Standard Chartered
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Standard Chartered Bank (Hong Kong) Limited

Directors' Report and Consolidated Financial Statements

For the year ended
31 December 2018

Standard Chartered Bank (Hong Kong) Limited
Contents

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 2018.

Principal place of business

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

Principal activities

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

Financial statements

The profit of the Bank and its subsidiaries (together the “Group”) for the year ended 31 December 2018 and the state of the Group’s affairs as at that date are set out in the consolidated financial statements on pages 13 to 166.

During the year ended 31 December 2018, the directors had declared and paid an ordinary dividend of HK$2.01728 (2017: HK$1.61276) per each “A” and “B” ordinary share totalling HK$3,908 million (2017: HK$3,124 million). Total dividend of HK$245 million (2017: HK$244 million) and HK$98 million (2017: HK$ nil) were paid in respect of the US$500 million 6.25% perpetual non-cumulative convertible preference shares and the US$250 million 5% perpetual non-cumulative subordinated capital securities classified as equity, respectively.

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

Charitable donations

Charitable donations made by the Group during the year amounted to HK$11 million (2017: HK$7 million).

Share capital

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

Directors

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

Executive directors
HUEN Wai Yi Mary
Yee Mann HAU

Report of the directors (continued)

Non-Executive directors
HUNG Pi Cheng Benjamin, Chairperson
Edward Martin WILLIAMS
Anna Elizabeth MARRS (resigned on 7 February 2018)
LEE Cheuk Kuen Gloria
Michael Andres GORRIZ (appointed on 7 February 2018)
FONG Ching*
Stephen Robert ENO*
CHENG Wai Sun Edward*
TUNG Lieh Cheung Andrew*

** Independent non-executive directors*

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

Directors' service contracts

The term of service contracts of all independent non-executive directors, and two non-executive directors, Edward Martin Williams and Lee Cheuk Kuen Gloria, is 2 years. Their remuneration was approved by the shareholders.

Directors' interests in Share Option Schemes

Certain directors of the Bank have been granted options under various share option schemes of Standard Chartered PLC, the ultimate holding company of the Bank. During the year, Anna Elizabeth Marrs, Hung Pi Cheng Benjamin, Edward Martin Williams, Michael Andres Gorriz, Huen Wai Yi Mary, and Hau Yee Mann were granted options under these schemes.

Directors' rights to acquire shares

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

Directors' interests in transactions, arrangements or contracts

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

Management contracts

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

Report of the directors (continued)

Indemnity of directors

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

Auditor

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

On behalf of the Board

HUNG Pi Cheng Benjamin
Chairman

Hong Kong, 26 February 2019

KPMG

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

(Incorporated in Hong Kong with limited liability)

Opinion

We have audited the consolidated financial statements of Standard Chartered Bank (Hong Kong) Limited (the "Bank") and its subsidiaries (together "the Group") set out on pages 13 to 166, which comprise the consolidated statement of financial position as at 31 December 2018, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended and notes to the consolidated financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2018 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board ("IASB") and with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for opinion

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

Key audit matters

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

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

(Incorporated in Hong Kong with limited liability)

Key audit matters (continued)

Impairment of loans and advances	
Refer to note 14 to the consolidated financial statements and the accounting policies on pages 35 to 44	
The Key Audit Matter	**How the matter was addressed in our audit**
Impairment of loans and advances across the banking industry continues to be an area of concern and elevated focus, as counterparties (particularly in Mainland China) continue to tackle liquidity and over-capacity concerns. The Group has loan exposures to Corporate & Institutional Banking ("CIB") clients, Commercial Banking ("CB") clients and loans and advances to banks. These exposures comprise larger loans that are monitored individually, based on the knowledge of each individual borrower. However, the Retail Banking and Private Banking clients' exposure comprises much smaller value loans to a much greater number of customers. Accordingly, these loans are not monitored on an individual basis, but are grouped by product into homogeneous exposures. Exposures are then monitored through delinquency statistics, which also drive the assessment of loan loss provisions. The Group has applied HKFRS 9/IFRS 9 Recognition and Measurement of Financial Instruments since 1 January 2018. The new financial instruments standard has amended the previous classification and measurement framework of financial instruments and introduced a more complex expected credit loss ("ECL") model to assess impairment. The Group is required to retrospectively apply the classification and measurement (including impairment) requirements and recognise any difference between the original carrying amount and new carrying amount at the date of initial application (i.e. 1 January 2018) in the opening retained earnings or other comprehensive income. The Group also developed a new impairment model for financial assets.	Our audit procedures to assess impairment of loans and advances included the following: • understanding and assessing the design, implementation and operating effectiveness of key internal controls of the financial reporting process related to the change of the financial instruments standard, the approval, recording and monitoring of loans and advances, the credit grading process, the ECL model build, approval, monitoring, governance and validation process, the measurement of impairment provisions for individually assessed loans and advances and key underlying systems used for the processing of transactions; • evaluating the accuracy of the classification of loans and advances. We obtained information on how management applied the classification requirements of the new financial instruments standard and the classification results. On a sample basis we assessed the contractual cash flow characteristics of the loans and advances and relevant documents in relation to the business model; • for loans and advances that are measured at fair value due to changes in classification, we obtained information on the valuation method and key parameters used, selecting samples to evaluate the validity of the valuation method and key parameters with the involvement of our internal valuation specialists and in light of industry practice;

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Independent auditor's report to the members of
Standard Chartered Bank (Hong Kong) Limited (continued)
(Incorporated in Hong Kong with limited liability)

Key audit matters (continued)

The determination of loss allowances using the ECL model is subject to a number of key parameters and assumptions, including the identification of loss stages, estimates of probability of default, loss given default, exposures at default and discount rate, adjustments for forward-looking information and other adjustment factors. Management judgement is involved in the selection of those parameters and the application of the assumptions. In particular, the determination of the loss allowances is heavily dependent on the external macro environment and the Group's internal credit risk management strategy. The ECL for corporate loans are derived from estimates including the historical losses, internal and external credit grading and other adjustment factors. The ECL for personal loans are derived from estimates whereby management takes into consideration historical overdue data, the historical loss experience for personal loans and other adjustment factors. Management also exercises judgement in determining the quantum of loss given default based on a range of factors. These include available remedies for recovery, the financial situation of the borrower, the recoverable amount of collateral, the seniority of the claim and the existence and cooperativeness of other creditors. Management refers to valuation reports issued by qualified third party valuers and considers the influence of various factors including the market price, location and use when assessing the value of property held as collateral. The enforceability, timing and means of realisation of collateral can also have an impact on the recoverable amount of collateral and, therefore, the amount of loss allowances as at the end of the reporting period. We identified impairment of loans and advances as a key audit matter because of the inherent uncertainty and management judgement involved and because of its significance to the financial results and capital of the Group.	• obtaining journal entries relating to adjustments made on transition to the new financial instruments standard and compared the list of classification of loans and advances, the original carrying amounts, the list of journal entries and new carrying amounts of the loans and advances to assess if the journal entries have been entirely put through the system accurately. We selected samples to assess if the accounting treatment is in accordance with prevailing accounting standards; • selecting samples to recalculate the new carrying amount of the loans and advances and assessing the accuracy of the opening balance at the date of initial application (i.e. 1 January 2018); • assessing the completeness and accuracy of data used for the key parameters in the ECL model. For key parameters derived from internal data relating to original loan agreements, we compared the total balance of the loan list used by management to assess the allowances for impairment with the general ledger, selecting samples and comparing individual loan information with the underlying agreements and other related documentation to assess the accuracy of compilation of the loan list. For key parameters derived from external data, we selected samples to inspect the accuracy of such data by comparing them with public resources. In addition, we involved our IT specialists to assess the logics and compilation of the overdue information and the operational process of the credit grading of corporate customers for selected samples;

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

(Incorporated in Hong Kong with limited liability)

Key audit matters (continued)

	• for key parameters involving judgement, critically assessing input parameters by seeking evidence from external sources and comparing to the Group's internal records including historical loss experience and type of collateral. As part of these procedures, we challenged management's revisions to estimates and input parameters compared with prior period and on transition to the new accounting standard and considered the consistency of judgement. We compared the economic factors used in the models with market information to assess whether they were aligned with market and economic development; • comparing the forward looking macroeconomic factors used in the models with market information to assess whether they were aligned with market and economic development; • for selected samples of loans and advances to customers, assessing the appropriateness of credit grades, management determination of significant deterioration in the credit risk and the accuracy of ECL staging by evaluating management's assessment on the forecast cash flows, valuation of collateral and repayment sources; • assessing the Stage 3 ECL balance by selecting a sample, based on specific risk criteria, of credit impaired loans and advances from the Bank's Group Special Assets Management portfolio and loans in industries vulnerable to the current economic slowdown in CB and CIB for credit assessment. For these samples, we evaluated the timing and means of realisation of collateral, assessed the forecast of recoverable cash flows, challenged the viability of the Group's recovery plans and evaluated other credit enhancements that are integral to the contract terms. We also evaluated the consistency of management's application of key assumptions and compared them with loan overdue information, business operations and financial information and market information about borrowers' businesses;

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Independent auditor's report to the members of
Standard Chartered Bank (Hong Kong) Limited (continued)
(Incorporated in Hong Kong with limited liability)

	• evaluating the experience, independence, competence and integrity of the external valuers engaged by the Bank to value certain property and illiquid collateral and comparing the valuations with externally derived data such as commodity prices and real estate valuations; • with the assistance of our internal specialists, assessing the reliability of the ECL model used by management in determining loss allowances, including assessing the appropriateness of the key parameters and assumptions in the ECL model, including the identification of loss stages, probability of default, loss given default, exposure at default, discount rate, adjustments for forward-looking information and other management adjustments; • recalculating the amount of credit loss allowance for 12 month and life time credit losses using the ECL model based on the above parameters and assumptions for a sample of loans and advances where the credit risk of the loan has not, or has, increased significantly since initial recognition, respectively; • assessing the appropriateness of material manual adjustments and overlays on ECL model outputs by evaluating management's assessment in determining the adjustments and overlays; and • evaluating whether the relevant disclosures in relation to the change in financial instruments standards and disclosures and impairment of loans and advances meet the disclosure requirements of prevailing accounting standards.

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Independent auditor's report to the members of
Standard Chartered Bank (Hong Kong) Limited (continued)
(Incorporated in Hong Kong with limited liability)

<table>
<tr><th colspan="2">Impairment of leased assets</th></tr>
<tr><td colspan="2">Refer to note 19 to the consolidated financial statements and the accounting policies on pages 22 to 23</td></tr>
<tr><td>The Key Audit Matter</td><td>How the matter was addressed in our audit</td></tr>
<tr><td>As at 31 December 2018, the Group has a fleet of 90 aircraft and 48 vessels, with a carrying value before impairment of HK$35 billion. The aircraft and vessels are classified as 'Operating lease assets' within other property, plant and equipment in the Group's consolidated statement of financial position and the carrying value is stated at cost less accumulated depreciation and impairment. On a quarterly basis, management performs an impairment assessment of the fleet by comparing the carrying values of each aircraft and vessel to the recoverable amount, which is the higher of its (i) current market value and (ii) value in use. If the recoverable amount is less than the carrying amount, the carrying amount of that asset is reduced to its recoverable amount. The reduction is an impairment loss and is recognised in the consolidated statement of comprehensive income.

The total impairment provisions amounted to HK$1,081 million as at 31 December 2018.

The impairment of leased assets is a highly subjective area due to the level of judgement applied by management in determining the recoverable amount.

Current market value is measured with reference to valuations provided by independent third party external appraisers and estimated costs of disposal, while value in use is determined by estimating the future cash flows anticipated for each aircraft and vessel over its remaining useful life and discounting these cash flows to present value using an appropriate discount rate.

Management exercises judgement in determining the value in use based on a range of assumptions. These include the discount rate, current contracted lease rates, future lease rates for subsequent leases, estimated residual value for sales proceeds, dry dock and other costs, and downtime assumptions.</td><td>Our audit procedures to assess impairment of leased assets included the following:

• evaluating the validity of the methodology applied to determine the current market value for the aircraft and vessels with reference to requirements of the prevailing accounting standards;

• evaluating the qualification, experience, independence, competence and integrity of the independent third party external appraisers utilised by the Group to determine the current market value and future lease rates;

• evaluating the validity of the models used in determining the value in use;

• assessing the appropriateness of the assumptions and key inputs to the value in use model, including current contracted lease rates, future lease rates for subsequent leases, estimated residual value for sales proceeds, dry dock and other costs, and downtime assumptions, timing of cash flows and the discount rate adopted;

• recalculating the impairment provision;

• assessing the reliability of management's cash flow forecasting process by performing a retrospective review of the previous year's forecasts with the current year's results, discussing significant variances with management and considering the effect of such variances on the models used; and

• assessing the financial statement disclosures in respect of the impairment assessments with reference to the requirements of the prevailing accounting standards.</td></tr>
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Independent auditor's report to the members of
Standard Chartered Bank (Hong Kong) Limited (continued)
(Incorporated in Hong Kong with limited liability)

We identified impairment of leased assets as a key audit matter because of the inherent subjectivity and management judgement involved in calculating impairment provisions and because of its significance to the financial results and capital of the Group.	

Assessing the fair value of level 3 financial instruments	
Refer to note 35 to the consolidated financial statements and the accounting policies on pages 23 to 34	
The Key Audit Matter	**How the matter was addressed in our audit**
At 31 December 2018 the fair value of the Group's financial instruments totaled HK$338,366 million of which HK$5,416 million was classified under the fair value hierarchy as level 3 financial instruments. The valuation of level 3 financial instruments held at fair value through profit or loss or as fair value through other comprehensive income may be misstated due to the application of valuation techniques which often involve the exercise of judgement and the use of assumptions and estimates. A subjective estimate exists for instruments where the valuation method uses significant unobservable inputs, which is principally the case for level 3 financial instruments. In addition, the Group has developed its own models to value certain level 3 financial instruments, which also involves significant management judgement. We identified assessing the fair value of level 3 financial instruments as a key audit matter because of the degree of complexity involved in valuing certain financial instruments and because of the degree of judgement exercised by management in determining the inputs used in the valuation models.	Our audit procedures to assess the fair value of financial instruments included the following: • assessing the design, implementation and operating effectiveness of key internal controls over valuation and model approval; • involving our internal valuation specialists to perform, on a sample basis, independent valuations of level 3 financial instruments and comparing these valuations with the Group's valuations. Our independent valuations included developing models, obtaining and independently verifying the inputs to the models; and • assessing whether the financial statement disclosures, including fair value hierarchy information and sensitivity to key inputs, appropriately reflected the Group's exposure to financial instrument valuation risk in accordance with the requirements of the prevailing accounting standards.

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

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

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

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

(Incorporated in Hong Kong with limited liability)

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

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

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

Responsibilities of the directors for the consolidated financial statements

The Directors are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with IFRSs issued by the IASB and with HKFRSs issued by the HKICPA and the Hong Kong Companies Ordinance and for such internal control as the Directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

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

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

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. This report is made solely to you, as a body, in accordance with section 405 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

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

(Incorporated in Hong Kong with limited liability)

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

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.

- Conclude on the appropriateness of the Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

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

KPMG

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

26 February 2019

Consolidated income statement
For the year ended 31 December 2018
(Expressed in millions of Hong Kong dollars)

	Note	*2018 HK$'M*	*2017 HK$'M (Restated)*
Interest income	4(a)	21,568	16,109
Interest expense	4(b)	(6,708)	(4,042)
Net interest income		14,860	12,067
Fee and commission income		7,174	7,493
Fee and commission expense		(1,252)	(701)
Net fee and commission income	4(c)	5,922	6,792
Net trading income	4(d)	2,075	1,842
Other operating income	4(e)	4,712	4,196
		12,709	12,830
Total operating income		27,569	24,897
Staff costs		(6,630)	(6,395)
Premises and equipment		(3,529)	(3,596)
Others		(6,083)	(6,266)
Operating expenses	4(f)	(16,242)	(16,257)
Operating profit before impairment		11,327	8,640
Credit impairment	5(a)	(445)	85
Other impairment	5(b)	(1,183)	(608)
Operating profit after impairment		9,699	8,117
Share of profit of associates		1,562	1,828
Profit before taxation		11,261	9,945
Taxation	6(a)	(1,593)	(1,462)
Profit after taxation		9,668	8,483

The notes on pages 19 to 166 form part of these consolidated financial statements.

Consolidated statement of comprehensive income
For the year ended 31 December 2018
(Expressed in millions of Hong Kong dollars)

	2018 *HK$'M*	*2017* *HK$'M*
Profit after taxation	9,668	8,483
Other comprehensive income:		
Items that will not be reclassified to the income statement:		
Own credit adjustment:		
– Gains/(losses) arising from fair value of own credit on financial liabilities designated at fair value through profit of loss	802	(381)
– Related tax effect	(69)	–
Defined benefit plans:		
– Remeasurement of net defined benefit liability	(158)	330
– Related tax effect	26	(54)
Equity securities at fair value through other comprehensive income/ Available-for-sale equity securities:		
– changes in fair value recognised during the year	92	–
Items that may be reclassified subsequently to the income statement:		
Debt securities at fair value through other comprehensive income/ Available-for-sale debt securities:		
– Changes in fair value recognised during the year	315	351
– Changes in fair value transferred to the income statement on disposal of debt securities	(28)	(24)
– Transfer to the income statement on fair value hedged items attributable to hedged risk	(201)	99
– Expected credit loss	1	–
– Share of impact from associates	273	(142)
– Related tax effect	(6)	(33)
Cash flow hedges:		
– Changes in fair value recognised during the year	291	234
– Transfer to the income statement on termination of hedging derivatives	30	18
– Related tax effect	(53)	(42)
Exchange difference	(701)	867
Other comprehensive income for the year, net of tax	614	1,223
Total comprehensive income for the year	10,282	9,706

The notes on pages 19 to 166 form part of these consolidated financial statements.

Consolidated statement of financial position as at 31 December 2018

(Expressed in millions of Hong Kong dollars)

	Note	2018 HK$'M	2017 HK$'M
Assets			
Cash and balances with banks, central banks and other financial institutions	9	13,748	18,350
Placements with banks and other financial institutions	10	153,503	150,256
Hong Kong SAR Government certificates of indebtedness	11	46,691	42,341
Financial assets at fair value through profit or loss	12	36,891	22,819
Investment securities	13	241,545	207,927
Advances to customers	14(a)	505,538	480,867
Amounts due from immediate holding company	16	85,479	59,075
Amounts due from fellow subsidiaries	16	23,714	24,208
Interest in associate	18	12,144	11,638
Property, plant and equipment	19	37,142	40,632
Goodwill and intangible assets	20	1,601	1,392
Current tax assets		–	11
Deferred tax assets	25	–	275
Other assets	21	18,238	15,258
		1,176,234	1,075,049
Liabilities			
Hong Kong SAR currency notes in circulation	11	46,691	42,341
Deposits and balances of banks and other financial institutions		21,652	19,613
Deposits from customers	22	907,083	833,899
Financial liabilities at fair value through profit or loss	24	26,981	19,775
Debt securities in issue	23	–	3,066
Amounts due to immediate holding company	16	41,536	44,246
Amounts due to fellow subsidiaries	16	11,937	9,477
Current tax liabilities		1,663	439
Deferred tax liabilities	25	572	470
Other liabilities	26	32,459	21,292
Subordinated liabilities	28	5,906	6,003
		1,096,480	1,000,621
Equity			
Share capital	29	20,256	20,256
Reserves	30	57,546	52,220
Shareholders' equity		77,802	72,476
Other equity instruments	29	1,952	1,952
		79,754	74,428
		1,176,234	1,075,049

Approved and authorised for issue by the Board of Directors on 26 February 2019.

Huen Wai Yi Mary
Director

Yee Mann Hau
Director

The notes on pages 19 to 166 form part of these consolidated financial statements.

Consolidated statement of changes in equity
For the year ended 31 December 2018

(Expressed in millions of Hong Kong dollars)

	Attributable to equity shareholders of the Group												
	Share capital HK$'M	Own credit adjustment reserve HK$'M	Available-for-sale investment reserve HK$'M	FVOCI reserve – Debt HK$'M	FVOCI reserve – Equity HK$'M	Cash flow hedge reserve HK$'M	Revaluation reserve HK$'M	Exchange reserve HK$'M	Retained profits HK$'M	Share option equity reserve HK$'M	Capital contribution reserve HK$'M	Other equity instrument HK$'M	Total HK$'M
At 1 January 2017	20,256	–	(274)	–	–	(192)	146	(856)	46,448	184	–	–	65,712
Transfer of own credit adjustment, net of taxation	–	363	–	–	–	–	–	–	(363)	–	–	–	–
Total comprehensive income	–	(381)	251	–	–	210	–	867	8,759	–	–	–	9,706
Dividend paid	–	–	–	–	–	–	–	–	(3,368)	–	–	–	(3,368)
Movement in respect of share-based compensation plans	–	–	–	–	–	–	–	–	–	134	–	–	134
Other equity instruments issued, net of expenses	–	–	–	–	–	–	–	–	–	–	–	1,952	1,952
Effect of deemed disposal of interest in an associate	–	–	–	–	–	–	(146)	255	146	–	–	–	255
Effect of transfer of a subsidiary to a commonly controlled entity	–	–	–	–	–	–	–	–	–	–	37	–	37
At 31 December 2017	20,256	(18)	(23)	–	–	18	–	266	51,622	318	37	1,952	74,428
Impact of HKFRS 9/IFRS 9 transition adjustments	–	–	23	(315)	161	–	–	–	(502)	–	–	–	(633)
At 1 January 2018	20,256	(18)	–	(315)	161	18	–	266	51,120	318	37	1,952	73,795
Total comprehensive income	–	733	–	354	92	268	–	(701)	9,536	–	–	–	10,282
Dividend paid	–	–	–	–	–	–	–	–	(4,251)	–	–	–	(4,251)
Movement in respect of share-based compensation plans	–	–	–	–	–	–	–	–	–	(72)	–	–	(72)
At 31 December 2018	20,256	715	–	39	253	286	–	(435)	56,405	246	37	1,952	79,754

During the year ended 31 December 2018, the directors had declared and paid an ordinary dividend of HK$2.01728 (2017: HK$1.61276) per each 'A' and 'B' ordinary shares totalling HK$3,908 million (2017: HK$3,124 million). Total dividend of HK$245 million (2017: HK$244 million) and HK$98 million (2017: HK$ nil) were paid in respect of the US$500 million 6.25% perpetual non-cumulative convertible preference shares, and the US$250 million 5% perpetual non-cumulative subordinated capital securities classified as equity, respectively.

The details of transition adjustments as at 1 January 2018 in relation to the adoption of Hong Kong Financial Reporting Standard 9 ("HKFRS 9")/International Financial Reporting Standard 9 ("IFRS 9") Financial Instruments are disclosed in note 43.

Note 30 includes a description of each reserve.

The notes on pages 19 to 166 form part of these consolidated financial statements.

Consolidated cash flow statement
For the year ended 31 December 2018

(Expressed in millions of Hong Kong dollars)

	Note	2018 HK$'M	2017 HK$'M
Operating activities			
Profit before taxation		11,261	9,945
Adjustments for:			
Credit impairment		445	(85)
Advances written off net of recoveries		(524)	(738)
Unwinding of discount on loan impairment provision		(21)	(27)
Other impairment		1,183	608
Depreciation on property, plant and equipment		2,258	2,211
Amortisation of intangible assets		186	161
Gains on disposal and write off of property, plant and equipment		(579)	(397)
Net loss on deemed disposal of an associate arising from loss of significant influence		–	240
Net losses on revaluation of investment properties		36	92
Share of profit of associates		(1,562)	(1,828)
Interest expense on subordinated liabilities and other borrowings		561	481
Expense in respect of the defined benefits plan		78	89
Fair value losses transferred from reserves on cash flow hedges		30	18
Exchange translation on subordinated liabilities		21	45
Dividend income from associate		(56)	–
		13,317	10,815
(Increase)/decrease in operating assets:			
Placements with banks and other financial institutions with original maturity beyond three months		15,788	11,625
Financial assets at fair value through profit or loss		(5,689)	(5,452)
Investment securities		15,422	(11,164)
Gross advances to customers		(28,071)	(39,995)
Amounts due from immediate holding company and fellow subsidiaries		(25,670)	(17,091)
Other assets		669	(7,714)
Increase/(decrease) in operating liabilities:			
Deposits and balances of banks and other financial institutions		2,165	179
Deposits from customers		73,184	55,661
Debt securities in issue		(3,066)	893
Financial liabilities at fair value through profit or loss		8,820	1,537
Amounts due to immediate holding company and fellow subsidiaries		(5,557)	502
Other liabilities		11,269	1,302
Cash generated from operations		72,581	1,098
Income tax paid		(342)	(925)
Net cash from operating activities		72,239	173

Consolidated cash flow statement (continued)
For the year ended 31 December 2018

(Expressed in millions of Hong Kong dollars)

	Note	2018 HK$'M	2017 HK$'M
Investing activities			
Payment for purchase of property, plant and equipment		(7,896)	(13,200)
Payment for purchase of intangible assets		(419)	(251)
Proceeds from disposal of property, plant and equipment		7,850	9,561
Proceeds from disposal of a subsidiary		–	271
Proceeds from disposal of an associate		1,076	–
Dividends received from an associate		18	–
Net cash generated from/(used in) investing activities		629	(3,619)
Financing activities			
Issue of Additional Tier 1 capital		–	1,952
Interest paid on subordinated liabilities		(555)	(474)
Dividend paid to shareholders of the Group		(4,251)	(3,368)
Net cash used in financing activities	31(c)	(4,806)	(1,890)
Net increase/(decrease) in cash and cash equivalents		68,062	(5,336)
Cash and cash equivalents at 1 January		143,700	140,893
Effect of foreign exchange		(4,324)	8,143
Cash and cash equivalents at 31 December	31	207,438	143,700
Cash flows from operating activities include:			
Interest received		21,129	15,793
Interest paid		6,065	3,573
Dividends received		22	33

The notes on pages 19 to 166 form part of these consolidated financial statements.

Notes to the consolidated financial statements

(Expressed in millions of Hong Kong dollars)

1 Principal activities

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

2 Significant accounting policies

(a) Statement of compliance

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

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

(b) Basis of preparation of the financial statements

(i) Basis of Preparation

The consolidated financial statements for the year ended 31 December 2018 comprise the Group and its interest in associates.

The measurement basis used in the preparation of the consolidated financial statements is the historical cost convention, as modified by the revaluation of financial assets and liabilities at fair value through other comprehensive income/available-for-sale (applicable prior to 31 December 2018), financial assets and liabilities (including derivatives) at fair value through profit or loss and investment properties, which are carried at fair value.

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

The preparation of the consolidated financial statements in conformity with adopted HKFRS/IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. Actual results may differ from these estimates.

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

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

(i) Basis of Preparation (continued)

Judgements made by management in the application of HKFRSs/IFRSs that have a significant effect on the financial statements and major sources of estimation uncertainty are discussed in note 39.

(ii) Consolidated Financial Statements

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

(c) Subsidiaries and non-controlling interests

Subsidiaries are all entities, including structured entities (note 2(x)), which the Group controls. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the investee. Subsidiaries are fully consolidated from the date on which the Group effectively obtains control. They are de-consolidated from the date that control ceases, and where any interest in the subsidiary remains, this is remeasured to its fair value and the change in carrying amount is recognised in the income statement. Details of the Group's principal subsidiaries are given in note 17.

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(d) Associates

Associates are entities in respect of which the Group has significant influence, but not control, over the financial and operating policies and procedures, generally accompanying a shareholding of between 20 percent and 50 percent of the voting rights.

Details of the Group's interest in associate are provided in note 18.

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

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

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

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

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

(e) Intangible assets

(i) Goodwill

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

Goodwill included in "Goodwill and intangible assets" is tested annually for impairment and carried at cost less any accumulated impairment losses. Detailed calculations are performed based on discounting expected pre-tax cash flows of the relevant cash generating units and discounting these at an appropriate discount rate, the determination of which requires the exercise of judgement. Goodwill is allocated to cash generating units for the purpose of impairment testing. Cash generating units represent the lowest level within the Group at which the goodwill is monitored for internal management purposes. Note 20 sets out the major cash-generating units to which goodwill has been allocated.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(e) Intangible assets (continued)

(ii) Acquired intangibles

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

(iii) Computer software

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Costs associated with the development of software are capitalised where it is probable that it will generate future economic benefits attributable to the asset that will flow from its use. Computer software costs are amortised on the basis of expected useful life (3 to 5 years). Costs associated with maintaining software are recognised as an expense as incurred.

(f) Investment properties

Investment properties are land and buildings which are owned either to earn rental income or for long term investments or for both. Investment properties are stated in the consolidated statement of financial position at fair value. Any gains or losses arising from a change in fair value or from the disposal of an investment property is recognised in the consolidated income statement.

(g) Other property, plant and equipment

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

Depreciation on property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

– Buildings, leasehold land and leasehold improvements, are depreciated over the shorter of their estimated useful lives, being 50 years from the date of completion, and the unexpired terms of the lease.

– Equipment and motor vehicles, are depreciated over 3 to 15 years.

– Aircraft and vessels, are depreciated up to 18 and 15 years respectively.

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(g) Other property, plant and equipment (continued)

At each reporting date, these assets are assessed for indicators of impairment. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, the asset is written down immediately.

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

(h) Leases

Where the Group is the lessee

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

Where the Group is the lessor

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

(i) Financial instruments

Policies effective from 1 January 2018

Classification and measurement of financial instruments

Classification

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

(1) Financial assets held at amortised cost and fair value through other comprehensive income ("FVOCI")

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial instruments (continued)

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial instruments (continued)

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

Equity instruments designated as held at FVOCI

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

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

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

Mandatorily classified at fair value through profit or loss

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial instruments (continued)

Designated at fair value through profit or loss

Financial assets and liabilities may be designated at fair value through profit or loss when the designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities on a different basis ("accounting mismatch").

Interest rate swaps have been acquired by the Group with the intention of significantly reducing interest rate risk on certain debt securities with fixed rates of interest. To significantly reduce the accounting mismatch between assets and liabilities and measurement bases, these debt securities have been designated at fair value through profit or loss.

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

– have fixed rates of interest and interest rate swaps or other interest rate derivatives have been entered with the intention of significantly reducing interest rate risk; or

– are exposed to foreign currency risk and derivatives have been acquired with the intention of significantly reducing exposure to market changes; or

– have been acquired to fund trading asset portfolios or assets.

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

(3) Financial liabilities held at amortised cost

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

Financial guarantee contracts and loan commitments

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial instruments (continued)

Fair value of financial assets and liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal market for the asset or liability, or in the absence of a principal market, the most advantageous market to which the Group has access at that date. The fair value of a liability includes the risk that the Group will not be able to honour its obligations.

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

The fair values of quoted financial assets and liabilities in active markets are based on current prices. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. If the market for a financial instrument, and for unlisted securities, is not active, the Group establishes fair value by using valuation techniques.

Initial recognition

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial instruments (continued)

__Subsequent measurement__

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

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

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

(2) Financial assets held at FVOCI

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

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

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

Financial assets and liabilities mandatorily held at fair value through profit or loss and financial assets designated at fair value through profit or loss are subsequently carried at fair value, with gains and losses arising from changes in fair value recorded in the net trading income line in the income statement unless the instrument is part of a cash flow hedging relationship. Contractual interest income on financial assets held at fair value through profit or loss is recognised as interest income in a separate line in the income statement.

(4) Financial liabilities designated at fair value through profit or loss

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial instruments (continued)

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

Derecognition of financial instruments

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

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

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

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

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

Modified financial instruments

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial instruments (continued)

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

Gains and losses arising from modifications for credit reasons are recorded as part of 'credit impairment'. Modification gains and losses arising for non-credit reasons are recognised either as part of "credit impairment" or within income depending on whether there has been a change in the credit risk on the financial asset subsequent to the modification. Modification gains and losses arising on financial liabilities are recognised within income. The movements in the applicable expected credit loss loan positions are disclosed in further detail in Note 34(a).

Reclassifications

Financial liabilities are not reclassified subsequent to initial recognition.

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

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

(1) Reclassified from amortised cost

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial instruments (continued)

(2) Reclassified from fair value through other comprehensive income

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

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

(3) Reclassified from fair value through profit or loss

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

Policies effective prior to 1 January 2018

Financial assets and liabilities (excluding derivatives)

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial instruments (continued)

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

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

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

– the designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities on a different basis, or

– a group of financial assets and/or liabilities is managed and its performance evaluated on a fair value basis, or

– assets or liabilities include embedded derivatives and such derivatives are not recognised separately.

(ii) Loans and receivables

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

(iii) Available-for-sale assets

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

(iv) Financial liabilities held at amortised cost

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

Initial recognition

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

Subsequent measurement

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial instruments (continued)

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

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

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

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

Fair value of financial assets and liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal market or in the absence of a principal market the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk.

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

Reclassifications

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(i) Financial instruments (continued)

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

Renegotiated loans

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

Derecognition

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

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

Derivative financial instruments

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

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

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

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.

For derivative transactions that do not qualify for hedge accounting, changes in the fair value of derivative instruments are recognised immediately in the consolidated income statement.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(j) Hedge accounting

The Group has chosen to continue to apply HKAS 39/IAS 39 hedging requirements rather than those of HKFRS 9/IFRS 9.

The Group designates certain derivatives as either: (1) hedges of the fair value of recognised assets or liabilities, or commitments (fair value hedge); or, (2) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (cash flow hedge). Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

The Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents the assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

(i) Fair value hedge

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

(ii) Cash flow hedge

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

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

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

(k) Impairment

Policies effective from 1 January 2018

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

– the Group's criteria for assessing if there has been a significant increase in credit risk;

– development of ECL models, including the choice of inputs relating to macroeconomic variables.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment (continued)

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

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

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

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

Measurement

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

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

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment (continued)

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

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

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

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

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

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

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

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

Recognition

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment (continued)

(2) Significant increase in credit risk (stage 2)

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment (continued)

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

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

– Significant financial difficulty of the issuer or borrower;

– Breach of contract such as default or a past due event;

– For economic or contractual reasons relating to the borrower's financial difficulty, the lenders of the borrower have granted the borrower concessions that lenders would not otherwise consider, which include forbearance actions;

– Pending or actual bankruptcy or other financial reorganisation to avoid or delay discharge of the borrower's obligations;

– The disappearance of an active market for the applicable financial asset due to financial difficulties of the borrower;

– Purchase or origination of a financial asset at a deep discount that reflects incurred credit losses.

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

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

Expert Credit Judgement

Instruments graded CG13 or CG14 are regarded as Non-Performing Loans, i.e. stage 3 or credit impaired exposures.

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment (continued)

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

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

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

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

Modified financial instruments

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

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

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

Forborne loans

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment (continued)

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

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

Write-offs of credit impaired instruments and reversal of impairment

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

Improvement in credit risk/curing

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment (continued)

Write-offs of credit impaired instruments and reversal of impairment (continued)

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

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

– At least a year has passed with no default based upon the forborne contract terms

– The customer is likely to repay its obligations in full without realising security

– The customer has no accumulated impairment against the amount outstanding

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

Policies effective prior to 1 January 2018

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

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

– whether the counterparty is in default of principal or interest payments;

– a counterparty files for bankruptcy protection (or the local equivalent) where this would avoid or delay repayment of its obligation;

– the Group files to have the counterparty declared bankrupt or file a similar order in respect of a credit obligation;

– the Group consents to a restructuring of the obligation, resulting in a diminished financial obligation, demonstrated by a material forgiveness of debt or postponement of scheduled payments;

– the Group sells a credit obligation at a material credit-related economic loss; or

– there is observable data indicating that there is a measurable decrease in the estimated future cash flows of a group of financial assets, although the decrease cannot yet be identified with specific individual financial assets.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment (continued)

Assets carried at amortised cost

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment (continued)

Available-for-sale assets

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

(l) Offsetting financial transactions

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

(m) Fiduciary activities

The Group commonly acts as trustee and in other fiduciary capacities that result in the holding or placing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions. The assets and income arising thereon are excluded from these financial statements, as they are not assets and income of the Group.

(n) Cash and cash equivalents

For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition, including: cash and balances with banks, central banks and other financial institutions, trading assets, placements with banks and other financial institutions, and amounts due from the immediate holding company and fellow subsidiaries.

(o) Revenue recognition

(i) Net interest income and other gains or losses arising from financial instruments

Policies applicable from 1 January 2018

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(o) Revenue recognition (continued)

(i) Net interest income and other gains or losses arising from financial instruments (continued)

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

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

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

Interest expense on financial liabilities designated at fair value through profit or loss is recognized within net trading income.

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(o) Revenue recognition (continued)

(i) Net interest income and other gains or losses arising from financial instruments (continued)

Policies effective prior to 1 January 2018

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

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

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

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

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

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

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

(ii) Fees and commissions

Fees and commissions are generally recognised on an accrual basis when the service has been provided or significant act performed. Loan syndication fees are recognised as revenue when the syndication has been completed and the Group has retained no part of the loan package for itself or has retained a part at the same effective interest rate as for the other participants. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportioned basis.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(p) Income tax

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

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the reporting date and that are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

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

Current and deferred tax relating to items which are charged or credited directly to equity, are credited or charged directly to equity and are subsequently recognised in the consolidated income statement together with the current or deferred gain or loss.

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

- in the case of current tax assets and liabilities, the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or

- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities for which a legal right of set off exists.

(q) Provisions

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(r) Employee benefits

(i) Short term employee benefits

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

(ii) Retirement benefit obligations

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

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis, and such amounts are charged to operating expenses. The Group has no further payment obligations once the contributions have been paid.

For funded defined benefit plans, the net liability recognised in the consolidated statement of financial position represents the present value of the defined benefit obligations at the reporting date less the fair value of plan assets. The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligations is determined by discounting the estimated future cash outflows using an interest rate equal to the yield on government bonds that are denominated in the currency in which the benefits will be paid, and that have a term to maturity approximating to the term of the related pension liability.

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

The Group determines the net interest expense on the net defined benefit liability for the year by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then net defined benefit liability, taking into account any changes in the net defined benefit liability during the year as a result of contributions and benefit payment.

(iii) Share-based compensation

The Group's ultimate holding company, Standard Chartered PLC ("SC PLC"), operates equity-settled share-based compensation plans in which the Group's employees participate. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. For deferred share awards granted as part of an annual performance award, the expense is recognised over the period from the start of the performance period to the vesting date. For all other awards the expense is recognised over the period from the start of the date of grant to the vesting date.

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 consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(r) Employee benefits (continued)

(iii) Share-based compensation (continued)

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

(s) Translation of foreign currencies

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

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

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

– assets and liabilities for each consolidated statement of financial position presented are translated at the closing rate at the reporting date.

– income and expenses for each consolidated income statement are translated at average exchange rates or at rates on the date of the transaction where exchange rates fluctuate significantly; and

– all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to other comprehensive income. When a foreign operation is sold, the exchange differences are recognised in the consolidated income statement as part of the gain or loss on disposal.

(t) Related parties

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

Notes to the consolidated 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 consolidated financial statements, are identified from the financial information provided regularly to the Group's most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

(v) Sale and repurchase agreements

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

Securities borrowed are not recognised in the consolidated financial statements, unless these are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income.

(w) Assets held for sale

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

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

(x) Structured entities

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(y) Other equity instrument

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

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

3 Changes in accounting policies

The HKICPA/IASB has issued a number of new HKFRSs and amendments to HKFRSs/IFRS that are first effective for the current accounting period of the Group. Of these, the following standards are relevant to the Group's financial statements:

(i) HKFRS 9/IFRS 9, Financial instruments

(ii) HKFRS 15/IFRS 15, Revenue from contracts with customers

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period.

HKFRS 9/IFRS 9 Financial Instruments

On 1 January 2018, the Group adopted HKFRS 9/IFRS 9 which replaces HKAS 39/IAS 39 Financial Instruments: Recognition and Measurement and introduces new requirements for: the classification and measurement of financial instruments, the recognition and measurement of credit impairment provisions, and provides for a simplified approach to hedge accounting.

The Group has further chosen:

- to continue to apply HKAS 39/IAS 39 hedging requirements rather than those of HKFRS 9/IFRS 9.
- not to restate comparative periods on the basis that it is not possible to do so without the use of hindsight.

HKFRS 15/IFRS 15 Revenue from Contracts with Customers

HKFRS 15/IFRS 15 is effective from 1 January 2018 and replaces HKAS 18/IAS 18 Revenue. HKFRS 15/IFRS 15 is conceptually similar to HKAS 18/IAS 18, but includes more granular guidance on how to recognise and measure revenue, and also introduces additional disclosure requirements. The Group has performed an assessment of the new standard and concluded that the current treatment of revenue from contracts with customers is consistent with the new principles, and there is no transitional impact to retained earnings.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

4 Operating profit

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

		2018 HK$'M	2017 HK$'M
(a)	***Interest income***		
	Interest income arising from financial assets:		
	– amortised cost (note)	17,206	13,722
	– measured at fair value through other comprehensive income/available-for-sale	3,484	2,003
	– held for trading	702	377
	– mandatorily at fair value through profit or loss other than held for trading	176	–
	– designated at fair value through profit or loss	–	7
		21,568	16,109

(note) The amount includes interest income from unwinding of discount on impairment provisions of HK$21 million (note 34(a)) (2017: HK$27 million), and fair value losses of HK$53 million transferred from reserve on cash flow hedges (2017: losses of HK$19 million).

		2018 HK$'M	2017 HK$'M (Restated)
(b)	***Interest expense***		
	Interest expense arising from financial liabilities:		
	– measured at amortised cost (note)	6,651	4,018
	– held for trading	57	24
		6,708	4,042

(note) The amount includes fair value gains of HK$23 million transferred from reserve on cash flow hedges (2017: gains of HK$1 million).

		2018 HK$'M	2017 HK$'M
(c)	***Net fee and commission income***		
	Net fee and commission income in the consolidated income statement includes the following:		
	Net fee and commission income (other than amounts included in determining the effective interest rate) arising from financial assets or financial liabilities that are not at fair value through profit or loss:		
	– fee and commission income	1,996	2,075
	– fee and commission expense	358	152
	Net fee and commission income from trust and other fiduciary activities that results in the holding of assets on behalf of customers		
	– fee and commission income	477	438
	– fee and commission expense	154	121

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

4 Operating profit (continued)

	2018 HK$'M	2017 HK$'M (Restated)
(d) Net trading income		
Net gains on instruments held for trading	2,257	2,001
Net gains on financial assets designated at fair value through profit or loss	–	27
Net losses on financial assets mandatorily at fair value through profit or loss other than held for trading	(24)	–
Net losses on financial liabilities designated at fair value through profit or loss	(158)	(186)
	2,075	1,842

	2018 HK$'M	2017 HK$'M
(e) Other operating income		
Rental income from operating lease assets	4,001	3,916
Dividend income from financial assets at fair value through other comprehensive income/available-for-sale securities	22	33
Dividend income from associate (note 18)	56	–
Net gains on disposal of debt securities at fair value through other comprehensive income/available-for-sale securities	28	24
Net gains on disposal and write-off of property, plant and equipment	579	397
Net losses on disposal of financial instruments measured at amortised cost	(34)	(5)
Net losses on revaluation of investment properties (note 19)	(36)	(92)
Net loss on deemed disposal of an associate arising from loss of significant influence	–	(240)
Others	96	163
	4,712	4,196

	2018 HK$'M	2017 HK$'M
(f) Operating expenses		
Staff costs		
– contributions to defined contribution plans	243	211
– expense in respect of the defined benefits plan (note 27(c))	78	89
– equity-settled share-based payment expenses	183	131
– salaries and other staff costs	6,126	5,964
Depreciation (note 19)	2,258	2,211
Premises and equipment expense, excluding depreciation		
– rental of premises	816	848
– others	455	537
Amortisation		
– other intangible assets (note 20)	186	161
Auditor's remuneration	16	18
Others	5,881	6,087
	16,242	16,257

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

5 Impairment charges

		2018 HK$'M	2017 HK$'M
(a)	***Credit impairment***		
	Net impairment charges/(releases) on advances to customers:		
	– collective impairment releases	–	(320)
	– individual impairment charges	–	235
		–	(85)
	Net expected credit loss charges/(releases) on:		
	– placements with banks and other financial institutions	2	–
	– advances to customers	447	–
	– debt securities at amortised cost	1	–
	– debt securities at fair value through other comprehensive income	1	–
	– loan commitments and financial guarantees	(6)	–
		445	–
		445	(85)
(b)	***Other impairment***		
	Charges for risk participation transactions	78	–
	Charges for property, plant and equipment (note 19)	1,081	572
	Charges for capitalised software and other intangible assets (note 20)	24	–
	Others	–	36
		1,183	608

6 Taxation in the consolidated income statement

(a) Taxation in the consolidated income statement represents:

	2018 HK$'M	2017 HK$'M
Current tax		
Hong Kong profits tax	1,327	1,308
Overseas taxation	11	12
(Over)/under-provision in respect of prior years	(6)	157
	1,332	1,477
Deferred tax (note 25)		
Origination/reversal of temporary differences	187	127
Under/(over)-provision in respect of prior years	74	(142)
	261	(15)
	1,593	1,462

The provision for Hong Kong profits tax for 2018 is calculated at 16.5% (2017: 16.5%) of the estimated assessable profits for the year. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

6 Taxation in the consolidated income statement (continued)

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

	2018 HK$'M	2017 HK$'M
Profit before taxation	11,261	9,945
Notional tax on profit before taxation, calculated at Hong Kong profits tax rate of 16.5%	1,858	1,641
Tax effect of non-deductible expenses	674	347
Tax effect of non-taxable revenue	(927)	(547)
Under-provision in prior years	68	15
Tax effect of different tax rates of subsidiaries operating in other jurisdictions	(24)	(21)
Others	(56)	27
Actual tax expense	1,593	1,462

7 Directors' remuneration

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

	Bank	
	2018 HK$'M	2017 HK$'M
Fees	3	3
Short-term employment benefits	30	29
Post-employment benefits	1	1
Equity compensation benefits	11	7
Termination benefits	–	5
	45	45

8 Segmental reporting

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

- **Corporate & Institutional Banking (CIB)** supports clients with their transaction banking, corporate finance, financial markets and borrowing needs, providing solutions to clients in some of the world's fastest-growing economies and most active trade corridors. The Group's clients include large corporations, governments, and banks.

- **Commercial Banking** serves local corporations and medium-sized enterprises. The Group aims to be its clients' main international bank, providing a full range of international financial solutions in areas such as trade finance, cash management, financial markets and corporate finance.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

8 Segmental reporting (continued)

- **Private Banking** offers a full suite of investment, credit and wealth planning solutions to grow and protect the wealth of high net worth individuals across the Group's footprint.

- **Retail Banking** serves individuals and small businesses with a focus on affluent and emerging affluent. The Group provides digital banking services with a human touch to its clients across deposits, payments, financing products and wealth management, as well as supporting client's business banking needs.

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

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

(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.

2018	*Corporate & Institutional Banking HK$'M*	*Commercial Banking HK$'M*	*Private Banking HK$'M*	*Retail Banking HK$'M*	*Central & Other Items HK$'M*	*Consolidated HK$'M*
Operating income						
– Net interest income	4,032	1,848	741	7,604	306	14,531
– Other operating income	6,960	919	679	5,427	853	14,838
	10,992	2,767	1,420	13,031	1,159	29,369
Operating expenses (note)	(5,594)	(1,484)	(1,500)	(6,770)	(68)	(15,416)
Operating profit/(loss) before impairment	5,398	1,283	(80)	6,261	1,091	13,953
Impairment (charges)/releases	(1,072)	(79)	10	(417)	–	(1,558)
Profit/(loss) before taxation	4,326	1,204	(70)	5,844	1,091	12,395
Segment assets	431,133	64,497	38,647	267,087	399,418	1,200,782
Segment liabilities	370,401	114,770	57,748	472,115	75,826	1,090,860

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

8 Segmental reporting (continued)

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

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

(note) Operating expenses in the Corporate & Institutional Banking segment included depreciation charges of HK$2,024 million (2017: HK$1,998 million) for commercial aircraft and vessels leased to customers under operating leases.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

8 Segmental reporting (continued)

(b) Reconciliation of reportable segment operating income, profit before taxation, assets and liabilities

	2018 HK$'M	*2017 HK$'M*
Operating income		
Reportable segment revenue	29,369	26,397
Income relating to Financial Market products	181	(208)
Cost of free funds	601	226
Others	(2,582)	(1,518)
Total operating income	27,569	24,897

	2018 HK$'M	*2017 HK$'M*
Profit before taxation		
Reportable segment profit before taxation	12,395	11,201
Income relating to Financial Market products	181	(208)
Cost of free funds	601	226
Reallocations of impairment charges	(68)	(9)
Others	(1,848)	(1,265)
Profit before taxation	11,261	9,945

	2018 HK$'M	*2017 HK$'M*
Assets		
Reportable segment assets	1,200,782	1,097,625
Assets of group companies not included in consolidated total assets	(4,499)	(3,180)
Amounts due from immediate holding company and fellow subsidiaries	109,193	83,283
Others	(129,242)	(102,679)
Total assets	1,176,234	1,075,049

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

8 Segmental reporting (continued)

(b) Reconciliation of reportable segment operating income, profit before taxation, assets and liabilities (continued)

	2018 HK$'M	2017 HK$'M
Liabilities		
Reportable segment liabilities	1,090,860	1,004,970
Liabilities of group companies not included in consolidated total liabilities	(2,215)	(1,774)
Amounts due to immediate holding company and fellow subsidiaries	53,473	53,723
Others	(45,638)	(56,298)
Total liabilities	1,096,480	1,000,621

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

Reportable segment assets and liabilities include assets and liabilities which are not booked on the Group's consolidated statement of financial position but which contribute to the reportable segment's income and profit before taxation.

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

	2018 HK$'M	2017 HK$'M
Cash in hand	2,713	2,152
Balances with central banks	682	8,678
Balances with banks and other financial institutions	10,353	7,520
	13,748	18,350

10 Placements with banks and other financial institutions

	2018 HK$'M	2017 HK$'M
Gross placements with banks and other financial institutions		
– maturing one month	63,480	63,984
– maturing one month to one year	89,243	80,377
– maturing one year to five years	789	5,175
– maturing five years to ten years	–	720
	153,512	150,256
Less: Impairment – individually assessed	–	–
Expected credit loss provision (note 15)	(9)	–
	153,503	150,256

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

11 Hong Kong SAR Government certificates of indebtedness and currency notes in circulation

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

12 Financial assets at fair value through profit or loss

	2018 *HK$'M*	*2017* *HK$'M*
Trading assets	29,395	22,483
Non-trading financial assets mandatorily at fair value through profit or loss	7,496	–
Financial assets designated at fair value through profit or loss (note)	–	336
	36,891	22,819

of which the trading assets balances comprise of the following:

	2018 *HK$'M*	*2017* *HK$'M*
Trading securities	25,346	18,642
Advances to customers	1,198	2,649
Positive fair values of trading derivatives	2,851	1,192
	29,395	22,483
Trading securities:		
Treasury bills	10,968	4,287
Certificates of deposit held	238	424
Debt securities	14,140	13,928
Equity securities	–	3
	25,346	18,642

(note) The financial assets designated at fair value at 31 December 2017 represent certain debt securities with embedded derivatives that are not separately recognised.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

13 Investment securities

	2018 *HK$'M*	*2017* *HK$'M*
At fair value through other comprehensive income/ Available-for-sale securities:		
Debt securities		
– Treasury bills	103,255	86,608
– Certificates of deposit held	20,387	19,378
– Other debt securities	113,080	96,190
	236,722	202,176
Equity shares	395	701
	237,117	202,877
At amortised cost/Loans and receivables:		
Debt instruments – other debt securities	4,440	5,050
Less: Expected credit loss provision (note 15)	(12)	–
	241,545	207,927

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

14 Advances to customers

		2018 HK$'M	2017 HK$'M
(a)	**Advances to customers**		
	Gross advances to customers	505,905	480,239
	Trade bills	1,308	1,778
		507,213	482,017
	Less:		
	Expected credit loss provision: (note 15) (note 34(a))	(1,675)	–
	Impairment provision: (note 34(a))		
	– collectively assessed	–	(243)
	– individually assessed	–	(907)
		(1,675)	(1,150)
		505,538	480,867
(b)	**Impaired advances to customers**		
	Gross impaired advances to customers	2,527	3,278
	Less:		
	Stage 3 expected credit loss provision (note 15)	(921)	–
	Impairment provision: individually assessed	–	(907)
		1,606	2,371
	Gross impaired advances to customers as a % of gross advances to customers	0.50%	0.68%
	Fair value of collateral held against the covered portion of impaired advances to customers	1,151	1,344
	Covered portion of impaired advances to customers	638	1,064
	Uncovered portion of impaired advances to customers	1,889	2,214

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

15 Analysis of expected credit loss provisions on financial instruments by stage

	At 31 December 2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
Expected credit loss provision on:				
– Placements with banks and other financial institutions (note 10)	7	2	–	9
– Advances to customers (note 14)	427	327	921	1,675
– Debt securities at amortised cost (note 13)	5	7	–	12
– Debt securities at fair value through other comprehensive income[1]	14	1	–	15
– Loan commitments and financial guarantees (note 26)	53	29	–	82
	506	366	921	1,793

	At 1 January 2018			
	Stage 1	*Stage 2*	*Stage 3*	*Total*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
				(note 34(c))
Expected credit loss provision on:				
– Placements with banks and other financial institutions	2	5	–	7
– Advances to customers	401	278	1,094	1,773
– Debt securities at amortised cost	3	8	–	11
– Debt securities at fair value through other comprehensive income[1]	14	–	–	14
– Loan commitments and financial guarantees	55	33	–	88
	475	324	1,094	1,893

[1] These instruments are held at fair value on the balance sheet. The corresponding expected credit loss provision is held within FVOCI reserve – Debt.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

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

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

During the year, none of the above deposits were transferred from/to a related company (2017: HK$ nil transferred from). As at 31 December 2018, the amounts due from immediate holding company shown on the consolidated statement of financial position is stated net of provision of HK$ nil (2017: HK$ nil) in respect of such obligations.

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

	Immediate holding company		*Fellow subsidiaries*	
	2018	*2017*	*2018*	*2017*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
Operating income	1,058	944	(634)	(211)
Operating expenses	2,513	2,589	843	648

Transactions entered during the year between the Bank and its subsidiaries included operating income of HK$2,139 million (2017: HK$1,966 million) and operating expense of HK$ nil million (2017: HK$85 million). Intra-group transactions are eliminated in full in the consolidated income statement.

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

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

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

	2018		*2017*	
	Immediate holding company HK$'M	*Fellow subsidiaries HK$'M*	*Immediate holding company HK$'M*	*Fellow subsidiaries HK$'M*
Amounts due from:				
Cash and balances with banks and other financial institutions	4,387	2,158	6,945	2,431
Placements with banks and other financial institutions	62,712	19,563	26,258	20,993
Financial assets at fair value through profit or loss				
– Positive fair values of trading derivatives	15,777	1,490	22,213	712
– Debt securities	22	–	7	–
Other assets				
– Positive fair values of hedging derivatives	441	32	596	–
– Others	2,140	471	3,056	72
	85,479	23,714	59,075	24,208

	2018		*2017*	
	Immediate holding company HK$'M	*Fellow subsidiaries HK$'M*	*Immediate holding company HK$'M*	*Fellow subsidiaries HK$'M*
Amounts due to:				
Deposits and balances of banks and other financial institutions	9,444	8,489	3,658	7,134
Financial liabilities at fair value through profit or loss				
– Negative fair values of trading derivatives	18,431	776	23,179	586
Subordinated liabilities (note)	6,263	–	6,252	–
Other liabilities				
– Negative fair values of hedging derivatives	405	3	396	405
– Others	6,993	2,669	10,761	1,352
	41,536	11,937	44,246	9,477

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

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

	2018		*2017*	
	Immediate holding company HK$'M	*Fellow subsidiaries HK$'M*	*Immediate holding company HK$'M*	*Fellow subsidiaries HK$'M*
Financial guarantees and other credit related contingent liabilities	1,794	103	2,029	21
Loan commitments and other credit related commitments	866	45,339	1,527	32,226

17 Investments in subsidiaries of the Bank and interests in structured entities

(a) Investments in subsidiaries

	Bank	
	2018 HK$'M	*2017 HK$'M*
Unlisted shares, at cost	1,738	1,181
Less: accumulated impairment provision	(735)	(412)
	1,003	769

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

Name of company	*Place of incorporation*	*Particulars of issued and paid up capital*	*Proportion of ownership interest held by the Bank*	*Principal activity*
Standard Chartered APR Limited	United Kingdom	21,971,715 ordinary shares of US$1 each	100%	Investment holdings
Standard Chartered Securities (Hong Kong) Limited	Hong Kong	1,000,000 ordinary shares	100%	Institutional brokerage
Standard Chartered Leasing Group Limited	Hong Kong	70,030,000 ordinary shares	100%	Provision of leasing services
Standard Chartered Trade Support (HK) Limited	Hong Kong	53,431 ordinary shares	100%	Provision of financing and other services and activities closely related to banking to clients for inventory and extended payments

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

(b) Interests in consolidated structured entities

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

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

	2018 Total assets HK$'M	2017 Total assets HK$'M
Aircraft and ship leasing	38,423	40,991
Assets – backed securitisation	2,644	–

18 Interest in associate

	2018 HK$'M	2017 HK$'M
Share of net assets	12,144	11,638

Name of associate	Place of establishment and operation	Particulars of issued and paid up capital	Proportion of ownership interest	Principal activity
China Bohai Bank Company Limited ("Bohai")	The People's Republic of China	13,855,000,000 ordinary shares of RMB1 each	19.99%	Provision of banking and related financial services (Note 1)

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

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

In respect of the year ended 31 December 2018, Bohai's result was included in the consolidated financial statements based on accounts drawn up to 30 November 2018. The Group has taken advantage of the provision contained in HKAS 28/IAS 28 "Investments in Associates" whereby it is permitted to include the attributable share of associates' results based on accounts drawn up to a non-coterminous period and where the difference is not greater than three months.

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

18 Interest in associate (continued)

Summary of financial information of the associate and reconciliation to the carrying amounts in the consolidated financial statements

	2018 HK$'M	*2017 HK$'M*
Gross amounts of the associate		
Assets	1,156,836	1,223,496
Liabilities	(1,096,088)	(1,165,275)
Net assets	60,748	58,221
Operating income	26,865	30,035
Profit after taxation	7,814	8,939
Other comprehensive income	1,366	(713)
Total comprehensive income	9,180	8,226
Dividends received from the associate	18	–
Dividends receivable from the associate	542	–
Total dividend from the associate	560	–
Of which: recognised in consolidated income statement (note 4(e))	56	–
Gross amount of net assets of the associate	60,748	58,221
Effective interest of the Group	19.99%	19.99%
Carrying amount in the consolidated financial statements	12,144	11,638

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

19 Property, plant and equipment

	2018					
	Buildings and leasehold land held for own use HK$'M	*Equipment, furniture & fixtures HK$'M*	*Operating lease assets HK$'M*	*Sub-total HK$'M*	*Investment properties HK$'M*	*Total property, plant and equipment HK$'M*
Cost or valuation:						
At 1 January 2018	2,780	518	44,424	47,722	866	48,588
Additions	106	272	7,518	7,896	–	7,896
Transferred to assets classified as held for sale	–	–	(957)	(957)	–	(957)
Disposals and write-offs	(37)	(90)	(9,454)	(9,581)	–	(9,581)
Reclassifications	(38)	38	–	–	–	–
Fair value adjustments (note 4(e))	–	–	–	–	(36)	(36)
At 31 December 2018	2,811	738	41,531	45,080	830	45,910
Representing:						
Cost	2,811	738	41,531	45,080	–	45,080
Valuation	–	–	–	–	830	830
	2,811	738	41,531	45,080	830	45,910
Accumulated depreciation and impairment:						
At 1 January 2018	951	229	6,776	7,956	–	7,956
Charge for the period (note 4(f))	119	115	2,024	2,258	–	2,258
Impairments (note 5(b))	–	–	1,081	1,081	–	1,081
Attributable to assets transferred to held for sale	–	–	(217)	(217)	–	(217)
Attributable to assets sold or written off	(37)	(90)	(2,183)	(2,310)	–	(2,310)
At 31 December 2018	1,033	254	7,481	8,768	–	8,768
Net book value:						
At 31 December 2018	1,778	484	34,050	36,312	830	37,142

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

19 Property, plant and equipment (continued)

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

19 Property, plant and equipment (continued)

(a) Buildings and leasehold land held for own use

	2018 HK$'M	2017 HK$'M
Leasehold in Hong Kong, at cost		
– medium-term leases	1,644	1,709
– short-term leases	134	120
	1,778	1,829

(b) Investment properties

	2018 HK$'M	2017 HK$'M
Freehold outside Hong Kong, at fair value	830	866

The investment property outside Hong Kong was revalued as at 31 December 2018 on an open market value basis. The valuation was carried out by an independent firm, CBRE DIFC Limited, which has among its staff, members of the Royal Institute of Chartered Surveyors with recent experience in the location and category of the property being valued.

The fair value of the investment property is primarily determined using comparable recent market transactions on arm's length terms.

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

(c) Operating lease assets:

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

	2018 HK$'M	2017 HK$'M
Within 1 year	3,744	3,911
After 1 year but within 5 years	12,224	13,679
After 5 years	7,546	9,486
	23,514	27,076

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

20 Goodwill and intangible assets

	2018		
	Capitalised software and other intangible assets HK$'M	Goodwill HK$'M	Total HK$'M
Cost:			
At 1 January 2018	1,039	729	1,768
Additions	419	–	419
Disposals and write-offs	(209)	–	(209)
At 31 December 2018	1,249	729	1,978
Accumulated amortisation:			
At 1 January 2018	376	–	376
Charge for the year (note 4(f))	186	–	186
Impairment (note 5(b))	24	–	24
Attributable to intangible assets sold or written off	(209)	–	(209)
At 31 December 2018	377	–	377
Carrying amount:			
At 31 December 2018	872	729	1,601

	2017		
	Capitalised software and other intangible assets HK$'M	Goodwill HK$'M	Total HK$'M
Cost:			
At 1 January 2017	977	729	1,706
Additions	251	–	251
Disposals and write-offs	(189)	–	(189)
At 31 December 2017	1,039	729	1,768
Accumulated amortisation:			
At 1 January 2017	404	–	404
Charge for the year (note 4(f))	161	–	161
Attributable to intangible assets sold or written off	(189)	–	(189)
At 31 December 2017	376	–	376
Carrying amount:			
At 31 December 2017	663	729	1,392

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

20 Goodwill and intangible assets (continued)

Impairment tests for cash-generating units containing goodwill

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

	2018	*2017*
	HK$'M	*HK$'M*
Lending	611	611
Private Banking	118	118
	729	729

The recoverable amounts of the CGUs are determined based on value in use calculations. The key assumptions and approach to determining value in use calculations, as set out below, are solely used for the purpose of assessing impairment on acquired goodwill. These calculations use cash flow projections over a 20-year period based on budgets and forecasts approved by management. These budgets and forecasts cover periods of five years and are extrapolated forward using steady growth rates of 3.1 per cent (2017: 3.0 per cent).

In assessing impairment of goodwill, the Group assumed growth at a steady rate in line with long-term forecast GDP growth. A discount rate of 11.1 per cent (2017: 13.1 per cent) was used.

21 Other assets

	2018	*2017*
	HK$'M	*HK$'M*
Prepayments and accrued income	3,054	2,892
Sundry debtors	3,556	2,913
Acceptances and endorsements	2,417	3,047
Unsettled trades and others	8,361	4,449
Assets held for sale (note)	850	1,957
	18,238	15,258

(note) As of 31 December 2018, assets held for sale included commercial aircraft and corporate loan. As of 31 December 2017, assets held for sale included the Group's interest in Asia Commercial Joint Stock Bank, which was subsequently sold on 9 January 2018.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

22 Deposits from customers

	2018 HK$'M	2017 HK$'M
Current accounts	195,817	165,554
Savings accounts	469,385	484,275
Time, call and notice deposits	232,593	177,029
Deposits and balances of central banks	9,288	7,041
	907,083	833,899

23 Debt securities in issue

	2018 HK$'M	2017 HK$'M
Certificates of deposit	–	1,870
Senior debt securities	–	1,196
	–	3,066

24 Financial liabilities at fair value through profit or loss

	2018 HK$'M	2017 HK$'M
Trading liabilities		
– Short position in securities	13,053	5,813
– Negative fair values of trading derivatives	3,512	2,488
	16,565	8,301
Financial liabilities designated at fair value through profit or loss:		
– Structured deposits from banks and customers	2,958	3,940
– Debt securities issued	7,458	7,534
	10,416	11,474
	26,981	19,775

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

– have fixed rates of interest and interest rate swaps or other interest related derivatives have been transacted with the intention of significantly reducing interest rate risk; or

– are exposed to equity price risk, foreign currency risk or credit risk and derivatives have been transacted with the intention of significantly reducing exposure to market changes.

At 31 December 2018, the contractual amount payable at maturity of these financial liabilities exceeded the carrying amount by HK$1,403 million (2017: HK$256 million). Of this, the cumulative fair value movement relating to changes in credit risk was a gain of HK$855 million (2017: a gain of HK$53 million). The amount of fair value movement relating to changes in credit risk recognised in other comprehensive income during the year was a gain of HK$802 million (2017: a loss of HK$381 million).

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

25 Taxation in the consolidated statement of financial position

Deferred tax assets and liabilities:

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

	2018					
	Depreciation allowances in excess of related depreciation HK$'M	*Impairment losses on financial assets HK$'M*	*Financial assets carried at fair value through other comprehensive income/ Available-for-sale securities HK$'M*	*Own credit adjustment HK$'M*	*Others HK$'M*	*Total HK$'M*
Deferred tax arising from:						
At 31 December 2017	1,247	(198)	(22)	–	(832)	195
Impact of HKFRS 9/IFRS 9	–	(90)	(2)	–	–	(92)
At 1 January 2018	1,247	(288)	(24)	–	(832)	103
Charge/(release) to consolidated income statement (note 6(a))	113	72	–	–	76	261
Charge to reserves	–	–	6	141	27	174
Others	1	–	–	–	33	34
At 31 December 2018	1,361	(216)	(18)	141	(696)	572
	2017					
At 1 January 2017	1,215	(93)	(55)	–	(1,012)	55
Charge/(release) to consolidated income statement (note 6(a))	22	(106)	–	–	69	(15)
Charge to reserves	–	–	33	–	96	129
Others	10	1	–	–	15	26
At 31 December 2017	1,247	(198)	(22)	–	(832)	195

	2018 HK$'M	*2017 HK$'M*
Analysed by:		
Net deferred tax asset recognised on the consolidated statement of financial position	–	(275)
Net deferred tax liability recognised on the consolidated statement of financial position	572	470
	572	195

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

26 Other liabilities

	2018 HK$'M	2017 HK$'M
Accruals and deferred income	4,704	4,086
Provision for liabilities and charges	324	129
Acceptances and endorsements	2,417	3,047
Unsettled trades and others	24,932	14,030
Expected credit loss provision on loan commitments and financial guarantees (note 15)	82	–
	32,459	21,292

27 Employee retirement benefits

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

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

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

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

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

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

(a) Amounts recognised in the consolidated statement of financial position

	2018 HK$'M	2017 HK$'M
Fair value of plan assets	1,716	1,988
Present value of wholly or partly funded obligations	(1,893)	(1,954)
Net (liability)/asset recognised in the consolidated statement of financial position (included in "Other liabilities/assets")	(177)	34

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

27 Employee retirement benefits (continued)

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

	Assets	*2018 Obligations*	*Total*
	HK$'M	*HK$'M*	*HK$'M*
At 1 January 2018	1,988	(1,954)	34
Contributions	25	–	25
Benefits paid	(173)	173	–
Current service cost	–	(78)	(78)
Net interest income/(cost)	32	(31)	1
Administrative expenses	(1)	–	(1)
Return on plan assets, excluding amounts included in interest income	(155)	–	(155)
Actuarial gain – from experience	–	(31)	(31)
Actuarial loss – from financial assumptions	–	28	28
At 31 December 2018	1,716	(1,893)	(177)

	Assets	*2017 Obligations*	*Total*
	HK$'M	*HK$'M*	*HK$'M*
At 1 January 2017	1,813	(2,045)	(232)
Contributions	25	–	25
Benefits paid	(198)	198	–
Current service cost	–	(84)	(84)
Net interest income/(cost)	29	(33)	(4)
Administrative expenses	(1)	–	(1)
Return on plan assets, excluding amounts included in interest income	320	–	320
Actuarial gain – from experience	–	11	11
Actuarial loss – from financial assumptions	–	(1)	(1)
At 31 December 2017	1,988	(1,954)	34

The weighted average duration of the defined benefit obligation as at 31 December 2018 is 5 years (2017: 5 years).

The Group expects to contribute approximately HK$24 million to the Scheme in 2019.

(c) Amounts recognised in the consolidated income statement for the year

	2018	*2017*
	HK$'M	*HK$'M*
Current service cost	78	84
Net interest cost	(1)	4
Administrative expenses	1	1
	78	89

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

27 Employee retirement benefits (continued)

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

	2018 *HK$'M*	*2017* *HK$'M*
Discount rate	2.00%	1.70%
Future salary increases	4.00%	4.00%

These assumptions are likely to change in the future and thus will affect the value placed on the defined benefit obligations. Changes at the reporting date to one of the relevant actuarial assumptions, holding other assumptions constant, would have affected the defined benefit obligation by the amounts shown below:

- if the discount rate increased by 25 basis points, the obligation would reduce by approximately HK$23 million (2017: HK$25 million).

- if the rate of growth of salaries was higher by 25 basis points the obligation would increase by approximately HK$22 million (2017: HK$24 million).

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

(e) Major categories of assets

	2018 *HK$'M*	*2017* *HK$'M*
Equities	62%	63%
Bonds	36%	36%
Cash	2%	1%
	100%	100%

As at 31 December 2018, the Scheme did not invest in the Group's own financial instruments and properties (2017: Nil). The Scheme has a benchmark asset allocation of 60% in equities and 40% in bonds and cash (2017: 60% in equities and 40% in bonds and cash). The long term strategic asset allocations of the Scheme are set and reviewed from time to time by the trustees taking into account the Scheme's membership, liability profile, liquidity requirements, and the risk appetite of the Group.

28 Subordinated liabilities

	2018 *HK$'M*	*2017* *HK$'M*
US$750 million 5.875% Fixed Rate Notes 2020 (note)	5,906	6,003

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

29 Share capital and other equity instruments

	2018		2017	
	No. of shares	*HK$'M*	*No. of shares*	*HK$'M*
Issued and fully paid				
A' ordinary shares	706 million	12,500	706 million	12,500
B' ordinary shares	1,231 million	78	1,231 million	78
US$500 million 6.25% perpetual non-cumulative convertible preference shares	10	3,878	10	3,878
Fully repurchased in prior years				
HK$3,800 million 8.25% non-cumulative preference shares	–	3,800	–	3,800
		20,256		20,256
Other equity instrument				
US$250 million 5% perpetual non-cumulative subordinated securities		1,952		1,952
		22,208		22,208

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

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

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

30 Reserves

Nature and purpose of reserves

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

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

(ii) Cash flow hedge reserve

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

(iii) Investment in debt securities at fair value through other comprehensive income reserve ("FVOCI reserve – Debt") and Investment in equity securities at fair value through other comprehensive income reserve ("FVOCI reserve – Equity")/Available-for-sale investment reserve

The FVOCI reserve – Debt and FVOCI reserve – Equity comprise respectively the cumulative net change in the fair value of the investment in debt securities and investment in equity securities measured at fair value through other comprehensive income, less the ECL allowance recognised in profit or loss. Before 1 January 2018, the available-for-sale investment reserve comprises the cumulative net change in the fair value of available-for-sale securities held at the reporting date and is dealt with in accordance with the accounting policy in note 2(i).

(iv) Revaluation reserve

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

(v) Exchange reserve

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

(vi) Share option equity reserve

SCPLC operates equity-settled share-based compensation plans in which the Group's employees participate. The fair value of the employee services received in exchange for the grant of the share awards is recognised as an expense with the corresponding amount credited to the share option equity reserve.

(vii) Capital contribution reserve

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

The Hong Kong Monetary Authority (HKMA) requires the Group to maintain a minimum level of impairment allowances which is in excess of the impairment allowances required under HKFRSs. Of the retained profits as at 31 December 2018, an amount of HK$3,954 million (2017: HK$5,145 million) has been reserved for this purpose.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

31 Cash and cash equivalents

	2018 HK$'M	2017 HK$'M
(a) Components of cash and cash equivalents in the consolidated cash flow statement		
Cash and balances with banks, central banks and other financial institutions	13,748	18,350
Financial assets at fair value through profit or loss with original maturity within three months	5,961	1,413
Placements with banks and other financial institutions with original maturity within three months	76,438	57,395
Investment securities with original maturity within three months	85,558	35,500
Amounts due from immediate holding company and fellow subsidiaries with original maturity within three months	31,341	31,257
Less: Overdrafts included in "deposits and balances of banks and other financial institutions	(1)	(127)
Less: Overdrafts included in "amounts due to immediate holding company"	(5,607)	(88)
	207,438	143,700

	2018 HK$'M	2017 HK$'M
(b) Reconciliation with the consolidated statement of financial position		
Cash and balances with banks, central banks, and other financial institutions	13,748	18,350
Financial assets at fair value through profit or loss	36,891	22,819
Placements with banks and other financial institutions	153,503	150,256
Investment securities	241,545	207,927
Amounts due from immediate holding company and fellow subsidiaries	109,193	83,283
Overdrafts included in "deposits and balances of banks and other financial institutions"	(1)	(127)
Overdrafts included in "amounts due to immediate holding company"	(5,607)	(88)
Financial assets designated at fair value through profit or loss included in "financial assets at fair value through profit or loss"	–	(336)
Amounts shown in the consolidated statement of financial position	549,272	482,084
Less: amounts with an original maturity of beyond three months	(341,834)	(338,384)
Cash and cash equivalents in the consolidated cash flow statement	207,438	143,700

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

31 Cash and cash equivalents (continued)

(c) *Reconciliation of liabilities arising from financing activities*

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

	Ordinary shares HK$'M	*Preference shares HK$'M*	*Additional equity instruments HK$'M*	*Subordinated liabilities (Note 16) HK$'M*	*Subordinated liabilities (Note 28) HK$'M*	*Total HK$'M*
At 1 January 2018	12,578	3,878	1,952	6,252	6,003	30,663
Changes from financing cash flows:						
Interest paid on subordinated liabilities	–	–	–	(210)	(345)	(555)
Dividends paid to shareholders of the Group	(3,908)	(245)	(98)	–	–	(4,251)
Total changes from financing cash flows	(3,908)	(245)	(98)	(210)	(345)	(4,806)
Exchange adjustments	–	–	–	11	10	21
Hedge accounting adjustment	–	–	–	–	(113)	(113)
Other changes:						
Dividends on shares	3,908	245	98	–	–	4,251
Interest expense on subordinated liabilities	–	–	–	210	351	561
Total other changes	3,908	245	98	210	351	4,812
At 31 December 2018	12,578	3,878	1,952	6,263	5,906	30,577

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

31 Cash and cash equivalents (continued)

(c) Reconciliation of liabilities arising from financing activities (continued)

	Ordinary shares HK$'M	Preference shares HK$'M	Additional equity instruments HK$'M	Subordinated liabilities (Note 16) HK$'M	Subordinated liabilities (Note 28) HK$'M	Total HK$'M
At 1 January 2017	12,578	3,878	–	6,204	6,088	28,748
Changes from financing cash flows:						
Issue of Additional Tier 1 capital	–	–	1,952	–	–	1,952
Interest paid on subordinated liabilities	–	–	–	(249)	(225)	(474)
Dividends paid to shareholders of the Group	(3,124)	(244)	–	–	–	(3,368)
Total changes from financing cash flows	(3,124)	(244)	1,952	(249)	(225)	(1,890)
Exchange adjustments	–	–	–	47	45	92
Hedge accounting adjustment	–	–	–	–	(136)	(136)
Other changes:						
Dividends on shares	3,124	244	–	–	–	3,368
Interest expense on subordinated liabilities	–	–	–	250	231	481
Total other changes	3,124	244	–	250	231	3,849
At 31 December 2017	12,578	3,878	1,952	6,252	6,003	30,663

32 Derivative financial instruments

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

32 Derivative financial instruments (continued)

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

	2018			2017		
	Notional principal amounts HK$'M	*Fair value assets HK$'M*	*Fair value liabilities HK$'M*	*Notional principal amounts HK$'M*	*Fair value assets HK$'M*	*Fair value liabilities HK$'M*
Foreign exchange derivative contracts:						
Forward foreign exchange contracts	452,269	3,088	(3,850)	339,177	2,594	(3,826)
Currency swaps and options	3,170,884	14,210	(14,511)	2,494,015	18,983	(18,589)
	3,623,153	17,298	(18,361)	2,833,192	21,577	(22,415)
Interest rate derivative contracts:						
Swaps	441,077	2,940	(1,803)	283,776	2,420	(593)
Forward rate agreement and options	117,026	27	(1,693)	52,819	19	(1,728)
	558,103	2,967	(3,496)	336,595	2,439	(2,321)
Other derivative contracts	20,521	326	(1,270)	35,609	697	(2,318)
Total derivatives	4,201,777	20,591	(23,127)	3,205,396	24,713	(27,054)

Derivative held for hedging

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

	2018			2017		
	Notional principal amounts HK$'M	*Fair value assets (Included in Amounts due from immediate holding company and fellow subsidiaries) HK$'M*	*Fair value liabilities (Included in Amounts due to immediate holding company and fellow subsidiaries) HK$'M*	*Notional principal amounts HK$'M*	*Fair value assets (Included in Amounts due from immediate holding company and fellow subsidiaries) HK$'M*	*Fair value liabilities (Included in Amounts due to immediate holding company and fellow subsidiaries) HK$'M*
Derivatives designated as fair value hedges:						
Interet rate swaps	46,918	92	(210)	16,530	111	(3)
Cross currency swaps	11,153	67	(42)	20,952	145	(685)
	58,071	159	(252)	37,482	256	(688)
Derivatives designated as cash flow hedges:						
Interest rate swaps	53,856	314	(151)	66,642	241	(113)
Cross currency swaps	547	–	(5)	798	99	–
	54,403	314	(156)	67,440	340	(113)
Total derivatives held for hedging	112,474	473	(408)	104,922	596	(801)

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

32 Derivative financial instruments (continued)

Fair value hedges

The fair value hedges principally consist of interest rate swaps and cross currency swaps. The interest rate swaps are used to protect against changes in the fair value of certain fixed rate assets and liabilities due to movements in market interest rates. The cross currency swaps are used to manage foreign exchange exposures and interest rate risk.

Maturity of hedging instruments

At 31 December 2018 the Group held the following derivatives as hedging instruments in fair value hedges.

Risk category	*More than one month and less than one year* *HK$'M*	*One to five years* *HK$'M*	*Total* *HK$'M*
Interest rate risk			
Notional Amount			
Hedge of debt securities	1,490	21,824	23,314
Hedge of treasury bills	6,299	9,459	15,758
Hedge of advances to customers	247	1,728	1,975
Hedge of subordinated liabilities	–	5,871	5,871
	8,036	38,882	46,918
Foreign exchange risk and interest rate risk			
Notional Amount			
Hedge of debt securities	1,193	134	1,327
Hedge of treasury bills	8,686	912	9,598
Hedge of deposits from customers	228	–	228
	10,107	1,046	11,153

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

32 Derivative financial instruments (continued)

Hedging Instruments and ineffectiveness

	2018				
		Carrying Amount*		Change in fair value used to calculate hedge ineffectiveness	Ineffectiveness recognised in net trading income
	Notional	Asset	Liability		
	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M
Interest rate risk					
Interest rate swaps – Hedge of debt securities	23,314	39	(211)	(133)	–
Interest rate swaps – Hedge of treasury bills	15,758	4	(71)	(41)	(3)
Interest rate swaps – Hedge of advances to customers	1,975	–	(13)	(12)	–
Interest rate swaps – Hedge of subordinated liabilities	5,871	44	–	44	–
	46,918	87	(295)	(142)	(3)
Foreign exchange risk and Interest rate risk					
Cross currency swaps – Hedge of debt securities	1,326	39	–	67	–
Cross currency swaps – Hedge of treasury bills	9,599	23	(34)	(44)	(2)
Cross currency swaps – Hedge of deposits from customers	228	–	(5)	(6)	–
	11,153	62	(39)	17	(2)

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

32 Derivative financial instruments (continued)

Hedged items

	2018					
	Carrying Amount		Accumulated amount of fair value hedge adjustments included in the carrying amount		Change in the value used for calculating hedge ineffectiveness	Accumulated amortising amount of fair value hedge adjustments no longer designated as hedges
	Asset HK$'M	Liability HK$'M	Asset HK$'M	Liability HK$'M	HK$'M	HK$'M
Debt securities	24,613	–	77	–	66	27
Treasury bills	25,234	–	66	–	80	25
Advances to customers	1,987	–	12	–	12	11
Deposits from customers	–	(234)	–	6	6	–
Subordinated liabilities	–	(5,906)	–	(44)	(44)	–
	51,834	(6,140)	155	(38)	120	63

Comparative information under HKAS 39/IAS 39

At 31 December 2017, the net negative fair value of derivatives held as fair value hedges was HK$431 million comprising assets of HK$257 million and liabilities of HK$688 million. The losses on the hedging instruments for the year were HK$115 million. The gains on the hedged item attributable to the hedged risk were HK$113 million.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

32 Derivative financial instruments (continued)

Cash flow hedges

The cash flow hedges principally consist of interest rate swaps and cross currency swaps that are used to hedge against the variability in cash flows of certain floating rate assets and liabilities.

At 31 December 2018 the Group held the following derivatives as hedging instruments in cash flow hedges.

Hedging instruments and ineffectiveness

	2018						
		Carrying Amount*					
	Notional	Asset	Liability	Change in fair value used to calculate hedge ineffectiveness	Changes in the value of the hedging instrument recognised in OCI	Ineffectiveness recognised in net trading income	Amount reclassified from reserves to net trading income
	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M
Interest rate risk							
Interest rate swaps – Hedge of debt securities	3,500	–	(2)	(2)	(2)	–	(6)
Interest rate swaps – Hedge of advances to customers	25,100	128	(15)	53	53	–	(88)
Interest rate swaps – Hedge of deposits from customers	25,256	280	(149)	39	39	–	64
	53,856	408	(166)	90	90	–	(30)
Foreign exchange risk and Interest rate risk							
Cross currency swaps – Hedge of debt securities	547	–	(6)	1	1	–	–
	547	–	(6)	1	1	–	–

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

32 Derivative financial instruments (continued)

Hedged items

	2018		
	Change in the value used for calculating hedge ineffectiveness HK$'M	Cash flow hedge reserve HK$'M	Balances remaining in the cash flow hedge reserve from hedging relationships for which hedge accounting is no longer applied HK$'M
Debt securities	1	(6)	(7)
Advances to customers	(53)	13	(72)
Deposits from customers	(39)	152	262
	(91)	159	183

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

	2018						
	Less than 1 year HK$'M	1 to 2 years HK$'M	2 to 3 years HK$'M	3 to 4 years HK$'M	4 to 5 years HK$'M	More than 5 years HK$'M	Total HK$'M
Forecast receivable cash flows	329	–	–	–	–	–	329
Forecast payable cash flows	(638)	(542)	(418)	(393)	(289)	(924)	(3,204)
	(309)	(542)	(418)	(393)	(289)	(924)	(2,875)

	2017						
	Less than 1 year HK$'M	1 to 2 years HK$'M	2 to 3 years HK$'M	3 to 4 years HK$'M	4 to 5 years HK$'M	More than 5 years HK$'M	Total HK$'M
Forecast receivable cash flows	306	54	–	–	–	–	360
Forecast payable cash flows	(382)	(399)	(353)	(341)	(330)	(949)	(2,754)
	(76)	(345)	(353)	(341)	(330)	(949)	(2,394)

Comparative information under HKAS 39/IAS 39

At 31 December 2017, the net positive fair value of derivatives held as cash flow hedges was HK$226 million comprising assets of HK$339 million and liabilities of HK$113 million. During 2017, there was no ineffectiveness recognised in the consolidated income statement that arose from cash flow hedges.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

33 Contingent liabilities and commitments

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

	2018 *HK$'M*	*2017* *HK$'M*
Direct credit substitutes	8,248	6,919
Transaction-related contingencies	9,050	7,341
Trade-related contingencies	9,120	10,560
Forward asset purchases	198	197
Forward forward deposits placed	–	1,527
Other commitments:		
which are not unconditionally cancellable:		
with original maturity of not more than one year	332	1,178
with original maturity of more than one year	32,457	27,827
which are unconditionally cancellable	372,899	321,564
	432,304	377,113
Credit risk weighted amount	32,164	33,013

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

(b) Capital commitments

Capital commitments outstanding at 31 December in respect of property, plant and equipment purchases not provided for in the consolidated financial statements were HK$3,481 million (2017: HK$3,640 million).

(c) Lease commitments

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

	2018 *HK$'M*	*2017* *HK$'M*
Within 1 year	828	824
After 1 year but within 5 years	1,282	1,599
After 5 years	121	186
	2,231	2,609

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

33 Contingent liabilities and commitments (continued)

(c) Lease commitments (continued)

During the year, HK$1,012 million (2017: HK$980 million) was recognised as an expense in the consolidated income statement in respect of operating leases. The Group leases various premises and equipment under non-cancellable operating lease agreements.

(d) Contingencies

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

34 Risk management

Risk management approach

Enterprise Risk Management Framework ("ERMF")

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

At the start of 2018, the Group introduced a new Enterprise Risk Management Framework ("ERMF") which replaces the existing Risk Management Framework ("RMF"). The ERMF provides better articulation of the principles and standards in how the Group manages risk in a more proactive way. Through the ERMF the Group manages enterprise-wide risks, with the objective of maximising risk-adjusted returns while remaining within our risk appetite.

The key changes under ERMF include the following:

- Refreshed the risk culture and Risk Appetite Statements for our Principal Risk Types;
- Changes in Principal Risk Types which include:
  - Elevating Conduct, Compliance, Financial Crime and Information and Cyber Security to Principal Risk Types;
  - Broadening the scope of Country cross border risk to cover Country Risk;
  - Integration of Strategy Risk as part of the overall Framework; and
  - Consolidation of Capital and Liquidity risk types as one Principal Risk Type.
- Strengthen risk assessment process by introducing a dynamic risk identification process; and
- Further clarity on accountability and responsibility by strengthening of the Three Lines of Defence.

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

Risk management approach (continued)

Risk culture

The Group's risk culture provides the guiding principles for the behaviours expected from our people when managing risk. The risk culture statement encourages the following behaviours and outcomes:

– An enterprise level ability to identify and assess current and future risks, openly discuss and take prompt actions;

– The highest level of integrity by being transparent and proactive in disclosing and managing all types of risks;

– A constructive and collaborative approach in providing oversight and challenge, and taking decisions in a timely manner;

– Everyone to be accountable for their decisions and feel safe using their judgment to make these considered decisions.

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

Strategic risk management

The Group approaches strategic risk management by

– Including in the strategy review process an impact analysis on the risk profile from the growth plans, strategic initiatives and business model vulnerabilities with an aim to proactively identify and manage new risks or existing risks that need to be reprioritised;

– Including in the strategy review process a confirmation that growth plans and strategic initiatives can be delivered within the approved risk appetite and or propose additional Risk Appetite for Board consideration; and

– Validating the corporate plan against the approved or proposed Risk Appetite Statement to the Board.

Roles and responsibilities

Three Lines of Defence model

Roles and responsibilities for risk management are defined under a Three Lines of Defence model. Each line of defence describes a specific set of responsibilities for risk management and control.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

Risk management approach (continued)

Roles and responsibilities (continued)

Lines of Defence	Definition	Key responsibilities
First	The businesses and functions engaged in or supporting revenue generating activities that **own and manage** risks	• Identify, monitor, and escalate risks and issues to Second Line and the Senior Management and promote a healthy risk culture and good conduct. • Manage risks within Risk Appetite, ensure laws and regulations are being complied with. • Ensure systems meet risk data aggregation, risk reporting and data quality requirements set by the Second Line.
Second	The control functions independent of the First Line that provide **oversight and challenge** of risk management to provide confidence to the Chief Risk Officer, the Senior Management and the Board	• Identify, monitor, and escalate risks and issues to the Chief Risk Officer, the Senior Management and the Board or Board level committees, and promote a healthy risk culture and good conduct. • Oversee and challenge First Line risk taking activities and review First Line risk proposals. • Propose Risk Appetite ("RA") to the Board, monitor and report adherence to Risk Appetite and intervene to curtail business if it is not in line with existing or adjusted RA. • Set risk data aggregation, risk reporting and data quality requirements.
Third	The internal audit function provides **independent assurance** of the effectiveness of controls that support First Line's risk management of business activities, and the processes maintained by the Second Line. Its role is defined and overseen by the Audit Committee of the Board	• Independently assess whether management has identified the key risks in the business and whether these are reported and governed in line with the established risk management processes. • Independently assess the adequacy of the design of controls and their operating effectiveness.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

Risk management approach (continued)

The Risk function

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

– To maintain the ERMF, ensuring it remains appropriate to the Group's activities, is effectively communicated and implemented across the Group, and to administer related governance and reporting processes;

– To uphold the overall integrity of the Group's risk/return decisions, and in particular to ensure that risks are properly assessed, that risk/return decisions are made transparently on the basis of this proper assessment, and controlled in accordance with the Group's standards and Risk Appetite; and

– To oversee and challenge the management of credit, traded, country, operational, reputational and information and cyber security risk types.

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

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

Risk Appetite and profile

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

– **Risk capacity** is the maximum level of risk the Group can assume, given its current capabilities and resources, before breaching constraints determined by capital and liquidity requirements, internal operational environment (including but not limited to technical infrastructure, risk management capabilities, expertise), or otherwise failing to meet the expectations of regulators and law enforcement agencies.

– **Risk appetite** is defined by the Group and approved by the Board. It is the maximum amount and type of risk that the Group is willing to assume in pursuit of its strategy. Risk appetite cannot exceed risk capacity.

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

Risk management approach (continued)

Risk Appetite and profile (continued)

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

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

Risk identification and assessment

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

To facilitate the above, the Group maintains a dynamic risk scanning process with inputs on the internal and external risk environment, as well as potential threats and opportunities from the business and client perspectives.

Stress testing

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

- Does not have a portfolio with excessive concentrations of risk that could produce unacceptably high losses under severe but plausible scenarios;
- Has sufficient financial resources to withstand severe but plausible scenarios;
- Has the financial flexibility to respond to extreme but plausible scenarios; and
- Understands the Group's key business model risks, considers what kind of event might crystallise those risks – even if extreme with a low likelihood of occurring – and has identified, as required, actions to mitigate the likelihood and/or the impact of those events.

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

Stress testing (continued)

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

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

Principal risk types

Principal risks are those risks that are inherent in the Group's strategy and the Group's business model. These risks are managed through distinct Risk Type Frameworks (RTF). As part of the overall risk management framework review in 2018 the Group also reviewed its principal risk types. The table below shows the Group's principal risks.

Principal risks	
Credit	Potential for loss due to the failure of a counterparty to meet its agreed obligations to pay the Group.
Traded	Potential for loss of earnings or economic value due to adverse changes in financial market rates or prices
Capital and Liquidity	Capital: Potential for insufficient level or composition of capital to support our normal activities. Liquidity: Potential for loss where we may not have sufficient stable or diverse sources of funding or financial resources to meet the obligations as they fall due.
Operational	Potential for loss resulting from inadequate or failed internal processes and systems, human error, or from the impact of external events.
Country	Potential for default losses due to political or economic events in a country.
Reputational	Potential for loss of earnings or market capitalisation as a result of stakeholders taking a negative view of the organisation or its actions.
Compliance	Potential for regulatory sanctions or loss from a failure on our part to comply with laws, or regulations.
Conduct	Potential regulatory sanctions or loss from a failure on our part to abide by our Conduct Risk Management Framework.
Information and Cyber Security	Potential for loss from a breach of confidentiality, integrity and availability of Bank information systems and assets through cyber attack, insider activity, error or control failure.
Financial Crime	Potential for legal or regulatory penalties, material financial loss or reputational damage resulting from the failure to comply with applicable laws and regulations relating to International Sanctions, Anti-Money Laundering and Anti-Bribery and Corruption.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

Executive and Board risk oversight

Overview

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

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

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

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

Executive Risk Committee

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

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

Asset and Liability Committee

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

Executive and Board risk oversight (continued)

Country Pensions Committee

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

Risk profile

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

(a) Credit risk

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

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

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

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

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

Credit rating and measurement

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

Credit rating and measurement (continued)

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

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

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

Credit Approval

The Bank has been locally incorporated since 1 July 2004. Since then, the approval process reflects strategic decisions that are being made in accordance with individual managers' delegated authorities and the terms of reference of appropriate committees. It is recognised that, as a major part of SC PLC, all significant risk decisions emanating from Hong Kong have an impact to SC PLC, be it regulatory, concentration, strategic, etc. It is therefore recognised that it is essential for SC PLC to consider such transactions to ensure that these issues are included as part of the decision making process. Delegated authorities approved by the ERC are delegated to the key risk managers to ensure that all risk decisions are made within the Group. Where proposals fall outside of the individual's authorities, the advice and guidance of SC PLC is sought. In such cases, the relevant SC PLC's authority, whether an individual or a committee, reviews the proposal from SC PLC's perspective and give their recommendation. On receipt of such recommendation, the Group's Excess Approval Committee ("EAC"), being a sub-committee of the ERC, meets to consider such advice and reach a suitable decision. Summary of the credit applications approved by the EAC are reported at each ERC meeting for noting.

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

Credit concentration risk

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

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

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

Credit monitoring

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

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

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

Client accounts are placed on Early Alert when they display signs of actual or potential weakness. For example where there is a decline in the client's position within the industry, financial deterioration, breach of covenants, non-performance of an obligation within the stipulated period, or there are concerns relating to ownership or management.

Such accounts and portfolios are subjected to a dedicated process overseen by the CIC. Client account strategies and credit grades are re-evaluated. In addition, remedial actions are agreed and monitored. Remedial actions include, but are not limited to, exposure reduction, security enhancement, exiting the account or immediate movement of the account into the control of Group Special Assets Management ("GSAM"), the Group's specialist recovery unit.

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

Credit mitigation

Credit policies set out the key consideration for eligibility, enforceability and effectiveness of credit risk mitigation arrangements. Potential credit losses from any given account, customer or portfolio are mitigated using a range of tools such as collateral, netting agreements, credit insurance, credit derivatives and guarantees. The reliance that can be placed on these mitigants is carefully assessed in light of issues such as legal certainty and enforceability, market valuation correlation and counterparty risk of the guarantor. The requirement for risk mitigation is, however, not a substitute for the ability to pay, which is the primary consideration for any lending decisions.

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

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

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

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

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

Traded Products

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

Credit mitigation (continued)

Securities

Within Corporate & Institutional Banking and Commercial Banking, the portfolio limits and parameters for the underwriting and purchase of all pre-defined securities assets to be held for sale are approved by the Group's Excess Approval Committee with support by the Group's Underwriting Committee ("UC"). The Excess Approval Committee is established under the authority of ERC. Corporate & Institutional Banking and Commercial Banking business operates within set limits, which include country, single issuer, holding period and credit grade limits.

Day to day credit risk management activities for traded securities are carried out by a specialist team within the Risk function whose activities include oversight and approval within the levels delegated by the UC. Issuer credit risk, including settlement and pre-settlement risk, and price risk are controlled by the Risk function.

The UC approves individual proposals to underwrite new corporate security issues for clients. Where an underwritten security is held for a period longer than the target sell-down period, the final decision on whether to sell the position rests within the Risk function.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

HKFRS 9/IFRS 9 methodology

Approach for determining expected credit losses

Credit loss terminology

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

Key differences between regulatory and IFRS expected credit loss models

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

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

Application of lifetime

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

Key assumptions and judgements in determining expected credit loss

Incorporation of forward-looking information and the impact of non-linearity

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

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

Forecast of key macroeconomic variables underlying the expected credit loss calculation

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

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

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

Significant increase in credit risk ("SICR")

Quantitative criteria

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

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

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

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

Qualitative criteria

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

Backstop

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

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

Corporate & Institutional Banking and Commercial Banking clients

Quantitative criteria

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

Qualitative criteria

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

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

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

Retail Banking clients

Quantitative criteria

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

Qualitative criteria

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

Private Banking clients

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

Qualitative criteria

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

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

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

Debt Securities

Quantitative criteria

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

Qualitative criteria

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

Assessment of credit-impaired financial assets

Retail Banking Clients

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

Corporate & Institutional Banking, Commercial Banking and Private Banking Clients

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

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

Write-offs

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

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

The models used in determining expected credit losses are reviewed and approved by the SC PLC Group Credit Model Assessment Committee (CMAC) which is appointed by the Stress Testing Committee. CMAC has the responsibility to assess and approve the use of models and to review and approve all HKFRS 9/IFRS 9 interpretations related to models. CMAC also provides oversight on operational matters related to model development, performance monitoring and model validation activities including standards, regulatory and Group Internal Audit matters.

Prior to submission to CMAC for approval, the models have been validated by SC PLC Group Model Validation (GMV), a function which is independent of the business and the model developers. GMV's analysis comprises review of model documentation, model design and methodology; data validation; review of model development and calibration process; out-of-sample performance testing; and assessment of compliance review against HKFRS 9/IFRS 9 rules and internal standards.

Key inputs into the calculation and resulting expected credit loss provisions are subject to review and approval by the SC PLC Group IFRS 9 Impairment Committee which is appointed by the SC PLC Group Risk Committee. The SC PLC Group IFRS 9 Impairment Committee consists of senior representatives from Risk, Finance, Treasury and Group Economic Research. It meets twice every quarter, once before the models are run to approve key inputs into the calculation, and once after the models are run to approve the expected credit loss provisions and any judgmental override that may be necessary.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

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

Maximum exposure to credit risk

The maximum exposures to credit risk of on-balance sheet financial instruments, before taking account of any collateral or other credit enhancements is the carrying amount reported on the statement of financial position. For off-balance sheet instruments, the maximum exposure to credit risk, which excludes loan commitments which are unconditionally cancellable, is the contractual nominal amounts as set out below:

	2018	*2017*
	HK$'M	*HK$'M*
Financial guarantees and other credit related contingent liabilities	26,418	24,820
Loan commitments and other credit related commitments	32,987	30,729
	59,405	55,549

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

(i) Loans and advances

Loans neither past due nor credit impaired

At 31 December 2018, the Group has HK$215,828 million (2017: HK$221,120 million) of mortgage loans in Retail Banking that are not credit impaired or past due. These are generally fully secured exposures (2017: fully secured).

In Corporate & Institutional Banking and Commercial Banking, the Group has HK$205,985 million (2017: HK$186,143 million) of corporate exposures that are not credit impaired or past due. Based on the fair value of the collateral held, 13% (2017: 17%) of these exposures are secured by tangible collateral.

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

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

Loans past due or credit impaired

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

	2018 *HK$'M*	*2017* *HK$'M*
Advances to customers:		
Estimated fair value of collateral (Note):		
Held against credit impaired advances	638	1,064
Held against past due but not credit impaired advances	2,081	1,445

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

Repossessed Collateral

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

	2018 *HK$'M*	*2017* *HK$'M*
Property, plant and equipment	110	138

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

Repossessed collateral obtained are intended to be realised in an orderly fashion to repay the impaired loans and are not held for the own use of the Group.

(ii) Off-balance sheet exposures

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

Credit quality

Loans and advances to customers

The following table sets out an analysis of the internal credit gradings for advances which are not past due and not considered credit-impaired. The credit gradings set out in the table below are based on a probability of default measure as set out on page 98 to 99.

	2018		*2017*	
	Advances to customers HK$'M	*Advances to banks HK$'M*	*Advances to customers HK$'M*	*Advances to banks HK$'M*
Credit grades:				
1 to 5	353,153	145,672	337,496	144,507
6 to 8	112,813	7,742	108,131	4,652
9 to 11	34,476	17	30,055	82
12	1,292	–	791	–
	501,734	153,431	476,473	149,241

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

Credit quality (continued)

Loans and advances to customers (continued)

The following table sets out the ageing of advances which are past due and not considered credit-impaired. 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. Past due loans greater than 90 days have been classified as stage 3 after HKFRS 9/IFRS 9 implementation.

	2018		*2017*	
	Advances to customers HK$'M	*Advances to banks HK$'M*	*Advances to customers HK$'M*	*Advances to banks HK$'M*
Past due				
– up to 30 days	2,728	81	1,988	1,015
– 31 - 60 days	161	–	153	–
– 61 - 90 days	63	–	41	–
– 91 - 120 days	–	–	53	–
– 121 - 150 days	–	–	31	–
	2,952	81	2,266	1,015

Debt securities and other eligible bills

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

	2018		*2017*	
Securities not considered credit impaired:	*Treasury bills HK$'M*	*Other debt securities HK$'M*	*Treasury bills HK$'M*	*Other debt securities HK$'M*
AAA	–	66,351	848	38,356
AA- to AA+	104,980	31,184	79,022	35,819
A- to A+	9,243	48,727	11,025	52,256
Lower than A-	–	5,200	–	7,403
Unrated	–	2,026	–	1,479
	114,223	153,488	90,895	135,313

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

Movement in credit impairment

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

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

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

Loans and advances to customers

	Stage 1			Stage 2			Stage 3			Total		
	Gross balance	Total credit impairment	Net carrying amount	Gross balance	Total credit impairment	Net carrying amount	Gross balance	Total credit impairment	Net carrying amount	Gross balance	Total credit impairment	Net carrying amount
	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M
As at 1 January 2018	460,666	401	460,265	15,099	278	14,821	3,365	1,094	2,271	479,130	1,773	477,357
Net changes in loss allowance during the period:												
Net transfers between stages	(17,976)	662	(18,638)	15,669	(769)	16,438	2,307	107	2,200	–	–	–
Net changes in exposures	47,136	(271)	47,407	(16,131)	(171)	(15,960)	(2,598)	(811)	(1,787)	28,407	(1,253)	29,660
Changes in models	–	–	–	–	–	–	–	–	–	–	–	–
Changes in risk parameters	–	(116)	116	–	658	(658)	–	1,096	(1,096)	–	1,638	(1,638)
Net re-measurement from stage change	–	(254)	254	–	316	(316)	–	–	–	–	62	(62)
Unwinding discount	–	–	–	–	–	–	–	(21)	21	–	(21)	21
Other movements	–	–	–	–	–	–	–	–	–	–	–	–
Write offs (net of recoveries)	–	–	–	–	–	–	(559)	(545)	(14)	(559)	(545)	(14)
Exchange translation differences	312	5	307	(89)	15	(104)	12	1	11	235	21	214
As at 31 December 2018	**490,138**	**427**	**489,711**	**14,548**	**327**	**14,221**	**2,527**	**921**	**1,606**	**507,213**	**1,675**	**505,538**
Income statement charge/(release)		**(641)**			**803**			**285**			**447**	

Comparative amounts for 2017 below represent allowance account for credit losses and reflect measurement basis under HKAS 39/IAS 39.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(a) Credit risk (continued)

Movement in credit impairment (continued)

Loans and advances to customers (continued)

	Individually assessed HK$'M	*2017 Collectively assessed HK$'M*	*Total HK$'M*
At 1 January 2017	1,437	563	2,000
Amounts written off	(1,311)	–	(1,311)
Recoveries of advances written off in previous years	573	–	573
Net charge/(release) to the consolidated income statement (note 5(a))	235	(320)	(85)
Unwind of discount on loan impairment provision (note 4(a))	(27)	–	(27)
At 31 December 2017 (note 14(a))	907	243	1,150

(b) Country risk

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

Policies and procedures are developed and deployed to put in place standards and controls to ensure effective management of country risk. The policies include standards for the acceptance and effective management of Country Risk in particular around identification, measurement, reporting and setting, calibrating and allocating Country Risk limits. The procedures outline the process for Country Risk limit setting and monitoring and reporting exposures.

The ERC is responsible for the approval of policies, setting and maintaining of control risk parameters, monitoring material risk exposures and directing appropriate action in response to material risk issues or themes that come to the Committee's attention, relating to Country Risk.

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(c) Market risk management

Market risk is the potential for loss of economic value due to adverse changes in financial market rates or prices. The Group's exposure to market risk arises predominantly from providing clients access to financial markets, facilitation of which entails the Group taking moderate market risk positions. All trading teams support client activity; there are no proprietary trading teams. Hence, income earned from market risk related activities is primarily driven by the volume of client activity rather than risk-taking. Market risk also arises in the non-trading book from the requirement to hold a large liquid assets buffer of high-quality liquid debt securities and from the translation of foreign currency denominated assets, liabilities and earnings.

The primary categories of market risk for the Group are:

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

- currency exchange rate risk: arising from changes in exchange rates and implied volatilities on foreign exchange options.

Market risk governance

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

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

Value at Risk

The Group measures the risk of losses arising from future potential adverse movements in market rates, prices and volatilities using a VaR methodology. VaR, in general, is a quantitative measure of market risk that applies recent historical market conditions to estimate the potential future loss in market value that will not be exceeded in a set time period at a set statistical confidence level. VaR provides a consistent measure that can be applied across trading businesses and products over time and can be set against actual daily trading profit and loss outcome.

VaR is calculated for expected movements over a minimum of one business day and to a confidence level of 97.5 per cent.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(c) Market risk management (continued)

Value at Risk (continued)

The Group applies two VaR methodologies:

- Historical simulation: involves the revaluation of all existing positions to reflect the effect of historically observed changes in market risk factors on the valuation of the current portfolio. This approach is applied for general market risk factors and the majority of specific (credit spread) risk VaR.

- Monte Carlo simulation: this methodology is similar to historical simulation but with considerably more input risk factor observations. These are generated by random sampling techniques, but the results retain the essential variability and correlations of historically observed risk factor changes. This approach is applied for some of the specific (credit spread) risk VaR in relation to idiosyncratic exposures in credit markets.

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

Stress Testing

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

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

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

Stress scenarios are regularly updated to reflect changes in risk profile and economic events. TRM reviews stress exposures and, where necessary, enforces reductions in overall market risk exposure. The ERC considers the results of stress tests as part of its supervision of risk appetite.

Regular stress test scenarios are applied to interest rates, credit spreads, and exchange rates. This covers all asset classes in the Financial Markets banking and trading books.

Ad hoc scenarios are also prepared reflecting specific market conditions and for particular concentrations of risk that arise within the business.

Market risk VaR coverage

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(c) Market risk management (continued)

Market risk VaR coverage (continued)

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

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

Value at risk:	*2018*				*2017*			
	Average HK$'M	*High** HK$'M*	*Low** HK$'M*	*Actual* HK$'M*	*Average HK$'M*	*High** HK$'M*	*Low** HK$'M*	*Actual* HK$'M*
Interest rate risk ^	43.4	52.6	37.3	51.8	47.4	72.0	32.1	38.1
Foreign exchange risk	3.4	7.5	1.1	3.4	4.1	10.2	1.3	5.0
Total ^^	43.5	53.4	36.5	52.3	48.1	74.5	31.9	41.0

Trading (VaR at 97.5%, 1 day)

Value at risk:	*2018*				*2017*			
	Average HK$'M	*High** HK$'M*	*Low** HK$'M*	*Actual* HK$'M*	*Average HK$'M*	*High** HK$'M*	*Low** HK$'M*	*Actual* HK$'M*
Interest rate risk	6.1	9.0	4.3	5.6	9.7	17.5	5.0	5.0
Foreign exchange risk	3.4	7.5	1.1	3.4	4.1	10.2	1.3	5.0
Total ^^	7.2	12.1	4.6	7.4	11.7	22.0	5.8	6.6

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

Value at risk:	*2018*				*2017*			
	Average HK$'M	*High** HK$'M*	*Low** HK$'M*	*Actual* HK$'M*	*Average HK$'M*	*High** HK$'M*	*Low** HK$'M*	*Actual* HK$'M*
Interest rate risk ^	41.7	53.1	34.8	51.7	45.0	70.7	30.3	37.5

* Actual one day VaR at period end date.

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

^ Interest rate risk VaR includes yield curve and credit spread risk arising from fair value securities, loan and receivables and held to maturity securities.

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(d) Foreign exchange risk

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

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

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

	2018 HK$'M	2017 HK$'M
US dollars exposure		
Spot assets	402,213	339,429
Spot liabilities	(388,575)	(328,208)
Forward purchases	1,758,336	1,378,261
Forward sales	(1,769,182)	(1,385,414)
Net long non-structural position	2,792	4,068

	2018 HK$'M	2017 HK$'M
Chinese Renminbi exposure		
Spot assets	55,506	53,737
Spot liabilities	(62,590)	(45,149)
Forward purchases	941,446	581,943
Forward sales	(933,691)	(590,659)
Net long/(short) non-structural position	671	(128)

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

	2018 HK$'M	2017 HK$'M
Chinese Renminbi	12,400	11,639
US dollars	2,762	3,263
	15,162	14,902

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(e) Interest rate risk in the banking book

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

(f) Liquidity risk

Liquidity risk is the potential for loss where we may not have sufficient stable or diverse sources of funding or financial resources to meet our obligations as they fall due.

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

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

Primary sources of funding

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

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

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

Liquidity risk management

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(f) Liquidity risk (continued)

Liquidity risk management (continued)

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

Governance

At a Board level, the Board Risk Committee oversees the effective management of liquidity risk. At the executive level, the ALCO ensures the Group remains in compliance with liquidity policies and practices, as well as local regulatory requirements. The ALCO also guides the Group's strategy on balance sheet optimisation and ensures that, executing the Group's strategy, the Group operates within internally approved liquidity risk appetite.

Monitoring

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

Internal risk management reports covering the balance sheet and the liquidity position of the Group are presented to ALCO. The reports contain key information on balance sheet trends, exposures against Risk Appetite and supporting risk measures which enable members to make informed decisions around the overall management of the Group's balance sheet.

Liquidity risk metrics

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

Liquidity Coverage Ratio (LCR)

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(f) Liquidity risk (continued)

Stress Coverage

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

The Group's approach to managing liquidity risk is reflected in the following Board-level Risk Appetite statement.

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

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

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

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

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

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

Stress testing results show that a positive surplus was maintained under all scenarios at 31 December 2018 i.e. the Group is able to survive for a period of time as defined under each scenario. The Combined scenario at 31 December 2018 showed the Group maintained liquidity resources to survive greater than 60 days, as per the Group's Board Risk Appetite.

The Group's credit ratings as at 31 December 2018 were A+ with stable outlook (S&P) and A1 with possible upgrade (Moody's). A downgrade in the long-term credit ratings would increase derivative collateral requirements and outflows due to rating-linked liabilities. The impact of a two-notch long term ratings downgrade has a minimal impact on the Group's derivatives collateral requirements.

External wholesale borrowing

The Board sets a risk limit to prevent excessive reliance on wholesale borrowing. As at the reporting date of 31 December 2018 the Group remained within Board Risk Appetite.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(f) Liquidity risk (continued)

Advances-to-deposits ratio

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

	2018	*2017*
	HK$'M	*HK$'M*
Advances to customers	505,538	480,867
Deposits from customers	907,083	833,899
Advances-to-deposits ratio	56%	58%

Net stable funding ratio (NSFR)

With effect from 1 January 2018, the Group monitors and reports the NFSR in line with the Banking (Liquidity) Rules issued by the HKMA. We maintained our NSFR position above the prudential requirement of 100%.

Maturity profiles

(i) Contractual maturity of assets and liabilities

The following table presents assets and liabilities by maturity groupings based on the remaining period to the contractual maturity date as at the balance sheet date on a discounted basis. Contractual maturities do not necessarily reflect actual repayments or cash flow. Within the tables below cash and balances with central banks, interbank placements, and investment securities that are available-for-sale are used by the Group principally for liquidity management purposes.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(f) Liquidity risk (continued)

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

	2018							
	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$'M	Total HK$'M
Assets								
Cash and balances with banks, central banks and other financial institutions	13,329	419	–	–	–	–	–	13,748
Placements with banks and other financial institutions	84	63,400	40,110	49,123	786	–	–	153,503
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	–	46,691	46,691
Financial asset at fair value through profit or loss	1,268	1,862	6,557	9,937	7,701	9,060	506	36,891
Investment securities	–	56,307	45,970	71,768	58,052	9,053	395	241,545
Advances to customers	21,556	79,575	41,157	30,484	101,286	231,480	–	505,538
Amounts due from immediate holding company	4,387	61,927	7,825	7,444	2,455	1,441	–	85,479
Amounts due from fellow subsidiaries	2,158	9,104	2,250	9,010	990	202	–	23,714
Others	835	4,091	12,486	437	144	58	51,074	69,125
Total Assets	43,617	276,685	156,355	178,203	171,414	251,294	98,666	1,176,234
Liabilities								
Hong Kong SAR currency notes in circulation	–	–	–	–	–	–	46,691	46,691
Deposits and balances of banks and other financial institutions	18,898	1,689	2	–	1,063	–	–	21,652
Deposits from customers	670,377	93,071	64,746	76,950	1,703	236	–	907,083
Financial liabilities at fair value through profit or loss	4	1,837	7,617	6,938	4,250	6,335	–	26,981
Amounts due to immediate holding company	9,401	3,315	11,596	7,762	1,361	8,016	85	41,536
Amounts due to fellow subsidiaries	2,944	3,156	2,851	251	2,735	–	–	11,937
Subordinated liabilities	–	–	–	–	5,906	–	–	5,906
Others	6,729	17,378	6,673	2,369	1,212	162	171	34,694
Total Liabilities	708,353	120,446	93,485	94,270	18,230	14,749	46,947	1,096,480

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(f) Liquidity risk (continued)

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

	2017							
	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$'M	Total HK$'M
Assets								
Cash and balances with banks, central banks and other financial institutions	18,350	–	–	–	–	–	–	18,350
Placements with banks and other financial institutions	1,201	62,784	50,389	29,987	5,175	720	–	150,256
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	–	42,341	42,341
Financial assets at fair value through profit or loss	–	615	4,354	6,044	3,452	8,354	–	22,819
Advances to customers	14,439	89,300	30,550	54,506	113,466	178,606	–	480,867
Investment securities	236	38,921	67,801	39,841	53,887	6,540	701	207,927
Amounts due from immediate holding company	6,693	14,976	16,295	19,946	735	430	–	59,075
Amounts due from fellow subsidiaries	2,408	11,457	2,524	4,235	3,584	–	–	24,208
Others	870	2,035	8,637	1,045	858	6	55,755	69,206
Total Assets	44,197	220,088	180,550	155,604	181,157	194,656	98,797	1,075,049
Liabilities								
Hong Kong SAR currency notes in circulation	–	–	–	–	–	–	42,341	42,341
Deposits and balances of banks and other financial institutions	18,404	88	2	920	199	–	–	19,613
Deposits from customers	654,100	76,683	52,069	47,721	3,100	226	–	833,899
Financial liabilities at fair value through profit or loss	–	7,637	640	3,168	3,463	4,867	–	19,775
Debt securities in issue	–	1,712	156	1,198	–	–	–	3,066
Amounts due to immediate holding company	2,124	8,209	19,146	7,582	477	6,708	–	44,246
Amounts due to fellow subsidiaries	7,130	549	1,272	514	12	–	–	9,477
Subordinated liabilities	–	–	–	–	6,003	–	–	6,003
Others	6,617	5,132	7,238	2,165	763	–	286	22,201
Total Liabilities	688,375	100,010	80,523	63,268	14,017	11,801	42,627	1,000,621

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(f) Liquidity risk (continued)

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

	2018							
	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$'M	Total HK$'M
Of which:								
Certificates of deposit held								
– included in financial assets at fair value through profit or loss as trading assets	–	60	–	132	44	2	–	238
– included in investment securities as financial assets at fair value through other comprehensive income	–	3,729	1,761	14,499	398	–	–	20,387
	–	3,789	1,761	14,631	442	2	–	20,625
Treasury bills								
– included in financial assets at fair value through profit or loss as trading assets	–	1,158	5,598	4,212	–	–	–	10,968
– included in investment securities as financial assets at fair value through other comprehensive income	–	51,669	33,961	17,625	–	–	–	103,255
	–	52,827	39,559	21,837	–	–	–	114,223
Debt securities								
– included in financial assets at fair value through profit or loss as trading assets	–	123	208	1,469	3,585	8,755	–	14,140
– included in financial assets at fair value through profit or loss as non-trading financial assets mandatorily at fair value through profit and loss	195	–	–	–	744	254	–	1,193
– included in investment securities classified as:								
– financial asset at fair value through other comprehensive income	–	850	9,738	39,644	56,577	6,271	–	113,080
– financial asset at amortised cost	–	59	–	510	1,077	2,794	–	4,440
	195	1,032	9,946	41,623	61,983	18,074	–	132,853

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(f) Liquidity risk (continued)

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(f) Liquidity risk (continued)

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

The cash flows presented in note 34(f)(i) reflect the cash flows that will be contractually payable over the residual maturity of the instruments. However, contractual maturities do not necessarily reflect the timing of actual repayments or cash flow. In practice, certain assets and liabilities behave differently from their contractual terms, especially for short-term customer accounts, credit card balances and overdrafts, which extend to a longer period than their contractual maturity. On the other hand, mortgage balances tend to have a shorter repayment period than their contractual maturity date. Expected customer behaviour is assessed and managed using qualitative and quantitative techniques, including analysis of observed customer behaviour over time.

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

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

Within the 'More than five years and undated' maturity band are undated financial liabilities, all of which relate to subordinated debt, on which interest payments are not included as this information would not be meaningful given the instruments are undated. Interest payments on these instruments are included within the relevant maturities up to five years.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(f) Liquidity risk (continued)

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

	2018						
	Repayable on demand HK$'M	*Due within 3 months HK$'M*	*Due between 3 months to 1 year HK$'M*	*Due between 1 year to 5 years HK$'M*	*Due after 5 years HK$'M*	*Undated HK$'M*	*Total HK$'M*
Deposits and balances of banks and other financial institutions	18,899	1,691	–	1,210	–	–	21,800
Deposits from customers	670,377	158,725	77,829	1,947	236	–	909,114
Financial liabilities at fair value through profit or loss	–	14,036	1,143	1,132	–	–	16,311
Amounts due to immediate holding company	9,401	14,978	7,965	2,439	8,824	85	43,692
Amounts due to fellow subsidiaries	2,944	6,032	251	2,735	–	–	11,962
Subordinated liabilities	–	–	347	6,525	–	–	6,872
Others	6,208	20,457	2,200	1,212	162	46,862	77,101
	707,829	215,919	89,735	17,200	9,222	46,947	1,086,852

	2017						
	Repayable on demand HK$'M	*Due within 3 months HK$'M*	*Due between 3 months to 1 year HK$'M*	*Due between 1 year to 5 years HK$'M*	*Due after 5 years HK$'M*	*Undated HK$'M*	*Total HK$'M*
Deposits and balances of banks and other financial institutions	18,404	90	1,008	209	–	–	19,711
Deposits from customers	654,100	129,169	48,209	3,212	226	–	834,916
Financial liabilities at fair value through profit or loss	–	7,536	2,656	2,945	4,847	–	17,984
Debt securities in issue	–	1,868	1,240	–	–	–	3,108
Amounts due to immediate holding company	2,124	27,421	7,784	1,553	7,784	–	46,666
Amounts due to fellow subsidiaries	7,130	1,821	514	12	–	–	9,477
Subordinated liabilities	–	–	352	6,534	–	–	6,886
Others	6,140	9,276	1,986	763	–	42,627	60,792
	687,898	177,181	63,749	15,228	12,857	42,627	999,540

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(f) 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 receiving leg is not shown in this table and as a result the derivative amounts in this table are inflated by their exclusion.

	2018				
	Due within 3 months HK$'M	*Due between 3 months to 1 year HK$'M*	*Due between 1 year to 5 years HK$'M*	*Due after 5 years HK$'M*	*Total HK$'M*
Derivative financial instruments	2,076,719	1,385,672	29,852	3,063	3,495,306

	2017				
	Due within 3 months HK$'M	*Due between 3 months to 1 year HK$'M*	*Due between 1 year to 5 years HK$'M*	*Due after 5 years HK$'M*	*Total HK$'M*
Derivative financial instruments	1,818,464	985,133	18,697	3,338	2,825,632

(g) Operational risk

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

Operational Risk Governance

The ERC provides oversight of operational risk management across the Group. It is supported by sub-committees including the Country Fraud Risk Management Committee ("CFRMC"), Data Governance Committee ("DGC"), and Third Party Risk Management Committee ("TPRMC"), which oversee operational risks arising from businesses and functions, internal and external fraud, data quality management, and third party risk management respectively.

Risk Appetite approach

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(g) Operational risk (continued)

Risk classification

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

OPERATIONAL RISK SUB-TYPES

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(h) Reputational risk

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

The Group takes a structured approach to the assessment of risks associated with how individual client, transaction, product and strategic coverage decisions may affect perceptions of the organisation and its activities. Wherever a potential for stakeholder concerns is identified, issues are subject to prior approval by a management authority commensurate with the materiality of matters being considered. The Group recognises that there is also the potential for consequential reputational risk should it fail to control other Principal Risk Types. Such secondary reputational risks are managed by the owners of each Principal Risk Type.

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

(i) Compliance

The Group defines Compliance Risk as the potential for regulatory sanctions or loss from a failure on its part to comply with laws or regulations.

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(j) Conduct

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

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

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

(k) Information and Cyber Security

Information and cyber security risk

The Group defines Information and cyber security risk as the potential for loss from a breach of confidentiality, integrity and availability of Bank information systems and assets through cyber attack, insider activity, error or control failure.

During 2017 the Group introduced the Chief Information Security Officer function and announced a revised operating model to address information and cyber security as a business risk incorporating it into its overall risk management strategy.

The Chief Information Security Officer function acts as a second line of defence and has overall responsibility for a structured risk management framework for information and cyber security risk. This function sets both the strategy and policy framework through which the risk to information assets and systems are managed. In addition, it provides oversight and challenge to the operational implementation of controls at the first line, which includes technology teams and business units who own information assets and systems. The Technical Information Security Team is a special technology team having responsibility for ensuring security of the Group's applications and technology infrastructure.

Following the introduction of the Chief Information Security Officer function in 2017 and throughout 2018, the risk monitoring capability continued to be enhanced as information and cyber security becomes a principal risk managed under the refreshed model. Currently monitoring is performed through a range of roles and activities in both the Chief Information Security Office and the Technical Information Security Team.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(l) Financial Crime

Financial crime risk

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

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

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

(m) Capital management

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

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

The process of allocating capital to specific operations and activities is undertaken by ALCO and is reviewed regularly by the Board.

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

The Group has complied with all externally imposed capital requirements during 2018.

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Risk management (continued)

(m) Capital management (continued)

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

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

The Group's consolidated capital as at 31 December 2018 consists of tier 1 capital after deduction of HK$63,279 million (2017: HK$57,666 million) and tier 2 capital after deductions of HK$11,241 million (2017: HK$12,535 million). Tier 2 capital includes subordinated debt and impairment allowances and regulatory reserve eligible for inclusion in Tier 2 capital.

35 Financial instruments

(a) Valuation of financial instruments carried at fair value

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

Valuation methodologies

The valuation hierarchy is set out below:

	Level 1	Level 2	Level 3
Fair value determined using:	Unadjusted quoted price in an active market for identical assets and liabilities	Directly or indirectly observable inputs other than unadjusted quoted prices included within Level 1 that are observable[1]	Significant inputs for the asset or liability that are not based on observable market data (unobservable inputs) (see note 35 (a)(i))

[1] These included valuation models such as discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. These models incorporate assumptions and inputs that other market participants would use in their valuations, such as discount rates, default rates, credit spreads and option volatilities. These inputs need to be directly or indirectly observable in order to be classified as level 2.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

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

	2018			
	Level 1	*Level 2*	*Level 3*	*Total*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
Financial assets at fair value through profit or loss				
– Trading assets				
– Debt securities	12,304	12,933	109	25,346
– Advances to customers	–	1,198	–	1,198
– Positive fair values of trading derivatives	8	2,843	–	2,851
– Non-trading financial assets mandatorily at fair value through profit or loss:				
– Debt securities	–	254	939	1,193
– Advances to customers	–	3,215	2,582	5,797
– Equity shares	–	–	506	506
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	55	15,722	–	15,777
– Positive fair values of hedging derivatives	–	441	–	441
– Debt securities	–	22	–	22
Amounts due from fellow subsidiaries				
– Positive fair values of trading derivatives	1	1,489	–	1,490
– Positive fair values of hedging derivatives	–	32	–	32
Investment securities at fair value through other comprehensive income				
– Treasury bills	103,255	–	–	103,255
– Certificates of deposit held	137	20,250	–	20,387
– Debt securities	42,939	70,141	–	113,080
– Equity shares	–	–	395	395
Total assets measured at fair value	158,699	128,540	4,531	291,770
Financial liabilities at fair value through profit or loss				
– Trading liabilities				
– Short positions in securities	9,751	3,302	–	13,053
– Negative fair values of trading derivatives	7	3,505	–	3,512
– Financial liabilities designated at fair value				
– Structured bank and customer deposits designated at fair value	–	2,958	–	2,958
– Debt securities issued	–	6,573	885	7,458
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	42	18,389	–	18,431
– Negative fair values of hedging derivatives	–	405	–	405
Amounts due to fellow subsidiaries				
– Negative fair values of trading derivatives	1	775	–	776
– Negative fair values of hedging derivatives	–	3	–	3
Total liabilities measured at fair value	9,801	35,910	885	46,596

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

	2017			
	Level 1 *HK$'M*	*Level 2* *HK$'M*	*Level 3* *HK$'M*	*Total* *HK$'M*
Financial assets at fair value through profit or loss:				
– Trading assets				
– Debt securities	8,042	10,573	24	18,639
– Advances to customers	–	2,649	–	2,649
– Positive fair values of derivatives	1	1,191	–	1,192
– Equity shares	3	–	–	3
– Financial assets designated at fair value through profit or loss				
– Debt securities	–	336	–	336
Amounts due from immediate holding company				
– Positive fair values of derivatives	44	22,765	–	22,809
– Debt securities	–	7	–	7
Amounts due from fellow subsidiaries				
– Positive fair values of derivatives	–	712	–	712
Available-for-sale securities				
– Treasury bills	86,608	–	–	86,608
– Certificates of deposit held	37	19,341	–	19,378
– Debt securities	36,843	59,347	–	96,190
– Equity shares	–	–	701	701
Total assets measured at fair value	131,578	116,921	725	249,224
Financial liabilities at fair value through profit or loss:				
– Trading liabilities				
– Short positions in securities	3,274	2,539	–	5,813
– Negative fair values of derivatives	3	2,485	–	2,488
– Financial liabilities designated at fair value through profit or loss				
– Structured bank and customer deposits	–	3,940	–	3,940
– Debt securities issued	–	6,370	1,164	7,534
Amounts due to immediate holding company				
– Negative fair values of derivatives	32	23,543	–	23,575
Amounts due to fellow subsidiaries				
– Negative fair values of derivatives	2	989	–	991
Total liabilities measured at fair value	3,311	39,866	1,164	44,341

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

(i) Valuation of financial instruments with significant unobservable inputs

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

Financial assets

	2018		
	Financial assets at fair value through profit or loss HK$'M	*Available-for-sale securities/ Financial assets at fair value through other comprehensive income HK$'M*	*Total level 3 assets HK$'M*
At 31 December 2017 – HKAS 39/IAS 39	24	701	725
Impact of adoption of HKFRS 9/IFRS 9			
– reclassification to fair value through profit or loss	4,456	(474)	3,982
– re-measurement	87	–	87
At 1 January 2018 – HKFRS 9/IFRS 9	4,567	227	4,794
Total losses recognised in the income statement			
– Net trading income	(46)	–	(46)
Total gains recognised in other comprehensive income			
– Net change in fair value	–	91	91
Purchases	863	77	940
Sales	(454)	–	(454)
Settlements	(796)	–	(796)
Transferred into level 3[1]	2	–	2
At 31 December 2018	4,136	395	4,531
Total gains/(losses) recognised in the income statement relating to assets held at 31 December 2018			
– Net trading income	(35)	–	(35)

1 Transfers into level 3 during the year relate to financial instruments where the valuation parameters became unobservable during the year.

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

35 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

(i) Valuation of financial instruments with significant unobservable inputs (continued)

Financial liabilities

	2018	
	Financial liabilities designated at fair value through profit or loss	Total level 3 liabilities
	HK$'M	HK$'M
At 1 January 2018	1,164	1,164
Total gains recognised in the income statement		
– Net trading income	(74)	(74)
Settlements	(205)	(205)
At 31 December 2018	885	885
Total gains recognised in the income statement relating to liabilities held at 31 December 2018		
– Net trading income	(74)	(74)

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

(i) Valuation of financial instruments with significant unobservable inputs (continued)

Financial assets

	Financial assets at fair value through profit or loss HK$'M	*Amounts due from immediate holding company HK$'M*	*Available-for-sale securities HK$'M*	*Total level 3 assets HK$'M*
At 1 January 2017	–	24	487	511
Total gains recognised in the income statement				
– Net trading income	–	20	–	20
Sales	–	–	(32)	(32)
Total gains recognised in the available-for-sale investment reserve	–	–	258	258
Purchases	24	–	8	32
Settlements	–	(44)	(20)	(64)
At 31 December 2017	24	–	701	725
Total gains recognised in the income statement relating to assets held at 31 December 2017				
– Net trading income	–	–	–	–

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

(i) Valuation of financial instruments with significant unobservable inputs (continued)

Financial liabilities

	Financial liabilities designated at fair value through profit or loss	*Total level 3 liabilities*
	HK$'M	*HK$'M*
At 1 January 2017	1,686	1,686
Total gains recognised in the income statement		
– Net trading income	(48)	(48)
Issuances	1,224	1,224
Settlements	(1,698)	(1,698)
At 31 December 2017	1,164	1,164
Total gains recognised in the income statement relating to liabilities held at 31 December 2017		
– Net trading income	(48)	(48)

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

(i) Valuation of financial instruments with significant unobservable inputs (continued)

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

Type of instruments	Principal valuation technique	Significant unobservable inputs	Range[1]	Weighted average[2]
Debt securities	Comparable pricing/Yield	Price/Yield	NA (2017: NA)	NA (2017: NA)
	Discounted cash flows	Price/Yield	1.0% to 10.96% (2017: 5%)	2.79% (2017: 5%)
Advances to customers	Comparable pricing/Yield	Price/Yield	NA (2017: NA)	NA (2017: NA)
	Discounted cash flows	Recovery rates	90.0% to 100.0% (2017: NA)	94.58% (2017: NA)
Equity shares	Discounted cash flows	Discount rates	10% (2017: 13.13%)	10% (2017: 13.13%)
Debt Securities in Issue	Discounted cash flows	Credit spreads	1.30% to 4.01% (2017: 0.9% to 4.0%)	2.80% (2017: 2.6%)

1 The ranges of values shown represent the highest and lowest used in the valuation of the level 3 financial instruments as at 31 December 2018 and 31 December 2017. The ranges of values used are reflective of the underlying characteristics of these level 3 financial instruments based on the market conditions at the reporting date. However, these ranges of values may not represent the uncertainty in fair value measurements of these level 3 financial instruments.

2 Weighted average for non-derivative financial instruments have been calculated by weighting inputs by the relative fair value.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

(i) Valuation of financial instruments with significant unobservable inputs (continued)

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

Yield

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

Recovery rates

Recovery rates are the expectation of the rate of recovery resulting from the liquidation of a particular loan. As the probability of default increases for a given instrument, the valuation of that instrument will increasingly reflect its expected recovery level assuming default. An increase in the recovery rate, in isolation, would result in a favourable movement in the fair value of the loan.

Credit spreads

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

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

Where the fair value of financial instruments are measured using valuation techniques that incorporate one or more significant inputs which are based on unobservable market data, we apply a 10 per cent increase or decrease on the values of these unobservable parameter inputs, to generate a range of reasonably possible alternative valuations in accordance with the requirements of HKFRS 7/IFRS 7, Financial Instruments: Disclosures. The percentage shift is determined by statistical analyses performed on a set of reference prices, which include certain equity indices, credit indices and volatility indices, based on the composition of the level 3 financial instruments. Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable parameters. This level 3 sensitivity analysis assumes a one way market move and does not consider offsets for hedges.

	2018					
	Held at fair value through profit or loss			*Financial assets at fair value through other comprehensive income*		
	Net exposure HK$'M	*Favourable changes HK$'M*	*Unfavourable changes HK$'M*	*Net exposure HK$'M*	*Favourable changes HK$'M*	*Unfavourable changes HK$'M*
Debt securities	1,048	1,070	1,016	–	–	–
Advances to customers	2,582	2,601	2,575	–	–	–
Equity shares	506	556	455	395	436	356
Debt securities issued	(885)	(847)	(915)	–	–	–
	3,251	3,380	3,131	395	436	356

	2017					
	Held at fair value through profit or loss			*Available-for-sale securities*		
	Net exposure HK$'M	*Favourable changes HK$'M*	*Unfavourable changes HK$'M*	*Net exposure HK$'M*	*Favourable changes HK$'M*	*Unfavourable changes HK$'M*
Debt securities	24	25	23	–	–	–
Equity shares	–	–	–	701	771	631
Debt securities issued	(1,164)	(1,088)	(1,180)	–	–	–
	(1,140)	(1,063)	(1,157)	701	771	631

These reasonably possible alternatives could have increased or decreased the values of financial instruments held at fair value through profit or loss and those classified as fair value through other comprehensive income/available-for-sale by the amounts disclosed below.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

Financial instruments	*Fair value changes*	*At 31 December 2018 HK$'M*	*At 31 December 2017 HK$'M*
Held at fair value through profit or loss	Possible increase	129	77
	Possible decrease	120	17
Held at fair value through other comprehensive income/Available-for-sale	Possible increase	41	70
	Possible decrease	39	70

(b) Valuation of financial instruments carried at amortised cost

All financial instruments are stated at fair value or amounts not materially different from their fair value as at 31 December 2018 and 2017, except for subordinated liabilities.

The following table summarises the carrying amounts and fair values (including the valuation hierarchy) of subordinated liabilities. The values in the table below are stated as at 31 December and may be different from the actual amounts that will be received on the settlement or maturity of the subordinated liabilities.

	2018			*2017*		
	Carrying amount HK$'M	*Fair value Level 1 HK$'M*	*Fair value Level 2 HK$'M*	*Carrying amount HK$'M*	*Fair value Level 1 HK$'M*	*Fair value Level 2 HK$'M*
Subordinated liabilities – US$750 million 5.875% Fixed Rate Notes 2020 (Note 28)	5,906	6,064	–	6,003	6,263	–
Subordinated liabilities – US$800 million 4.30% Fixed Rate debt 2026 (Note 16)	6,263	–	6,267	6,252	–	6,316

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

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

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

Placements with banks and other financial institutions

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

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

35 Financial instruments (continued)

(b) Valuation of financial instruments carried at amortised cost (continued)

Advances to customers

Advances are net of provisions for impairment. The estimated fair value of advances represents the discounted amount of future cash flows expected to be received, including assumptions relating to prepayment rates and, where appropriate, credit spreads. Expected cash flows are discounted at current market rates to determine fair value.

Deposits and balances of banks, other financial institutions and customers

The estimated fair value of deposits with no stated maturity is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on discounted cash flows using the prevailing market rates for debts with a similar credit risk and remaining maturity.

Debt securities in issue and subordinated liabilities

The aggregate fair values are calculated based on quoted market prices. For those securities where quoted market prices are not available, a discounted cash flow model is used based on a current market yield curve appropriate for the remaining term to maturity.

(c) Transfers of financial assets

The Group enters into collateralised repurchase agreements (repos). These transactions typically entitle the Group and its counterparties to have recourse to assets similar to those provided as collateral in the event of a default. Assets pledged in respect of repos continue to be recognised on the consolidated statement of financial position as the Group retains substantially the associated risk and rewards of these assets. The associated liability is included in “Amounts due to immediate holding company”.

The table below sets out the financial assets provided by the Group as collateral for repurchase transactions:

	2018 HK$’M	*2017 HK$’M*
Collateral pledged against repurchase agreements		
On balance sheet		
Cash	–	–
Investment securities	9	–
Off balance sheet		
Repledged collateral received	–	–
	9	–
Balance sheet liabilities – repurchase agreements		
Amount due to immediate holding company	12	–
	12	–

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Financial instruments (continued)

(d) Offsetting financial assets and financial liabilities

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

			2018		
Assets	*Gross amounts of recognised financial assets HK$'M*	*Gross amounts of recognised financial liabilities offset in the consolidated statement of financial position HK$'M*	*Net amounts of financial assets presented in the consolidated statement of financial position HK$'M*	*Related amounts not offset in the consolidated statement of financial position HK$'M*	*Net amount HK$'M*
Positive fair values of derivative financial instruments	20,591	–	20,591	(18,205)	2,386
Reverse repos, securities borrowing and similar agreements	60,932	–	60,932	(60,932)	–
	81,523	–	81,523	(79,137)	2,386

Liabilities	*Gross amounts of recognised financial liabilities HK$'M*	*Gross amounts of recognised financial assets offset in the consolidated statement of financial position HK$'M*	*Net amounts of financial liabilities presented in the consolidated statement of financial position HK$'M*	*Related amounts not offset in the consolidated statement of financial position HK$'M*	*Net amount HK$'M*
Negative fair values of derivative financial instruments	23,127	–	23,127	(20,423)	2,704
Repos and similar agreements	12	–	12	(9)	3
	23,139	–	23,139	(20,432)	2,707

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Financial instruments (continued)

(d) Offsetting financial assets and financial liabilities (continued)

	2017				
Assets	*Gross amounts of recognised financial assets HK$'M*	*Gross amounts of recognised financial liabilities offset in the consolidated statement of financial position HK$'M*	*Net amounts of financial assets presented in the consolidated statement of financial position HK$'M*	*Related amounts not offset in the consolidated statement of financial position HK$'M*	*Net amount HK$'M*
Positive fair values of derivative financial instruments	24,713	–	24,713	(23,083)	1,630
Reverse repos, securities borrowing and similar agreements	36,352	–	36,352	(36,294)	58
	61,065	–	61,065	(59,377)	1,688

Liabilities	*Gross amounts of recognised financial liabilities HK$'M*	*Gross amounts of recognised financial assets offset in the consolidated statement of financial position HK$'M*	*Net amounts of financial liabilities presented in the consolidated statement of financial position HK$'M*	*Related amounts not offset in the consolidated statement of financial position HK$'M*	*Net amount HK$'M*
Negative fair values of derivative financial instruments	27,054	–	27,054	(23,989)	3,065
Repos and similar agreements	–	–	–	–	–
	27,054	–	27,054	(23,989)	3,065

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Financial instruments (continued)

(d) Offsetting financial assets and financial liabilities (continued)

The Group is able to offset assets and liabilities which do not meet the HKAS32/IAS 32 netting criteria (see note 2(l)). Such arrangements include master netting arrangements for derivatives and global master repurchase agreements for repos and reverse repos. These agreements generally allow that all outstanding transactions with a particular counterparty can be offset but only in the event of default or other pre-determined events, therefore the related financial assets and financial liabilities are not offset in the consolidated statement of financial position.

Under repos and reverse repos, the Group would pledge (legally sell) and obtain (legally purchase) financial collateral which are mainly highly liquid assets which can be sold in the event of a default.

The related amounts not offset in the consolidated statement of financial position which are disclosed in the table above include financial instruments covered by master netting arrangements and financial collateral pledged and obtained, but exclude the effect of over collateralisation.

36 Assets pledged as security for liabilities

The Group maintains pledged cash and securities accounts to secure any borrowings or other obligations resulting from the Group's use of clearing systems and to cover short positions. As at 31 December 2018, the Group had securities amounting to HK$13,053 million (2017: HK$5,813 million) to cover the short positions.

Reverse repos and securities borrowing transactions

The Group also undertakes reverse repos and securities borrowing transactions as set out in the table below:

	2018	*2017*
	HK$'M	*HK$'M*
Consolidated statement of financial position assets - reverse repos and securities borrowing		
Placements with banks and other financial institutions	8,327	18,912
Advances to customers	–	–
Amounts due from immediate holding company	52,605	17,440
	60,932	36,352

Under reverse repos and securities borrowing arrangements, the Group obtains securities on terms that permit it to repledge or resell the securities to others. The amount of securities which the Group is able to repledge or resell are as follows:

	2018	*2017*
	HK$'M	*HK$'M*
Securities and collateral that can be repledged or sold (at fair value)	62,397	36,966
Thereof repledged/transferred to others under repos (at fair value)	–	–

These transactions are conducted under terms that are usual and customary to standard lending and stock borrowing activities.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Material related party transactions

In addition to the transactions and balances disclosed elsewhere in these financial statements, the Group entered into the following material related party transactions.

(a) Key management personnel remuneration

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

	2018 *HK$'M*	*2017* *HK$'M*
Short-term employee benefits	69	66
Post-employment benefits	3	2
Equity compensation benefits	16	10
Termination benefits	–	5
	88	83

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

(b) Credit facilities and loans to key management personnel

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

	2018 *HK$'M*	*2017* *HK$'M*
Loan balances:		
At 1 January	34	65
At 31 December	19	34
Average balance during the year	25	41
Income earned	–	1

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Material related party transactions (continued)

(c) Share based payments

SC PLC operates a number of share-based arrangements for its directors and employees.

2011 Standard Chartered Share Plan (the '2011 Plan')

The 2011 Plan was approved by shareholders in May 2011 and is SC PLC's main share plan. Since approval, it has been used to deliver various types of share awards:

(i) Long Term Incentive Plan ('LTIP')

These are awards granted with vesting subject to performance measures. Performance measures attached to awards granted previously include: total shareholder return ('TSR'); return on equity ('RoE') with a common equity tier 1 ('CET 1') underpin; strategic measures; earnings per share ('EPS') growth; and return on risk-weighted assets ('RoRWA'). Each measure is assessed independently over a three-year period. Awards granted from 2016 have an individual conduct gateway that results in the award lapsing if not met.

(ii) Deferred share awards

Deferred awards are used to deliver the deferred portion of variable remuneration, in line with both market practice and regulatory requirements. These awards vest in instalments on anniversaries of the award date specified at the time of grant. Deferred awards are not subject to any plan limit. This enables SC PLC to meet regulatory requirements relating to deferral levels, and is in line with market practice.

(iii) Restricted shares

Restricted share awards, made outside of the annual performance process as replacement buy-out awards to new joiners who forfeit awards on leaving their previous employers, vest in instalments on the anniversaries of the award date specified at the time of grant. This enables SC PLC to meet regulatory requirements relating to buy-outs, and is in line with market practice. In line with similar plans operated by the Group's competitors, restricted share awards are not subject to an annual limit and do not have any performance measures.

Under the 2011 Plan, no grant price is payable to receive an award. The remaining life of the 2011 Plan during which new awards can be made is three years.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Material related party transactions (continued)

(c) Share based payments (continued)

2001 Performance Share Plan (2001 PSP)

SC PLC's previous plan for delivering performance shares was the 2001 PSP and there remain outstanding vested awards.

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

2006 Restricted Share Scheme ("2006 RSS")/ 2007 Supplementary Restricted Share Scheme (2007 SRSS)

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

2013 Sharesave Plan

Under the 2013 Sharesave Plan, employees have the choice of opening a savings contract. Within a period of six months after the third anniversary, employees may purchase ordinary shares in the ultimate holding company. The price at which they may purchase shares is at a discount of up to 20 per cent on the share price at the date of invitation. There are no performance measures attached to options granted under the 2013 Sharesave Plan.

The 2013 Sharesave Plan was approved by shareholders of SC PLC in May 2013 and all future Sharesave invitations are made under this plan. The remaining life of the 2013 Sharesave Plan is four years.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Material related party transactions (continued)

(c) Share based payments (continued)

2011 Standard Chartered Share Plan (the 2011 plan)

Valuation – LTIP

The vesting of awards granted in both 2017 and 2018 is subject to the satisfaction of RoE (subject to a capital underpin) and relative TSR performance measures and achievement of a strategic scorecard. The fair value of the TSR component is calculated using the probability of meeting the measures over a three-year performance period, using a Monte Carlo simulation model. The number of shares expected to vest is evaluated at each reporting date, based on the expected performance against the RoE and strategic measures in the scorecard, to determine the accounting charge.

Dividend equivalents accrue on the 2017 awards during the vesting period, so no discount is applied. However, for the 2018 awards, no dividend equivalents accrue and the fair value takes this into account, calculated by reference to market consensus dividend yield.

	2018	*2017*
Grant Date	*9 March*	*13 March*
Share price at grant date (£)	7.78	7.43
Vesting period (years)	3 - 7	3 - 7
Expected dividends (yield) (%)	5.00	N/A
Fair value (RoE) (£)	2.59,2.59	2.48,2.48
Fair value (TSR) (£)	1.14,1.11	1.81,1.38
Fair value (Strategic) (£)	2.59,2.59	2.48,2.48

Valuation – deferred shares and restricted shares

The fair value for deferred awards which are not granted to material risk takers is based on 100 per cent of the face value of the shares at the date of grant as the share price will reflect expectations of all future dividends. For awards granted to material risk takers in 2018, the fair value of awards takes into account the lack of dividend equivalents, calculated by reference to market consensus dividend yield.

Deferred shares and underpin shares accrue dividend equivalent payments during the vesting period.

	2018		*2017*		
Grant Date	*18 June*	*9 March*	*3 October*	*15 June*	*13 March*
Share price at grant date (£)	7.12	7.78	7.56	7.69	7.43
Vesting period	Fair value (£)	Fair value (£)	Fair value (£)	Fair value (£)	Fair value (£)
1-3 years	7.12	7.78	7.56	7.69	7.43
1-5 years	7.12	7.78	–	–	7.43
3-7 years		7.78	–	–	7.43

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Material related party transactions (continued)

(c) Share based payments (continued)

Restricted Share Awards

	2018							
Grant Date	29 November		2 October		18 June		9 March	
Share price at grant date (£)	6.11		6.16		7.12		7.78	
Vesting Period	Expected dividend yield (%)	Fair value (£)	Expected dividend yield (%)	Fair value (£)	Expected dividend yield (%)	Fair value (£)	Expected dividend yield (%)	Fair value (£)
6 months	–	–	–	–	–	–	–	–
1 year	5.0	6.11	5.0	6.16	5.0	7.12	5.0	7.78
2 years	5.0	6.11	5.0	6.16	5.0	7.12	5.0	7.78
2-3 years	–	–	–	–	–	–	–	–
3 years	5.0	6.11	5.0	6.16	5.0	7.12	5.0	7.78
4 years	–	–	5.0	6.16	5.0	7.12	5.0	7.78
5 years	–	–	5.0	6.16	–	–	5.0	7.78
6 years	–	–	–	–	–	–	–	–

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

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

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Material related party transactions (continued)

(c) Share based payments (continued)

Sharesave (2004 International Sharesave, 2004 UK Sharesave and 2013 Sharesave)

Valuation

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

	2018	2017
Grant Date	*2 October*	*3 October*
Share price at grant date (£)	6.16	7.71
Exercise price (£)	5.13	6.20
Vesting period (years)	3	3
Expected volatility (%)	33.8	34.9
Expected option life (years)	3.33	3.33
Risk free rate (%)	0.87	0.47
Expected dividends (yield) (%)	5.00	1.87
Fair value (£)	1.39	2.32

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

Reconciliation of share award movements for the year to 31 December 2018

	2011 Plan					
	LTIP	*Deferred/ Restricted shares*	*PSP*	*RSS*	*2013 Sharesave*	*Weighted average Sharesave exercise price (£)*
Outstanding at 1 January 2018	2,431,307	3,100,042	7,629	15,815	981,765	5.86
Granted	130,591	1,306,579	–	–	320,702	5.13
Lapsed	–	(183,280)	(324)	(1,910)	(224,486)	6.55
Exercised	–	(1,181,567)	(2,127)	(13,905)	(140,815)	5.58
Outstanding at 31 December 2018	2,561,898	3,041,774	5,178	–	937,166	5.49
Exercisable at 31 December 2018	–	557,403	5,178	–	328,574	
Range of exercise prices (£)	–	–	–	–	5.13 – 6.20	
Weighted average contractual remaining life (years)	7.31	7.88	2.62	–	1.90	

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Material related party transactions (continued)

(c) Share based payments (continued)

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

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

(d) Loans to directors

Loans to directors of the Group disclosed pursuant to section 383(1)(d) of the Hong Kong Companies Ordinance and Part 3 of the Companies (Disclosure of Information about Benefits of Directors) Regulation are as follows:

	2018 HK$'M	2017 HK$'M
Aggregate amount of relevant loans by the Group outstanding at 31 December	9	11
Maximum aggregate amount of relevant loans by the Group outstanding during the year	37	25

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Material related party transactions (continued)

(e) Related party transactions with associates and joint ventures of SC PLC Group

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

	2018 HK$'M	2017 HK$'M
Amounts due from associates and joint ventures	21	9
Deposits from associates and joint ventures	128	174
Debt securities issued to associates and joint ventures	–	120
Operating income	47	35

38 Ultimate and immediate holding company

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

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

39 Significant accounting estimates and judgements

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

Pensions

Actuarial assumptions are made in valuing defined benefit obligations as set out in note 27 and are updated periodically.

Taxes

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

Fair value of financial instruments

Notes 2(i) and 35 provide further information on the Group's fair value accounting policy and process.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Significant accounting estimates and judgements (continued)

Impairment of financial assets

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

Goodwill impairment

An annual assessment is made, as set out in note 20, as to whether the current carrying value of goodwill is impaired.

40 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2018

Up to the date of issue of the consolidated financial statements, the HKICPA/IASB has issued a number of amendments, new standards and interpretations which are not yet effective for the accounting year ended 31 December 2018 and which have not been adopted in these financial statements. These include the following which may be relevant to the Group.

- HKFRS 16/IFRS 16, *Leases* (effective on 1 January 2019)
- Amendments to HKFRS 9/IFRS 9, *Prepayment features with negative compensation* (effective on 1 January 2019)
- HK(IFRIC) 23/IFRIC 23, *Uncertainty over income tax treatments* (effective on 1 January 2019)
- Amendments to HKAS 12/IAS 12, *Income taxes* (effective on 1 January 2019)

The Group is in the process of making an assessment of what the impact of these amendments, new standards and interpretations is expected to be in the period of initial application. So far the Group has identified some aspects of HKFRS 16/IFRS 16 which may have a significant impact on the consolidated financial statements. Further details of the expected impact is discussed below. As the Group has not completed its assessment, further impact may be identified in due course and will be taken into consideration when determining whether to adopt any of these new requirements before their effective date and which transitional approach to take, where there are alternative approaches allowed under the new standards.

HKFRS 16/IFRS 16, Leases

The effective date of HKFRS 16/IFRS 16 is 1 January 2019. HKFRS 16/IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. HKFRS 16/IFRS 16 substantially carries forward the lessor accounting requirements in HKAS 17/IAS 17 Leases. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

The impact of HKFRS 16/IFRS 16 on the Group is primarily where the Group is a lessee in property lease contracts. The Group has elected the simplified approach of transition and will not restate comparative information. On 1 January 2019 the Group will recognise a lease liability, being the remaining lease payments including extension options where renewal is reasonably certain, discounted using the Group's incremental borrowing rate at the date of initial application in the economic environment of the lease. The corresponding right-of-use asset recognised will be the amount of the lease liability adjusted by prepaid or accrued lease payments related to those leases. Any difference will be recognised in retained earnings at the date of initial application. The balance sheet increase as a result of recognition of the lease liability and right-of-use asset as of 1 January 2019 will be approximately HK$2,997 million.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

41 Statement of financial position as at 31 December 2018

	2018 HK$'M	2017 HK$'M
Assets		
Cash and balances with banks, central banks and other financial institutions	13,309	18,347
Placements with banks and other financial institutions	153,497	150,249
Hong Kong SAR Government certificates of indebtedness	46,691	42,341
Financial assets at fair value through profit or loss	36,891	22,819
Investment securities	241,545	207,927
Advances to customers	503,661	478,138
Amounts due from immediate holding company	83,875	57,633
Amounts due from fellow subsidiaries	23,484	23,929
Amounts due from subsidiaries of the Bank	37,098	41,380
Investments in subsidiaries of the Bank	1,003	769
Interest in associate	3,168	3,168
Property, plant and equipment	3,091	2,984
Goodwill and intangible assets	1,399	1,206
Deferred tax assets	–	219
Other assets	16,842	12,770
	1,165,554	1,063,879
Liabilities		
Hong Kong SAR currency notes in circulation	46,691	42,341
Deposits and balances of banks and other financial institutions	21,652	19,613
Deposits from customers	907,083	833,899
Financial liabilities at fair value through profit or loss	26,981	19,261
Debt securities in issue	–	3,066
Amounts due to immediate holding company	41,519	44,132
Amounts due to fellow subsidiaries	9,292	9,476
Amounts due to subsidiaries of the Bank	4,257	1,828
Current tax liabilities	1,655	436
Deferred tax liabilities	4	–
Other liabilities	31,609	19,755
Subordinated liabilities	5,906	6,003
	1,096,649	999,810
Equity		
Share capital	20,256	20,256
Reserves	46,697	41,861
Shareholders' equity	66,953	62,117
Other equity instruments	1,952	1,952
	68,905	64,069
	1,165,554	1,063,879

Approved and authorised for issue by the Board of Directors on 26 February 2019.

Huen Wai Yi Mary
Director

Yee Mann Hau
Director

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

42 Statement of changes in equity for the year ended 31 December 2018

	Share capital HK$'M	Own credit adjustment reserve HK$'M	Available-for-sale investment reserve HK$'M	FVOCI reserve – Debt HK$'M	FVOCI reserve – Equity HK$'M	Cash flow hedge reserve HK$'M	Retained profits HK$'M	Share option equity reserve HK$'M	Capital contribution reserve HK$'M	Other equity instrument reserve HK$'M	Total HK$'M
At 1 January 2017	20,256	–	(278)	–	–	(192)	37,497	98	–	–	57,381
Transfer of own credit adjustment, net of taxation	–	363	–	–	–	–	(363)	–	–	–	–
Total comprehensive income	–	(381)	395	–	–	210	7,596	–	–	–	7,820
Dividend paid	–	–	–	–	–	–	(3,368)	–	–	–	(3,368)
Movement in respect of share-based compensation plans	–	–	–	–	–	–	–	130	–	–	130
Other equity instruments issued, net of expenses	–	–	–	–	–	–	–	–	–	1,952	1,952
Effect of transfer of a subsidiary to a commonly controlled entity	–	–	–	–	–	–	–	–	154	–	154
At 31 December 2017	20,256	(18)	117	–	–	18	41,362	228	154	1,952	64,069
Impact of HKFRS 9/IFRS 9 transition adjustments	–	–	(117)	(165)	161	–	(680)	–	–	–	(801)
At 1 January 2018	20,256	(18)	–	(165)	161	18	40,682	228	154	1,952	63,268
Total comprehensive income	–	733	–	80	92	268	8,782	–	–	–	9,955
Dividend paid	–	–	–	–	–	–	(4,251)	–	–	–	(4,251)
Movement in respect of share-based compensation plans	–	–	–	–	–	–	–	(67)	–	–	(67)
At 31 December 2018	20,256	715	–	(85)	253	286	45,213	161	154	1,952	68,905

During the year ended 31 December 2018, the directors had declared and paid an ordinary dividend of HK$2.01728 (2017: HK$1.61276) per each 'A' and 'B' ordinary shares totalling HK$3,908 million (2017: HK$3,124 million). A total dividend of HK$245 million (2017: HK$244 million) were paid in respect of the US$500 million 6.25% perpetual non-cumulative convertible preference shares classified as equity, and a total dividend of HK$98 million (2017: HK$ nil) was paid in respect of the US$250 million 5% perpetual non-cumulative subordinated capital securities classified as equity.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

43 Impact of Transition to HKFRS 9/IFRS 9 Financial Instruments on 1 January 2018

(a) Impact of HKFRS 9/IFRS 9 on Shareholders' Equity

The impact of transition to HKFRS 9/IFRS 9 in respect of classification and measurement; adoption of the ECL methodology; share of impact from associate; and related tax effects are set out by category of reserve in the table below.

	Share capital HK$'M	*Own credit adjustment reserve HK$'M*	*Available-for-sale reserve HK$'M*	*FVOCI reserve – Debt HK$'M*	*FVOCI reserve – Equity HK$'M*	*Exchange reserve HK$'M*	*Cash flow hedge reserve HK$'M*	*Retained earnings HK$'M*	*Share option equity reserve HK$'M*	*Capital contribution reserve HK$'M*	*Other equity instruments HK$'M*	*Total HK$'M*
As at 31 December 2017	20,256	(18)	(23)	–	–	266	18	51,622	318	37	1,952	74,428
Impact of changes in classification and measurement:												
– reclassifications[1]	–	–	23	(319)	161	–	–	135	–	–	–	–
– re-measurements[2]	–	–	–	–	–	–	–	87	–	–	–	87
	–	–	23	(319)	161	–	–	222	–	–	–	87
Impact of adoption of expected credit loss provision[3]	–	–	–	14	–	–	–	(743)	–	–	–	(729)
Impact of HKFRS 9/IFRS 9 on share of associate	–	–	–	(10)	–	–	–	(90)	–	–	–	(100)
Related tax effects	–	–	–	–	–	–	–	109	–	–	–	109
Total impact of HKFRS 9/IFRS 9 transition	–	–	23	(315)	161	–	–	(502)	–	–	–	(633)
As at 1 January 2018	**20,256**	**(18)**	**–**	**(315)**	**161**	**266**	**18**	**51,120**	**318**	**37**	**1,952**	**73,795**

1 The available-for-sale category has been removed under HKFRS 9/IFRS 9. Unrealised gains and losses have been transferred to FVOCI reserves where the instruments are held as FVOCI, or retained earnings where the instruments are held at fair value through profit or loss ("FVTPL"). The Group has elected to hold HK$227 million of equity instruments at FVOCI. These principally relate to investments held for strategic purposes, including investments in industry utilities. Fair value gains and losses arising on these investments are held within the FVOCI reserve - equity, and are never recycled to the income statement. Only dividend income received is reported in the income statement.

2 Represents the re-measurement impact of financial assets that are now measured at fair value under HKFRS 9/IFRS 9.

3 The impact from adopting expected credit losses on retained earnings was HK$743 million (see note 34(c) for further details). As FVOCI debt instruments are held at fair value on the balance sheet, the expected credit loss charged to retained earnings is recognised as a credit to the FVOCI reserve. The FVOCI reserve relating to FVOCI debt instruments will be recycled to the income statement on disposal of the instruments.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

43 Impact of Transition to HKFRS 9/IFRS 9 Financial Instruments on 1 January 2018 (continued)

(b) Impact of HKFRS 9/IFRS 9 on consolidated statement of financial position as of 1 January 2018

The table below sets out the impact of adopting HKFRS 9/IFRS 9 on the Group's consolidated statement of financial position as of 1 January 2018.

	HKAS 39/IAS 39 31 December 2017 HK$'M	*Classification & measurement[1] HK$'M*	*Expected credit losses[2] HK$'M*	*Other impacts[3] HK$'M*	*HKFRS 9/IFRS 9 1 January 2018 HK$'M*
Cash and balances at banks, central banks and other financial institutions	18,350	–	–	–	18,350
Placements with banks and other financial institutions	150,256	–	(7)	–	150,249
Hong Kong SAR Government certificates of indebtedness	42,341	–	–	–	42,341
Financial assets at fair value through profit or loss	22,819	4,543	–	–	27,362
Investment securities	207,927	(1,569)	(11)	–	206,347
Advances to customers	480,867	(2,887)	(623)	–	477,357
Amounts due from immediate holding company	59,075	–	–	–	59,075
Amounts due from fellow subsidiaries	24,208	–	–	–	24,208
Interest in associate	11,638	–	–	(100)	11,538
Property, plant and equipment	40,632	–	–	–	40,632
Goodwill and intangible assets	1,392	–	–	–	1,392
Current tax assets	11	–	–	–	11
Deferred tax assets	275	–	–	92	367
Other assets	15,258	–	–	–	15,258
	1,075,049	87	(641)	(8)	1,074,487

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

43 Impact of Transition to HKFRS 9/IFRS 9 Financial Instruments on 1 January 2018 (continued)

(b) Impact of HKFRS 9/IFRS 9 on consolidated statement of financial position as of 1 January 2018 (continued)

	HKAS 39/IAS 39 31 December 2017 HK$'M	Classification & measurement[1] HK$'M	Expected credit losses[2] HK$'M	Other impacts[3] HK$'M	HKFRS 9/IFRS 9 1 January 2018 HK$'M
Hong Kong SAR currency notes in circulation	42,341	–	–	–	42,341
Deposits and balances of banks and other financial institutions	19,613	–	–	–	19,613
Deposits from customers	833,899	–	–	–	833,899
Financial liabilities at fair value through profit or loss	19,775	–	–	–	19,775
Debt securities in issue	3,066	–	–	–	3,066
Amounts due to immediate holding company	44,246	–	–	–	44,246
Amounts due to fellow subsidiaries	9,477	–	–	–	9,477
Current tax liabilities	439	–	–	(17)	422
Deferred tax liabilities	470	–	–	–	470
Other liabilities	21,292	–	88	–	21,380
Subordinated liabilities	6,003	–	–	–	6,003
	1,000,621	–	88	(17)	1,000,692
Share capital	20,256	–	–	–	20,256
Reserves	52,220	87	(729)	9	51,587
Shareholders' equity	72,476	87	(729)	9	71,843
Other equity instruments	1,952	–	–	–	1,952
	74,428	87	(729)	9	73,795
	1,075,049	87	(641)	(8)	1,074,487

1 Classification and measurement reclassifications primarily relate to the following:

– a small number of products in Retail Banking and a small number of contracts within the corporate lending portfolios of HK$2,887 million that do not meet the SPPI criteria have been de-designated from an amortised cost basis and recognised as FVTPL of HK$2,974 million.

– a small portfolio of strategic equity instruments of HK$227 million which are irrevocably designated at FVOCI of HK$227 million.

– certain equity and debt securities classified as loan and receivables of HK$1,569 million under HKAS 39/IAS 39 have been de-designated and recognised as FVTPL of HK$1,656 million as a result of business model assessment.

2 Impact of additional expected credit loss provisions (see note 34 (a)).

3 Includes the change in the Group's share of net assets from associate in adopting HKFRS 9/IFRS 9, and the related tax effect of the HKFRS 9/IFRS 9 adjustments.

Notes to the consolidated financial statements (continued)

(Expressed in millions of Hong Kong dollars)

43 Impact of Transition to HKFRS 9/IFRS 9 Financial Instruments on 1 January 2018 (continued)

(c) Impact of expected credit losses

The table sets out a comparison of impairment loss provisions under HKAS 39/IAS 39 to those under HKFRS 9/IFRS 9 as of 1 January 2018.

	Impairment provision under HKAS 39/ IAS 39 HK$'M (note 14(a))	*Additional expected credit loss provision under HKFRS 9/ IFRS 9 HK$'M* (note 43(a))	*Expected credit loss provision under HKFRS 9/ IFRS 9 HK$'M* (note 15)
Provision on:			
– Placements with banks and other financial institutions	–	7	7
– Advances to customers	1,150	623	1,773
– Debt securities at amortised cost	–	11	11
– Debt securities at fair value through other comprehensive income	–	14	14
– Loan commitments and financial guarantees	–	88	88
	1,150	743	1,893

44 Comparative figures

Upon the adoption of HKFRS 9/IFRS 9, the following items are re-grouped on the consolidated income statement and the consolidated statement of financial position to align with the presentation of the Bank's ultimate holding company, SC PLC:

- Net gains/losses from financial instruments designated or mandatorily at fair value through profit or loss are presented within "net trading income"
- Net gains/losses from disposal of financial instruments at FVOCI/available-for-sale securities are presented within "other operating income"
- Trading assets and financial assets designated or mandatorily at fair value through profit or losses are presented together as "financial assets at fair value through profit or loss"
- Trading liabilities and financial liabilities designated at fair value through profit or losses are presented together as "financial liabilities at fair value through profit or loss"

In addition to the above, in alignment with SC PLC Group's accounting policies, the presentation of interest expense arising from financial liabilities designated at fair value are presented within "Net trading income", from "Interest Expense".

45 Post balance sheet events

On 21 February 2019, the Board of SC PLC approved a group reconstruction in which SC PLC will acquire the direct ownership of the Group currently held by the Group's immediate holding company, Standard Chartered Bank. The restructuring as a common control transaction will have no financial impact on the consolidated accounts of the Group. The transaction is subject to Standard Chartered Bank and Standard Chartered Holdings Limited passing necessary resolutions and completing the necessary transfers, which are expected to be completed in March 2019.

Appendix I: Corporate Governance Report

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the Hong Kong Monetary Authority ("HKMA")

Corporate Governance Practices and objectives

Standard Chartered Bank (Hong Kong) Limited (the "Bank") has followed the module on "Corporate Governance of Locally Incorporated Authorised Institutions" ("CG-1") under the Supervisory Policy Manual ("SPM") issued by the HKMA throughout the year ended 31 December 2018.

Organisational and governance structure and policies

Board Composition

Chairman

HUNG Pi Cheng Benjamin

Executive Directors

HUEN Wai Yi Mary
Yee Mann HAU

Non-Executive Directors

Edward Martin WILLIAMS
Anna Elizabeth MARRS (resigned on 7 February 2018)
LEE Cheuk Kuen Gloria
Michael Andres GORRIZ (appointed on 7 February 2018)

Independent Non-Executive Directors

FONG Ching
Stephen Robert ENO
CHENG Wai Sun Edward
TUNG Lieh Cheung Andrew

HUNG Pi Cheng Benjamin

Chairman, Non-Executive Director

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

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

Mr. Hung joined Standard Chartered Group in 1992 and has held a number of senior management positions spanning corporate, commercial and retail banking. Prior to his current role, Mr. Hung was the Regional CEO of Greater China. Mr. Hung had worked in American Express Bank Canada and Spar Aerospace Canada before joining Standard Chartered.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Composition (continued)

HUNG Pi Cheng Benjamin (continued)

Mr. Hung is a member of the Hong Kong Chief Executive's Council of Advisers on Innovation and Strategic Development, the Exchange Fund Advisory Committee, the Hong Kong Exchanges and Clearing Limited's Board of Directors, the General Committee of the Hong Kong General Chamber of Commerce and the Belt and Road Committee of the Hong Kong Trade Development Council. He was previously the chairman of the Hong Kong Association of Banks, a member of the Financial Services Development Council, a board member of the Hong Kong Airport Authority and the Hong Kong Hospital Authority, and a Council Member of the University of Hong Kong.

He holds a Master of Business Administration from University of Toronto and a Bachelor of Arts in Business Administration from University of Washington.

HUEN Wai Yi Mary

Executive Director and Chief Executive Officer

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

Prior to the current role, Ms. Huen was the Regional Head of Retail Banking, Greater China & North Asia, responsible for setting the strategic agenda and driving the performance delivery of all the retail operations in the region. Before taking on the regional role, as the Head of Retail Banking, Hong Kong, she led the Retail Banking business in Hong Kong into becoming one of the most successful business segments in the Group globally, delivering strong income growth and generating remarkable profit contribution.

Ms. Huen has over 25 years of experience in business management and banking services. Since joining the Bank in 1991, she has held various key positions across the management of balance sheet products, Wealth Management and distribution.

Ms. Huen is the Chairperson of the Hong Kong Association of Banks, Vice President of the council of the Hong Kong Institute of Bankers, a board member of the Hong Kong Interbank Clearing Limited, and a council member of the Treasury Markets Association. She is also a member of the Banking Advisory Committee, and the Exchange Fund Advisory Committee Financial Infrastructure and Market Development Sub-Committee as well as the Currency Board Sub-committee of the Hong Kong Monetary Authority. Outside of banking, she is a council member of the Hong Kong Trade Development Council, a member of the Board of the Community Chest of Hong Kong, a panel member of the Anti-Money Laundering and Counter-Terrorist Financing Review Tribunal, a co-opted council member of the Hong Kong Management Association, a member of the Advisory Board of the MBA Programmes at the Chinese University of Hong Kong and a member of the Women's Commission established under the Labour and Welfare Bureau of the Hong Kong government.

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

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Composition (continued)

HAU Yee Mann

Executive Director and Chief Financial Officer

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

Prior to her current role, Ms. Hau was the Chief Financial Officer of Standard Chartered Bank (China) Limited. Ms Hau joined the Bank in Hong Kong in 2007 and was previously Financial Controller, Hong Kong. Ms. Hau qualified as a chartered accountant with KPMG in London, and moved to Hong Kong with KPMG. Ms. Hau has over 20 years of banking experience. Before joining the Bank, Ms. Hau worked for 12 years with HSBC in Hong Kong.

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

Edward Martin WILLIAMS

Non-Executive Director

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

Prior to 2017, Mr. Williams was the Deputy Group Chief Risk Officer for Standard Chartered Group and responsible for risk governance for a significant number of the Group's major operating subsidiaries. He was also responsible for approvals and the oversight of a significant number of Standard Chartered's largest and most complex transactions and counter-party exposures, as well as significant consumer bank portfolios. Mr. Williams was actively involved in Standard Chartered Group's problem credit portfolio and most significant risk problems.

Mr. Williams has over 40 years of financial services experience, with over 20 years in Asia. He has worked at the Standard Chartered Group for over 17 years, holding or having held directorships of the Standard Chartered Group's subsidiaries in China, Korea, Taiwan and Malaysia. Mr. Williams was previously Group Head of Group Special Assets Management, the corporate restructuring and workout division. Prior to joining Standard Chartered Group, Mr. Williams had held a variety of senior management positions at Citicorp/Citibank and Westpac Banking Corporation in various countries.

Mr. Williams holds a Master's degree in Business Administration from Harvard Graduate School of Business, a Master of Science degree in Aerospace Engineering from Massachusetts Institute of Technology, and a Bachelor of Science degree in Aerospace Engineering from Princeton University.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Composition (continued)

LEE Cheuk Kuen Gloria

Non-Executive Director

Ms. Lee was appointed to the Board in May 2017.

Prior to her appointment as Non-executive Director of the Bank, Ms. Lee had held numerous roles in Standard Chartered Group including Vice Chair, Commercial Banking, Hong Kong; Vice Chair, Corporate & Institutional Clients, Hong Kong; Head, Corporate & Institutional Clients, Hong Kong; Head of Origination & Client Coverage, Hong Kong; Head of Client Relationships, Hong Kong; Head of Local Corporates, Hong Kong and Pearl River Delta and Senior Manager, General Manufacturing and Trading, Hong Kong.

Ms. Lee received a Bachelor of Social Sciences Degree majoring in Economics from the University of Hong Kong.

Michael Andres GORRIZ

Non-Executive Director

Mr. Gorriz was appointed to the Board in February 2018.

Mr. Gorriz was appointed Group Chief Information Officer in July 2015 and is currently responsible for the systems development and technology infrastructure which underpin Standard Chartered Group's client services, and defines and implements Standard Chartered Bank's digital and innovation agenda.

Prior to joining Standard Chartered, Mr. Gorriz was Vice President and Chief Information Officer at Daimler AG where he was globally responsible for strategy, planning and development of the Daimler Group's IT systems, as well as the operation of its technical infrastructure. During his 28 years at Daimler, Mr. Gorriz progressed through specialist research and design roles in aerospace to general management roles.

Mr. Gorriz is a physicist and engineer by background and obtained a PhD in Engineering. He is based in Singapore.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Composition (continued)

FONG Ching

Independent Non-Executive Director

Dr. Fong was appointed to the Board in May 2013.

Dr. Fong was the former Non-Executive Chairman of the Securities and Futures Commission from 2006 to 2012 in Hong Kong. He is currently the Chairman of the Process Review Panel in relation to the Regulation of Mandatory Provident Fund Intermediaries. He serves as an independent non-executive director of Standard Chartered Bank (China) Limited and MTR Corporation Limited. He is also the Chairman of Lifeline Express Hong Kong Foundation.

His past public services include serving as a Non-Executive Director of the Hong Kong Mortgage Corporation Limited and Mandatory Provident Fund Schemes Authority; a member of the Hong Kong Housing Authority and Chairman of the Open University of Hong Kong.

Dr. Fong received his education both in Hong Kong and in the United Kingdom. He graduated from the University of Kent in the United Kingdom and subsequently qualified as a member of the Institute of Chartered Accountants in England and Wales. Upon returning to Hong Kong, he continued to pursue a career in public accounting. He was a senior audit partner with PricewaterhouseCoopers until his retirement in 2003.

Dr. Fong was appointed a Justice of the Peace in 1996 and was awarded the Gold Bauhinia Star in 2008 by the HKSAR Government. He was also awarded an Honorary Doctor of Civil Law by the University of Kent in July 1997 and an Honorary Doctor of Social Services by the Hong Kong Open University in December 2017. He was awarded an Honorary Fellowship by the Hong Kong Academy for Performing Arts in 2010.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Composition (continued)

Stephen Robert ENO

Independent Non-Executive Director

Mr. Eno was appointed to the Board in July 2013.

Mr. Eno was a partner of Baker & McKenzie from July 1987 to December 2011 and continued as a global consultant from 1 January 2012 to 30 June 2013. He was the Chairman of the Education Committee of the British Chamber of Commerce from 2004 to 2014, and a member of the Board of Governors of Chinese International School from 1995 to 2017. He is also currently a director of the Hong Kong Youth Arts Foundation.

Mr. Eno holds a BA (hons.) degree in law (2:1) from the University of Kent in England. He is qualified as a solicitor in Hong Kong and England and Wales, as a notary in Hong Kong, and is also an accredited Hong Kong Mediator.

CHENG Wai Sun Edward

Independent Non-Executive Director

Mr. Cheng was appointed to the Board in April 2014.

Mr. Cheng is the Deputy Chairman and Chief Executive of Wing Tai Properties Limited, and the Chairman of Lanson Place Hospitality Management Limited.

Mr. Cheng has many years of public service experience in urban renewal, housing, finance, corruption prevention, technology and education. He was the Chairman of each of the Urban Renewal Authority and the University Grants Committee of Hong Kong. He is currently a non-executive director of the Securities and Futures Commission and a member of the Chief Executive’s Council of Advisers on Innovation and Strategic Development.

Mr. Cheng has a Bachelor’s degree in political science and economics from Cornell University, and a Bachelor’s degree in jurisprudence and a Master’s degree from Oxford University. He was qualified as a solicitor in England and Wales as well as in Hong Kong. He is a Justice of the Peace, and has been awarded the Gold Bauhinia Star by the HKSAR Government.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Composition (continued)

TUNG Lieh Cheung Andrew

Independent Non-Executive Director

Mr. Tung was appointed to the Board in July 2015.

Mr. Tung has been an Executive Director of Orient Overseas (International) Limited since 2 November 2011 and is a member of the Executive Committee, the Finance Committee, the Inside Information Committee and the Risk Committee of Orient Overseas (International) Limited. He has been a Director and a member of the Executive Committee of Orient Overseas Container Line Limited ("OOCLL"), a wholly-owned subsidiary of Orient Overseas (International) Limited, since March 2006, and re-designated from the Chief Executive Officer to Co-Chief Executive Officer of OOCLL since 3 August 2018. He is also a director of various subsidiaries of Orient Overseas (International) Limited. Between 1993 and 1998, he has served the Orient Overseas Container Line Group in various capacities including Director of Reefer Trade of OOCLL. The last position Mr. Tung held in Hong Kong Dragon Airlines Limited prior to joining OOCLL in 2006 was the Chief Operating Officer.

Mr. Tung holds a Bachelor's degree from Princeton University and a Master of Business Administration degree from Stanford University in the USA. Mr. Tung is an independent non-executive director of Cathay Pacific Airways Limited (a company listed in Hong Kong). He is currently a member of the Hong Kong Logistics Development Council, a member of the Hong Kong Maritime and Port Board, and the Chairman of the Maritime and Port Development Committee. He was the Vice-Chairman of the International Chamber of Commerce Commission for Transport & Logistics.

Board selection process

The Nomination Committee regularly reviews the structure, size and composition of the Board and identifies individuals suitably qualified to become members of the Board. The Committee makes recommendations to the Board on the appointment of and succession planning for Directors (subject to the approval of the HKMA), having regard to the skills, knowledge, experience and diversity the candidate adds to the Board and compliance with corporate governance standards set out in the HKMA Supervisory Policy Manual CG-1 and the guidance on Empowerment of Independent Non-Executive Directors ("INEDs") in the Banking Industry in Hong Kong issued by the HKMA.

A candidate being considered for Board appointment is expected to devote adequate time to attend all Board meetings and, where relevant, Committee meetings in person. An individual who is to be appointed as an INED should also meet the independence status prior to their appointment.

In accordance with the Articles of Association of the Bank, a Director appointed by the Board shall hold office only until the next following Annual General Meeting and shall be eligible for re-election.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Committees

(a) The Board of Directors ("the Board")

The Board is responsible for overseeing the management of the business and affairs of the Bank including the determination and approval of the Bank's financial objectives and strategic plan. It oversees the Bank's compliance with statutory and regulatory obligations, its capital and corporate structure and ensures a sound system of internal control and risk management. The Board also reviews performance in light of the Bank's strategy, objectives, corporate and business plans and budgets and determines appropriate levels for the Bank's capital and liquidity positions. The Board delegates day-to-day management of the Bank's risks to a number of committees. Risk profiles and capital related matters are reviewed by the Board on a regular basis. The Board has held four scheduled meetings and one ad-hoc meeting in 2018.

The below committees operate under the direct authority of the Board.

(b) Executive Committee ("EXCO")

The EXCO meets regularly in relation to the day to day management, operation and control of the business. It also sub-delegates to various committees certain aspects of the conduct of the business as detailed below. The EXCO includes the Chief Executive Officer ("CEO"), the Chief Financial Officer ("CFO") and the heads of various businesses and functions. During the year, 11 EXCO meetings have been held.

(c) Audit Committee ("AC")

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

The AC reviews, on behalf of the Board, the Bank's internal financial controls to identify, assess, manage and monitor financial risks and to review the bank's internal control systems. The AC also reviews the annual and interim financial statements, discusses matters raised by Internal Audit and external auditors and ensures that audit recommendations are implemented accordingly.

The AC comprises three independent non-executive directors ("INEDs" or "INED") and two non-executive directors ("NEDs" or "NED") namely Fong Ching (AC Chairman and INED), Stephen Robert Eno (INED), Cheng Wai Sun Edward (INED), Edward Martin Williams (NED) and Lee Cheuk Kuen Gloria (NED).

During the year, four AC meetings have been held.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Organisational and governance structure and policies (continued)

Board Committees (continued)

(d) Board Risk Committee ("BRC")

The BRC exercises oversight on behalf of the Board of the overall risk appetite and risk management strategy and its implementation by management. The BRC reviews the appropriateness and effectiveness of the Bank's risk management systems and controls. The BRC also advises and assists the Board in discharging its responsibilities for the Bank's culture-related matters, including the oversight of effective mechanisms to assess behavioural standards and whistleblowing policy.

The BRC comprises three INEDs and two NEDs namely Stephen Robert Eno (BRC Chairman and INED), Fong Ching (INED), Tung Lieh Cheung Andrew (INED), Edward Martin Williams (NED) and Lee Cheuk Kuen Gloria (NED).

During the year, four BRC meetings have been held.

(e) Nomination Committee ("NomCo")

The NomCo is responsible for identifying individuals suitably qualified to become members of the Board or of key senior management, and selecting, or recommending such individuals to the Board. The NomCo reviews succession plans of the Board and key senior management roles. It also reviews the structure, size and composition of the Board and makes recommendations to the Board with regard to any adjustments that are deemed necessary.

The NomCo comprises three INEDs and one NED namely Cheng Wai Sun Edward (NomCo Chairman and INED), Stephen Robert Eno (INED), and Tung Lieh Cheung Andrew (INED) and Hung Pi Cheng Benjamin (NED).

During the year, one NomCo meeting has been held.

(f) Remuneration Committee ("RemCo")

The RemCo was established on 1 October 2018. It is responsible for reviewing the framework and policies for remuneration and compliance with the applicable laws and regulatory guidelines. The RemCo shall ensure, on behalf of the Board, that the Company's remuneration policies are consistent with effective risk management.

The RemCo comprises three INEDs and one NED namely Tung Lieh Cheung Andrew (RemCo Chairman and INED), Fong Ching (INED), Cheng Wai Sun Edward (INED) and Hung Pi Cheng Benjamin (NED).

During the year, one Remco meeting has been held.

Appendix I: Corporate Governance Report (continued)

Disclosure on Corporate Governance of Locally Incorporated Authorised Institutions issued by the HKMA (continued)

Sub-committees of EXCO

(a) Asset and Liability Committee ("ALCO")

The ALCO, appointed by the EXCO, is responsible for the implementation of, and compliance with, balance sheet management policies, including management of the Bank's liquidity, capital adequacy, loss absorbing capacity, leverage, earning risk and meets internal and external recovery and resolution planning requirements. The ALCO comprises of the CEO, the CFO and the Chief Risk Officer ("CRO") as members, with attendance from key business and risk management heads. During the year, 19 ALCO meetings have been convened.

(b) Executive Risk Committee ("ERC")

The ERC, through its authority delegated by the EXCO, is responsible for the management of all risks other than those delegated to ALCO and the Country Pensions Committee ("CPC"). The ERC oversees effective application of the Bank's Enterprise Risk Management Framework, recommends risk appetite for approval by the Board, approves and reviews new products before launch and risk control parameters including policies, risk exposure limits, or other control levers. The ERC is chaired by the CRO with members including the CEO, the CFO, and the key business and risk management heads. There were in total 12 standing ERC meetings held in 2018.

(c) Pillar III Committee ("Pillar III")

The Pillar III, through its authority delegated by the Board, is responsible for reviewing, approving and compliance of the Pillar III disclosure statement in accordance with the Bank's Disclosure Policy and the Banking (Disclosure) Rules. The Pillar III is chaired by the CFO and the CRO, with members including key finance and risk management heads. There were two meetings held in 2018.

Risk appetite

The details of the Group's risk appetite are disclosed in note 34 to the consolidated financial statements.

Major share ownership and voting rights

The Bank is wholly owned by Standard Chartered PLC through Standard Chartered Holdings Limited ("SCHL") and Standard Chartered Bank ("SCB"). SCHL and SCB (the Bank's immediate holding company) hold 49% and 51% of the voting rights in the Bank respectively. Each of SC PLC and SCHL is a company incorporated in England and Wales whereas SCB is a company incorporated in England by Royal Charter.

Related party transactions

All related party transactions during the year ended 31 December 2018 are disclosed in notes 16 and 37 to the consolidated financial statements.

Complex structures

A structured entity is consolidated into the Group's consolidated financial statements where the Group controls the structured entity. For details, please refer to note 17 to the consolidated financial statements.

Appendix II: directors of the Bank's subsidiaries

The names of all directors who have served on the board of the subsidiaries of the Bank during the year and up to 26 February 2019:

*	Nigel ANTON
*	AU Siu Luen
*	Garry BURKE
*	Peter William BURNETT
*	Paul Stuart CHAMBERS
*	CHAN Fong
	CHEN Poonis Annie
*	CHEUNG Wai Hing
*	CHEUNG Yup Fan
*	CHUNG Byung Ho
*	Kieran CORR
*	Christopher John DANIELS
*	Jean FERNANDES
*	Deniz GUVEN
*	Yee Mann HAU
*	Christopher David HELME
*	Jonathan Davey HOWARD
*	HUEN Wai Yi Mary
	Guy Roland ISHERWOOD
	KOH Wai Yong
*	Nils Kristian KOVDAL
*	Dinesh KUMAR
	LAI Darcy Tat-Sze
*	LAI Yan Hong
*	LAM Hui Yip
	LAW Heung Yee, Nita
	MAI Wai Lam
*	Shikkoh MALIK
*	Alex MANSON
*	William MCCALLUM
*#	Peter MOYLAN
	Barnaby Joel NELSON
*	NG Chau Shing Dantes
*	NG Chi Ming
*	Ivo Laurence PHILIPPS
*	PUAR Wei Yong Eugene
*	Amit Kumar PURI
*	Xiaomin RONG
*@	Richard Douglas John STAFF
*	Samir SUBBERWAL
	SZETO Ho Yin Jeffrey
*	TAN Ming Kin John
*	Amit Kishorchandra TANNA
*^	Tiara Ltd
	Jim WANG
*	Wanjun WANG
*	Xi WANG
*	Tianwei XU
*	YIM Mei Ling Carolyn

Also as Alternate director
@ Serve as Alternate director only
^ Corporate director
* Directors serving the Board as at 26 February 2019