Standard Chartered
渣打銀行
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Standard Chartered Bank (Hong Kong) Limited

Directors' Report and Consolidated Financial Statements

For the year ended
31 December 2015

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 2015.

Principal place of business

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

Principal activities

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

Financial statements

The profit of the Bank and its subsidiaries for the year ended 31 December 2015 and the state of the Bank’s and its subsidiaries’ affairs as at that date are set out in the financial statements on pages 5 to 127.

During the year ended 31 December 2015, the directors had declared and paid an ordinary dividend of HK$4.0214 (2014: HK$1.9215) per each “A” and “B” ordinary share totalling HK$7,790 million (2014: HK$3,722 million. A total dividend of HK$242 million (2014: Nil) was paid in respect of the US$500 million 6.25% perpetual non-cumulative convertible preference shares classified as equity.

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

Charitable donations

Charitable donations made by the Bank and its subsidiaries during the year amounted to HK$8 million (2014: HK$11 million).

Share capital

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

Directors

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

Executive directors
Tan Siew Boi
Ling Fou Tsong

Report of the directors (continued)

Non-executive directors
Hung Pi Cheng Benjamin, Chairperson
Jaspal Singh Bindra (resigned on 30 June 2015)
Julian Fong Loong Choon (resigned on 31 August 2015)
Sunil Kaushal
Edward Martin Williams (appointed on 4 August 2015)
Anna Elizabeth Marrs (appointed on 11 September 2015)
Chan Wing Kin* (resigned on 17 July 2015)
Fong Ching*
Stephen Robert Eno*
Cheng Edward Wai Sun*
Tung Lieh Cheung Andrew* (appointed on 31 July 2015)

** Independent non-executive directors*

Tung Lieh Cheung Andrew, Edward Martin Williams and Anna Elizabeth Marrs will be subject to re-election at the 2016 annual general meeting in accordance with Article 110 of the Bank's Article of Association.

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

Directors' service contracts

The maximum term of appointment of independent non-executive directors is 2 years. Their remuneration is determined by the shareholders at the annual general meeting.

Directors' interests in Share Option Schemes

Certain directors of the Bank have been granted options under various share option schemes of Standard Chartered PLC, the ultimate holding company of the Bank. During the year, Jaspal Singh Bindra, Anna Elizabeth Marrs, Hung Pi Cheng Benjamin, Julian Fong Loong Choon, Edward Martin Williams, Ling Fou Tsong, Tan Siew Boi and Sunil Kaushal 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.

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.

Report of the directors (continued)

Auditor

The financial statements have been audited by KPMG who will retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG as 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, 23 February 2016

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

(Incorporated in Hong Kong with limited liability)

We have audited the consolidated financial statements of Standard Chartered Bank (Hong Kong) Limited (the "Bank") and its subsidiaries (together "the Bank and its subsidiaries") set out on pages 5 to 127, which comprise the consolidated statement of financial position as at 31 December 2015, 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 a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the consolidated financial statements

The directors of the Bank are responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board and with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants 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 misstatements, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. 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.

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

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

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Bank and its subsidiaries as at 31 December 2015 and of the Bank and its subsidiaries' financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and with Hong Kong Financial Reporting Standards and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

KPMG
Certified Public Accountants

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

23 February 2016

Consolidated income statement
For the year ended 31 December 2015

(Expressed in millions of Hong Kong dollars)

	Note	*2015 HK$'M*	*2014 HK$'M*
Interest income	4(a)	16,103	18,899
Interest expense	4(b)	(4,724)	(5,169)
Net interest income		11,379	13,730
Fee and commission income		9,759	10,434
Fee and commission expense		(382)	(520)
Net fee and commission income	4(c)	9,377	9,914
Net trading income	4(d)	1,143	1,023
Net gains from financial instruments designated at fair value through profit or loss	4(e)	13	641
Net gains from disposal of available-for-sale securities	5	85	19
Other operating income	4(f)	4,845	3,121
		15,463	14,718
Total operating income		26,842	28,448
Staff costs		(6,762)	(6,924)
Premises and equipment		(3,104)	(2,763)
Others		(5,069)	(5,156)
Operating expenses	4(g)	(14,935)	(14,843)
Operating profit before impairment		11,907	13,605
Impairment charges on advances to banks and customers	6(a)	(3,067)	(2,141)
Other impairment charges	6(b)	(763)	(911)
Operating profit after impairment		8,077	10,553
Share of profit of associates		1,388	1,412
Profit before taxation		9,465	11,965
Taxation	7(a)	(975)	(1,560)
Profit after taxation		8,490	10,405

The notes on pages 11 to 127 form part of these financial statements.

Consolidated statement of comprehensive income
For the year ended 31 December 2015
(Expressed in millions of Hong Kong dollars)

	2015 *HK$'M*	*2014* *HK$'M*
Profit after taxation	8,490	10,405
Other comprehensive income:		
Items that will not be reclassified to the income statement:		
Defined benefit plans:		
– Remeasurement of net defined benefit liability	(143)	9
– Related tax effect	23	(2)
Items that may be reclassified subsequently to the income statement:		
Available-for-sale securities:		
– Changes in fair value recognised during the year	(298)	237
– Changes in fair value transferred to the income statement on disposal	(85)	(19)
– Transfer to the income statement on fair value hedged items attributable to hedged risk	(7)	54
– Related tax effect	72	(13)
Cash flow hedges:		
– Changes in fair value recognised during the year	(6)	102
– Transfer to the income statement on termination of hedging derivatives	(34)	(1)
– Related tax effect	7	(17)
Exchange difference	(572)	(63)
Other comprehensive income for the year, net of tax	(1,043)	287
Total comprehensive income for the year	7,447	10,692

The notes on pages 11 to 127 form part of these financial statements.

Consolidated statement of financial position as at 31 December 2015

(Expressed in millions of Hong Kong dollars)

	Note	2015 HK$'M	2014 HK$'M
Assets			
Cash and balances with banks, central banks and other financial institutions	10	48,769	53,076
Placements with banks and other financial institutions	11	119,658	145,770
Hong Kong SAR Government certificates of indebtedness	12	38,031	36,741
Trading assets	13	18,597	23,388
Financial assets designated at fair value	14	666	1,575
Investment securities	17	210,572	172,302
Advances to customers	15(a)	414,955	454,996
Amounts due from immediate holding company	18	30,357	70,263
Amounts due from fellow subsidiaries	18	16,105	46,061
Interest in associates	20	9,481	9,008
Property, plant and equipment	21	37,480	39,950
Goodwill and intangible assets	22	1,075	1,116
Current tax assets		556	266
Deferred tax assets	27	314	141
Other assets	23	12,349	24,389
		958,965	1,079,042
Liabilities			
Hong Kong SAR currency notes in circulation	12	38,031	36,741
Deposits and balances of banks and other financial institutions		24,655	32,605
Deposits from customers	24	745,701	851,029
Trading liabilities	28	8,847	12,800
Financial liabilities designated at fair value	26	13,724	14,915
Debt securities in issue	25	1,209	13,838
Amounts due to immediate holding company	18	27,519	17,209
Amounts due to fellow subsidiaries	18	8,314	3,644
Current tax liabilities		4	18
Deferred tax liabilities	27	274	212
Other liabilities	29	15,245	19,582
Subordinated liabilities	31	10,093	10,406
		893,616	1,012,999
Equity			
Share capital	32	20,256	20,256
Reserves	33	45,093	45,787
Shareholders' equity		65,349	66,043
		958,965	1,079,042

Approved and authorised for issue by the Board of Directors on 23 February 2016.

Tan Siew Boi
Director

Ling Fou Tsong
Director

The notes on pages 11 to 127 form part of these financial statements.

Consolidated statement of changes in equity
For the year ended 31 December 2015

	Attributable to equity shareholders of the Bank										
	Share capital HK$'M	*Share premium HK$'M*	*Capital redemption reserve HK$'M*	*Cash flow hedge reserve HK$'M*	*Available-for-sale investment reserve HK$'M*	*Revaluation reserve HK$'M*	*Exchange reserve HK$'M*	*Property revaluation reserve HK$'M*	*Retained profits HK$'M*	*Share option equity reserve HK$'M*	*Total HK$'M*
At 1 January 2014	97	12,477	3,804	(33)	52	146	432	2	37,804	265	55,046
Total comprehensive income	–	–	–	84	259	–	(63)	–	10,412	–	10,692
Dividend paid	–	–	–	–	–	–	–	–	(3,722)	–	(3,722)
Movement in respect of share-based compensation plans	–	–	–	–	–	–	–	–	–	149	149
Amalgamation of share premium and capital redemption reserve with share capital (note 33(i))	16,281	(12,477)	(3,804)	–	–	–	–	–	–	–	–
Issuance of perpetual non-cumulative convertible preference shares, net of issuance cost (note 32)	3,878	–	–	–	–	–	–	–	–	–	3,878
At 31 December 2014	20,256	–	–	51	311	146	369	2	44,494	414	66,043
Total comprehensive income	–	–	–	(33)	(318)	–	(572)	–	8,370	–	7,447
Dividend paid	–	–	–	–	–	–	–	–	(8,032)	–	(8,032)
Movement in respect of share-based compensation plans	–	–	–	–	–	–	–	–	–	(108)	(108)
Disposal of interest in a subsidiary and an associate	–	–	–	–	–	–	(1)	(2)	2	–	(1)
At 31 December 2015	20,256	–	–	18	(7)	146	(204)	–	44,834	306	65,349

The notes on pages 11 to 127 form part of these financial statements.

Consolidated cash flow statement
For the year ended 31 December 2015

(Expressed in millions of Hong Kong dollars)

	Note	*2015 HK$'M*	*2014 HK$'M*
Operating activities			
Profit before taxation		9,465	11,965
Adjustments for:			
Impairment charges on advances to banks and customers		3,067	2,141
Advances written off net of recoveries		(2,708)	(1,180)
Unwinding of discount on loan impairment provision		(44)	(36)
Other impairment charges		763	911
Depreciation		1,717	1,422
Amortisation of intangible assets		121	112
Lossed/(gains) on disposal of property, plant and equipment		61	(104)
Gains on disposal of a subsidiary and an associate		(1,758)	–
Net gains on revaluation of investment properties		(3)	(306)
Share of profit of associates		(1,388)	(1,412)
Interest expense on subordinated liabilities		364	343
Expense in respect of the defined benefit plan		99	101
Fair value gains transferred from reserves on cash flow hedges		(34)	(1)
Exchange translation on subordinated liabilities		(272)	(185)
		9,450	13,771
(Increase)/decrease in operating assets:			
Placements with banks and other financial institutions with original maturity beyond three months		(12,112)	(5,096)
Trading assets		3,410	12,167
Financial assets designated at fair value		909	579
Investment securities		(13,636)	42,148
Gross advances to customers		39,740	(14,599)
Amounts due from immediate holding company and fellow subsidiaries		16,931	(13,280)
Other assets		13,921	5,859
Increase/(decrease) in operating liabilities:			
Deposits and balances of banks and other financial institutions		(7,953)	17,431
Deposits from customers		(105,330)	34,407
Debt securities in issue		(12,629)	(1,498)
Financial liabilities designated at fair value		(1,191)	9,192
Amounts due to immediate holding company and fellow subsidiaries		16,562	(3,415)
Trading liabilities		(3,953)	(10,747)
Other liabilities		(4,707)	(5,783)
Cash (used in)/generated from operations		(60,588)	81,136
Income tax paid		(1,248)	(2,404)
Net cash (used in)/generated from operating activities		(61,836)	78,732

Consolidated cash flow statement (continued)
For the year ended 31 December 2015

(Expressed in millions of Hong Kong dollars)

	Note	2015 HK$'M	2014 HK$'M
Investing activities			
Dividend received from associates		35	36
Payment for purchase of property, plant and equipment		(6,897)	(15,395)
Payment for purchase of intangible assets		(80)	(111)
Proceeds from disposal of property, plant and equipment		5,539	2,950
Proceeds from disposal of a subsidiary and an associate		4,437	–
Net cash generated from/(used in) investing activities		3,034	(12,520)
Financing activities			
Issuance of perpetual non-cumulative convertible preference shares		–	3,878
Interest paid on subordinated liabilities		(348)	(330)
Dividend paid to shareholders of the Bank		(8,032)	(3,722)
Net cash used in financing activities		(8,380)	(174)
Net (decrease)/increase in cash and cash equivalents		(67,182)	66,038
Cash and cash equivalents at 1 January		232,850	168,807
Effect of foreign exchange		(2,808)	(1,995)
Cash and cash equivalents at 31 December	34	162,860	232,850
Cash flows from operating activities include:			
Interest received		16,079	18,877
Interest paid		4,660	5,100
Dividends received		25	20

The notes on pages 11 to 127 form part of these financial statements.

Notes to the financial statements

(Expressed in millions of Hong Kong dollars)

1 Principal activities

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

2 Significant accounting policies

(a) Statement of compliance

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs"), which collective term includes all applicable Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs") and Interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong and the requirements of the Hong Kong Companies Ordinance. As HKFRSs are consistent with International Financial Reporting Standards ("IFRSs"), which collective term includes all applicable individual International Financial Reporting Standards, International Accounting Standards ("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 Bank 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 Bank and its subsidiaries. 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 Bank and its subsidiaries 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 2015 comprise the Bank and its subsidiaries and the interest in associate.

The measurement basis used in the preparation of the financial statements is the historical cost convention, as modified by the revaluation of investment properties, available-for-sale assets, and financial assets and liabilities (including derivatives) at fair value through profit or loss.

The preparation of financial statements in conformity with adopted HKFRS/IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank and its subsidiaries' accounting policies. Actual results may differ from these estimates. The significant judgements made by management in applying the accounting policies and key sources of uncertainty were the same as those applied to the consolidated financial statements as at and for the year ended 31 December 2014.

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

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

(ii) Consolidated Financial Statements

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

(c) Subsidiaries and non-controlling interests

Subsidiaries are all entities which the Bank and its subsidiaries control. The Bank and its subsidiaries control an entity when they are exposed to, or have rights to, variable returns from their involvement with the entity and have the ability to affect those returns through their power over the investee. Subsidiaries are fully consolidated from the date on which the Bank and its subsidiaries effectively obtain 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 Bank's principal subsidiaries are given in note 19.

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

Non-controlling interests represent the portion of the net assets of subsidiaries attributable to interests that are not owned by the Bank, whether directly or indirectly through subsidiaries, and in respect of which the Bank and its subsidiaries have not agreed any additional terms with the holders of those interests which would result in the Bank and its subsidiaries as a whole having a contractual obligation in respect of those interests that meet the definition of a financial liability. Non-controlling interests are presented in the consolidated statement of financial position within equity, separately from equity attributable to the equity shareholders of the Bank. 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 Bank.

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

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

(d) Associates and joint arrangements

Associates are entities in respect of which the Bank 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.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(d) Associates and joint arrangments (continued)

Joint arrangements are where two or more parties either have rights to the assets, and obligations of the joint arrangement (joint operations) or have rights to the net assets of the joint arrangement (joint venture). The Bank and its subsidiaries evaluate the contractual terms of joint arrangements to determine whether a joint arrangement is a joint operation or a joint venture. At 31 December 2015, the Bank and its subsidiaries have an insignificant contractual interest in a joint venture but do not have any contructual interest in joint operations. Details of the Bank and its subsidiaries' interest in associates are provided in note 20.

Investments in associates and joint ventures are accounted for using the equity method of accounting in the consolidated financial statements and are initially recognised at cost. The Bank and its subsidiaries' investment in associates and joint ventures includes goodwill identified on acquisition and accumulated impairment loss.

The Bank and its subsidiaries' share of its associates' and joint ventures' post-acquisition profits or losses are recognised in the 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 Bank and its subsidiaries' share of losses in an associate or a joint venture is equal to or exceeds its interest in the associate and joint venture, including any other unsecured receivables, the Bank and its subsidiaries do not recognise further losses, unless they have incurred obligations or made payments on behalf of the associate and joint venture.

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

In the Bank's statement of financial position, investment in associates and joint ventures are stated at cost less impairment losses and dividends from pre-acquisition profits received prior to 1 January 2009, if any.

(e) Intangible assets

(i) Goodwill

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

Goodwill included in "Goodwill and intangible assets" is tested annually for impairment and carried at cost less any accumulated impairment losses. 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 Bank and its subsidiaries at which the goodwill is monitored for internal management purposes. Note 22 sets out the major cash-generating units to which goodwill has been allocated.

Notes to the 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 in excess of its cost. Computer software costs are amortised on the basis of expected useful life (5 years). Costs associated with maintaining software are recognised as an expense as incurred. 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.

(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 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 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 Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

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

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

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

- Aircraft and vessels, are depreciated over 25 years.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

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

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date. At each reporting date, these assets are assessed for indicators of impairment. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, the asset is written down immediately.

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

(h) Leases

Where the Bank and its subsidiaries are the lessees

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

Where the Bank and its subsidiaries are the lessors

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 income statement on a straight-line basis unless another systematic basis is more representative.

(i) Financial assets and liabilities (excluding derivatives)

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

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

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

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

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

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

- 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 Bank and its subsidiaries commit 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 income statement.

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

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

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 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.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

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

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 Bank and its subsidiaries have 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 Bank and its subsidiaries establish fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Reclassifications

Reclassifications of financial assets, other than as disclosed below, or of financial liabilities between 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 Bank and its subsidiaries have the intent and ability to hold the assets for the foreseeable future or until maturity.

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

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

Renegotiated loans

Loans and receivables with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank and its subsidiaries have 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 Bank and its subsidiaries have transferred substantially all risks and rewards of ownership.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

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

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

(j) Derivative financial instruments and hedge accounting

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

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

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

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

The Bank and its subsidiaries document, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Bank and its subsidiaries also document 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 that qualify as fair value hedging instruments are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to the income statement over the period to maturity or derecognition.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(j) Derivative financial instruments and hedge accounting (continued)

(ii) Cash flow hedge

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

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

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

Derivatives that do not qualify for hedge accounting

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

(k) Impairment of financial assets

The Bank and its subsidiaries assess 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 Bank and its subsidiaries file to have the counterparty declared bankrupt or file a similar order in respect of a credit obligation;
- the Bank and its subsidiaries consent 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 Bank and its subsidiaries sell a credit obligation at a material credit-related economic loss; or

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment of financial assets (continued)

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

Assets carried at amortised cost

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

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

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

Future cash flows in a group of financial assets that are collectively evaluated for impairment are 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 income statement.

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment of financial assets (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 income statement) is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

(l) Offsetting financial transactions

Financial assets and liabilities are offset and the net amount reported in the 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 Bank and its subsidiaries commonly act 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 Bank and its subsidiaries.

(n) Cash and cash equivalents

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

(o) Revenue recognition

(i) Interest income and expense

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(o) Revenue recognition (continued)

(i) Interest income and expense (continued)

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

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

(ii) Fees and commissions

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

(iii) Other income from financial assets and liabilities

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

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

Dividends on equity instruments are recognised in the income statement when the Bank and its subsidiaries' right to receive payment is established.

(p) Income tax

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

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(p) Income tax (continued)

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 income statement together with the current or deferred gain or loss.

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

– in the case of current tax assets and liabilities, the Bank or its subsidiaries intend 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 Bank recognises a provision for a present legal or constructive obligation resulting from a past event when it is more likely than not that it will be required to transfer economic benefits to settle the obligation and the amount of the obligation can be estimated reliably.

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

(r) Employee benefits

(i) Short term employee benefits

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

(ii) Retirement benefit obligations

The Bank and its subsidiaries operate a number of defined contribution and defined benefit plans.

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

For funded defined benefit plans, the net liability recognised in the 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.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(r) Employee benefits (continued)

(ii) Retirement benefit obligations (continued)

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

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

For equity-settled awards, the total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and growth targets). The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments is estimated using an appropriate valuation technique, such as a binomial option pricing model.

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

(s) Translation of foreign currencies

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(s) Translation of foreign currencies (continued)

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

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

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

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

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

(t) Related parties

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

(u) Segment reporting

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

(v) Sale and repurchase agreements

Securities sold subject to repurchase agreements ("repos") remain on the 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 Group companies", as appropriate. Securities purchased under agreements to re-sell ("reverse repos") are not recognised on the 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 Group Companies" 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 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.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(w) Assets held for sale

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

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

3 Changes in accounting policies

Amendments to HKFRSs/IFRSs and new interpretation

The HKICPA/IASB has issued the following amendments to HKFRSs/IFRSs that are first effective for the current accounting period commencing 1 January 2015.

– Amendments to HKAS 19/IAS 19, Employee benefits: Defined benefit plans: Employee contributions
– Annual Improvements to HKFRSs/IFRSs 2010-2012 Cycle
– Annual Improvements to HKFRSs/IFRSs 2011-2013 Cycle

The Bank and its subsidiaries adopted the above amendments to existing accounting standards from 1 January 2015. The application of these amendments did not have a material impact on these consolidated financial statements.

4 Operating profit

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

	2015 HK$'M	2014 HK$'M
(a) Interest income		
Interest income on listed securities	1,112	1,023
Interest income on unlisted securities	1,424	1,474
Other interest income (note)	13,567	16,402
Amount shown in the income statement	16,103	18,899
Less: interest income arising from trading assets	(359)	(401)
Less: interest income on financial assets designated at fair value	(49)	(57)
Total interest income on financial assets that are not measured at fair value through profit or loss	15,695	18,441

(note) The amount includes interest income on unwinding of discounts on loan impairment provisions of HK$44 million (note 16) (2014: HK$36 million), and fair value gains of HK$31 million transferred from reserves on cash flow hedges (2014: HK$1 million).

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

4 Operating profit (continued)

	2015 HK$'M	2014 HK$'M
(b) Interest expense		
Interest expense on customer deposits, deposits of banks, certificates of deposit issued, debt securities issued, trading liabilities and financial liabilities designated at fair value (note)	4,360	4,826
Interest expense on subordinated liabilities	364	343
Amount shown in the income statement	4,724	5,169
Less: interest expense arising from trading liabilities	(66)	(89)
Less: interest expense arising from financial liabilities designated at fair value	(119)	(64)
Total interest expense on financial liabilities that are not measured at fair value through profit or loss	4,539	5,016

(note) The amount includes fair value gains of HK$3 million transferred from reserve on cash flow hedges (2014: nil).

	2015 HK$'M	2014 HK$'M
(c) Net fee and commission income		
Net fee and commission income (other than amounts included in determining the effective interest rate) arising from financial assets or financial liabilities that are not held for trading or designated at fair value		
– fee and commission income	2,880	3,241
– fee and commission expense	112	165
Net fee and commission income from trust and other fiduciary activities where the Bank and its subsidiaries hold or invest assets on behalf of its customers		
– fee and commission income	605	512
– fee and commission expense	159	123

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

4 Operating profit (continued)

		2015 HK$'M	2014 HK$'M
(d)	***Net trading income***		
	Gains less losses from dealing in foreign currencies	1,008	988
	Gains less losses from trading securities	168	172
	Gains less losses from other dealing activities	(33)	(137)
	Amount shown in the income statement	1,143	1,023
	Add: interest income arising from trading assets	359	401
	Less: interest expense arising from trading liabilities	(66)	(89)
	Net income from trading instruments	1,436	1,335

		2015 HK$'M	2014 HK$'M
(e)	***Net gains from financial instruments designated at fair value***		
	Net gains as shown in the income statement	13	641
	Add: interest income arising from financial assets designated at fair value	49	57
	Less: interest expense arising from financial liabilities designated at fair value	(119)	(64)
		(57)	634

		2015 HK$'M	2014 HK$'M
(f)	***Other operating income***		
	Rental income from operating lease assets	3,120	2,662
	Dividend income from listed available-for-sale securities	–	–
	Dividend income from unlisted available-for-sale securities	25	20
	Net (losses)/gains on disposal of property, plant and equipment	(61)	104
	Net losses on disposal of financial instruments measured at amortised cost	(76)	(31)
	Net gains on revaluation of investment properties (note 21)	3	306
	Net gains on disposal of a subsidiary and an associate	1,758	–
	Others	76	60
		4,845	3,121

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

4 Operating profit (continued)

	2015 HK$'M	2014 HK$'M
(g) Operating expenses		
Staff costs		
– contributions to defined contribution plans	39	223
– expense in respect of the defined benefits plan (note 30(c))	99	101
– equity-settled share-based payment expenses	226	341
– salaries and other staff costs	6,398	6,259
Depreciation (note 21)	1,717	1,422
Premises and equipment expense, excluding depreciation		
– rental of premises	998	935
– others	389	406
Amortisation		
– other intangible assets (note 22)	121	112
Auditor's remuneration	19	17
Others	4,929	5,027
	14,935	14,843

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

	2015 HK$'M	2014 HK$'M
Net gains transferred from reserves	85	19

6 Impairment charges

	2015 HK$'M	2014 HK$'M
(a) Impairment charges on advances to banks and customers		
Individual impairment provisions (note 16)		
– additions	2,804	2,574
– releases	(19)	(40)
– recoveries	(173)	(242)
	2,612	2,292
Portfolio impairment charges/(releases) (note 16)	455	(151)
	3,067	2,141
(b) Other impairment charges		
Charges for an interest in an associate	357	620
Charges for goodwill and intangible assets	–	291
Charges for risk participation transactions	270	–
Charges for property, plant and equipment (note 21)	133	–
Others	3	–
	763	911

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

7 Taxation in the consolidated income statement

(a) Taxation in the consolidated income statement represents:

	2015 HK$'M	*2014 HK$'M*
Current tax		
Hong Kong profits tax	1,008	1,609
Overseas taxation	20	31
Over-provision in respect of prior years	(44)	(255)
	984	1,385
Deferred tax (note 27)		
Origination/reversal of temporary differences	4	126
(Over)/under-provision in respect of prior years	(13)	49
	(9)	175
	975	1,560

The provision for Hong Kong profits tax for 2015 is calculated at 16.5% (2014: 16.5%) of the estimated assessable profits for the year. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

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

	2015 HK$'M	*2014 HK$'M*
Profit before taxation	9,465	11,965
Notional tax on profit before taxation, calculated at Hong Kong profits tax rate of 16.5%	1,562	1,974
Tax effect of non-deductible expenses	253	289
Tax effect of non-taxable revenue	(762)	(480)
Over-provision in prior years	(57)	(206)
Tax effect of different tax rates of subsidiaries operating in other jurisdictions	(26)	(20)
Others	5	3
Actual tax expense	975	1,560

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

8 Directors' remuneration

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

	Bank	
	2015	2014
	HK$'M	HK$'M
Fees	1	1
Short-term employment benefits	45	58
Post-employment benefits	1	2
Equity compensation benefits	4	19
	51	80

9 Segmental reporting

The Bank and its subsidiaries manage its businesses by four client segments: Corporate and Institutional, Commercial, Private Banking and Retail:

- **Corporate & Institutional (C&I) Clients** comprises Global Corporates (major multinational corporations and large business groups which have sophisticated, cross-border needs requiring high levels of international service); Local Corporates (typically clients with operations in three geographies or less); and Financial Institutions (Banks, Investor clients, Insurance companies, Broker Dealers, Public Sector names (including Central Banks, Sovereign Wealth Funds and Development Organisations) and other types of financial institutions). The majority of C&I client income is generated by Transaction Banking, Financial Markets and Corporate Finance products.

- **Commercial Clients** segment serves medium-sized business clients and Mid Markets clients providing products across Transaction Banking, Financial Markets and Lending.

- **Private Banking Clients** segment is dedicated to giving high net worth clients highly personalised service and a comprehensive suite of products and services tailored to meet their financial needs. Income from Private Banking clients primarily relates to Wealth Management and Retail products.

- **Retail Clients** comprises:
  - Priority & International clients, managing and servicing High Value Segment customers and delivering a distinct and differentiated customer experience to them;
  - Personal & Preferred clients, providing banking products and services to a broader consumer market; and
  - Business clients, serving small business clients, sole proprietors and private companies, offering solutions such as working capital, business expansion, businesses protection and yield enhancement.

Besides the four client segments, trading and proprietary activities undertaken by the Bank are classified as Own Account. In addition, certain items which do not fall within the client segments and Own Account, including unallocated central costs are reported in "Other Banking". Financial information is presented internally to the Bank's senior management using these segments.

On 19 July 2015, the Group announced a simplification of its organisational structure that will improve accountability, speed up decision-making and operational efficiency. This involves a simplified client-facing structure, comprising three client businesses (Corporate & Institutional Banking; Commercial & Private Banking and Retail Banking). The simplified organisational structure will be fully in place by 1 January 2016 and the segment reporting will be based on the new structure from 1 January 2016.

The Bank and its subsidiaries comprise 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 Bank, the location of the branch responsible for reporting the results or advancing the funds.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

9 Segmental reporting (continued)

(a) Segment results, assets and liabilities

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

2015	*Corporate & Institutional Clients HK$'M*	*Commercial Clients HK$'M*	*Private Banking Clients HK$'M*	*Retail Clients HK$'M*	*Own Account HK$'M*	*Other Banking HK$'M*	*Consolidated Total HK$'M*
Operating income							
– Net interest income	3,386	896	444	5,488	1,760	(36)	11,938
– Other operating income	8,585	725	617	5,169	(350)	1,708	16,454
	11,971	1,621	1,061	10,657	1,410	1,672	28,392
Operating expenses (note)	(6,184)	(1,242)	(962)	(5,459)	(353)	(48)	(14,248)
Operating profit before impairment	5,787	379	99	5,198	1,057	1,624	14,144
Impairment charges	(1,199)	(574)	(725)	(765)	–	(2)	(3,265)
Profit/(loss) before taxation	4,588	(195)	(626)	4,433	1,057	1,622	10,879
Segment assets	253,546	23,124	27,956	247,319	413,698	53,664	1,019,307
Segment liabilities	323,833	57,742	49,836	355,870	49,360	104,561	941,202

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

9 Segmental reporting (continued)

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

2014	*Corporate & Institutional Clients HK$'M*	*Commercial Clients HK$'M*	*Private Banking Clients HK$'M*	*Retail Clients HK$'M*	*Own Account HK$'M*	*Other Banking HK$'M*	*Consolidated Total HK$'M*
Operating income							
– Net interest income	3,949	1,195	421	6,477	2,271	(111)	14,202
– Other operating income	9,120	1,444	540	4,843	(320)	22	15,649
	13,069	2,639	961	11,320	1,951	(89)	29,851
Operating expenses (note)	(5,915)	(1,403)	(784)	(5,491)	(218)	91	(13,720)
Operating profit before impairment	7,154	1,236	177	5,829	1,733	2	16,131
Impairment charges	(1,449)	(492)	(1)	(1,108)	–	(271)	(3,321)
Profit/(loss) before taxation	5,705	744	176	4,721	1,733	(269)	12,810
Segment assets	349,407	32,512	28,919	250,720	379,330	52,779	1,093,667
Segment liabilities	419,706	59,436	58,592	355,958	61,612	93,220	1,048,524

(note): Operating expenses in Corporate & Institutional Clients segment included depreciation charges of HK$1,538 million (2014: HK$1,214 million) for commercial aircraft and vessels leased to customers under operating leases.

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

	2015 HK$'M	*2014 HK$'M*
Operating income		
Reportable segment revenue	28,392	29,851
Income relating to Financial Market products	(1,134)	(1,776)
Cost of free funds	78	108
Others	(494)	265
Total operating income	26,842	28,448

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

9 Segmental reporting (continued)

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

	2015 HK$'M	2014 HK$'M
Profit before taxation		
Reportable segment profit before taxation	10,879	12,810
Income relating to Financial Market products	(1,134)	(1,776)
Cost of free funds	78	108
Reallocations of impairment charges	(452)	290
Others	94	533
Profit before taxation	9,465	11,965

	2015 HK$'M	2014 HK$'M
Assets		
Reportable segment assets	1,019,307	1,093,667
Assets of group companies not included in consolidated total assets	(1,804)	(2,872)
Amounts due from immediate holding company and fellow subsidiaries	46,462	116,324
Others	(105,000)	(128,077)
Total assets	958,965	1,079,042

	2015 HK$'M	2014 HK$'M
Liabilities		
Reportable segment liabilities	941,202	1,048,524
Liabilities of group companies not included in consolidated total liabilities	(1,386)	(1,415)
Amounts due to immediate holding company and fellow subsidiaries	35,833	20,853
Others	(82,033)	(54,963)
Total liabilities	893,616	1,012,999

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

	2015 HK$'M	2014 HK$'M
Cash in hand	1,572	1,905
Balances with central banks	38,290	29,732
Balances with banks and other financial institutions	8,907	21,439
	48,769	53,076

11 Placements with banks and other financial institutions

	2015 HK$'M	2014 HK$'M
Gross placements with banks and other financial institutions		
– maturing within one month	64,774	85,928
– maturing between one month to one year	53,090	58,053
– maturing between one year to five years	1,794	1,789
	119,658	145,770
Less: impairment provision – individually assessed (note 16(b))	–	–
	119,658	145,770

There were no impaired placements with banks and other financial institutions as at 31 December 2014 and 2015.

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

13 Trading assets

	2015 HK$'M	2014 HK$'M
Trading securities	16,721	20,768
Advances to customers	163	1,604
Positive fair values of trading derivatives	1,713	1,016
	18,597	23,388
Trading securities:		
Treasury bills	3,127	3,016
Certificates of deposit held	388	374
Debt securities	12,897	15,841
Equity securities	309	1,537
	16,721	20,768
Issued by:		
Central governments and central banks	13,808	14,181
Banks and other financial institutions	1,490	1,285
Corporate entities	1,423	5,302
	16,721	20,768
By place of listing:		
Listed in Hong Kong	7,191	8,327
Listed outside Hong Kong	7,036	8,768
	14,227	17,095
Unlisted	2,494	3,673
	16,721	20,768

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

14 Financial assets designated at fair value

	2015 HK$'M	2014 HK$'M
Debt securities	666	1,575
Issued by:		
Corporate entities	666	1,575
By place of listing:		
Listed outside Hong Kong	453	1,239
Unlisted	213	336
	666	1,575

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

15 Advances to customers

(a) Advances to customers

	2015 HK$'M	2014 HK$'M
Gross advances to customers	415,278	453,552
Trade bills	1,785	3,237
	417,063	456,789
Less : Impairment provision		
– individually assessed (note 16(a))	(1,300)	(1,440)
– collectively assessed (note 16(a))	(808)	(353)
	414,955	454,996

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

15 Advances to customers (continued)

(b) Impaired advances to customers

	2015 *HK$'M*	*2014* *HK$'M*
Gross impaired advances to customers	3,807	2,712
Impairment provision – individually assessed	(1,300)	(1,440)
	2,507	1,272
Gross impaired advances to customers as a % of gross advances to customers	0.91%	0.59%
Fair value of collateral held against the covered portion of impaired advances to customers	1,967	1,206
Covered portion of impaired advances to customers	1,452	725
Uncovered portion of impaired advances to customers	2,355	1,987

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

16 Movement in impairment provision on advances to banks and customers

(a) Advances to customers

	2015		
	Individually assessed HK$'M	*Collectively assessed HK$'M*	*Total HK$'M*
At 1 January 2015	1,440	353	1,793
Amounts written off	(2,881)	–	(2,881)
Recoveries of advances written off in previous years	173	–	173
Net charge to the income statement (note 6(a))	2,612	455	3,067
Unwind of discount on loan impairment provision (note 4(a))	(44)	–	(44)
At 31 December 2015 (note 15(a))	1,300	808	2,108

	2014		
	Individually assessed HK$'M	*Collectively assessed HK$'M*	*Total HK$'M*
At 1 January 2014	382	665	1,047
Amounts written off	(1,400)	–	(1,400)
Recoveries of advances written off in previous years	242	–	242
Net charge to the income statement (note 6(a))	2,270	(151)	2,119
Unwind of discount on loan impairment provision (note 4(a))	(36)	–	(36)
Transfer to asset held for sale	(18)	(161)	(179)
At 31 December 2014 (note 15(a))	1,440	353	1,793

(b) Placements with banks and other financial institutions

	Individually assessed	
	2015 HK$'M	*2014 HK$'M*
At 1 January	–	–
Charge to the income statement (note 6(a))	–	22
Unwind of discount on loan impairment provision (note 4(a))	–	–
Amounts written off	–	(22)
At 31 December (note 11)	–	–

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

17 Investment securities

	2015 HK$'M	2014 HK$'M
Available-for-sale securities		
Treasury bills	60,737	53,424
Certificates of deposit held	14,952	15,086
Debt securities	126,441	94,505
Equity shares	632	468
Less: impairment provision	(11)	(15)
	202,751	163,468
Loans and receivables – Debt securities	7,821	8,834
	210,572	172,302
Issued by:		
Available-for-sale securities		
Central governments and central banks	121,623	84,229
Public sector entities	4,686	2,802
Banks and other financial institutions	49,286	49,707
Corporate entities	27,156	26,730
	202,751	163,468
Loans and receivables – Debt securities		
Corporate entities	7,821	8,834
	210,572	172,302
By place of listing:		
Available-for-sale securities		
Listed in Hong Kong	8,095	15,155
Listed outside Hong Kong	105,257	64,540
	113,352	79,695
Unlisted	89,399	83,773
	202,751	163,468
Loans and receivables – Debt securities		
Listed outside Hong Kong	3,278	2,489
Unlisted	4,543	6,345
	7,821	8,834
	210,572	172,302

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

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

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

During the year, HK$270 million of the above deposits (2014: Nil) were transferred to the related companies. As at 31 December 2015, the amount due from group companies shown on the statement of financial position is stated net of HK$1,819 million (2014: HK$1,554 million) in respect of such obligations.

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

	Immediate holding company		*Fellow subsidiaries*	
	2015	*2014*	*2015*	*2014*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
Operating income	2,280	2,632	130	728
Operating expenses	2,042	1,917	578	560

Material transactions entered during the year between the Bank and its subsidiaries included operating income of HK$1,660 million (2014: HK$1,910 million) and operating expense of HK$97 million (2014: HK$81 million). Intra-group transactions are eliminated in full in the consolidated income statement.

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

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

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

	2015 Immediate holding company HK$'M	*2015* Fellow subsidiaries HK$'M	*2014* Immediate holding company HK$'M	*2014* Fellow subsidiaries HK$'M
Amounts due from:				
Cash and balances with banks and other financial institutions	1,733	628	8,170	5,028
Placements with banks and other financial institutions	12,024	13,687	53,852	35,891
Trading assets				
– Positive fair values of trading derivatives	14,390	–	4,817	1
Investment securities				
– Listed available-for-sale debt securities	–	1,395	–	4,509
Other assets				
– Positive fair values of hedging derivatives	1,214	92	833	103
– Others	996	303	2,591	529
	30,357	16,105	70,263	46,061

	2015 Immediate holding company HK$'M	*2015* Fellow subsidiaries HK$'M	*2014* Immediate holding company HK$'M	*2014* Fellow subsidiaries HK$'M
Amounts due to:				
Deposits and balances of banks and other financial institutions	4,991	6,630	6,200	1,634
Deposits from customers	–	–	–	389
Trading liabilities:				
– Negative fair values of trading derivatives	15,405	–	5,580	1
Debt securities in issue	–	1,387	–	1,296
Other liabilities				
– Negative fair values of hedging derivatives	1,755	27	1,196	–
– Others	5,368	270	4,233	324
	27,519	8,314	17,209	3,644

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

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

	2015		*2014*	
	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	4,615	89	2,740	135
Loan commitments and other credit related commitments	–	29,866	3,877	41,789

19 Investments in subsidiaries of the Bank

	Bank	
	2015 HK$'M	*2014 HK$'M*
Unlisted shares, at cost less impairment provision, if any	853	853

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

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%	Equity capital markets, corporate finance and institutional brokerage
Standard Chartered Leasing Group Limited	Hong Kong	30,000 ordinary shares	100%	Provision of leasing services

20 Interest in associates

	2015 HK$'M	*2014 HK$'M*
Share of net assets	9,206	8,376
Goodwill	1,717	1,717
Less: Impairment provision	(1,442)	(1,085)
	9,481	9,008

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

20 Interest in associates (continued)

The following list contains only the particulars of material associates:

Name of associate	*Place of establishment and operation*	*Particulars of issued and paid up capital*	*Proportion of ownership interest*	*Principal activity*
Asia Commercial Joint Stock Bank ("ACB")	Vietnam	937,696,506 ordinary shares of VND10,000 each	15%	Provision of banking and related financial services (Note 1)
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 2)

Note 1: ACB is a strategic partner for the Group, providing investment opportunities and access to the Vietnam market.

Note 2: Bohai is a strategic partner for the Group to develop its China business.

Shareholdings in associated companies include a listed investment of HK$967 million (2014: HK$1,351 million). At the reporting date, the investment based on quoted market prices was valued at HK$961 million (2014: HK$785 million). Impairment testing on the investment has been carried out using a value-in-use methodology and this demonstrates that the recoverable amount of the investment was HK$967 million and an additional impairment charge of HK$357 million was recorded in 2015.

The Bank and its subsidiaries' investments in ACB and Bohai are less than 20% but both companies are considered to be associates because of the significant influence the Bank is able to exercise over the management of these companies and their financial and operating policies. Significant influence is evidenced largely through the interchange of management personnel and the provision of expertise.

In respect of the year ended 31 December 2015, the share of the results of ACB was included in these financial statements based on accounts drawn up to 30 September 2015, but taking into account any events or transactions in the subsequent period from 1 October 2015 to 31 December 2015 that would materially affect the results. Bohai's result was included in the financial statements based on accounts drawn up to 30 November 2015. The Bank and its subsidiaries have 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.

Both of the above associates are accounted for using the equity method in the consolidated financial statements.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

20 Interest in associates (continued)

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

	2015 ACB HK$'M	2015 Bohai HK$'M	2014 ACB HK$'M	2014 Bohai HK$'M
Gross amounts of the associates				
Assets	66,572	959,690	64,979	826,655
Liabilities	(62,220)	(917,098)	(60,447)	(788,351)
Net assets	4,352	42,592	4,532	38,304
Operating income	2,353	23,012	2,003	19,413
Profit after taxation	341	6,677	198	6,863
Other comprehensive income	–	67	–	597
Total comprehensive income	341	6,744	198	7,460
Dividends received from the associate	35	–	36	–
Gross amount of net assets of the associate	4,352	42,592	4,532	38,304
Effective interest of the Bank and its subsidiaries	15%	19.99%	15%	19.99%
Share of net assets of the associate attributable to the Bank and its subsidiaries	653	8,514	680	7,657
Fair value adjustment on acquisition	39	–	39	–
Goodwill	1,717	–	1,717	–
Less: Impairment provision	(1,442)	–	(1,085)	–
Carrying amount in the consolidated financial statements	967	8,514	1,351	7,657

Reconciliation to the Bank and its subsidiaries' total interest in associates:

	2015 HK$'M	2014 HK$'M
Carrying amount of material associates		
- ACB	967	1,351
- Bohai	8,514	7,657
Interest in associates in the consolidated financial statements	9,481	9,008

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

21 Property, plant and equipment

	2015					
	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 2015	2,921	518	39,116	42,555	934	43,489
Additions	23	37	6,837	6,897	–	6,897
Transferred to asset classified as asset held for sale	–	–	(2,049)	(2,049)	–	(2,049)
Disposals and write-offs	(41)	(97)	(5,796)	(5,934)	–	(5,934)
Reclassifications	(25)	25	–	–	–	–
Fair value adjustments (note 4(f))	–	–	–	–	3	3
At 31 December 2015	2,878	483	38,108	41,469	937	42,406
Representing:						
Cost	2,878	483	38,108	41,469	–	41,469
Valuation	–	–	–	–	937	937
	2,878	483	38,108	41,469	937	42,406
Accumulated depreciation:						
At 1 January 2015	721	255	2,563	3,539	–	3,539
Charge for the period (note 4(g))	91	88	1,538	1,717	–	1,717
Impairments (note 6(b))	64	17	52	133	–	133
Transferred to asset classified as asset held for sale	–	–	(129)	(129)	–	(129)
Attributable to assets sold or written off	(39)	(97)	(198)	(334)	–	(334)
At 31 December 2015	837	263	3,826	4,926	–	4,926
Net book value:						
At 31 December 2015	2,041	220	34,282	36,543	937	37,480

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

21 Property, plant and equipment (continued)

	2014					
	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 2014	2,977	505	26,884	30,366	638	31,004
Additions	88	61	15,246	15,395	–	15,395
Transferred to asset classified as asset held for sale	(53)	(7)	–	(60)	(10)	(70)
Disposals and write-offs	(56)	(76)	(3,014)	(3,146)	–	(3,146)
Reclassifications	(35)	35	–	–	–	–
Fair value adjustments (note 4(f))	–	–	–	–	306	306
At 31 December 2014	2,921	518	39,116	42,555	934	43,489
Representing:						
Cost	2,921	518	39,116	42,555	–	42,555
Valuation	–	–	–	–	934	934
	2,921	518	39,116	42,555	934	43,489
Accumulated depreciation:						
At 1 January 2014	676	238	1,517	2,431	–	2,431
Charge for the period (note 4(g))	111	97	1,214	1,422	–	1,422
Transferred to asset classified as asset held for sale	(10)	(4)	–	(14)	–	(14)
Attributable to assets sold or written off	(56)	(76)	(168)	(300)	–	(300)
At 31 December 2014	721	255	2,563	3,539	–	3,539
Net book value:						
At 31 December 2014	2,200	263	36,553	39,016	934	39,950

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

21 Property, plant and equipment (continued)

(a) Buildings and leasehold land held for own use

	2015 *HK$'M*	*2014* *HK$'M*
Leasehold in Hong Kong, at cost		
– medium-term leases	1,847	1,935
– short-term leases	83	82
	1,930	2,017
Freehold outside Hong Kong, at cost	111	183
	2,041	2,200

(b) Investment properties

	2015 *HK$'M*	*2014* *HK$'M*
Freehold outside Hong Kong, at fair value	937	934

The investment property outside Hong Kong was revalued as at 31 December 2015 on an open market value basis. The valuation was carried out by an independent firm, CBRE 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.

These fair values are categorised as level 2 valuations 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:

	2015 *HK$'M*	*2014* *HK$'M*
Within 1 year	3,730	3,664
After 1 year but within 5 years	13,779	11,855
After 5 years	10,814	15,850
	28,323	31,369

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

22 Goodwill and intangible assets

	2015		
	Capitalised software and other intangible assets HK$'M	*Goodwill HK$'M*	*Total HK$'M*
Cost:			
At 1 January 2015	668	729	1,397
Additions	80	–	80
Disposals and write-offs	(63)	–	(63)
At 31 December 2015	685	729	1,414
Accumulated amortisation:			
At 1 January 2015	281	–	281
Charge for the year (note 4(g))	121	–	121
Attributable to intangible assets sold or written off	(63)	–	(63)
At 31 December 2015	339	–	339
Carrying amount:			
At 31 December 2015	346	729	1,075

	2014		
	Capitalised software and other intangible assets HK$'M	*Goodwill HK$'M*	*Total HK$'M*
Cost:			
At 1 January 2014	702	1,507	2,209
Additions	111	–	111
Transferred to as asset held for sale	(14)	(525)	(539)
Disposals and write-offs	(131)	(253)	(384)
At 31 December 2014	668	729	1,397
Accumulated amortisation:			
At 1 January 2014	276	–	276
Charge for the year (note 4(g))	112	–	112
Transferred to asset held for sale	(14)	–	(14)
Attributable to intangible assets sold or written off	(93)	–	(93)
At 31 December 2014	281	–	281
Carrying amount:			
At 31 December 2014	387	729	1,116

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

22 Goodwill and intangible assets (continued)

Impairment tests for cash-generating units containing goodwill

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

	2015 HK$'M	2014 HK$'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 year and are extrapolated forward using steady growth rates of 3.0 per cent (2014: 3.9 per cent).

In assessing impairment of goodwill, the Bank and its subsidiaries assumed growth at a steady rate in line with long-term forecast GDP growth. A discount rate of 14.1 per cent (2014: 15.1 per cent) was used.

23 Other assets

	2015 HK$'M	2014 HK$'M
Prepayments and accrued income	2,631	2,230
Sundry debtors	2,642	1,667
Acceptances and endorsements	2,588	2,843
Unsettled trades and others	2,568	4,432
Assets held for sale (note)	1,920	13,217
	12,349	24,389

(note) Assets held for sale as of 31 December 2015 included commercial aircraft and vessels held for sale. Assets held for sale as of 31 December 2014 included the disposal group which consists of Prime Credit Limited and Shenzhen Prime Credit Limited. The assets and liabilities of the disposal group are summarised in note 46.

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

24 Deposits from customers

	2015 HK$'M	2014 HK$'M
Current accounts	158,967	142,839
Savings accounts	432,975	410,954
Time, call and notice deposits	144,672	261,688
Deposits and balances of central banks	9,087	35,548
	745,701	851,029

25 Debt securities in issue

	2015 HK$'M	2014 HK$'M
Certificates of deposit	–	13,838
Other debt securities	1,209	–
	1,209	13,838

26 Financial liabilities designated at fair value

	2015 HK$'M	2014 HK$'M
Structured deposits from banks and customers	6,542	7,528
Debt securities issued	7,182	7,387
	13,724	14,915

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

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

– are exposed to 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 2015, the contractual amount payable at maturity of these financial liabilities exceeded the carrying amount by HK$1,328 million (2014: HK$594 million). Of this, the cumulative fair value movement relating to changes in credit risk was a gain of HK$1,112 million (2014: HK$725 million). The amount of fair value movement relating to changes in credit risk recognised in the income statement during the year was HK$387 million (2014: HK$723 million).

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

27 Taxation in the statement of financial position

Deferred tax assets and liabilities:

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

	Depreciation allowances in excess of related depreciation HK$'M	*Impairment losses on financial assets HK$'M*	*Available-for-sale securities HK$'M*	*Others HK$'M*	*Total HK$'M*
			2015		
Deferred tax arising from:					
At 1 January 2015	688	(59)	37	(595)	71
Charge/(release) to income statement (note 7(a))	200	(75)	–	(134)	(9)
Release to reserves	–	–	(72)	(30)	(102)
At 31 December 2015	888	(134)	(35)	(759)	(40)
			2014		
At 1 January 2014	452	(110)	24	(529)	(163)
Charge/(release) to income statement (note 7(a))	235	25	–	(85)	175
Charge to reserves	–	–	13	19	32
Transfer to assets held for sale	1	26	–	–	27
At 31 December 2014	688	(59)	37	(595)	71

	2015 HK$'M	*2014 HK$'M*
Analysed by:		
Net deferred tax asset recognised on the statement of financial position	(314)	(141)
Net deferred tax liability recognised on the statement of financial position	274	212
	(40)	71

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

28 Trading liabilities

	2015 HK$'M	2014 HK$'M
Short positions in securities	8,476	11,995
Negative fair values of trading derivatives	371	805
	8,847	12,800

29 Other liabilities

	2015 HK$'M	2014 HK$'M
Accruals and deferred income	3,340	4,009
Provision for liabilities and charges	314	311
Acceptances and endorsements	2,588	2,843
Unsettled trades and others	9,003	10,417
Liabilities held for sale (note)	–	2,002
	15,245	19,582

(note) Liabilities held for sale include the disposal group which consists of Prime Credit Limited and Shenzhen Prime Credit Limited. The assets and liabilities of the disposal group is summarised in note 46.

30 Employee retirement benefits

The Bank 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 Bank 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 Bank to interest rate risk, investment risk and salary risk.

The Bank'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 2014.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

30 Employee retirement benefits (continued)

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

	2015 HK$'M	2014 HK$'M
Fair value of plan assets	1,970	2,173
Present value of wholly or partly funded obligations	(2,226)	(2,229)
Net liability recognised in the statement of financial position (included in "Other liabilities")	(256)	(56)

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

	2015 Assets HK$'M	 Obligations HK$'M	 Total HK$'M
At 1 January 2015	2,173	(2,229)	(56)
Contributions	40	–	40
Benefits paid	(244)	244	–
Current service cost	–	(98)	(98)
Net interest income/(cost)	36	(36)	–
Administrative expenses	(1)	–	(1)
Return on plan assets, excluding amounts included in interest income	(34)	–	(34)
Actuarial loss – from experience	–	(58)	(58)
Actuarial loss – from financial assumptions	–	(49)	(49)
At 31 December 2015	1,970	(2,226)	(256)

	2014 Assets HK$'M	 Obligations HK$'M	 Total HK$'M
At 1 January 2014	2,203	(2,225)	(22)
Contributions	58	–	58
Benefits paid	(188)	188	–
Current service cost	–	(101)	(101)
Net interest income/(cost)	43	(42)	1
Administrative expenses	(1)	–	(1)
Return on plan assets, excluding amounts included in interest income	58	–	58
Actuarial loss – from experience	–	(11)	(11)
Actuarial loss – from financial assumptions	–	(38)	(38)
At 31 December 2014	2,173	(2,229)	(56)

The weighted average duration of the defined benefit obligation as at 31 December 2015 is 5 years (2014: 6 years).

The Bank expects to contribute approximately HK$30 million to the Scheme in 2016.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

30 Employee retirement benefits (continued)

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

	2015 HK$'M	*2014 HK$'M*
Current service cost	98	101
Net interest income	–	(1)
Administrative expenses	1	1
	99	101

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

	2015 HK$'M	*2014 HK$'M*
Discount rate	1.30%	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$31 million (2014: HK$32 million).

- if the rate of growth of salaries was higher by 25 basis points the obligation would increase by approximately HK$29 million (2014: HK$30 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

	2015 HK$'M	*2014 HK$'M*
Equities	59%	59%
Bonds	37%	35%
Cash	4%	6%
	100%	100%

As at 31 December 2015, the Scheme did not invest in the Bank's own financial instruments and properties (2014: Nil). The Scheme has a benchmark asset allocation of 60% in equities and 40% in bonds and cash (2014: 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 Bank.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

31 Subordinated liabilities

	2015 HK$'M	2014 HK$'M
US$750 million 5.875% Fixed Rate Notes 2020 (note 1)	6,191	6,213
SGD750 million 4.15% Fixed Rate Notes 2021 (note 2)	3,902	4,193
	10,093	10,406

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

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

(note 2) Interest rate at 4.15 per cent per annum, payable semi-annually, to the maturity date on 27 October 2021.

32 Share capital

	2015		2014	
	No. of share	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

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 amounted to HK$12,477 million was originated from class 'A' and class 'B' ordinary shares, and the capital redemption reserve amounted 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.

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.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

32 Share capital (continued)

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.

33 Reserves

Nature and purpose of reserves

(i) Share premium and capital redemption reserve

Prior to 3 March 2014, the application of the share premium account and the capital redemption reserve was governed by sections 48B and 49H respectively of the former Hong Kong Companies Ordinance (Cap. 32). In accordance with the transitional provisions set out in section 37 of Schedule 11 to the new Hong Kong Companies Ordinance (Cap. 622), on 3 March 2014 any amount standing to the credit of the share premium account and the capital redemption reserve has become part of the Bank's share capital (see note 32). The use of share capital from 3 March 2014 is governed by the new Hong Kong Companies Ordinance (Cap. 622).

(ii) Available-for-sale investment reserve

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

(iii) 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).

(iv) Exchange reserve

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

(v) Revaluation reserve

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

(vi) Share option equity reserve

The Group operates equity-settled share-based compensation plans in which the Bank and its subsidiaries' 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.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

33 Reserves (continued)

Nature and purpose of reserves (continued)

(vii) Property revaluation reserve

The property revaluation reserve represents the revaluation surplus arising upon the reclassification of a property previously included in "Buildings and leasehold land held for own use" to "investment properties".

The HKMA requires the Bank and its subsidiaries to maintain a minimum level of impairment allowances which is in excess of the impairment allowances required under Hong Kong Financial Reporting Standards. Of the retained earnings as at 31 December 2015, an amount of HK$5,428 million (2014: HK$6,501 million) has been reserved for this purpose.

34 Cash and cash equivalents

	2015 *HK$'M*	*2014* *HK$'M*
(a) Components of cash and cash equivalents in the cash flow statement		
Cash and balances with banks, central banks and other financial institutions	48,769	53,076
Trading assets with original maturity within three months	1,120	2,501
Placements with banks and other financial institutions with original maturity within three months	42,925	81,149
Investment securities with original maturity within three months	60,346	35,325
Amounts due from immediate holding company and fellow subsidiaries with original maturity within three months	10,824	64,071
Add: Cash and balances with banks, central banks and other financial insititutions included in "Assets held for sale"	–	125
Less: Overdrafts included in "deposits and balances of banks and other financial institutions	(3)	–
Less: Overdrafts included in "amounts due to immediate holding company"	(1,121)	(3,397)
	162,860	232,850

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

34 Cash and cash equivalents (continued)

	2015 HK$'M	2014 HK$'M
(b) Reconciliation with the consolidated statement of financial position		
Cash and balances with banks, central banks, and other financial institutions	48,769	53,076
Trading assets	18,597	23,388
Placements with banks and other financial institutions	119,658	145,770
Investment securities	210,572	172,302
Amounts due from immediate holding company and fellow subsidiaries	46,462	116,324
Cash and balances with banks, central banks, and other financial institutions included in "Assets held for sale"	–	125
Overdrafts included in "deposits and balances of banks and other financial institutions"	(3)	–
Overdrafts included in "amounts due to immediate holding company"	(1,121)	(3,397)
Amounts shown in the statement of financial position	442,934	507,588
Less: amounts with an original maturity of beyond three months	(280,074)	(274,738)
Cash and cash equivalents in the consolidated cash flow statement	162,860	232,850

35 Derivative financial instruments

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

(a) Notional amounts of derivatives

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Derivative financial instruments (continued)

(a) Notional amounts of derivatives (continued)

The following is a summary of the notional amounts of each significant type of derivative entered into by the Bank and its subsidiaries:

	2015			
	Qualifying for hedge accounting HK$'M	Managed in conjunction with financial instruments designated at fair value through profit or loss HK$'M	Others, including held for trading HK$'M	Total HK$'M
Exchange rate contracts				
Forwards	630	–	1,646,789	1,647,419
Cross currency swaps	39,252	2,224	12,944	54,420
Options purchased	–	2,661	–	2,661
Options written	–	4	4,317	4,321
Interest rate contracts				
Swaps	97,206	1,744	38,706	137,656
Options purchased	–	143	276	419
Options written	–	4,983	–	4,983
Other derivatives	–	6,710	6,074	12,784
	137,088	18,469	1,709,106	1,864,663

	2014			
Exchange rate contracts				
Forwards	202	–	1,359,821	1,360,023
Cross currency swaps	26,365	3,282	19,331	48,978
Options purchased	–	289	402	691
Options written	–	19	4,187	4,206
Interest rate contracts				
Swaps	67,336	2,225	38,381	107,942
Options purchased	–	166	448	614
Options written	–	3,897	2,182	6,079
Other derivatives	–	4,172	5,821	9,993
	93,903	14,050	1,430,573	1,538,526

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Derivative financial instruments (continued)

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

	2015			2014		
	Fair value assets HK$'M	Fair value liabilities HK$'M	Credit risk weighted amount (note) HK$'M	Fair value assets HK$'M	Fair value liabilities HK$'M	Credit risk weighted amount HK$'M
Exchange rate contracts	14,931	14,749	3,801	5,153	5,495	5,813
Interest rate contracts	2,170	2,600	701	1,430	1,889	7,347
Other derivatives	308	209	463	187	198	331
	17,409	17,558	4,965	6,770	7,582	13,491

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

(note) The credit risk weighted amounts have taken into account the bilateral netting arrangements since 2015.

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

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

	2015	
	Assets (Included in Amounts due from immediate holding company and fellow subsidiaries) HK$'M	Liabilities (Included in Amounts due to immediate holding company and fellow subsidiaries) HK$'M
Exchange rate contracts	826	944
Interest rate contracts	480	838
	1,306	1,782

	2014	
	Assets (Included in Other assets and Amounts due from immediate holding company and fellow subsidiaries) HK$'M	Liabilities (Included in Amounts due to immediate holding company and fellow subsidiaries) HK$'M
Exchange rate contracts	444	307
Interest rate contracts	492	889
	936	1,196

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Derivative financial instruments (continued)

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

Fair value hedges

The fair value hedges principally consist of interest rate swaps and cross currency swaps. The interest rate swaps are used to protect against changes in the fair value of certain fixed rate assets and liabilities due to movements in market interest rates. The cross currency swaps are used to manage foreign exchange exposures. At 31 December 2015, the net negative fair value of derivatives held as fair value hedges was HK$495 million (2014: negative HK$417 million) comprising assets of HK$1,261 million (2014: HK$752 million) and liabilities of HK$1,756 million (2014: HK$1,169 million). The losses on the hedging instruments for the year were HK$272 million (2014: losses of HK$615 million). The gains on the hedged item attributable to the hedged risk were HK$233 million (2014: gains of HK$568 million).

Cash flow hedges

The cash flow hedges principally consist of interest rate swaps and cross currency swaps that are used to hedge against the variability in cash flows of certain floating rate assets and liabilities. At 31 December 2015, the net positive fair value of derivatives held as cash flow hedges was HK$19 million (2014: positive HK$157 million) comprising assets of HK$45 million (2014: HK$184 million) and liabilities of HK$26 million (2014: HK$27 million). During the year, there was no ineffectiveness recognised in the income statement that arose from cash flow hedges (2014: Nil).

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

	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$'M*	*Total HK$'M*
			2015			
Forecast receivable cash flows	129	72	6	–	68	275
Forecast payable cash flows	(14)	(26)	(24)	(6)	–	(70)
	115	46	(18)	(6)	68	205
			2014			
Forecast receivable cash flows	156	132	34	6	–	328
Forecast payable cash flows	(18)	(34)	(52)	(32)	(5)	(141)
	138	98	(18)	(26)	(5)	187

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

36 Contingent liabilities and commitments

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

	2015 HK$'M	2014 HK$'M
Direct credit substitutes	7,288	5,262
Transaction-related contingencies	6,259	5,519
Trade-related contingencies	13,124	17,265
Forward asset purchases	105	289
Forward forward deposits placed	358	3,877
Other commitments:		
which are not unconditionally cancellable:		
with original maturity of not more than one year	1,761	6,982
with original maturity of more than one year	15,726	17,822
which are unconditionally cancellable	339,269	391,520
	383,890	448,536
Credit risk weighted amount	38,333	40,839

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 financial statements were as follows:

	2015 HK$'M	2014 HK$'M
Contracted for	5	50
Authorised but not contracted for	4	55
	9	105

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

36 Contingent liabilities and commitments (continued)

(c) Lease commitments

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

	2015	*2014*
	HK$'M	*HK$'M*
Within 1 year	845	821
After 1 year but within 5 years	1,882	1,727
After 5 years	643	1,067
	3,370	3,615

During the year, HK$1,031 million (2014: HK$966 million) was recognised as an expense in the income statement in respect of operating leases. The Bank and its subsidiaries lease various premises and equipment under non-cancellable operating lease agreements.

(d) Contingencies

The Bank and its subsidiaries receive legal claims against it arising in the normal course of business. The Bank and its subsidiaries consider none of these matters as material. Where appropriate the Bank and its subsidiaries recognise 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.

37 Risk management

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

Risk management framework

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

Through its Risk Management Framework ("RMF") the Bank manages enterprise-wide risks, with the objective of maximising risk-adjusted returns while remaining within its risk tolerance.

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

Balancing risk and return

- We manage our risks to build a sustainable franchise, in the interests of all our stakeholders
- We only take risk within our risk tolerances and risk appetite, and where consistent with our approved strategy
- We manage our risk profile to maintain a low probability of an unexpected loss event that would materially undermine the confidence of our investors

Conduct of business

- We demonstrate we are Here for Good through our conduct, and are mindful of the reputational consequences of inappropriate conduct
- We seek to achieve good outcomes for clients, investors, and the markets in which we operate, while abiding by the spirit and letter of laws and regulations
- We treat our colleagues fairly and with respect

Responsibility and Accountability

- We take individual responsibility to ensure risk-taking is disciplined and focused, particularly within our area of authority
- We make sure risk taking is transparent, controlled and reported in line with the risk management framework, within risk appetite and risk tolerance boundaries, and only where there is appropriate infrastructure and resource

Anticipation

- We seek to anticipate material future risks, learn lessons from events that have produced adverse outcomes and ensure awareness of known risks

Competitive advantage

- We seek to achieve competitive advantage through efficient and effective risk management and control

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

Risk governance

Ultimate responsibility for setting risk tolerance boundaries and for the effective management of risk rests with the Board.

Acting within an authority delegated by the Board, the Board's Audit and Risk Committee ("BARC"), whose membership is comprised exclusively of non-executive directors, has responsibility for oversight and review of prudential risks including but not limited to credit, market, capital, liquidity and operational risks. It reviews the Bank's overall risk tolerance statement and makes recommendations thereon to the Board.

Acting within an authority delegated by the Board via the Executive Committee ("ExCo"), the Bank's Executive Risk Committee ("ERC") is responsible for the management of all risks other than those delegated to the Asset and Liability Committee ("ALCO") and the Country Pensions Committee ("CPC"). The ERC is responsible for the establishment of, and compliance with policies relating to credit risk, country cross-border risk, market risk, operational risk and reputational risk. The ERC also defines the overall risk management framework.

The ALCO is responsible for the management of capital and the establishment of, and compliance with, policies relating to balance sheet management, including management of our liquidity, capital adequacy and structural foreign exchange and interest rate risk. The CPC is responsible for the management of Pensions Risk.

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

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.

- First line of defence: all employees are required to ensure the effective management of risks within the scope of their direct organisational responsibilities. Business, function and geographic governance heads are accountable for risk management in their respective businesses and functions, and for countries where they have governance responsibilities.

- Second line of defence: this comprises the Risk Control Owners, supported by their respective control functions. Risk Control Owners are responsible for ensuring that the risks within the scope of their responsibilities remain within appetite. The scope of a Risk Control Owner's responsibilities is defined by a given Risk Type and the risk management processes that relate to that Risk Type. These responsibilities cut across the Bank and are not constrained by functional and business boundaries. The major risk types are described individually in the following sections.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

Risk governance (continued)

- Third line of defence: the independent assurance provided by the Internal Audit ("IA") function. Its role is defined and overseen by the BARC.

  — The findings from IA's audits are reported to all relevant management and governance bodies, accountable line managers, relevant oversight function or committee and committees of the Board.

  — IA provides independent assurance of the effectiveness of management's control of its own business activities (the first line) and of the processes maintained by the Risk Control Functions (the second line). As a result, IA provides assurance that the overall system of control effectiveness is working as required within the RMF.

The Risk function

The Country Chief Risk Officer ("CCRO") directly manages a Risk function that is separate from and independent of the origination, trading and sales functions of the businesses. The CCRO chairs the ERC and is a member of ExCo.

The role of the Risk function is:

- To maintain the RMF, ensuring it remains appropriate to the Bank's activities, is effectively communicated and implemented across the Bank and to administer related governance and reporting processes.

- To uphold the overall integrity of the Bank's risk/return decisions, and in particular ensure that risks are properly assessed, that risk/return decisions are made transparently on the basis of this proper assessment, and are controlled in accordance with the Bank's standards and risk appetite.

- To exercise direct Risk Control Ownership for Credit, Market, Country Cross-Border, Short-term Liquidity and Operational 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. This is particularly important given that revenues are recognised from the point of sale, while losses arising from risk positions typically manifest themselves over time.

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

Risk tolerance and appetite

The Bank manages risks to build a sustainable franchise in the interests of all our stakeholders.

There are three sets of constraints which determine the risks that the Bank is willing to take in pursuit of its strategy:

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

Risk tolerance and appetite (continued)

- Risk capacity defines externally imposed constraints within which the Bank must operate. It is the maximum level of risk the Bank can assume, given its current capabilities and resources, before breaching constraints determined by regulatory capital and liquidity requirements, or otherwise failing to meet the expectations of regulators and law enforcement agencies

- Risk tolerance is the boundary defined by the Board that determines the maximum level of risk the Bank is ordinarily willing to take in pursuit of its strategy, in accordance with its risk principles and recognizing that the Bank is a key part of the wider Standard Chartered Bank Group. Risk tolerance must constrain risk to the levels where the potential for any financial or reputational damage is consistent with the sustained pursuit of strategy and in line with the reasonable expectations of stakeholders. Risk tolerance cannot exceed risk capacity

- Risk appetite is the amount of risk that the Bank regards as optimal in order to generate returns, taking account of current and reasonably foreseeable external market conditions. Risk appetite cannot exceed risk tolerance

The Bank's risk profile is the 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 Bank's risk profile within risk appetite (and therefore also risk tolerance and risk capacity).

The Board has approved a Risk Tolerance Statement, which is underpinned by a set of financial and operational control parameters, known as risk tolerances. These risk tolerances directly constrain the aggregate risk exposures that can be taken across the Bank.

The Bank's Risk Tolerance Statement, and the related risk tolerance categories approved by the Board, are as follows:

- General: the Bank will not compromise adherence to its risk tolerances in order to pursue revenue growth or higher returns

- Credit and country cross-border: the Bank manages its credit and country cross-border exposures, so that all concentrations are appropriate to the prevailing economic and political environment, are actively managed and do not threaten adherence to its risk tolerance

- Capital and earnings volatility: under stressed conditions, of a severity experienced on average once in 25 years, the Bank's prudential capital ratios on a transitional basis should exceed minimum regulatory capital requirements, without recourse to external sources (including the Group)

- Market risk: the Bank should control its trading portfolio and activities to ensure that market risk losses (financial or reputational) do not cause material damage to the Bank's franchise or the Group franchise

- Liquidity risk: the Bank should be able to meet its payment and collateral obligations under extreme but plausible liquidity stress scenarios without recourse to extraordinary central bank support

- Operational risk: the Bank aims to control operational risks to ensure that operational losses (financial or reputational), including any related to conduct of business matters, do not cause material damage to the Bank's franchise or the Group franchise.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

Risk tolerance and appetite (continued)

- Reputational risk: the Bank will protect its reputation to ensure that there is no material damage to the Bank's franchise or the Group franchise

The ERC and ALCO are responsible for ensuring that the Bank's risk profile is managed in compliance with the risk tolerances set by the Board.

Stress testing

Stress testing and scenario analysis are used to assess the ability of the Bank to continue operating effectively under extreme but macro-financial conditions.

The Bank's stress testing framework is designed to:

- Contribute to the setting and monitoring of risk tolerance limits
- Identify key risks to capital and liquidity position, strategy, franchise, and reputation
- Support the development of strategic management actions and contingency plans including business continuity, to ensure the Bank can recover from extreme but plausible conditions
- Meet regulatory requirements.

The Bank's stress testing activity focuses on the potential impact of macro-financial, geo-political and physical events on relevant geographies, client segments and risk types.

(a) Credit risk

Credit risk is the potential for loss due to the failure of a counterparty to meet its obligations to pay 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. There is a clear segregation of duties between transaction originators in the businesses and the approvers in the Risk function. All credit exposure limits are approved within a defined credit approval authority framework.

Group-wide credit policies and standards are considered and approved by the Group Risk Committee ("GRC"), which also oversees the delegation of credit approval and loan impairment provisioning authorities. These policies set key control standards on credit origination and credit risk assessment, concentration risk and large exposures, credit risk mitigation, credit monitoring, collection and recovery management. In addition, there are other Group-wide policies integral to credit risk management such as 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, risk limits and risk exposure delegated approval authority frameworks. 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.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(a) Credit risk (continued)

Credit rating and measurement

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

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

A standard alphanumeric credit risk-grade ("CG") system for Corporate & Institutional Clients and Commercial Clients used. The numeric grades run from 1 to 14 and some of the grades are further sub-classified. Lower credit grades are indicative of a lower likelihood of default. Credit grades 1 to 12 are assigned to performing customers or accounts, while credit grades 13 and 14 are assigned to non-performing or defaulted customers. For Retail Clients IRB portfolios, the Bank uses 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 CGs are not intended to replicate external credit grades (where these are available) and ratings assigned by external ratings agencies are not used in determining the Bank's internal credit grades. Nonetheless, as the factors used to grade a borrower may be similar, a borrower rated poorly by an external rating agency is typically assigned a worse internal credit grade.

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

IRB risk measurement models are approved by the ERC, on the recommendation of the Group Model Assessment Committee ("MAC") and the Bank's Model Assessment Forum ("MAF"). The Bank's MAF supports the ERC in ensuring risk identification and measurement capabilities are objective and consistent, so that risk control and risk origination decisions are properly informed. Prior to review by the 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 periodic review. Reviews are also triggered if the performance of a model deteriorates materially against predetermined thresholds during the ongoing model performance monitoring process.

Credit Approval

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(a) Credit risk (continued)

Credit concentration risk

Credit concentration risk is managed within concentration caps set by counterparty or groups of connected counterparties, by country and industry in Corporate & Institutional Clients and Commercial Clients; and tracked by product in Retail Clients. Additional targets are set and monitored for concentrations by credit rating.

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

Credit monitoring

The Bank and its subsidiaries regularly monitor credit exposures, portfolio performance, and external trends that may impact risk management outcomes.

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

The Bank's Credit Issues Committee ("CIC") meets regularly to assess the impact of external events and trends on the Corporate & Institutional Clients and Commercial Clients credit risk portfolio and to define and implement the Bank'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, a financial deterioration, a 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. This is to maintain an effective oversight over the existing Early Alert portfolio. Client account plans and credit grades are re-evaluated and 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 Bank's specialist recovery unit.

The Retail Clients 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.

In Retail Clients, portfolio performance and delinquency trends are monitored continuously at various detailed segment levels. Individual customer behaviour is also tracked and considered for lending decisions. Accounts that are past due are subject to collections processes, managed independently by the Risk function. Charged-off accounts are managed by a specialist recovery team.

The Business Clients segment is managed within Retail Clients. The credit processes are managed through Programmed Lending, in line with Retail Clients procedures with specific controls and limits designed for Business Clients lending.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(a) Credit risk (continued)

Credit mitigation

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 other guarantees. The reliance that can be placed on these mitigants is carefully assessed in light of issues such as legal certainty and enforceability, market value and counterparty risk of the guarantor.

Collateral is held to mitigate credit risk exposures. Where appropriate, credit derivatives are used to reduce credit risks in the portfolio. Due to their potential impact on income volatility, such derivatives are used in a controlled manner with reference to their expected volatility.

Risk mitigation policies determine the key consideration for eligibility, enforceability and effectiveness of credit risk mitigation arrangements. Collateral types which are eligible for risk mitigation include: cash; residential, commercial and industrial property; property, plant and equipment such as motor vehicles, aircraft, plant and machinery; marketable securities; commodities; bank guarantees; and letters of credit.

Collateral is valued in accordance with the Bank's risk mitigation policy, which prescribes the frequency of valuation for different collateral types. The valuation frequency is driven by the level of price volatility of each type of collateral and the nature of the underlying product or risk exposure.

In Corporate & Institutional Clients and Commercial Clients, the effectiveness of credit mitigation is ensured by policies which govern eligibility criteria such as monitoring of concentration of collateral, correlation of the collateral to underlying assets, adjustments for currency fluctuations for collateral. For all credit risk mitigation that meets the policy criteria, a clear set of procedures are applied to ensure that the value of the underlying collateral is appropriately recorded and updated regularly.

In Retail Clients, effective use of collateral is a key tool by which credit risk is mitigated. All eligible collateral accepted by Retail Clients is covered by a product proposal approved by senior credit officers delegated with the relevant authority. New collateral types have to be vetted through a stringent 'New Business Approval' process and are approved in accordance with the delegated authorities within Retail Clients Risk Committee. In order to be recognised as security and for the loan to be classified as secured, all items pledged must be valued and an active secondary resale market must exist for the collateral. Documentation must be held to enable Retail Clients to realise the asset without the cooperation of the asset owner in the event that this is necessary.

Detailed procedures over collateral management are in place for each business.

Traded Products

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

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

For derivative contracts, the Bank limits its exposure to credit losses in the event of default by entering into master netting agreements with certain counterparties. As required by HKAS 32/IAS 32, exposures are presented on a gross basis in the financial statements as such transactions are not intended to be settled net in the ordinary course of business.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(a) Credit risk (continued)

Traded Products (continued)

In addition, the Bank enters into Credit Support Annexes ("CSA") with counterparties where collateral is deemed a necessary or desirable mitigant to the exposure. Under a variation margin process, additional collateral is called from the counterparty if total uncollateralised mark-to-market exposure exceeds the threshold and minimum transfer amount specified in the CSA. With certain counterparties, the CSA is reciprocal and requires the Bank to post collateral if the overall mark-to-market value of positions is in the counterparty's favour and exceeds an agreed threshold.

Securities

Within Corporate & Institutional Clients and Commercial Clients, the Group's Underwriting Committee ("UC") (as approved by the Bank's Board) approves the portfolio limits and parameters for the underwriting and purchase of all pre-defined securities assets to be held for sale. The UC is established under the authority of the Board and under advice of the Group. Corporate & Institutional Clients and Commercial Clients 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 Traded Credit Risk Management whose activities include oversight and approval within the levels delegated by the UC. Issuer credit risk, including settlement and pre-settlement risk, is controlled by Corporate & Institutional Clients and Commercial Clients Risk, while price risk is controlled by Market and Traded Credit Risk function ("MTCR").

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

Maximum exposure to credit risk

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

	2015 *HK$'M*	*2014* *HK$'M*
Financial guarantees and other credit related contingent liabilities	26,671	28,046
Loan commitments and other credit related commitments	17,950	28,970
	44,621	57,016

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(a) Credit risk (continued)

(i) Loans and advances

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

Loans neither past due nor impaired

At 31 December 2015, the Bank and its subsidiaries have HK$214,572 million (2014: HK$195,366 million) of mortgage loans in Retail Clients that are neither past due nor impaired. These are generally fully secured exposures (2014: fully secured).

In Corporate & Institutional Clients and Commercial Clients, the Bank and its subsidiaries have HK$141,857 million (2014: HK$196,678 million) of corporate exposures that are neither past due nor impaired. Based on the fair value of the collateral held, 28% (2014: 25%) of these exposures are secured by tangible collateral.

The Bank and its subsidiaries also undertake collateralised lending and borrowing (reverse repos and repos) arrangements, and the collateral held against these types of loans are set out in note 39 to the financial statements.

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

Loans past due or impaired

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

	2015		2014	
	Advances to customers HK$'M	Advances to banks HK$'M	Advances to customers HK$'M	Advances to banks HK$'M
Estimated fair value of collateral (Note):				
Held against impaired advances	1,452	–	725	–
Held against past due but not impaired advances	1,399	–	2,570	–

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(a) Credit risk (continued)

(i) Loans and advances (continued)

Loans past due or impaired (continued)

(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.

Repossessed Collateral

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

	2015 *HK$'M*	*2014* *HK$'M*
Property, plant and equipment	185	229

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 Bank and its subsidiaries.

(ii) Off-balance sheet exposures

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(a) Credit risk (continued)

Credit quality

(i) Analysis of the loan portfolio

	2015		2014	
	Advances to customers HK$'M	*Advances to banks HK$'M*	*Advances to customers HK$'M*	*Advances to banks HK$'M*
Loans and advances				
– neither past due nor impaired	411,174	119,653	450,427	145,757
– past due but not impaired	2,082	5	3,650	13
– impaired, net of individually assessed impairment provision	2,507	–	1,272	–
Less: collectively assessed impairment provision	(808)	–	(353)	–
	414,955	119,658	454,996	145,770

The following tables set out an analysis of the internal credit gradings for advances which are not past due and for which no individual impairment provision has been raised. The credit gradings set out in the tables below are based on a probability of default measure as set out on page 70.

	2015		2014	
	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	294,070	118,920	291,715	145,050
6 to 8	88,339	676	119,307	523
9 to 11	27,891	57	37,625	184
12	874	–	1,780	–
	411,174	119,653	450,427	145,757

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(a) Credit risk (continued)

(i) Analysis of the loan portfolio (continued)

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

	2015		2014	
	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	1,775	5	3,319	13
– 31 - 60 days	165	–	145	–
– 61 - 90 days	58	–	97	–
– 91 - 120 days	48	–	51	–
– 121 - 150 days	36	–	38	–
	2,082	5	3,650	13

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

	2015			
	Treasury bills HK$'M	*Debt securities HK$'M*	*Equity shares HK$'M*	*Total HK$'M*
Impaired securities	–	–	19	19
Impairment provisions	–	–	(11)	(11)
Net impaired securities	–	–	8	8
Securities neither past due nor impaired	63,864	164,560	922	229,346

	2014			
	Treasury bills HK$'M	*Debt securities HK$'M*	*Equity shares HK$'M*	*Total HK$'M*
Impaired securities	–	–	34	34
Impairment provisions	–	–	(15)	(15)
Net impaired securities	–	–	19	19
Securities neither past due nor impaired	56,440	140,724	1,971	199,135

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(a) Credit risk (continued)

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

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

	2015		*2014*	
	Treasury bills HK$'M	*Debt securities HK$'M*	*Treasury bills HK$'M*	*Debt securities HK$'M*
AAA	–	48,203	–	39,413
AA - to AA +	62,618	58,082	56,278	43,109
A - to A +	1,246	53,863	162	51,612
Lower than A -	–	2,595	–	2,348
Unrated	–	1,817	–	4,242
	63,864	164,560	56,440	140,724

(b) Country cross-border risk

Country cross-border risk is the risk that the Bank will be unable to obtain payment from our customers or third parties on their contractual obligations as a result of certain actions taken by foreign governments, chiefly relating to convertibility and transferability of foreign currency.

The ERC is responsible for country cross-border risk limits and delegates the setting and management of those limits to the country's Risk function. The business teams manage exposures within these limits and policies. Countries designated as higher risk are subject to increased monitoring.

Assets that generate country cross-border exposure are those where the main source of repayment or security is derived from a country other than the country in which the asset is booked. These cover a wide range of products including loans and advances, interest-bearing deposits with other banks, trade and other bills, acceptances, amounts receivable under finance leases, derivatives, certificates of deposit and other negotiable paper, investment securities and formal commitments. Cross-border assets also include exposures to local residents denominated in currencies other than the local currency and local currency assets funded by intra-group funding. Cross-border exposure also includes the value of commodity, aircraft and shipping assets owned by the Group that are held in a given country.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(c) Market risk management

Market risk governance

Market risk is the potential for loss of earnings or economic value due to adverse changes in financial market rates or prices. The Bank's exposure to market risk arises in support of its activities, facilitation of which entails the Bank's 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 broadly stable.

The primary categories of market risk for the Bank 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.

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

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

Value at Risk

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(c) Market risk management (continued)

Value at Risk (continued)

The Bank applies two VaR methodologies:

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

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

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

Stress Testing

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

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

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

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

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

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

Market risk VaR coverage

Interest rate risk from non-trading book portfolios is transferred to Financial Markets where it is managed by the Asset and Liability Management (ALM) desk under the supervision of ALCO. ALM deals in the market in approved financial instruments in order to manage the net interest rate risk, subject to approved VaR and risk limits.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(c) Market risk management (continued)

Market risk VaR coverage (continued)

VaR and stress tests are therefore applied to these non-trading book exposures in the same way as for the trading book, including available-for-sale securities. Securities classed as Loans and Receivables or Held to Maturity are not reflected in VaR or stress tests since they are accounted on an amortised cost basis, so market price movements have limited effect on either profit and loss or reserves.

Structural foreign exchange currency risks are managed by Group Treasury, 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:	*2015*				*2014*			
	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 ^	51.3	67.9	35.1	54.9	45.3	60.0	35.0	38.6
Foreign exchange risk	3.8	10.6	0.9	7.7	2.4	5.7	1.1	4.4
Total ^^	51.9	67.9	35.2	57.1	45.9	60.9	34.7	38.5

Trading (VaR at 97.5%, 1 day)

Value at risk:	*2015*				*2014*			
	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	9.6	12.9	6.0	11.0	9.9	14.1	6.8	9.0
Foreign exchange risk	3.8	10.6	0.9	7.7	2.4	5.7	1.1	4.4
Total ^^	11.1	20.0	7.0	15.9	10.2	14.0	6.9	8.6

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

Value at risk:	*2015*				*2014*			
	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 ^	47.2	63.9	30.9	47.1	40.3	51.5	31.3	36.0

* Actual one day VaR at period end date.

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

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

^^ The total VaR shown in the tables above is not a sum of the component risks due to offsets between them. Total included trading book equity risk that is insignificant.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(d) Foreign exchange risk

The foreign exchange positions of the Bank and its subsidiaries arise from foreign exchange trading and commercial banking operations. Foreign exchange trading exposures are principally derived from customer driven transactions.

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

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

	2015 HK$'M	2014 HK$'M
US dollars exposure		
Spot assets	278,272	373,653
Spot liabilities	(293,469)	(340,519)
Forward purchases	838,812	669,828
Forward sales	(819,270)	(696,706)
Net option position	–	–
Net long non-structural position	4,345	6,256

	2015 HK$'M	2014 HK$'M
Chinese renminbi exposure		
Spot assets	83,495	135,189
Spot liabilities	(55,165)	(97,721)
Forward purchases	564,160	477,387
Forward sales	(590,802)	(516,333)
Net option position	–	–
Net long/(short) non-structural position	1,688	(1,478)

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(d) Foreign exchange risk (continued)

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

	2015 *HK$'M*	*2014* *HK$'M*
Chinese Renminbi	8,515	7,803
US dollars	2,147	1,570
	10,662	9,373

(e) Interest rate risk in the banking book

Interest rate risk in the banking book is managed chiefly by the Asset and Liability Management ("ALM") function within Financial Markets. These interest rate risk positions are measured, reported and monitored independently against limits on a daily basis.

Assumptions on loan prepayment and behaviour of deposits are country and product specific. Transfer pricing of interest rate risk is overseen by local ALCOs in accordance with the Bank's Fund Transfer Pricing Policy.

(f) Liquidity risk

Liquidity risk is the risk that the Bank either does not have sufficient financial resources available to meet all its obligations as they fall due, or can only access these financial resources at excessive cost.

It is the Bank's policy to maintain adequate liquidity and funding at all times and hence to be in a position to meet obligations as they fall due. The Bank manages liquidity risk both on a short-term and structural basis. In the short-term, the focus is on ensuring that the cash flow demands can be met when required. In the medium-term, the focus is on ensuring the statement of financial position remains structurally sound and aligned to the Bank's funding strategy.

Liquidity is managed by the Asset and Liability Committee, supported by the Asset and Liability Management function. The Bank operates within predefined liquidity limits and in compliance with Group liquidity policies and practices, as well as local regulatory requirements. MTCR and Group Treasury propose and oversee the implementation of policies and other controls relating to the above risks.

The Bank seeks to manage the liquidity prudently. Exceptional market events could impact the Bank adversely, thereby potentially affecting the Bank's ability to fulfil obligations as they fall due. The principal uncertainties for liquidity risk are that customers withdraw their deposits at a substantially faster rate than expected, or that asset repayments are not received on the expected maturity date. To mitigate these uncertainties, the Bank maintains a diverse and largely customer-driven funding base. In addition the Bank has contingency funding plans including a portfolio of liquid assets that can be realised if a liquidity stress occurs, as well as ready access to wholesale funds under normal market conditions.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(f) Liquidity risk (continued)

Customer assets are as far as possible funded in the same currency. Where mismatches arise, they are controlled by limits on the amount of foreign currency that can be swapped to local currency and vice versa. Such limits are therefore a means of reducing the risk that obligations could not be met in the required currency in the event that access to foreign exchange markets becomes restricted. In sizing the limits, the Bank considers a range of factors including:

- The size and depth of local foreign exchange markets; and
- The local regulatory environment, particularly the presence or risk of imposition of foreign exchange controls.

Liquidity risk framework

The Board sets liquidity risk tolerance levels for liquidity stress survival horizons, short-term wholesale borrowing, minimum assets-to-deposits and regulatory liquidity coverage ratios. ALCO may set risk appetite levels such that the Bank operates within the Board's tolerance.

For stress survival horizons, the tolerance reflects the Bank's specific structure. The Bank intends to maintain a prudent and sustainable funding and liquidity position such that it can withstand severe liquidity stress:

- The Bank intends to be able to meet its payment and collateral obligations for at least 60 days in a combined name-specific and market-wide liquidity stress, without recourse to extraordinary central bank support;

There are further limits on:

- The Liquidity Coverage Ratio ("LCR"), to maintain a minimum level of high quality liquid assets and ensure the Group remains resilient to sudden liquidity shocks
- The local and foreign currency cash flow gaps
- The level of borrowing from other countries within the Group, to contain the risk of contagion from one country to another
- Commitments, both on- and off-balance sheet, to ensure there are sufficient funds available in the event of drawdown
- The amount of assets that may be funded from other currencies
- The amount of medium-term assets that have to be funded by medium-term funding

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(f) Liquidity risk (continued)

Liquidity risk framework (continued)

All limits are reviewed at least annually, and more frequently if required, to ensure that they remain relevant given market conditions and business strategy. Compliance with limits is monitored independently on a regular basis by MTCR and Finance. Limit excesses are escalated and approved under a delegated authority structure and reported to the Asset and Liability Committee.

The Bank has significant levels of marketable securities, including government securities that can be monetised or pledged as collateral in the event of liquidity stress. In addition, a Funding Crisis Response and Recovery Plan ("FCRRP") is reviewed and approved annually. The FCRRP strengthens existing governance processes by providing a broad set of Early Warning Indicators ("EWIs"), an escalation framework and a set of management actions that could be effectively implemented by the appropriate level of senior management in the event of a liquidity stress.

Liquidity metrics

The Bank monitors key liquidity metrics on a regular basis. The key metrics are:

(1) Advances to deposits ratio

This is defined as the ratio of total loans and advances to customers relative to total customer deposits. A low advances to deposits ratio demonstrates that customer deposits exceed customer loans resulting from emphasis placed on generating a high level of stable funding from customers.

	2015 HK$'M	2014 HK$'M
Advances to customers	414,955	454,996
Deposits from customers	745,701	851,029
Advances to deposits ratio	56%	53%

(2) Liquidity Coverage Ratio ("LCR")

The Bank monitors the LCR in line with the Bank of International Settlements and Hong Kong Monetary Authority's guidelines. The Bank is reporting of its LCR on a monthly basis to its local regulator, the Hong Kong Monetary Authority (HKMA).

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

37 Risk management (continued)

(f) Liquidity risk (continued)

Liquidity metrics (continued)

(3) Other liquidity metrics

A range of short-term and structural liquidity metrics are monitored to ensure a robust liquidity strategy in line with the Bank's overall risk appetite. The contractual medium term funding ratio is intended to highlight reliance on the ability of the Bank to rollover short term liabilities to fund medium term assets based on the Bank's contractual obligations. The behavioural medium term funding ratio is intended to highlight whether the Bank's business / product mix and statement of financial position structure in a business-as-usual environment is sustainable over time. The Maximum Cumulative Outflow report allows the Bank to manage any mismatches in the maturity of cash inflows and outflows. Intraday liquidity risk, wholesale borrowing capacity and outflows due to off-balance sheet commitments are also monitored.

Liquidity management – stress scenarios

The Bank conducts a range of liquidity related stress analyses, both for internal and regulatory purposes. Internally, three types of stress tests are run routinely: an acute 8-day name-specific stress, a 30-day market wide stress and a 90-day combined name specific and market wide stress. Liquidity risks are also considered as part of the bank's wider periodic scenario analysis, including reverse stress testing. In addition, the bank runs a range of stress tests to meet regulatory requirements, as defined by the local regulator.

The 8-day stress is specifically designed to determine a minimum quantity of marketable securities that must be held at all times. This stress is computed daily, and the minimum marketable securities requirement is observed daily. This is intended to ensure that, in the unlikely event of an acute loss of confidence in the Bank, there is sufficient time to take corrective action. No support from Group is presumed. The Bank's resilience to market-wide disruption, such as a loss of interbank money or foreign exchange markets, is tested using the 30-day market-wide stress scenario, and is monitored by Asset and Liability Committee.

The Bank's liquidity stress testing also considers potential currency mismatches between outflows and inflows. Particular focus is paid to mismatches in less liquid currencies and those that are not freely convertible. Mismatches are controlled by management action triggers set by MTCR.

The Bank's credit ratings as at the end of December 2015 were AA- with negative outlook (Fitch), A+ (S&P) and Aa2 with negative outlook (Moody's). A downgrade in credit rating would increase derivative collateral requirements. The impact of a 2-notch downgrade has a minimal impact on the Bank's derivative collateral requirements.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(f) Liquidity risk (continued)

(i) Contractual maturity of assets and liabilities

The table analyses assets and liabilities in relevant maturity groupings based on the remaining period to the contractual maturity date as at the reporting date on a discounted basis. Contractual maturities do not necessarily reflect actual repayments or cash flow. Within the tables below cash and balances with banks, central banks and other financial institutions, placements with banks and other financial institutions, and trading assets are used by the Bank principally for liquidity management purposes.

	2015							
	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	48,769	–	–	–	–	–	–	48,769
Placements with banks and other financial institutions	12	64,762	39,993	13,097	1,794	–	–	119,658
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	–	38,031	38,031
Trading assets	–	259	1,506	6,094	6,783	3,646	309	18,597
Financial assets designated at fair value	–	–	–	–	–	666	–	666
Advances to customers	11,337	70,496	27,664	53,656	91,205	162,705	(2,108)	414,955
Investment securities	234	20,866	49,071	41,139	83,570	15,071	621	210,572
Amounts due from group companies	2,384	9,235	15,494	13,116	6,877	1,175	(1,819)	46,462
Others	532	1,242	7,440	990	321	679	50,051	61,255
Total Assets	63,268	166,860	141,168	128,092	190,550	183,942	85,085	958,965
Liabilities								
Hong Kong SAR currency notes in circulation	–	–	–	–	–	–	38,031	38,031
Deposits and balances of banks and other financial institutions	22,637	1,107	–	–	911	–	–	24,655
Deposits from customers	595,324	62,853	51,438	35,237	849	–	–	745,701
Trading liabilities	–	8,537	73	139	87	11	–	8,847
Financial liabilities designated at fair value	–	68	2,051	3,356	2,978	5,271	–	13,724
Debt securities in issue	–	–	–	–	1,209	–	–	1,209
Amounts due to group companies	7,778	5,750	8,411	8,796	2,637	2,461	–	35,833
Subordinated liabilities	–	–	–	–	6,191	3,902	–	10,093
Others	5,985	1,459	5,178	2,107	256	282	256	15,523
Total Liabilities	631,724	79,774	67,151	49,635	15,118	11,927	38,287	893,616

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(f) Liquidity risk (continued)

(i) Contractual maturity (continued)

	2014							
	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	53,076	–	–	–	–	–	–	53,076
Placements with banks and other financial institutions	120	85,808	18,442	39,611	1,789	–	–	145,770
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	–	36,741	36,741
Trading assets	–	1,562	3,338	4,087	10,219	2,645	1,537	23,388
Financial assets designated at fair value	–	–	–	–	62	1,513	–	1,575
Advances to customers	19,153	80,048	35,368	61,735	112,252	148,234	(1,794)	454,996
Investment securities	234	33,011	30,810	30,242	61,394	16,158	453	172,302
Amounts due from group companies	13,202	51,259	9,162	20,089	22,703	1,463	(1,554)	116,324
Others	756	1,799	7,909	4,186	5,291	4,583	50,346	74,870
Total Assets	86,541	253,487	105,029	159,950	213,710	174,596	85,729	1,079,042
Liabilities								
Hong Kong SAR currency notes in circulation	–	–	–	–	–	–	36,741	36,741
Deposits and balances of banks and other financial institutions	28,402	2,683	595	14	911	–	–	32,605
Deposits from customers	563,433	131,109	92,598	62,644	1,221	24	–	851,029
Trading liabilities	–	12,333	135	235	56	–	41	12,800
Financial liabilities designated at fair value	–	169	1,456	4,780	2,714	5,796	–	14,915
Debt securities in issue	–	9,796	3,930	90	22	–	–	13,838
Amounts due to group companies	6,133	2,428	6,060	2,253	2,331	1,648	–	20,853
Subordinated liabilities	–	–	–	–	–	10,406	–	10,406
Others	8,215	6,069	3,793	868	212	599	56	19,812
Total Liabilities	606,183	164,587	108,567	70,884	7,467	18,473	36,838	1,012,999

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(f) Liquidity risk (continued)

(i) Contractual maturity (continued)

	2015							
	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 Trading assets	–	1	6	301	80	–	–	388
– included in Investment securities as available-for-sale securities	–	–	2,089	12,863	–	–	–	14,952
	–	1	2,095	13,164	80	–	–	15,340
Treasury bills								
– included in Trading assets	–	40	1,225	1,862	–	–	–	3,127
– included in Investment securities as available-for-sale securities	–	19,017	41,720	–	–	–	–	60,737
	–	19,057	42,945	1,862	–	–	–	63,864
Debt securities								
– included in Trading assets	–	94	160	3,100	6,149	3,394	–	12,897
– included in Financial assets designated at fair value	–	–	–	–	–	666	–	666
– included in Investment securities classified as:								
– available-for-sale securities	–	1,849	5,262	26,339	77,920	15,071	–	126,441
– loans and receivables	234	–	–	1,937	5,650	–	–	7,821
– included in Amounts due from fellow subsidiaries classified as:								
– available-for-sale securities	–	1,395	–	–	–	–	–	1,395
	234	3,338	5,422	31,376	89,719	19,131	–	149,220

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(f) Liquidity risk (continued)

(i) Contractual maturity (continued)

	2014							
	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 Trading assets	–	50	2	302	7	13	–	374
– included in Investment securities as available-for-sale securities	–	381	9,044	4,715	946	–	–	15,086
	–	431	9,046	5,017	953	13	–	15,460
Treasury bills								
– included in Trading assets	–	832	1,737	447	–	–	–	3,016
– included in Investment securities as available-for-sale securities	–	31,529	17,645	4,250	–	–	–	53,424
	–	32,361	19,382	4,697	–	–	–	56,440
Debt securities								
– included in Trading assets	–	508	1,387	2,904	8,602	2,440	–	15,841
– included in Financial assets designated at fair value	–	–	–	–	62	1,513	–	1,575
– included in Investment securities classified as:								
– available-for-sale securities	–	1,101	4,121	21,044	52,081	16,158	–	94,505
– loans and receivables	234	–	–	233	8,367	–	–	8,834
– included in Amounts due from fellow subsidiaries classified as:								
– available-for-sale securities	–	–	–	–	4,509	–	–	4,509
	234	1,609	5,508	24,181	73,621	20,111	–	125,264

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(f) Liquidity risk (continued)

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

The cash flows presented in note 37(f)(i) reflect the cash flows which will be contractually payable over the residual maturity of the instruments. However, contractual maturities do not necessarily reflect the timing of actual repayments or cash flow. In practice, certain liability instruments behave differently from their contractual terms and, especially for short term customer accounts, which extend to a longer period than their contractual maturity. Such behavioural adjustments are identified and managed through analysis of the historic behaviour of balances. The Bank's expectation of when liabilities are likely to become due is provided below. No information has been presented for financial liabilities which will become payable on their contractual due dates.

			2015		
	Within 3 months HK$'M	*Between 3 months and 1 year HK$'M*	*Between 1 year and 5 years HK$'M*	*After 5 years HK$'M*	*Total HK$'M*
Deposits and balances of banks and other financial institutions	23,745	–	910	–	24,655
Deposits from customers	104,097	71,801	569,803	–	745,701
Total	127,842	71,801	570,713	–	770,356

			2014		
	Within 3 months HK$'M	*Between 3 months and 1 year HK$'M*	*Between 1 year and 5 years HK$'M*	*After 5 years HK$'M*	*Total HK$'M*
Deposits and balances of banks and other financial institutions	31,680	14	911	–	32,605
Deposits from customers	122,812	93,099	635,118	–	851,029
Total	154,492	93,113	636,029	–	883,634

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

The following tables analyse the contractual cash flows payable for the bank's financial liabilities by remaining contractual maturity 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. The cash flows presented in the tables reflect the cash flows which will be contractually payable over the residual maturity of the instruments. In practice, however, the liability instruments behave differently from their contractual terms and typically, for short term customer accounts, extend to a longer period than their contractual maturity.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(f) Liquidity risk (continued)

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

	2015						
	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	22,638	1,107	–	949	–	–	24,694
Deposits from customers	595,325	114,630	35,556	871	–	–	746,382
Trading liabilities	–	8,494	–	–	–	–	8,494
Financial liabilities designated at fair value	–	2,163	3,370	3,589	5,761	–	14,883
Debt securities in issue	–	–	41	1,298	–	–	1,339
Amounts due to group companies	7,778	14,162	8,796	2,643	2,461	–	35,840
Subordinated liabilities	–	–	510	8,068	4,064	–	12,642
Others	5,824	6,336	2,067	254	282	38,287	53,050
	631,565	146,892	50,340	17,672	12,568	38,287	897,324

	2014						
	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	28,402	3,283	14	933	–	–	32,632
Deposits from customers	563,433	224,371	63,135	1,264	24	–	852,227
Trading liabilities	–	11,987	–	–	–	41	12,028
Financial liabilities designated at fair value	–	1,637	4,821	3,507	5,480	–	15,445
Debt securities in issue	–	13,727	91	22	–	–	13,840
Amounts due to group companies	6,134	8,489	2,255	2,342	1,648	–	20,868
Subordinated liabilities	–	–	522	2,094	10,750	–	13,366
Others	7,954	9,478	729	213	599	36,797	55,770
	605,923	272,972	71,567	10,375	18,501	36,838	1,016,176

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 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.

	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*
			2015		
Derivative financial instruments	946,903	718,835	37,099	6,606	1,709,443
			2014		
Derivative financial instruments	833,363	540,553	27,853	5,428	1,407,197

(g) Operational risk

Operational risk is the potential for loss arising from the failure of people, process or technology or the impact of external events. We seek to minimize our exposure to operational risk. Operational risk exposures are managed through a consistent set of management processes that drive risk identification, assessment, control and monitoring.

Operational risks can arise from all business lines and from all activities carried out by the Bank.

Operational Risk Framework (ORF)

The Bank defines operational risk as the potential for loss resulting from inadequate or failed internal processes, people and systems or from the impact of external events, including legal risks.

As operational risk arises from all activities carried out within the Bank, the potential for operational risk events occurring across a large and complex international organisation is a constant challenge. To address this we aim to achieve 'industrial strength' process and control design standards for all activities, and benchmark practices against peers, other industries and regulatory requirements.

Operational Risk Governance

The ERC provides oversight of operational risk management across the Bank. It is supported by the Country Operational Risk Committee ("CORC") and the Financial Crime Risk Committee ("FCRC"), which oversees operational risk arising from businesses and functions, and financial crime compliance respectively.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(g) Operational risk (continued)

Risk Tolerance approach

Operational risk is managed within tolerances aligned to achieve the Board-approved Risk Tolerance Statement. The Bank aims to control operational risks to ensure that operational losses (financial or reputational), including any related to conduct of business matters, do not cause material damage to the Group's franchise.

In order to comply with this statement, the operational risk management approach includes the following requirements:

- The Bank will systematically identify Top Risks and emerging risks with the involvement of Senior Management/Board to define the appropriate course of action including business restrictions

- All processes will be mapped and owned with appropriate key control standards defined to mitigate risks

- The Bank will not miss any opportunity to learn lessons from internal or external events and will implement relevant mitigation actions

- The Bank will systematically test internal capital adequacy through scenario analysis and stress testing

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(g) Operational risk (continued)

Risk classification

Risk types are the different ways that the Bank may be exposed to loss. Each risk type is a grouping of potential losses that are material, and which may arise in different activities or areas of the Bank.

The Bank uses risk types principally as an aid to ensure comprehensive and consistent identification of risks, wherever they may arise. Operational risk types are listed in the table below:

OPERATIONAL RISK SUB-TYPES AND DESCRIPTIONS

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(g) Operational risk (continued)

Conduct

Conduct of business, or conduct, is a term that is used in a broad number of ways across the financial services industry. At its broadest, good conduct is the appropriate execution of business, by the Bank or any individual acting on its behalf, in accordance with our strategic intent, risk management principles and risk appetite. More narrowly, it refers to specific regulations designed to achieve fair outcomes for customers and the effective operation of markets.

Good conduct is evidenced through disciplined adherence to our overall framework of systems and controls outlined in the risk management framework and the standards of individual behaviour set out in the Code of Conduct (the 'Code').

Specifically for operational risk:

- External rules and regulations classifications defined in the ORF include specific categories of regulation designed to achieve fair outcomes for clients (client conduct) and the effective operation of markets (market conduct). This ensures that each category of regulation is properly classified and aligned to the Bank's systems and control structures. Risk control owners are responsible for defining the Bank's minimum standards and controls in respect of each category. The Bank's policies and standards may frequently exceed the minimum requirements or expectations of regulators

- Conduct is considered in the Bank's top risks. The Bank aims to prevent the risks of failure to deliver the conduct of business standards expected by the Bank's clients, investors and markets in which we operate. Many of the top risks can be driven by poor conduct so the Bank is focused on its control standards around these risks. Additionally, there is a specific top risk for additional conduct related liability for bribery and corruption

(h) Reputational risk

Reputational risk could arise from the failure by the Bank to effectively mitigate the risks in its businesses including one or more of country, credit, liquidity, market, regulatory, legal, strategic or other operational risk. Damage to the Bank's reputation could cause existing clients to reduce or cease to do business with the Bank and prospective clients to be reluctant to do business with the Bank. All employees are responsible for day to day identification and management of reputational risk. These responsibilities form part of the Code of Conduct and are further embedded through values-based performance assessments. Risk Control Owners must identify material reputational risks arising from any business activity or transaction that they control and ensure that these are escalated and controlled in accordance with the Reputational Risk Policy and applicable procedures.

Reputational risk may also arise from a failure to comply with environmental and social standards. The Bank's primary environmental and social impacts arise through relationship with clients and customers and the financing decisions the Bank takes. The Group has published a series of Position statements that we apply in the provision of financial services to clients who operate in sectors with specific risks, and for key issues. The Bank have mechanisms in the origination and credit processes to identify and assess environmental and social risks, and a dedicated Environmental and Social Risk Management team that reviews proposed transactions with identified risks.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(h) Reputational risk (continued)

The ERC and its sub-committee, the SCBHK Reputational Risk Sub-committee, provides Bank-wide oversight on reputational risk, sets policy and monitors material risks. The Head of Corporate Affairs is the overall risk control owner for reputational risk. The ExCo provides additional oversight of reputational risk on behalf of the Board.

The Head of Corporate Affairs as risk control owner is responsible for the protection of the Bank's reputation with the support of the country management team. The Head of Corporate Affairs and Chief Executive Officer must actively:

- Promote awareness and application of the Bank's policies and procedures regarding reputational risk.
- Encourage businesses and functions to take account of the Bank's reputation in all decision-making, including dealings with customers and suppliers.
- Implement effective in-country reporting systems to ensure they are aware of all potential issues in tandem with respective business committees.
- Promote effective, proactive stakeholder management through ongoing engagement.

(i) Pension risk

Pension risk is the potential for loss due to having to meet an actuarially assessed shortfall in the Bank's pension scheme. Pension risk exposure is not concerned with the financial performance of the Bank's pension scheme but is focused upon the risk to the Bank's financial position arising from the need to meet pension scheme funding obligations. The risk assessment is focused on the obligations towards the Bank's pension scheme, ensuring that the Bank's funding obligation is comfortably within the Bank's financial capacity. Pension risk is monitored on a semi-annual basis taking account of the actual variations in asset values and updated expectations regarding the progression of the pension fund assets and liabilities.

The CPC is the body responsible for governance of pension risk and it receives its authority from ExCo.

(j) Capital management

The HKMA sets and monitors capital requirements for the Bank and certain subsidiaries specified by the HKMA. In implementing current capital requirements, the HKMA requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. The Bank 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 Bank's primary objectives when managing capital are to safeguard the Bank and its subsidiaries' ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, by pricing products and services commensurately with the level of risk and by securing access to finance at a reasonable cost. The Bank actively and regularly reviews and manages its capital structure to maintain a balance between the higher shareholder returns that might otherwise be possible with greater gearing and the advantages and security afforded by a sound capital position, and makes adjustments to the capital structure in light of changes in economic conditions.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Risk management (continued)

(j) Capital management (continued)

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 Bank monitors its capital structure on the basis of the capital adequacy ratio and there have been no material changes in the Bank's policy on the management of capital during the year.

The Bank and its subsidiaries have complied with all externally imposed capital requirements throughout the years ended 31 December 2015 and 2014.

The Bank uses the IRB approach for both the measurement of credit risk capital and the management of credit risk for the majority of its portfolios. The Bank also uses the standardised (credit risk) approach for certain insignificant portfolios exempted from IRB. The Bank adopts the internal ratings-based (securitization) approach to calculate its credit risk for securitization exposures.

For market risk, the Bank uses an internal models approach for two guaranteed funds and the standardized (market risk) approach for other exposures. In addition, the Bank adopts the standardized (operational risk) approach for operational risk.

The Banking (Capital) Rules issued by the HKMA require all authorized institutions in Hong Kong to meet three levels of minimum capital ratios, namely common equity tier 1, tier 1 and total capital ratios.

The Bank's consolidated capital as at 31 December 2015 consists of tier 1 capital after deduction of HK$51,412 million (2014: HK$51,577 million) and tier 2 capital after deductions of HK$9,618 million (2014: HK$10,867 million). Tier 2 capital includes subordinated debt and collective impairment allowances for impaired assets.

38 Financial instruments

(a) Valuation of financial instruments carried at fair value

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

Valuation methodologies

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

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

(Note 1) These included valuation models such as discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. These models incorporate assumptions and inputs that other market participants would use in their valuations, such as discount rates, default rates, credit spreads and option volatilities. These inputs need to be directly or indirectly observable in order to be classified as Level 2.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 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:

	2015			
	Level 1 HK$'M	*Level 2 HK$'M*	*Level 3 HK$'M*	*Total HK$'M*
Trading assets				
– Trading securities	9,010	7,711	–	16,721
– Advances to customers	–	163	–	163
– Positive fair values of trading derivatives	–	1,713	–	1,713
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	–	13,919	471	14,390
– Positive fair values of hedging derivatives	–	1,214	–	1,214
Amounts due from fellow subsidiaries				
– Listed available-for-sale debt securities	–	1,395	–	1,395
– Positive fair values of hedging derivatives	–	92	–	92
Financial assets designated at fair value				
– Debt securities	–	666	–	666
Available-for-sale securities				
– Treasury bills	60,737	–	–	60,737
– Certificates of deposit held	–	14,952	–	14,952
– Debt securities	60,921	65,380	140	126,441
– Equity shares, net of impairment	8	1	612	621
Total assets measured at fair value	130,676	107,206	1,223	239,105
Trading liabilities				
– Short positions in securities	3,198	5,278	–	8,476
– Negative fair values of trading derivatives	–	371	–	371
Financial liabilities designated at fair value				
– Structured bank and customer deposits	–	6,533	9	6,542
– Debt securities issued	–	5,367	1,815	7,182
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	–	15,393	12	15,405
– Negative fair values of hedging derivatives	–	1,755	–	1,755
Amounts due to fellow subsidiaries				
– Negative fair values of hedging derivatives	–	27	–	27
Total liabilities measured at fair value	3,198	34,724	1,836	39,758

The Bank's policy is to recognize transfer into and transfer out of fair value hierarchy levels as of the date of the event or change in circumstances that caused the transfer. The Bank transferred government bonds with a carrying value of HK$9,348 million during 2015 from Level 1 into Level 2 where the market for such bonds became inactive.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

	2014			
	Level 1	*Level 2*	*Level 3*	*Total*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
Trading assets				
– Trading securities	16,251	4,517	–	20,768
– Advances to customers	–	1,604	–	1,604
– Positive fair values of trading derivatives	1	1,015	–	1,016
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	–	4,784	33	4,817
– Positive fair values of hedging derivatives	–	833	–	833
Amounts due from fellow subsidiaries				
– Listed available-for-sale debt securities	–	4,509	–	4,509
– Positive fair values of trading derivatives	–	1	–	1
– Positive fair values of hedging derivatives	–	103	–	103
Financial assets designated at fair value				
– Debt securities	–	1,513	62	1,575
Available-for-sale securities				
– Treasury bills	53,424	–	–	53,424
– Certificates of deposit held	–	15,086	–	15,086
– Debt securities	39,646	54,859	–	94,505
– Equity shares, net of impairment	71	1	381	453
Total assets measured at fair value	109,393	88,825	476	198,694
Trading liabilities				
– Short positions in securities	11,995	–	–	11,995
– Negative fair values of trading derivatives	1	804	–	805
Financial liabilities designated at fair value				
– Structured bank and customer deposits	–	7,519	9	7,528
– Debt securities issued	–	6,735	652	7,387
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	–	5,570	10	5,580
– Negative fair values of hedging derivatives	–	1,196	–	1,196
Amounts due to fellow subsidiaries				
– Negative fair values of trading derivatives	–	1	–	1
Total liabilities measured at fair value	11,996	21,825	671	34,492

There were no significant transfers between level 1 and level 2 instruments in 2014.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

(i) Valuation of financial instruments with significant unobservable inputs

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

	2015			
	Financial assets designated at fair value HK$'M	*Amounts due from immediate holding company HK$'M*	*Available-for-sale securities HK$'M*	*Total level 3 assets HK$'M*
Financial assets				
At 1 January 2015	62	33	381	476
Total gains recognised in the income statement				
– Net trading income	–	80	–	80
– Net gains from financial instruments designated at fair value through profit or loss	1	–	–	1
Total (losses)/gains recognised in the available-for-sale investment reserve	–	–	38	38
Purchases	–	358	190	548
Settlements	(63)	–	(295)	(358)
Transferred into level 3 (Note 1)	–	–	438	438
At 31 December 2015	–	471	752	1,223
Total gains recognised in the income statement relating to assets held at 31 December 2015				
– Net trading income	–	438	–	438
– Net gains from financial instruments designated at fair value through profit or loss	–	–	–	–

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

(i) Valuation of financial instruments with significant unobservable inputs (continued)

	Financial liabilities designated at fair value	*Amounts due to immediate holding company*	*Total level 3 liabilities*
	HK$'M	*HK$'M*	*HK$'M*
Financial liabilities			
At 1 January 2015	661	10	671
Total losses recognised in the income statement			
– Net losses from financial instruments designated at fair value through profit or loss	65	–	65
Issuances	1,098	2	1,100
At 31 December 2015	1,824	12	1,836
Total losses recognised in the income statement relating to liabilities held at 31 December 2015			
– Net losses from financial instruments designated at fair value through profit or loss	65	–	65

(Note 1) Transfers into/(out of) level 3 during the year relate to financial instruments where the valuation parameters became unobservable/(observable) during the year.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

(i) Valuation of financial instruments with significant unobservable inputs (continued)

	2014				
	Financial assets designated at fair value HK$'M	*Amounts due from immediate holding company HK$'M*	*Amounts due from fellow subsidiaries (Note 1) HK$'M*	*Available-for-sale securities HK$'M*	*Total level 3 assets HK$'M*
Financial assets					
At 1 January 2014	83	1	498	990	1,572
Total gains recognised in the income statement					
– Net trading income	–	32	–	–	32
– Net gains from financial instruments designated at fair value through profit or loss	5	–	–	–	5
– Net gains from disposal of available-for-sale securities	–	–	2	–	2
Total (losses)/gains recognised in the available-for-sale investment reserve	–	–	(11)	39	28
Purchases	–	–	–	14	14
Sales	–	–	–	(25)	(25)
Settlements	(26)	–	(489)	(199)	(714)
Transferred into level 3 (Note 2)	–	–	–	–	–
Transferred out of level 3 (Note 2)	–	–	–	(438)	(438)
At 31 December 2014	62	33	–	381	476
Total gains recognised in the income statement relating to assets held at 31 December 2014					
– Net trading income	–	32	–	–	32
– Net gains from financial instruments designated at fair value through profit or loss	3	–	–	–	3

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

(i) Valuation of financial instruments with significant unobservable inputs (continued)

	Financial liabilities designated at fair value	*Amounts due to immediate holding company*	*Total level 3 liabilities*
	HK$'M	*HK$'M*	*HK$'M*
Financial liabilities			
At 1 January 2014	65	12	77
Total losses/(gains) recognised in the income statement			
– Net trading income	–	(2)	(2)
– Net losses from financial instruments designated at fair value through profit or loss	32	–	32
Issuances	620	–	620
Settlements	(56)	–	(56)
At 31 December 2014	661	10	671
Total losses/(gains) recognised in the income statement relating to liabilities held at 31 December 2014			
– Net trading income	–	(2)	(2)
– Net losses from financial instruments designated at fair value through profit or loss	31	–	31

(Note 1) Amounts due from fellow subsidiaries included debt securities which are available for sale and designated at fair value.

(Note 2) Transfers into/(out of) level 3 during the year relate to financial instruments where the valuation parameters became unobservable/(observable) during the year.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

(i) Valuation of financial instruments with significant unobservable inputs (continued)

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

Type of instruments	Principal valuation technique	Significant unobservable inputs	Range (Note 1)	Weighted average (Note 2)
Debt securities	Discounted cash flows	Yield	2.1% (2014: 2.39% to 2.92%)	2.1% (2014: 2.65%)
Structured bank and customer deposits	Internal pricing model	Equity-equity correlation	Nil (2014: 56% to 75%)	Nil (2014: N/A)
		Equity-foreign exchange correlation	40% to 75% (2014: Nil)	58% (2014: Nil)
Debt securities in issue	Discounted cash flows	Credit spreads	1.9% to 4.0% (2014: 4%)	2.1% (2014: 4%)
Derivative financial Instruments	Internal pricing model	Equity-equity correlation	Nil (2014: 56% to 75%)	Nil (2014: N/A)
		Equity-foreign exchange correlation	40% to 75% (2014: Nil)	58% (2014: Nil)
	Discounted cash flows	Credit spreads	1.9% to 4.0% (2014: 4%)	2.4% (2014: 4%)

(Note 1) The ranges of values shown represent the highest and lowest levels used in the valuation of the level 3 financial instruments as at 31 December 2015 and 2014. The ranges of values used are reflective of the underlying characteristics of these level 3 financial instruments based on the market conditions at the reporting date. However, these ranges of values may not represent the uncertainty in fair value measurements of these level 3 financial instruments.

(Note 2) Weighted average for non-derivative financial instruments have been calculated by weighting inputs by the relative fair value. Weighted average for derivatives has been provided by weighting inputs by the risk relevant to that variable. N/A has been entered for the cases where weighted average is not a meaningful indicator.

(Note 3) Level 3 equity shares, which are mainly measured using unadjusted net asset value, are excluded.

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

Yield

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

Correlation

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

(i) Valuation of financial instruments with significant unobservable inputs (continued)

Credit spreads

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

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

	2015					
	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*
Amounts due from immediate holding company	471	533	401	–	–	–
Debt securities	–	–	–	140	141	140
Equity securities	–	–	–	612	673	551
Amounts due to immediate holding company	(12)	(12)	(12)	–	–	–
Structured bank and customer deposits	(9)	(8)	(9)	–	–	–
Debt securities issued	(1,815)	(1,746)	(1,885)	–	–	–
	(1,365)	(1,233)	(1,505)	752	814	691

	2014					
	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*
Amounts due from immediate holding company	33	88	(23)	–	–	–
Debt securities	62	62	62	–	–	–
Equity securities	–	–	–	381	419	343
Amounts due to immediate holding company	(10)	(10)	(10)	–	–	–
Structured bank and customer deposits	(9)	(8)	(10)	–	–	–
Debt securities issued	(652)	(608)	(696)	–	–	–
	(576)	(476)	(677)	381	419	343

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(a) Valuation of financial instruments carried at fair value (continued)

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. The percentage shift is determined by statistical analyses performed on a set of reference prices, which included certain equity indices, credit indices and volatility indices, based on the composition of our 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.

As of 31 December 2015, these reasonably possible alternatives could have increased the net fair values of financial instruments held at fair value through profit or loss by HK$132 million (2014: HK$100 million) or decreased them by HK$140 million (2014: HK$101 million); and increased the fair values of available-for-sale securities by HK$62 million (2014: HK$38 million) or decreased them by HK$61 million (2014: HK$38 million).

(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 2015 and 2014, 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.

	2015		*2014*	
	Carrying amount	*Fair value Level 1*	*Carrying amount*	*Fair value Level 1*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
Subordinated liabilities	10,093	10,579	10,406	10,973

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

Cash and balances with banks, 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 financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 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 Bank enters into collateralised repurchase agreements (repos). These transactions typically entitle the Bank 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 statement of financial position as the Bank 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 Bank as collateral for repos:

	2015 HK$'M	*2014 HK$'M*
Collateral pledged against repos		
On balance sheet		
Cash	–	4
Off balance sheet		
Repledged collateral received	–	626
	–	630
Statement of financial position liabilities - repos		
Amount due to Group companies	–	622
	–	622

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(d) Offsetting financial assets and financial liabilities

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

			2015		
Assets	*Gross amounts of recognised financial assets*	*Gross amounts of recognised financial liabilities offset in the statement of financial position*	*Net amounts of financial assets presented in the statement of financial position*	*Related amounts not offset in the statement of financial position*	*Net amount*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*	*HK$'M*
Positive fair values of derivative financial instruments	17,409	–	17,409	(15,900)	1,509
Reverse repos, securities borrowing and similar agreements	34,924	–	34,924	(34,722)	202
	52,333	–	52,333	(50,622)	1,711

Liabilities	*Gross amounts of recognised financial liabilities*	*Gross amounts of recognised financial assets offset in the statement of financial position*	*Net amounts of financial liabilities presented in the statement of financial position*	*Related amounts not offset in the statement of financial position*	*Net amount*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*	*HK$'M*
Negative fair values of derivative financial instruments	17,558	–	17,558	(17,343)	215
Repos and similar agreements	–	–	–	–	–
	17,558	–	17,558	(17,343)	215

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(d) Offsetting financial assets and financial liabilities (continued)

			2014		
Assets	*Gross amounts of recognised financial assets HK$'M*	*Gross amounts of recognised financial liabilities offset in the statement of financial position HK$'M*	*Net amounts of financial assets presented in the statement of financial position HK$'M*	*Related amounts not offset in the statement of financial position HK$'M*	*Net amount HK$'M*
Positive fair values of derivative financial instruments	6,770	–	6,770	(5,797)	973
Reverse repos, securities borrowing and similar agreements	19,538	–	19,538	(19,433)	105
	26,308	–	26,308	(25,230)	1,078

Liabilities	*Gross amounts of recognised financial liabilities HK$'M*	*Gross amounts of recognised financial assets offset in the statement of financial position HK$'M*	*Net amounts of financial liabilities presented in the statement of financial position HK$'M*	*Related amounts not offset in the statement of financial position HK$'M*	*Net amount HK$'M*
Negative fair values of derivative financial instruments	7,582	–	7,582	(6,875)	707
Repos and similar agreements	622	–	622	(622)	–
	8,204	–	8,204	(7,497)	707

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Financial instruments (continued)

(d) Offsetting financial assets and financial liabilities (continued)

The Bank and its subsidiaries are 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 statement of financial position.

Under repos and reverse repos, the Bank and its subsidiaries 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 statement of financial position which are disclosed in the table above include financial instruments covered by master netting arrangements and financial collateral pledged and obtained, but exclude the effect of over collateralisation.

39 Assets pledged as security for liabilities

The Bank maintains pledged cash and securities accounts to secure any borrowings or other obligations resulting from the Bank's use of clearing systems and to cover short positions. As at 31 December 2015, the Bank had securities amounting to HK$8,476 million (2014: HK$11,995 million) to cover the short positions.

Reverse repos and securities borrowing transactions

The Bank also undertakes reverse repos and securities borrowing transactions as set out in the table below:

	2015	*2014*
	HK$'M	*HK$'M*
Statement of financial position assets - reverse repos and securities borrowing		
Placements with banks and other financial institutions	29,499	19,154
Advances to customers	5,425	384
	34,924	19,538

Under reverse repos and securities borrowing arrangements, the Bank obtains securities on terms that permit it to repledge or resell the securities to others. The amount of securities which the Bank is able to repledge or resell are as follows:

	2015	*2014*
	HK$'M	*HK$'M*
Securities and collateral that can be repledged or sold (at fair value)	34,802	19,474
Thereof repledged/transferred to others under repos (at fair value)	–	626

These transactions are conducted under terms that are usual and customary to standard lending and stock borrowing activities.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Material related party transactions

In addition to the transactions and balances disclosed elsewhere in these financial statements, the Bank and its subsidiaries entered into the following material related party transactions. The transactions of the Bank are materially the same as those appearing in the consolidated financial statements in 2015 and 2014.

(a) Key management personnel remuneration

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

	2015 HK$'M	*2014 HK$'M*
Short-term employee benefits	94	127
Post-employment benefits	3	5
Equity compensation benefits	8	30
Termination benefits	3	–
	108	162

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

(b) Credit facilities and loans to key management personnel

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

	2015 HK$'M	*2014 HK$'M*
Loan balances:		
At 1 January	203	105
At 31 December	1,468	203
Average balance during the year	1,627	383
Income earned	15	6

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Material related party transactions (continued)

(c) Share based payments

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

2011 Standard Chartered Share Plan (the 2011 Plan)

Approved by shareholders in May 2011, this is the Group's main share plan. The 2011 Plan is designed to deliver performance shares, deferred awards and restricted shares, giving the Group sufficient flexibility to meet the challenges of the changing regulatory and competitive environment. Share awards are a key part of both executive directors' and senior management's variable compensation and their significance as a proportion of potential total remuneration is one of the strongest indicators of the Group's commitment to pay for sustainable performance ensuring there is an appropriate return for the risk taken and that a measure is aligned with the Group's risk appetite. Performance and restricted share awards will generally be in the form of nil price options to acquire shares in SC PLC.

Performance shares

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

Deferred share awards/Restricted shares

Deferred awards are used to deliver the deferred portion of total variable compensation, in line with both market practice and regulatory requirements. These awards are subject to a three-year deferral period, vesting equally one third on each of the first, second and third anniversaries. These awards are not subject to an annual limit to ensure that regulatory requirements relating to deferral levels can be met and in line with market practice of our competitors. Deferred awards will not be subject to any further performance criteria, although the Group's claw-back policy will apply.

Restricted share awards which are made outside of the annual performance process, as additional incentive or retention mechanisms, are provided as restricted shares under the 2011 Plan. These awards vest in equal instalments on the second and the third anniversaries of the award date. In a few circumstances, some awards vest over a four-year period in equal tranches. In line with similar plans operated by our competitors, restricted share awards are not subject to an annual limit and do not have any performance conditions.

1997/2006 Restricted Share Scheme (2006 RSS)/ 2007 Supplementary Restricted Share Scheme (2007 SRSS)

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Material related party transactions (continued)

(c) Share based payments (continued)

2000 Executive Share Option Scheme (2000 ESOS)

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

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

2001 Performance Share Plan (2001 PSP)

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

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

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

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

The Standard Chartered 2014 Sharesave Plan was approved by Shareholders in May 2014 and since then all Sharesave invitations have been made under this plan.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Material related party transactions (continued)

(c) *Share based payments (continued)*

2011 Standard Chartered Share Plan (the 2011 plan)

Performance Shares

Valuation

The fair value is based on the market value less an adjustment to take into account the expected dividends over the vesting period and the relevant performance condition applying to that portion of the award. The fair value of the TSR component is derived by discounting a third of the award that is subject to the TSR condition by the loss of expected dividends over the performance period together with the probability of meeting the TSR condition. The EPS fair value is derived by discounting one third of the award respectively by the loss of expected dividends over the performance period. The same approach is applied to calculate the RoRWA fair value for one third of the award. In respect of the EPS and RoRWA components only, the number of shares expected to vest is adjusted for actual performance when calculating the charge for the year. The same fair value is applied to awards made to both directors and employees of the Group.

	2014		
Grant Date	*10 December*	*18 June*	*13 March*
Share price at grant date (£)	9.34	12.83	11.92
Shares granted	6,781	71	568,381
Vesting period (years)	3	3	3
Expected dividends (yield) (%)	5.7	5.6	5.3
Fair value (EPS) (£)	2.64	3.63	3.40
Fair value (RoRWA) (£)	2.64	3.63	3.40
Fair value (TSR) (£)	1.07	1.48	1.38

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

No share awards were granted in 2015.

A reconciliation of movements for the year to 31 December 2015 and 2014 is shown below:

	2015	*2014*
	No. of shares	*No. of shares*
Outstanding at 1 January	1,721,430	1,626,356
Adjustment for rights issue	57,236	–
Granted	–	575,233
Lapsed	(539,920)	(358,901)
Exercised	(52,471)	(121,258)
Outstanding at 31 December	1,186,275	1,721,430
Weighted average remaining contractual life	7.66 years	8.16 years
Exercisable at 31 December	45,068	40,549

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Material related party transactions (continued)

(c) Share based payments (continued)

Deferred Share Awards

Valuation

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

	2015		*2014*	
Grant Date	*17 June*	*19 March*	*18 June*	*13 March*
Share price at grant date (£)	10.28	10.5	12.83	11.92
Shares granted	3,723	1,564,894	1,217	1,226,630
Vesting period (years)	1/2/3/4/5	1/2/3/4/5	1/2/3	1/2/3
Expected dividends yield (%)	n/a	n/a	n/a	n/a
Fair value (£)	10.28	10.5	12.83	11.92

Deferred awards accrue dividend equivalent payments during the vesting period.

Restricted Share Awards

Valuation

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

	2015			
Grant Date	*1 December*	*22 September*	*17 June*	*19 March*
Share price at grant date (£)	5.57	6.73	10.28	10.50
Shares granted	8,496	20,585	4,379	19,527
Vesting period (years)	2/3	2/3, 1/2/3/4	2/3	2/3
Expected dividends (yield) (%)	6.4	6.4	7.0	7.0
Fair value (£)	4.77	5.77	8.68	8.88

	2014			
Grant Date	*10 December*	*17 September*	*18 June*	*13 March*
Share price at grant date (£)	9.34	12.28	12.83	11.92
Shares granted	27,869	88,253	45,901	4,026
Vesting period (years)	2/3, 1/2/3/4	2/3, 1/2/3/4	2/3, 1/2/3/4	2/3
Expected dividends (yield) (%)	5.5	5.7	6.1	5.8
Fair value (£)	8.17	10.69	11.08	10.37

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Material related party transactions (continued)

(c) Share based payments (continued)

Deferred Share Awards/ Restricted Shares

A reconciliation of movements for the year to 31 December 2015 and 2014 is shown below:

	2015	*2014*
	No. of shares	*No. of shares*
Outstanding at 1 January	2,910,711	2,351,016
Adjustment for rights issue	171,608	–
Granted	1,621,604	1,393,896
Additional shares for Notional Dividend	118,179	72,958
Lapsed	(196,422)	(128,748)
Exercised	(1,095,977)	(778,411)
Outstanding at 31 December	3,529,703	2,910,711
Weighted average remaining contractual life	5.42 years	5.50 years
Exercisable at 31 December	489,970	193,128

1997/2006 Restricted Share Scheme (2006 RSS)

No share awards were granted in 2015 and 2014.

A reconciliation of movements for the year ended 31 December 2015 and 2014 is shown below:

	2015	*2014*
	No. of shares	*No. of shares*
Outstanding at 1 January	327,711	917,138
Adjustment for rights issue	6,067	–
Additional shares for Notional Dividend	–	20,632
Lapsed	(103,612)	(11,301)
Exercised	(104,640)	(598,758)
Outstanding at 31 December	125,526	327,711
Weighted average remaining contractual life	1.65 years	2.53 years
Exercisable at 31 December	125,526	327,711

2007 Supplementary Restricted Share Scheme (2007 SRSS)

No share awards were granted in 2015 and 2014.

A reconciliation of movements for the year to 31 December 2015 and 2014 is shown below:

	2015	*2014*
	No. of shares	*No. of shares*
Outstanding at 1 January	119,766	180,281
Adjustment for rights issue	1,565	–
Lapsed	(54,546)	(1,972)
Exercised	(34,291)	(58,543)
Outstanding at 31 December	32,494	119,766
Weighted average remaining contractual life	1.19 years	2.08 years
Exercisable at 31 December	32,494	119,766

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Material related party transactions (continued)

(c) Share based payments (continued)

2000 Executive Share Option Scheme (2000 ESOS)

No share awards were granted in 2015 and 2014.

A reconciliation of option movements for the year ended 31 December 2015 and 2014 is shown below:

	2015		2014	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	–	–	5,840	£7.89
Exercised	–	–	(5,840)	£7.89
Outstanding at 31 December	–	–	–	–
Exercisable at 31 December	–	–	–	–

2001 Performance Share Plan (PSP)

No share awards were granted in 2015 and 2014.

A reconciliation of movements for the year ended 31 December 2015 and 2014 is shown below:

	2015	2014
	No. of shares	No. of shares
Outstanding at 1 January	17,720	30,800
Adjustment for rights issue	159	–
Lapsed	(10,900)	(1,321)
Exercised	(3,661)	(11,759)
Outstanding at 31 December	3,318	17,720
Weighted average remaining contractual life	0.2 years	3.38 years
Exercisable at 31 December	3,318	17,720

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Material related party transactions (continued)

(c) Share based payments (continued)

Sharesave (2004 International Sharesave, 2004 UK Sharesave and 2013 Sharesave)

Valuation

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

	2015	*2014*
Grant Date	*7 October*	*8 October*
Share price at grant date (£)	7.41	11.12
Exercise price (£)	5.57	9.85
Shares granted	1,034,721	506,846
Vesting period (years)	3	3
Expected volatility (%)	28.0	25.1
Expected option life (years)	3.33	3.33
Risk free rate (%)	0.9	1.19
Expected dividends (yield) (%)	6.3	5.8
Fair value (£)	1.4	1.61

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Material related party transactions (continued)

(c) *Share based payments (continued)*

Sharesave (2004 International Sharesave and 2004 UK Sharesave)

No share awards were granted in 2015 and 2014.

A reconciliation of option movements for the year ended 31 December 2015 and 2014 is shown below:

	2015		*2014*	
	No. of shares	*Weighted average exercise price*	*No. of shares*	*Weighted average exercise price*
Outstanding at 1 January	687,108	£11.26	1,270,791	£11.48
Adjustment for rights issue	15,812	N/A	–	N/A
Lapsed	(556,014)	£10.89	(554,367)	£11.69
Exercised	(27,078)	£10.66	(29,316)	£12.25
Outstanding at 31 December	119,828	£10.76	687,108	£11.26
Exercisable at 31 December	102,923	£10.86	132,559	£10.69

	2015			*2014*		
Range of exercise price	*Weighted average exercise price*	*No. of shares*	*Weighted average remaining contractual life*	*Weighted average exercise price*	*No. of shares*	*Weighted average remaining contractual life*
£10.14/£13.93 (2014: £10.65/£14.63)	£10.76	119,828	0.56 years	£11.26	687,108	1.26 years

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

40 Material related party transactions (continued)

(c) Share based payments (continued)

2013 Sharesave

	2015		2014	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	679,102	£10.66	413,113	£11.78
Adjustment for rights issue	71,357	N/A	–	N/A
Granted	1,034,721	£5.86	506,846	£9.85
Lapsed	(371,007)	£9.78	(240,857)	£10.88
Outstanding at 31 December	1,414,173	£6.73	679,102	£10.66
Exercisable at 31 December	–	–	–	–

	2015			2014		
Range of exercise price	Weighted average exercise price	No. of shares	Weighted average remaining contractual life	Weighted average exercise price	No. of shares	Weighted average remaining contractual life
£5.58/£11.21 (2014: £10.66)	£6.73	1,414,173	3.06 years	£10.66	679,102	3 years

(d) Loans to directors

Loans to directors of the Bank 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:

	2015 HK$'M	2014 HK$'M
Aggregate amount of relevant loans by the Bank outstanding at 31 December	28	26
Maximum aggregate amount of relevant loans by the Bank outstanding during the year	37	97

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Material related party transactions (continued)

(e) Related party transactions with associates and joint ventures of the Group

During the year, the Bank and its subsidiaries entered into transactions with associates and joint ventures of the 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:

	2015 *HK$'M*	*2014* *HK$'M*
Amounts due from associates and joint ventures	3	3
Deposits from associates and joint ventures	540	688
Operating income	26	19

41 Ultimate holding company

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

42 Significant accounting estimates and judgements

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

Pensions

Actuarial assumptions are made in valuing defined benefit obligations as set out in note 30 and are updated periodically.

Taxes

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

42 Significant accounting estimates and judgements (continued)

Fair value of financial instruments

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

Impairment of financial assets

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

Goodwill impairment

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

Impairment of interest in associates

Details of impairment testing are set out in note 20.

43 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2015

Up to the date of issue of the financial statements, the HKICPA/IASB has issued a number of new standards which are not yet effective for the accounting year ended 31 December 2015 and which have not been adopted in these financial statements.

These include:

– HKFRS 9/IFRS 9, *Financial instruments* (effective on 1 January 2018)

– HKFRS 15/IFRS 15, *Revenue from contracts with customers* (effective on 1 January 2017)

– HKFRS 16/IFRS 16, *Leases* (effective on 1 January 2019)

The Bank and its subsidiaries are in the process of making an assessment of what the impact of these amendments is expected to be in the period of initial application. It is not yet practicable to quantify the effect on these consolidated financial statements.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

44 Statement of financial position as at 31 December 2015

	2015 HK$'M	2014 HK$'M
Assets		
Cash and balances with banks, central banks and other financial institutions	48,763	53,064
Placements with banks and other financial institutions	119,648	145,757
Hong Kong SAR Government certificates of indebtedness	38,031	36,741
Trading assets	18,597	23,388
Financial assets designated at fair value	666	1,575
Investment securities	210,572	172,302
Advances to customers	412,619	452,717
Amounts due from immediate holding company	29,749	68,680
Amounts due from fellow subsidiaries	15,687	45,785
Amounts due from subsidiaries of the Bank	39,684	49,900
Investments in subsidiaries of the Bank	853	853
Interest in associates	3,570	3,729
Property, plant and equipment	3,053	3,163
Goodwill and intangible assets	1,075	1,116
Current tax assets	550	256
Deferred tax assets	306	122
Other assets	8,596	9,365
	952,019	1,068,513
Liabilities		
Hong Kong SAR currency notes in circulation	38,031	36,741
Deposits and balances of banks and other financial institutions	24,655	32,605
Deposits from customers	745,701	851,029
Trading liabilities	8,847	12,800
Financial liabilities designated at fair value	13,724	14,915
Debt securities in issue	1,209	13,838
Amounts due to immediate holding company	27,397	16,589
Amounts due to fellow subsidiaries	8,314	3,580
Amounts due to subsidiaries of the Bank	2,114	2,458
Other liabilities	14,332	16,210
Subordinated liabilities	10,093	10,406
	894,417	1,011,171
Equity		
Share capital	20,256	20,256
Reserves	37,346	37,086
Shareholders' equity	57,602	57,342
	952,019	1,068,513

Approved and authorised for issue by the Board of Directors on 23 February 2016.

Tan Siew Boi
Director

Ling Fou Tsong
Director

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

45 Statement of changes in equity for the year ended 31 December 2015

	Share capital HK$'M	Share premium HK$'M	Capital redemption reserve HK$'M	Cash flow hedge reserve HK$'M	Available-for-sale investment reserve HK$'M	Retained profits HK$'M	Share option equity reserve HK$'M	Total HK$'M
At 1 January 2014	97	12,477	3,804	(33)	115	31,734	178	48,372
Total comprehensive income	–	–	–	84	140	8,449	–	8,673
Dividend paid	–	–	–	–	–	(3,722)	–	(3,722)
Movement in respect of share-based compensation plans	–	–	–	–	–	–	141	141
Amalgamation of share premium and capital redemption reserve with share capital (note 33(i))	16,281	(12,477)	(3,804)	–	–	–	–	–
Issuance of perpetual non-cumulative convertible preference shares, net of issuance cost (note 32)	3,878	–	–	–	–	–	–	3,878
At 31 December 2014	20,256	–	–	51	255	36,461	319	57,342
Total comprehensive income	–	–	–	(33)	(332)	8,753	–	8,388
Dividend paid	–	–	–	–	–	(8,032)	–	(8,032)
Movement in respect of share-based compensation plans	–	–	–	–	–	–	(96)	(96)
At 31 December 2015	20,256	–	–	18	(77)	37,182	223	57,602

During the year ended 31 December 2015, the directors had declared and paid an ordinary dividend of HK$4.0214 (2014: HK$1.9215) per each 'A' and 'B' ordinary share totalling HK$7,790 million (2014: HK$3,722 million). A total dividend of HK$242 million (2014: Nil) was paid in respect of the US$500 million 6.25% perpetual non-cumulative convertible preference shares classified as equity.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

46 Disposal group held for sale

The assets and liabilities of the disposal group held for sale is summarised below:

	2014 *HK$'M*
Assets	
Cash and balances with banks and other financial institution	125
Advances to customers	12,220
Interest in associates	144
Property, plant and equipment	56
Goodwill and intangible assets	525
Other assets	147
Assets held for sale	13,217
Liabilities	
Deposits and balances of banks and other financial institutions	1,020
Deposit from customers	808
Other liabilities	174
Liabilities held for sale	2,002

Appendix I: unaudited supplementary financial information

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

Pursuant to section 3 of CG-5 on Guideline on a Sound Remuneration System of the Supervisory Policy manual issued by the Hong Kong Monetary Authority and the Pillar 3 disclosure requirements for remuneration by the Basel Committee on Banking Supervision, the following disclosures are made:

a) Information relating to the governance structure of the remuneration system

b) Information relating to the design and structure of the remuneration processes

c) Description of the ways in which current and future risks are taken into account in the remuneration processes

d) Description of the ways in which the Bank seeks to link performance during a performance measurement period with levels of remuneration

e) Description of the ways in which the Bank seeks to adjust remuneration to take account of longer-term performance

f) Description of the different forms of variable remuneration that the Bank utilizes and the rationale for using these different forms

g) Number of meetings held by the Board Remuneration Committee during the financial year and remuneration paid to the staff

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

h) Aggregate quantitative information on remuneration for Senior Management and Key Personnel (note 1) for the year ended 31 December 2015 and 31 December 2014 are as follows:

Analysis of remuneration split between fixed and variable compensation

	2015		2014	
	Senior Management HK$'000	Key Personnel HK$'000	Senior Management HK$'000	Key Personnel HK$'000
Fixed compensation	22,383	24,502	35,218	10,665
Variable compensation				
– Up front cash	9,565	9,308	11,455	3,669
– Up front shares	3,194	7,140	2,009	–
– Deferred cash	1,055	4,159	557	–
– Deferred shares:				
– Restricted shares	6,843	13,744	14,145	2,812
– Performance shares	–	–	8,310	528
Total	43,040	58,853	71,694	17,674
Number of staff at 31 December	8	13	12	10

Appendix I: unaudited supplementary financial information (continued)

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

Analysis of deferred remuneration (note 2)

	2015		2014	
	Senior Management HK$'000	Key Personnel HK$'000	Senior Management HK$'000	Key Personnel HK$'000
At 1 January	33,049	42,090	49,928	6,620
Adjusted for rights issue	(4)	(6)	–	–
Awarded during the year	7,899	17,903	23,012	3,340
Paid out during the year	(5,845)	(8,602)	(5,356)	(3,037)
Vested and lapsed during the year	–	(403)	–	–
Not vested due to performance adjustment	(4,503)	(3,305)	(4,999)	(170)
At 31 December	30,596	47,677	62,585	6,753
Vested during the year	7,256	12,860	12,082	2,205

Analysis of total amount of outstanding deferred remuneration

	2015		2014	
	Senior Management HK$'000	Key Personnel HK$'000	Senior Management HK$'000	Key Personnel HK$'000
At 31 December				
– Vested	6,089	7,246	9,493	325
– Not-vested	24,507	40,431	53,092	6,428
	30,596	47,677	62,585	6,753
At 31 December				
– Cash	1,287	7,205	1,494	189
– Shares	29,309	40,472	61,091	6,564
	30,596	47,677	62,585	6,753
Total amount of outstanding deferred remuneration exposed to ex post explicit and/or implicit adjustments (note 3)	30,596	47,677	62,585	6,753

Appendix I: unaudited supplementary financial information (continued)

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

Analysis of adjustments of deferred remuneration

	2015		2014	
	Senior Management HK$'000	Key Personnel HK$'000	Senior Management HK$'000	Key Personnel HK$'000
Total amount of adjustments during the financial year due to				
– ex post explicit adjustments	(4,503)	(3,305)	(4,999)	(170)
– ex post implicit adjustments	(8,928)	(13,484)	(16,620)	(1,902)

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

	2015		2014	
	Senior Management HK$'000	Key Personnel HK$'000	Senior Management HK$'000	Key Personnel HK$'000
Guaranteed bonuses awarded	–	–	2,792	–
Sign-on awards made	–	–	–	–
Severance payments awarded and made	3,101	215	–	–
Highest severance payments awarded	2,210	215	–	–
Number of beneficiaries of guaranteed bonuses awarded	–	–	1	–
Number of beneficiaries of sign-on awards made	–	–	–	–
Number of beneficiaries of severance payments awarded and made	2	1	–	–

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

Note 2: The population of Senior Management and Key Personnel in 2015 differs from that of 2014.

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

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 23 February 2016:

*	TAN Siew Boi
*	LING Fou Tsong
*	AACHI Vinod
*	Sami ABDELKAFI
	Timothy William ANDREW
*	Sanjeev AGRAWAL
*	Nigel ANTON
*	Stan BARNES
	Stephen Gordon Delano BARNES
*	Stephen John BARNHAM
	Russell Trevor Michael BEARDMORE-HAGELBERG
*	Garry BURKE
*	Peter William BURNETT
*	Paul Stuart CHAMBERS
*	CHAN Ericson Lap Ming
	CHAN Kang Muk
	Conlon CHEN
*	CHEN Poonis Annie
	CHEUNG Chi Leung
	CHEUNG Yup Fan
*	CHUNG Byung Ho
*	Kieran CORR
*	Christopher John DANIELS
*	Andrew William DAWSON
*	Carlos Ruiz DE LUZURIAGA
*	Jean FERNANDES
	FONG Julian Loong Choon
*	FUNG Alan Joi Lun
	Edward Leo HOGAN
*	HON Sau Yee, Kenneth
*	Jonathan Davey HOWARD
*	HUI Helen S
*	Guy Roland ISHERWOOD
	Richard KAO
*	KONG Pik Tung
*	Nils Kristian KOVDAL
*	Dinesh KUMAR
*	LAI Darcy Tat-Sze
*	LAI Yan Hong
*	LAM Chi Kwong Jonathan
*	LAM Hui Yip
*	LAW Heung Yee, Nita
*	LEE Hoi Keung
*	Patrick LEE
	LEE Wei Hsiung
*	LIM Han Siang Peter
	Thomas LIU
*#	Tim LORD
*	MAI Wai Lam
	Knut MATHIASSEN

Appendix II: directors of the Bank's subsidiaries (continued)

*	William MCCALLUM
	Craig MCGEE
*	Peter MOYLAN
*	Peter NAGLE
*	Francis Edwin NEVIS
*	NG Chau Shing Dantes
*	NG Chi Ming
	Richard Ray NIETO
*	Amit Kumar PURI
*	Pradeep RANA
	David William Ryman RICHARDS
*	Sander Johan Willem SCHEEPENS
*	Madhav SHANKAR
*#	Allison Helen STRACHAN
*	Samir SUBBERWAL
*	SZETO Ho Yin Jeffrey
	Sandip TALUKDAR
*	TAM Patrick Kwong Yuen
	Adeline TAN
	TAN Kok Boon
	TAN Ming Kiu John
	David Louis TAYLOR
*^	Tiara Ltd
*	Sam VILO
*	Jim WANG
	Paul David WILDEN
	YEUNG Chun Sing
	Amelia ZHANG
*	ZHANG Xiao Lei

Alternate director
^ Corporate director
* Directors serving the Board as at 23 February 2016