedging derivatives	–	50	–	50
<b>Total assets measured at fair value</b>	<b>91,003</b>	<b>83,809</b>	<b>2,383</b>	<b>177,195</b>
Trading liabilities				
– Short positions in securities	28,378	–	–	28,378
– Negative fair values of derivatives	5	653	–	658
Financial liabilities designated at fair value				
– Structured customer deposits	–	7,566	–	7,566
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	3	1,018	–	1,021
– Negative fair values of hedging derivatives	–	223	–	223
Other liabilities				
– Negative fair values of hedging derivatives	–	14	–	14
<b>Total liabilities measured at fair value</b>	<b>28,386</b>	<b>9,474</b>	<b>–</b>	<b>37,860</b>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***39 Fair value information (continued)****(a) Financial instruments carried at fair value (continued)****Bank**

	2009 HK\$M			Total
	Level 1	Level 2	Level 3	
Trading assets				
– Trading securities	30,118	1,887	–	32,005
– Placement with banks and other financial institutions	–	38	–	38
– Advances to customers	–	136	–	136
– Positive fair values of derivatives	–	522	–	522
Amount due from immediate holding company				
– Positive fair values of trading derivatives	7	2,116	–	2,123
– Positive fair values of hedging derivatives	–	74	–	74
Amount due from fellow subsidiaries				
– Unlisted available-for-sale debt securities	–	–	2,292	2,292
Amount due from subsidiaries of the Bank				
– Unlisted available-for-sale debt securities	–	908	–	908
Available-for-sale securities				
– Treasury bills (including Exchange Fund Bills)	49,895	–	–	49,895
– Certificates of deposit held	–	11,807	–	11,807
– Debt securities	10,928	66,063	53	77,044
– Equity shares, net of impairment	25	–	38	63
Other assets				
– Positive fair values of hedging derivatives	–	3	–	3
<b>Total assets measured at fair value</b>	<b>90,973</b>	<b>83,554</b>	<b>2,383</b>	<b>176,910</b>
Trading liabilities				
– Short positions in securities	28,378	–	–	28,378
– Negative fair values of derivatives	5	653	–	658
Financial liabilities designated at fair value				
– Structured customer deposits	–	7,566	–	7,566
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	3	754	–	757
– Negative fair values of hedging derivatives	–	223	–	223
Other liabilities				
– Negative fair values of hedging derivatives	–	14	–	14
<b>Total liabilities measured at fair value</b>	<b>28,386</b>	<b>9,210</b>	<b>–</b>	<b>37,596</b>

During the year, there were no significant transfers between Level 1 and Level 2 instruments.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***39 Fair value information (continued)****(a) Financial instruments carried at fair value (continued)**

The movement during the year for level 3 financial assets is as follows:

**Consolidated and Bank**

	<i>Amounts due from fellow subsidiaries HK\$'M</i>	<i>Available-for-sale securities HK\$'M</i>	<i>Total level 3 assets HK\$'M</i>
At 1 January 2009	2,419	91	2,510
Total gains or losses recognised in the income statement	53	–	53
Total gains or losses recognised in available-for-sale investment reserve	7	–	7
Purchases	602	–	602
Sales	(785)	–	(785)
Settlements	(4)	–	(4)
At 31 December 2009	<u>2,292</u>	<u>91</u>	<u>2,383</u>
Total gains/losses recognised in the income statement relating to assets held at 31 December 2009	<u>24</u>	<u>–</u>	<u>24</u>

Although the Bank believes that its estimates of fair value are appropriate, the use of different assumptions could lead to different measurements of fair value. A 10 per cent increase or decrease in credit spreads of the debt securities, has been used to generate a range of reasonably possible alternative valuations. As of 31 December 2009, these stresses could have increased or decreased the available-for-sale investment reserve by HK\$21 million.

**Notes to the financial statements (continued)**

*(Expressed in millions of Hong Kong dollars)*

**39 Fair value information (continued)****(b) Instruments carried at amortized cost**

All financial instruments are stated at fair value or amounts not materially different from their fair value as at 31 December 2009 and 2008.

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

**Cash and balances with banks 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 and, where appropriate, credit spreads. Expected cash flows are discounted at current market rates to determine fair value.

**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.

**40 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 2009, the Bank did not have borrowings due to the financial institutions and had securities amounting to HK\$28,378 million (2008: HK\$15,389 million) to cover short positions.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***41 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 2009 and 2008.

**(a) Key management personnel remuneration**

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

	<i>Consolidated</i>	
	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Short-term employee benefits	89	101
Post-employment benefits	4	5
Equity compensation benefits	16	26
	<u>109</u>	<u>132</u>

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

**(b) Credit facilities and loans to key management personnel**

During the year, the 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>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Loan balances:		
At 1 January	<u>853</u>	<u>341</u>
At 31 December	<u>852</u>	<u>853</u>
Average balance during the year	<u>817</u>	<u>802</u>
Income earned	<u>12</u>	<u>21</u>

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***41 Material related party transactions (continued)****(c) Share based payments**

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

**1997/2006 Restricted Share Scheme**

The Restricted Share Scheme is used as a vehicle for deferring part of the annual performance awards for certain employees and as an incentive plan to motivate and retain high performing staff. Except where used for bonus deferral purposes, executive directors are not generally eligible to participate in the RSS. However upon recruitment to the Group, awards may be made on an exceptional basis. The deferred element of the 2009 annual performance award will vest in three equal tranches over one, two and three years. Under the Restricted Share Scheme, the value of shares awarded in any year to any individual may not exceed two times their base salary. Half of the award vests two years after the date of grant and the balance after three years.

**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 must be met before options can be exercised.

Executive share options to purchase ordinary shares in the Ultimate Holding Company are exercisable after the third, but before the tenth anniversary of the date of grant. The exercise price per share is the share price at the date of grant and options can only be exercised if a performance condition is satisfied.

**2001 Performance Share Plan**

The Performance Share Plan is designed to be an intrinsic part of total remuneration for the Bank and its subsidiaries' executive directors and for a small number of the Bank and its subsidiaries' 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 Bank and its subsidiaries. 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 Bank and its subsidiaries. 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, as appropriate, employees may purchase ordinary shares in the Ultimate Holding Company. The price at which they may purchase shares is at a discount of up to 20 per cent on the share price at the date of invitation. There are no performance conditions attached to options granted under all the employee sharesave schemes.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***41 Material related party transactions (continued)****(c) Share based payments (continued)****2007 Supplementary Restricted Share Scheme**

The Bank and its subsidiaries operate a Supplementary Restricted Share Scheme which is similar to the Restricted Share Scheme. The scheme is principally used for Global Market employees and is also used to defer one third of an employee's deferred annual performance award which vests after one year. 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.

**2000 Executive Share Option Scheme**

No options under the 2000 Executive Share Option Scheme were granted in 2009 or 2008.

A reconciliation of option movements for the year ended 31 December 2009 and 2008 is shown below:

	2009		2008	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	1,501,848	£7.14	1,504,950	£8.09
Additional shares for rights issue	—	—	187,245	£7.14
Lapsed	—	—	(3,348)	£6.91
Exercised	(262,014)	£7.10	(186,999)	£7.60
Outstanding at 31 December	1,239,834	£7.15	1,501,848	£7.14
Exercisable at 31 December	1,239,834	£7.15	1,501,848	£7.14

Range of exercise price	2009			2008		
	Weighted average exercise price	No. of shares	Weighted average remaining contractual life	Weighted average exercise price	No. of shares	Weighted average remaining contractual life
£6.044/£9.099						
(2008: £6.905/£10.395)	£7.15	1,239,834	2.4years	£7.14	1,501,848	3.5 years

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***41 Material related party transactions (continued)****(c) Share based payments (continued)****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	2009		2008		
	23 June	11 March	16 September	24 April	11 March
Share price at grant date	£11.75	£8.10	£13.86	£17.82	£16.26
Shares granted	6,382	418,154	14,196	2,824	180,144
Vesting period (years)	3	3	3	3	3
Expected dividends (yield) (%)	3.41	3.41	2.60	2.60	2.60
Fair value (EPS) (£)	5.40	3.73	12.83	16.50	15.06
Fair value (TSR) (£)	2.13	1.46	5.04	6.49	5.89

The expected dividend yield is based on the historical dividend yield over the last 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 2009 and 2008 is shown below:

	2009	2008
	No. of shares	No. of shares
Outstanding at 1 January	670,858	470,761
Granted	424,536	197,164
Additional shares for rights issue	–	83,639
Lapsed	(44,410)	(11,536)
Exercised	(87,844)	(69,170)
Outstanding at 31 December	963,140	670,858
Weighted average remaining contractual life	8.15 years	8.25 years
Exercisable at 31 December	66,243	20,470

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***41 Material related party transactions (continued)****(c) Share based payments (continued)****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	2009			2008		
	15 September	23 June	11 March	16 September	24 April	11 March
Share price at grant date	£14.44	£11.75	£8.10	£17.82	£13.86	£16.26
Shares granted	15,832	12,214	1,638,953	29,910	39,359	159,940
Vesting period (years)	2/3	2/3	2/3	3	3	3
Expected dividends (yield) (%)	3.45	3.73	3.73	2.40	2.40	2.40
Fair value (£)	13.27	10.72	7.39	8.25	8.25	8.25

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

A reconciliation of movements for the year ended 31 December 2009 and 2008 is shown below:

	2009	2008
	No. of shares	No. of shares
Outstanding at 1 January	1,057,773	993,893
Granted	1,666,999	229,209
Additional shares for rights issue	–	131,875
Lapsed	(55,517)	(38,944)
Exercised	(342,795)	(258,260)
Outstanding at 31 December	2,326,460	1,057,773
Weighted average remaining contractual life	5.59 years	4.71 years
Exercisable at 31 December	307,338	291,273

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***41 Material related party transactions (continued)****(c) Share based payments (continued)****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.

Grant Date	2009				2008	
	3 December	15 September	23 June	11 March	16 September	11 March
Share price at grant date	£15.51	£14.44	£11.75	£8.10	£13.86	£16.26
Shares granted	46,821	144,013	41,189	1,149,734	31,144	182,114
Vesting period (years)	2/3	2/3	2/3	2/3	3	3
Expected dividends (yield) (%)	3.45	3.45	3.73	3.73	2.40	2.40
Fair value (£)	14.25	13.27	10.72	7.39	13.06	12.41

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

A reconciliation of movements for the year to 31 December 2009 and 2008 is shown below:

	2009	2008
	No. of shares	No. of shares
Outstanding at 1 January	233,036	–
Granted	1,381,757	213,258
Additional shares for rights issue	–	29,054
Lapsed	(51,909)	(7,947)
Exercised	(11,733)	(1,329)
Outstanding at 31 December	1,551,151	233,036
Weighted average remaining contractual life	6.17 years	6.27 years
Exercisable at 31 December	–	–

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***41 Material related party transactions (continued)****(c) Share based payments (continued)****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:

<i>Grant Date</i>	<i>2009</i>	<i>2008</i>
	<i>9 October</i>	<i>3 October</i>
Share price at grant date	£15.57	£14.52
Exercise price	£11.46	£11.62
Shares granted	825,238	960,282
Vesting period (years)	3/5	3/5
Expected volatility (%)	44-53	40-49
Expected option life (years)	3.33-5.33	3.33-5.33
Risk free rate (%)	1.8-2.5	2.3-2.5
Expected dividends (yield) (%)	3.2-3.3	2.5-2.7
Fair value (£)	6.2-6.4	3.0

The expected volatility is based on historical volatility over the last three to five years or three to five years prior to grant. The expected life is the average expected period to exercise. The risk free rate of return is the yield on zero-coupon UK government bonds of a term consistent with the assumed option life. The expected dividend yield is based on historical dividend yield for three years prior to grant. 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 2009 and 2008 is shown below:

	<i>2009</i>		<i>2008</i>	
	<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	2,294,281	£9.66	2,170,055	£10.96
Granted	825,238	£11.46	960,282	£11.62
Additional shares for rights issue	–	–	286,044	£8.64
Lapsed	(487,286)	£10.16	(1,053,178)	£11.62
Exercised	(467,554)	£9.04	(68,922)	£7.61
Outstanding at 31 December	2,164,679	£10.37	2,294,281	£9.66
Exercisable at 31 December	143,580	£9.06	583,448	£8.64

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***41 Material related party transactions (continued)****(c) Share based payments (continued)**

Range of exercise price	2009			2008		
	Weighted average exercise price	No. of shares	Weighted average remaining contractual life	Weighted average exercise price	No. of shares	Weighted average remaining contractual life
£6.50/£10.88 (2008: £7.43/£12.43)	£10.37	2,164,679	2.2 years	£9.66	2,294,281	1.8 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 2009 and 2008 is shown below:

	2009	2008
	No. of shares	No. of shares
Outstanding at 1 January	24,485	17,365
Shares vested	–	(16,555)
Shares awarded	–	20,622
Additional shares for rights issue	–	3,053
Shares lapsed	(816)	–
Shares exercised	(23,669)	–
Outstanding at 31 December	–	24,485

**(d) Loans to officers**

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

	2009	2008
	HK\$'M	HK\$'M
Aggregate amount of relevant loans by the Bank outstanding at 31 December	33	46
Maximum aggregate amount of relevant loans by the Bank outstanding during the year	76	50

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***41 Material related party transactions (continued)****(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:

	<i>2009</i>	<i>2008</i>
	<i>HK\$'M</i>	<i>HK\$'M</i>
Amounts due from associates	245	425
Deposits from associates	96	99
Interest income	1	9

**42 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.

**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 defined pension obligations as set out in note 31 and are updated periodically.

*Taxes*

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

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***43 Significant accounting estimates and judgements (continued)***Fair value of financial instruments*

Fair value is the amount for which an asset could be exchanged or a liability settled, between knowledgeable willing parties in an arm's length transaction. Notes 2(i) and 39 provide further information on the Bank's fair value accounting policy and process.

*Impairment of financial assets*

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

*Goodwill impairment*

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

**44 Restatement of prior periods***Acquisition of ACB*

The carrying amount of interest in associates reflected on the consolidated balance sheet as at 31 December 2008 contained provisional amounts for goodwill and share of net assets in connection with the step-acquisition of ACB which became an associate in 2008. These provisional figures were finalized in 2009. In accordance with HKFRS 3 'Business Combinations', the adjustments to the provisional amounts have been made as at the date of acquisition and the 2008 balance sheet amounts were restated as follows:–

	<i>As reported at 2008</i> <i>HK\$'M</i>	<i>Adjustment</i> <i>HK\$'M</i>	<i>Restated at 2008</i> <i>HK\$'M</i>
Investment in associates	3,401	146	3,547
Revaluation reserve	–	146	146

*Comparative figures*

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

**45 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2009**

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 2009 and which have not been adopted in these financial statements.

**Notes to the financial statements (continued)***(Expressed in millions of Hong Kong dollars)***45 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2009 (continued)**

These include:

- HKFRS 3 (Revised), “Business Combinations”
- Amendments to HKAS 27, “Consolidated and separate financial statements”
- Amendments to HKAS 39, “Financial instruments: Recognition and measurement - Eligible hedged items”
- HK(IFRIC) 17, “Distributions of non-cash assets to owners”
- Improvements to HKFRSs (2009)
- Amendment to HKAS 24, “Related party transactions”
- Amendments to HKFRS 8, “Operating segments”
- HKFRS 9 – “Financial Instruments”

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

**46 Post-Balance Sheet Event**

On 14 January 2010, the Bank subscribed for 699,650,000 ordinary shares in China Bohai Bank Company Limited (“Bohai”) at a cost of RMB 699,650,000. The additional equity of RMB 699,650,000 represented 19.99% of the total additional equity of RMB 3.5 billion raised by all existing shareholders of Bohai. Therefore, the Bank’s interest in Bohai remains at 19.99%.