Standard Chartered

Standard Chartered Bank (Hong Kong) Limited

Directors' Report and Consolidated Financial Statements

For the year ended 31 December 2010

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 2010.

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 20 to the financial statements.

Financial statements

The profit of the Bank and its subsidiaries for the year ended 31 December 2010 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 123.

During the year ended 31 December 2010, the directors had declared and paid an ordinary dividend of HK$3.6085 (2009: nil) per each "A" and "B" ordinary share totalling HK$6,990 million (2009: nil).

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 (2009: HK$8 million).

Fixed assets

Details of the movements in fixed assets are set out in note 22 to the financial statements.

Share capital

There were no movements in the Bank's share capital during the year.

Directors

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

Executive directors
Benjamin Hung Pi Cheng
Julian Fong Loong Choon
Saleem Razvi (appointed on 3 May 2010)
Tan Siew Boi

Report of the directors (continued)

Non-executive directors
Katherine Tsang King Suen (appointed as Chairperson on 1 Jan 2011)
Chow Chung Kong*, Chairman (resigned on 1 Jan 2011)
Jaspal Singh Bindra
Olga Louise Zoutendijk
Raymond Kwok Ping Luen*
Ma Xuezheng*
Norman Lyle*
Chan Wing Kin*
Michael Thomas Pratt (appointed on 1 February 2010)
Stefano Paolo Bertamini (resigned on 1 February 2010)

** Independent non-executive directors*

Mr Saleem Razvi will retire in accordance with Article 109 of the Bank's Articles of Association at the forthcoming annual general meeting and being eligible, offer himself for re-election.

Directors' service contracts

The independent non-executive directors were appointed by the board of directors for a term of 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, Katherine Tsang King Suen, Benjamin Hung Pi Cheng, Julian Fong Loong Choon, Saleem Razvi, Tan Siew Boi, Michael Thomas Pratt, Stefano Paolo Bertamini and Olga Louise Zoutendijk were granted options under these schemes.

Directors' rights to acquire shares

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

Directors' interests in contracts

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

Report of the directors (continued)

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

Katherine Tsang King Suen
Chairperson

Hong Kong, 2 March 2011

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

(Incorporated in Hong Kong SAR with limited liability)

We have audited the consolidated financial statements of Standard Chartered Bank (Hong Kong) Limited (the "Bank") and its subsidiaries (together "the Bank and its subsidiaries") set out on pages 5 to 123, which comprise the consolidated and the bank balance sheets as at 31 December 2010, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated and the bank statements of changes in equity and the consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the financial statements

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

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance 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 state of affairs of the Bank and of the Bank and its subsidiaries as at 31 December 2010 and of the Bank and its subsidiaries' profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

KPMG
Certified Public Accountants

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

2 March 2011

Consolidated income statement
For the year ended 31 December 2010

(Expressed in millions of Hong Kong dollars)

	Note	2010 HK$'M	Restated 2009 HK$'M
Interest income	4(a)	11,730	13,087
Interest expense	4(b)	(1,923)	(2,600)
Net interest income		9,807	10,487
Fee and commission income		6,493	4,876
Fee and commission expense		(520)	(619)
Net fee and commission income	4(c)	5,973	4,257
Net trading income	4(d)	2,367	2,181
Net gains/(losses) from financial instruments designated at fair value through profit or loss	4(e)	39	(1)
Net gains from disposal of available-for-sale securities	5	156	172
Other operating income	4(f)	110	58
		8,645	6,667
Total operating income		18,452	17,154
Staff costs		(5,754)	(4,726)
Premises and equipment		(1,079)	(1,123)
Others		(4,187)	(3,402)
Operating expenses	4(g)	(11,020)	(9,251)
Operating profit before impairment		7,432	7,903
Impairment charges on advances to banks and customers	6(a)	(392)	(1,115)
Other impairment reversals/(charges)	6(b)	12	(1,010)
Operating profit after impairment		7,052	5,778
Share of profit of associates		326	164
Profit before taxation		7,378	5,942
Taxation	7(a)	(1,151)	(745)
Profit after taxation		6,227	5,197
Attributable to:			
Equity shareholders of the Bank		6,185	5,175
Non-controlling interests		42	22
Profit after taxation		6,227	5,197

The notes on pages 13 to 123 form part of these financial statements.

Consolidated balance sheet as at 31 December 2010

(Expressed in millions of Hong Kong dollars)

	Note	*2010* *HK$'M*	*Restated* *2009* *HK$'M*
Assets			
Cash and balances with banks and other financial institutions	10	29,902	8,957
Placements with banks and other financial institutions	11(a)	97,167	144,968
Hong Kong SAR Government certificates of indebtedness	12	31,581	26,461
Trading assets	13	48,719	32,654
Financial assets designated at fair value	14	6,560	–
Investment securities	17	135,019	145,472
Advances to customers	15(a)	334,850	230,457
Amounts due from immediate holding company	19	33,665	54,406
Amounts due from fellow subsidiaries	19	20,660	18,508
Interest in associates	21	4,513	3,595
Fixed assets	22	3,035	2,938
Goodwill and intangible assets	23	1,725	1,737
Deferred tax assets	29	350	504
Other assets	24	10,809	8,403
		758,555	679,060
Liabilities			
Hong Kong SAR currency notes in circulation	12	31,581	26,461
Deposits and balances of banks and other financial institutions		19,745	22,426
Deposits from customers	26	573,277	525,173
Trading liabilities	30	36,446	29,036
Financial liabilities designated at fair value	28	3,052	7,566
Debt securities in issue	27	–	1,063
Amounts due to immediate holding company	19	24,586	8,847
Amounts due to fellow subsidiaries	19	5,983	3,023
Current tax liabilities		360	331
Deferred tax liabilities	29	17	39
Other liabilities	31	16,480	13,073
Subordinated liabilities	33	8,055	2,306
		719,582	639,344
Equity			
Share capital	34	97	97
Reserves	35	38,807	39,592
Shareholders' equity		38,904	39,689
Non-controlling interests		69	27
		38,973	39,716
		758,555	679,060

Approved and authorised for issue by the Board of Directors on 2 March 2011.

Tsang King Suen Katherine
Chairperson

Hung Pi Cheng Benjamin
Director

Saleem Razvi
Director

Wang Wei Min
Company Secretary

The notes on pages 13 to 123 form part of these financial statements.

Balance sheet as at 31 December 2010

(Expressed in millions of Hong Kong dollars)

	Note	2010 HK$'M	2009 HK$'M
Assets			
Cash and balances with banks and other financial institutions	10	29,892	8,871
Placements with banks and other financial institutions	11(a)	96,900	144,947
Hong Kong SAR Government certificates of indebtedness	12	31,581	26,461
Trading assets	13	48,719	32,701
Financial assets designated at fair value	14	6,560	–
Investment securities	17	133,500	143,069
Advances to customers	15(a)	325,591	226,236
Amounts due from immediate holding company	19	33,361	54,267
Amounts due from fellow subsidiaries	19	20,374	17,101
Amounts due from subsidiaries of the Bank	19	8,854	1,947
Investments in subsidiaries of the Bank	20	1,092	2,808
Interest in associates	21	3,362	2,724
Fixed assets	22	2,870	2,852
Goodwill and intangible assets	23	886	921
Deferred tax assets	29	312	488
Other assets	24	9,995	8,041
		753,849	673,434
Liabilities			
Hong Kong SAR currency notes in circulation	12	31,581	26,461
Deposits and balances of banks and other financial institutions		19,036	19,952
Deposits from customers	26	572,813	524,050
Trading liabilities	30	36,446	29,036
Financial liabilities designated at fair value	28	3,052	7,566
Debt securities in issue	27	–	1,063
Amounts due to immediate holding company	19	24,250	8,468
Amounts due to fellow subsidiaries	19	4,563	2,384
Amounts due to subsidiaries of the Bank	19	1,730	1,042
Current tax liabilities		182	247
Other liabilities	31	15,717	12,532
Subordinated liabilities	33	8,055	2,306
		717,425	635,107
Equity			
Share capital	34	97	97
Reserves	35	36,327	38,230
Shareholders' equity		36,424	38,327
		753,849	673,434

Approved and authorised for issue by the Board of Directors on 2 March 2011.

Tsang King Suen Katherine
Chairperson

Hung Pi Cheng Benjamin
Director

Saleem Razvi
Director

Wang Wei Min
Company Secretary

The notes on pages 13 to 123 form part of these financial statements.

Consolidated statement of comprehensive income
For the year ended 31 December 2010

(Expressed in millions of Hong Kong dollars)

	2010 HK$'M	Restated 2009 HK$'M
Profit after taxation	6,227	5,197
Other comprehensive income:		
Defined benefit plans:		
– Actuarial gains	1	462
– Related tax effect	–	(71)
Available-for-sale securities:		
– Changes in fair value recognised during the year	188	111
– Changes in fair value transferred to the income statement on disposal	(156)	(172)
– Transfer to income statement on fair value hedged items attributable to hedged risk	(204)	(2)
– Related tax effect	27	37
Cash flow hedges:		
– Changes in fair value recognised during the year	(63)	(86)
– Changes in fair value transferred to the income statement on termination of hedging derivatives	3	(23)
– Related tax effect	9	22
Exchange difference	(16)	(12)
Net changes in share option equity reserve	294	–
Other comprehensive income for the year, net of tax	83	266
Total comprehensive income for the year	6,310	5,463
Attributable to:		
Shareholders of the Bank	6,268	5,441
Non-controlling interests	42	22
	6,310	5,463

The notes on pages 13 to 123 form part of these financial statements.

Consolidated statement of changes in equity
For the year ended 31 December 2010

(Expressed in millions of Hong Kong dollars)

	Share capital HK$'M	Share premium HK$'M	Capital redemption reserve HK$'M	Cash flow hedge reserve HK$'M	Available-for-sale investment reserve HK$'M	Revaluation reserve HK$'M	Pension reserve HK$'M	Exchange reserve HK$'M	Retained profits HK$'M	Share option equity reserve HK$'M	Merger reserve* HK$'M	Non-controlling interests HK$'M	Total HK$'M
At 1 January 2009, as previously stated	97	12,477	3,804	43	216	146	(502)	178	17,121	–	–	5	33,585
Effect of merger of a commonly controlled entity	–	–	–	(26)	–	–	–	–	269	–	645	–	888
Restated as at 1 January 2009	97	12,477	3,804	17	216	146	(502)	178	17,390	–	645	5	34,473
Total comprehensive income	–	–	–	(87)	(26)	–	391	(12)	5,175	–	–	22	5,463
Cash distribution to a fellow subsidiary (Note)	–	–	–	–	–	–	–	–	(220)	–	–	–	(220)
At 31 December 2009	97	12,477	3,804	(70)	190	146	(111)	166	22,345	–	645	27	39,716
At 1 January 2010, as previously stated	97	12,477	3,804	(56)	190	146	(111)	166	22,010	–	–	27	38,750
Effect of merger of a commonly controlled entity	–	–	–	(14)	–	–	–	–	335	–	645	–	966
Restated as at 1 January 2010	97	12,477	3,804	(70)	190	146	(111)	166	22,345	–	645	27	39,716
Total comprehensive income	–	–	–	(51)	(145)	–	1	(16)	6,185	294	–	42	6,310
Dividend paid	–	–	–	–	–	–	–	–	(6,990)	–	–	–	(6,990)
Cash distribution to a fellow subsidiary (Note)	–	–	–	–	–	–	–	–	(63)	–	–	–	(63)
Transfer to retained earnings	–	–	–	–	–	–	–	–	645	–	(645)	–	–
At 31 December 2010	97	12,477	3,804	(121)	45	146	(110)	150	22,122	294	–	69	38,973

* Merger reserve arising on the acquisition of Prime Credit Limited ("PCL"). On 1 July 2010, the Bank acquired 100 per cent of the share capital of PCL at a cost of HK$204 million (Notes 2 and 20)

Note: Dividends of HK$63 million (2009: HK$220 million) were paid by PCL to a fellow subsidiary of the Bank prior to the Bank's acquisition of PCL in July 2010.

The notes on pages 13 to 123 form part of these financial statements.

Statement of changes in equity
For the year ended 31 December 2010
(Expressed in millions of Hong Kong dollars)

	Share capital HK$'M	Share premium HK$'M	Capital redemption reserve HK$'M	Cash flow hedge reserve HK$'M	Available-for-sale investment reserve HK$'M	Pension reserve HK$'M	Retained profits HK$'M	Share option equity reserve HK$'M	Total HK$'M
At 1 January 2009	97	12,477	3,804	43	260	(502)	17,049	–	33,228
Total comprehensive income	–	–	–	(99)	(69)	359	4,908	–	5,099
At 31 December 2009	97	12,477	3,804	(56)	191	(143)	21,957	–	38,327
Total comprehensive income	–	–	–	(59)	(140)	–	4,992	294	5,087
Dividend paid	–	–	–	–	–	–	(6,990)	–	(6,990)
At 31 December 2010	97	12,477	3,804	(115)	51	(143)	19,959	294	36,424

During the year ended 31 December 2010, the directors had declared and paid an ordinary dividend of HK$3.6085 (2009: Nil) per each 'A' and 'B' ordinary share totalling HK$6,990 million (2009: Nil).

The notes on pages 13 to 123 form part of these financial statements.

Consolidated cash flow statement
For the year ended 31 December 2010

(Expressed in millions of Hong Kong dollars)

	Note	2010 HK$'M	Restated 2009 HK$'M
Operating activities			
Profit before taxation		7,378	5,942
Adjustments for:			
Impairment charges on advances to banks and customers		392	1,115
Advances written off net of recoveries		(823)	(1,120)
Unwinding of discount on loan impairment charges		(25)	(42)
Other impairment reversals/(charges)		(12)	1,010
Depreciation		200	221
Amortisation of intangible assets		93	80
Gains on disposal of fixed assets		(32)	–
Share of profit of associates		(326)	(164)
Gain on disposal of investment in an associate		–	(7)
Interest expense on subordinated liabilities		198	168
Fair value losses/(gains) transferred from reserves on cash flow hedges		3	(23)
Exchange translation on subordinated liabilities		(2)	3
		7,044	7,183
(Increase)/decrease in operating assets:			
Placements with banks and other financial institutions with original maturity beyond three months		13,464	(8,039)
Trading assets		601	(17,485)
Financial assets designated at fair value		(6,560)	–
Investment securities		9,222	(67,889)
Gross advances to customers		(98,344)	(13,389)
Amounts due from immediate holding company and fellow subsidiaries		52,052	7,973
Other assets		(3,211)	(1,376)
Increase/(decrease) in operating liabilities:			
Deposits and balances of banks and other financial institutions		(2,711)	13,660
Deposits from customers		48,104	47,203
Debt securities in issue		(1,063)	(2,682)
Financial liabilities designated at fair value		(4,514)	2,260
Amounts due to immediate holding company and fellow subsidiaries		19,397	(1,296)
Trading liabilities		7,410	13,416
Other liabilities		3,369	(987)
Cash generated from/(used in) operations		44,260	(21,448)
Income tax paid		(954)	(1,032)
Net cash generated from/(used in) operating activities		43,306	(22,480)

Consolidated cash flow statement (continued)
For the year ended 31 December 2010

(Expressed in millions of Hong Kong dollars)

	Note	2010 HK$'M	Restated 2009 HK$'M
Investing activities			
Dividend received from an associate		169	74
Payment for purchase of a subsidiary, net of cash and cash equivalents acquired		–	(341)
Payment for purchases of consumer finance businesses, net of cash and cash equivalents acquired		(5,574)	–
Acquisition of a subsidiary from a fellow subsidiary		(204)	–
Payment for additional investment in an associate		(795)	–
Payment for purchase of fixed assets		(181)	(152)
Payment for purchase of intangible assets		(74)	(61)
Proceeds from disposal of investment in an associate		–	31
Proceeds from disposal of fixed assets		48	7
Proceeds from disposal of intangible assets		31	11
Net cash used in investing activities		(6,580)	(431)
Financing activities			
Repurchase of subordinated liabilities		–	(3,810)
Proceeds from issuance of subordinated liabilities		5,785	–
Interest paid on subordinated liabilities		(186)	(197)
Cash distribution to a fellow subsidiary		(63)	(220)
Dividend paid		(6,990)	–
Net cash used in financing activities		(1,454)	(4,227)
Net increase/(decrease) in cash and cash equivalents		35,272	(27,138)
Cash and cash equivalents at 1 January		88,405	114,546
Effect of foreign exchange		631	997
Cash and cash equivalents at 31 December	36	124,308	88,405
Cash flows from operating activities include:			
Interest received		11,340	13,734
Interest paid		1,602	2,718
Dividends received		16	17

The notes on pages 13 to 123 form part of these financial statements.

Notes to the financial statements

(Expressed in millions of Hong Kong dollars)

1 Principal activities

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

2 Significant accounting policies

(a) Statement of compliance

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

(b) Basis of preparation of the financial statements

(i) Basis of Preparation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries made up to 31 December 2010.

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

The preparation of financial statements in conformity with adopted HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank and its subsidiaries' accounting policies. 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 2009.

Application of merger accounting

On 1 July 2010, the Bank acquired 100 per cent of the share capital of Prime Credit Limited ("PCL"), from a fellow subsidiary company at a cost of HK$204 million.

As the Bank and PCL were under the common control of Standard Chartered PLC Group (the "Group") before and after the above-mentioned acquisition, the Bank has applied Accounting Guideline No.5 – "Merger Accounting for Common Control Combinations" issued by the HKICPA in accounting for the acquisition of PCL in its consolidated financial statements. In accordance with the principles of merger accounting, the Bank and its subsidiaries' consolidated financial statements have been presented as if the acquisition by the Bank had occurred from the date when PCL first came under the control of Standard Chartered PLC Group.

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)

(i) Basis of Preparation (continued)

The net assets of PCL have been recognised using the carrying amounts in the consolidated financial statements of Standard Chartered PLC Group. Comparative amounts have been restated so that they are presented as if PCL had been combined at the previous balance sheet date.

The excess of carrying value over consideration at the time of acquisition was recognised as a merger reserve in equity. The effects of all transactions between the Bank and its subsidiaries and PCL, whether occurring before or after the combination, are eliminated in preparing the consolidated financial statements. The transaction costs for the acquisition were expensed in the consolidated income statement.

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

(ii) Consolidated Financial Statements

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

(c) Subsidiaries and non-controlling interests

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

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

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 balance sheet 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.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(c) Subsidiaries and non-controlling interests (continued)

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 balance sheet, its investments in subsidiaries are stated at cost less impairment losses, if any (see note 20).

(d) Associates

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

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

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

In the Bank's balance sheet, the investment in an associate is stated at cost less any impairment and dividends from pre-acquisition profits received prior to 1 January 2010, 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. Goodwill is allocated to cash-generating units for the purpose of impairment testing.

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

(iii) Computer software

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

(f) Investment properties

Investment properties are land and buildings which are owned either to earn rental income or for long term investments or for both. Investment properties are stated in the balance sheet at depreciated cost less impairment. Investment properties are depreciated over their estimated useful lives on a straight-line basis.

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

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

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)

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

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

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

(h) Leases

Where the Bank is the lessee

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

Where the Bank is the lessor

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

(i) Financial assets and liabilities (excluding derivatives)

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

– 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.

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)

(ii) Loans and receivables

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

(iii) Available-for-sale assets

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

Initial recognition

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

Subsequent measurement

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

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

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

The fair values of quoted financial assets or financial liabilities in active markets are based on current prices. If the market for a financial asset or financial liability is not active, and for unlisted securities, the Bank and its subsidiaries establish fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Reclassifications

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

Held for trading non-derivative financial assets can only be transferred out of the held at fair value through profit or loss category in the following circumstances: (i) to the available-for-sale category, where, in rare circumstances, they are no longer held for the purpose of selling or repurchasing in the near term; or (ii) to the 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.

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 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 has made concessions that it would not otherwise consider. Renegotiated loans and receivables are subject to ongoing monitoring to determine whether they remain impaired or past due.

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognised when they are extinguished, i.e. when the obligation is discharged, cancelled or expires.

(j) Derivative financial instruments and hedge accounting

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

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)

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

(i) Fair value hedge

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

(ii) Cash flow hedge

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

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

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

Derivatives that do not qualify for hedge accounting

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

(k) Impairment of financial assets

Assets carried at amortised cost

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(k) Impairment of financial assets (continued)

Assets carried at amortised cost (continued)

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

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

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

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of 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 in determining whether the equity security is impaired. Where objective evidence of impairment exists for available-for-sale financial assets, the cumulative loss (measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss) is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

(l) Offsetting financial transactions

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

(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 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 and other financial institutions, placements with banks and other financial institutions, and treasury bills.

(o) Revenue recognition

(i) Interest income and expense

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

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

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)

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

(ii) Fees and commissions

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

(iii) Other income from financial assets and liabilities

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

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

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

(p) Income tax

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

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

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(p) Income tax (continued)

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

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

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

(q) Provisions

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

(r) Employee benefits

(i) Short term employee benefits

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

(ii) Pension obligations

The Bank 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 asset recognised in the balance sheet represents the excess of the fair value of plan assets over the present value of the defined benefit obligations at the balance sheet date. The defined benefit obligations are calculated annually by independent actuaries using the projected unit method. The present value of the defined benefit obligations is determined by discounting the estimated future cash outflows using an interest rate equal to the yield on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have a term to maturity approximating to the term of the related pension liability.

Actuarial gains and losses that arise are recognised in shareholders' equity and presented in the consolidated statement of other comprehensive income in the period they arise. Past service costs are recognised immediately to the extent that benefits are vested and are otherwise recognised over the average period until benefits are vested on a straight-line basis. Current service costs and any past service costs, together with the unwinding of the discount on plan liabilities, offset by the expected return on plan assets where applicable, are charged to operating expenses.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(r) Employee benefits (continued)

(iii) Share-based compensation

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 options is recognised as an expense.

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

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

(s) Translation of foreign currencies

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

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

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

– assets and liabilities for each balance sheet presented are translated at the closing rate at the balance sheet date.

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

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

2 Significant accounting policies (continued)

(t) Related parties

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

(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

Where securities are sold subject to a commitment to repurchase them at a predetermined price ('repos'), they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to re-sell ('reverse repos') are not recognised on the balance sheet and the consideration paid is recorded in 'Advances to customers' or 'Placements with banks and other financial institutions' as appropriate. The difference between the sale and repurchase price is treated as interest and recognised over the life of the agreement.

3 Changes in accounting policies

The IASB has issued a number of new and revised IFRSs and Interpretations that are first effective for the current accounting period commencing 1 January 2010 or are available for early adoption. The equivalent new and revised HKFRSs and Interpretations consequently issued by HKICPA have the same effective date as those issued by the IASB and are in all material respects identical to the pronouncements issued by the IASB. There have been no other material changes to HKFRSs.

On 1 January 2010, the Bank and its subsidiaries adopted prospectively HKFRS 3 (revised) 'Business Combinations' and consequential amendments to HKAS 27 'Consolidated and Separate Financial Statements', HKAS 28 'Investment in Associates', and HKAS 31 'Interest in Joint Ventures', none of which had a material impact on the consolidated financial statements.

HKFRS 3 (revised) continues to apply the acquisition method to business combinations but with some significant changes compared with HKFRS 3. For example, all acquisition-related costs are expensed and no longer capitalised as part of the cost of acquisition and all payments to acquire a business – including those that are contingent – are recorded at fair value at the acquisition date. Also, when a controlling interest in an entity is acquired, any previously held interest in that entity is effectively disposed of at its fair value – with any gain or loss when compared to its carrying value recognised in the income statement – and re-acquired in aggregate with the controlling stake. The revised standard has also changed certain terminology with minority interests now referred to as non-controlling interests.

The amendments to HKAS 27 (revised) require the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The amendments also specify the accounting when control is lost, with any remaining interest in the entity re-measured to fair value and any resulting gain or loss recognised in profit or loss.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

3 Changes in accounting policies (continued)

On 1 January 2010, the Bank and its subsidiaries adopted improvements to HKFRS (2009), which are a collection of amendments to a number of IFRSs. The amendments to HKFRS 2, HKFRS 8, HKAS 1, HKAS 7, HKAS 18, HKAS 39 and HKFRIC 16 were applied on a retrospective basis and amendments to HKFRS 5, HKAS 36, HKAS 38 and HKFRIC 9 were applied on a prospective basis. None of these amendments had a material impact on the consolidated financial statements.

HKAS 17 (Amendments), 'Leases' deletes specific guidance regarding classification of leases of land, so as to eliminate inconsistency with the general guidance on lease classification. As a result, leases of land should be classified as either finance or operating leases using the general principles of HKAS 17, i.e. depending on whether the lease transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee. Prior to the amendment, land interest for which title was not expected to pass to the lessee at the end of the lease term was classified as an operating lease. This amendment does not have an impact on the Bank and its subsidiaries as all leasehold land had been classified together with buildings as finance leases.

4 Operating profit

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

	2010 HK$'M	Restated 2009 HK$'M
(a) Interest income		
Interest income on listed securities	330	288
Interest income on unlisted securities	2,242	2,124
Other interest income	9,158	10,675
Amount shown in the income statement	11,730	13,087
Less: interest income arising from trading assets	(333)	(177)
Less: interest income on financial assets designated at fair value	(22)	–
Total interest income on financial assets that are not measured at fair value through profit or loss	11,375	12,910

Other interest income includes interest income on unwinding of discounts on loan impairment charges of HK$25 million (note 16) (2009: HK$42 million), and fair value losses of HK$3 million transferred from reserves on cash flow hedges (2009: fair value gains of HK$23 million).

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

4 Operating profit (continued)

	2010 HK$'M	Restated 2009 HK$'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	1,725	2,432
Interest expense on subordinated liabilities	198	168
Amount shown in the income statement	1,923	2,600
Less: interest expense arising from trading liabilities	(323)	(158)
Less: interest expense arising from financial liabilities designated at fair value	(32)	(44)
Total interest expense on financial liabilities that are not measured at fair value through profit or loss	1,568	2,398
(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	2,804	2,047
– fee and commission expense	221	165
Net fee income from trust and other fiduciary activities where the Bank holds or invests assets on behalf of its customers		
– fee and commission income	444	301
– fee and commission expense	101	106
(d) Net trading income		
Gains less losses from dealing in foreign currencies	2,031	1,688
Gains less losses from trading securities	126	8
Gains from other dealing activities	210	485
Amount shown in the income statement	2,367	2,181
Add: interest income arising from trading assets	333	177
Less: interest expense arising from trading liabilities	(323)	(158)
Net income from trading instruments	2,377	2,200

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

4 Operating profit (continued)

	2010 HK$'M	Restated 2009 HK$'M
(e) Net gains/(losses) from financial instruments designated at fair value		
Net gains/(losses) as shown in the income statement	39	(1)
Add: interest income arising from financial assets designated at fair value	22	–
Less: interest expense arising from financial liabilities designated at fair value	(32)	(44)
	29	(45)
(f) Other operating income		
Dividend income from listed available-for-sale securities	1	2
Dividend income from unlisted available-for-sale securities	15	15
Gains on disposal of fixed assets	32	–
Net loss on disposal of financial instruments measured at amortised cost	(9)	(43)
Gain on disposal of investment in an associate	–	7
Others	71	77
	110	58
(g) Operating expenses		
Staff costs		
– contributions to defined contribution plans	140	122
– expense in respect of the defined benefits plans (note 32(d))	26	30
– equity-settled share-based payment expenses	400	223
– salaries and other staff costs	5,188	4,351
Depreciation (note 22)	200	221
Premises and equipment expense, excluding depreciation		
– rental of premises	605	580
– others	274	322
Amortisation		
– other intangible assets (note 23)	93	80
Auditor's remuneration	12	11
Others	4,082	3,311
	11,020	9,251

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

	2010 HK$'M	2009 HK$'M
Net gains transferred from reserves	156	172

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

6 Impairment charges

	2010 HK$'M	Restated 2009 HK$'M
(a) Impairment charges on advances to banks and customers		
Individual impairment provisions (note 16)		
– additions	762	1,424
– releases	(99)	(123)
– recoveries	(241)	(244)
	422	1,057
Portfolio impairment (releases)/charges (note 16)	(30)	58
	392	1,115
(b) Other impairment (reversals)/charges		
(Releases)/charges for contingent liabilities	(9)	1,010
Impairment reversal for investment securities	(3)	–
	(12)	1,010

7 Taxation in the consolidated income statement

(a) Taxation in the consolidated income statement represents:

	2010 HK$'M	Restated 2009 HK$'M
Current tax		
Hong Kong profits tax	881	1,036
Overseas taxation	96	54
Under/(over)-provision in respect of prior years	6	(4)
	983	1,086
Deferred tax (note 29)		
Origination/(reversal) of temporary differences	197	(351)
(Over)/under-provision in respect of prior years	(29)	10
	168	(341)
	1,151	745

The provision for Hong Kong profits tax for 2010 is calculated at 16.5% (2009: 16.5%) of the estimated assessable profits for the year. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

7 Taxation in the consolidated income statement (continued)

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

	2010 HK$'M	Restated 2009 HK$'M
Profit before taxation	7,378	5,942
Notional tax on profit before taxation, calculated at Hong Kong profits tax rate of 16.5%	1,217	980
Tax effect of non-deductible expenses	43	55
Tax effect of non-taxable revenue	(121)	(67)
(Over)/under-provision in prior years	(23)	6
Tax effect of different tax rates of subsidiaries operating in other jurisdictions	44	27
Tax effect of structured investments	–	(305)
Others	(9)	49
Actual tax expense	1,151	745

8 Directors' remuneration

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

	Bank	
	2010 HK$'M	2009 HK$'M
Fees	2	3
Salaries and other emoluments	38	38
	40	41

9 Segmental reporting

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

- Consumer Banking which provides financial services to customers including lending and deposit taking activities, credit card facilities and investment services; and

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

9 Segmental reporting (continued)

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

(a) Segment results, assets and liabilities

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

	Consumer banking		*Wholesale banking*		*Other banking*		*Inter-segment eliminations*		*Consolidated Total*	
		Restated								*Restated*
	2010	*2009*	*2010*	*2009*	*2010*	*2009*	*2010*	*2009*	*2010*	*2009*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*	*HK$'M*	*HK$'M*	*HK$'M*	*HK$'M*	*HK$'M*	*HK$'M*
Operating income										
– Net interest income	5,168	5,188	4,640	5,212	(90)	(24)			9,718	10,376
– Other operating income	3,520	3,033	5,975	4,793	–	34			9,495	7,860
	8,688	8,221	10,615	10,005	(90)	10			19,213	18,236
Operating expenses	(5,524)	(4,636)	(4,912)	(4,495)	(60)	36			(10,496)	(9,095)
Operating profit before impairment	3,164	3,585	5,703	5,510	(150)	46			8,717	9,141
Impairment charges	(352)	(807)	25	(327)	5	–			(322)	(1,134)
Share of losses of associates	–	–	–	–	–	(59)			–	(59)
Profit before taxation	2,812	2,778	5,728	5,183	(145)	(13)			8,395	7,948
Total assets	206,195	161,206	565,612	510,402	50,997	60,203	(39,160)	(35,359)	783,644	696,452
Segment liabilities	301,946	274,756	460,027	401,778	22,015	13,776	(39,160)	(35,359)	744,828	654,951

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

Revenue

	Consolidated	
		Restated
	2010	*2009*
	HK$'M	*HK$'M*
Reportable segment revenue	19,213	18,236
Income relating to Financial Market products	(1,009)	(944)
Cost of free funds	206	187
Others	42	(325)
Total operating income	18,452	17,154

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

9 Segmental reporting (continued)

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

	Consolidated 2010 HK$'M	Consolidated Restated 2009 HK$'M
Profit before taxation		
Reportable segment profit before taxation	8,395	7,948
Income relating to Financial Market products	(1,009)	(944)
Cost of free funds	206	187
Reallocations of impairment charges	–	(1,010)
Others	(214)	(239)
Profit before taxation	7,378	5,942

	Consolidated 2010 HK$'M	Consolidated Restated 2009 HK$'M
Assets		
Reportable segment assets	783,644	696,452
Assets of subsidiaries not included in consolidated total assets	(2,186)	(599)
Others	(22,903)	(16,793)
Total assets	758,555	679,060

	Consolidated 2010 HK$'M	Consolidated Restated 2009 HK$'M
Liabilities		
Reportable segment liabilities	744,828	654,951
Liabilities of subsidiaries not included in consolidated total liabilities	(2,335)	(665)
Others	(22,911)	(14,942)
Total liabilities	719,582	639,344

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

10 Cash and balances with banks and other financial institutions

	Consolidated		Bank	
		Restated		
	2010	2009	2010	2009
	HK$'M	HK$'M	HK$'M	HK$'M
Cash in hand	1,307	1,357	1,297	1,340
Balances with central bank	12,879	1,946	12,879	1,946
Balances with banks and other financial institutions	15,716	5,654	15,716	5,585
	29,902	8,957	29,892	8,871

11 Placements with banks and other financial institutions

(a) Placements with banks and other financial institutions

	Consolidated		Bank	
	2010	2009	2010	2009
	HK$'M	HK$'M	HK$'M	HK$'M
Gross placements with banks and other financial institutions				
– maturing within one month	58,671	92,638	58,404	92,617
– maturing between one month to one year	38,285	51,608	38,285	51,608
– maturing between one year to five years	213	722	213	722
	97,169	144,968	96,902	144,947
Less: impairment charges individually assessed (note 16(b))	(2)	–	(2)	–
	97,167	144,968	96,900	144,947

Of which:

Balances under collateralised reverse repurchase agreements	29,941	–	29,941	–

(b) Impaired placements with banks and other financial institutions

	Consolidated and Bank	
	2010	2009
	HK$'M	HK$'M
Gross impaired advances to banks	65	184
Impairment charges – individually assessed	(2)	–
	63	184
Gross impaired advances to banks as a % of gross advances to banks	0.07%	0.13%

There is no collateral held against impaired advances to banks.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

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

13 Trading assets

	Consolidated		*Bank*	
	2010	*2009*	*2010*	*2009*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
Trading securities	46,451	32,005	46,451	32,005
Placements with banks and other financial institutions	333	38	333	38
Advances to customers	1,155	136	1,155	136
Positive fair values of derivatives	780	475	780	522
	48,719	32,654	48,719	32,701
Trading securities:				
Treasury bills (including Exchange Fund Bills)	25,165	18,472	25,165	18,472
Certificates of deposit held	368	1,237	368	1,237
Debt securities	20,918	12,296	20,918	12,296
	46,451	32,005	46,451	32,005
Issued by:				
Central governments and central banks	44,969	30,118	44,969	30,118
Public sector entities	13	2	13	2
Banks and other financial institutions	1,090	1,601	1,090	1,601
Corporate entities	379	284	379	284
	46,451	32,005	46,451	32,005
By place of listing:				
Listed in Hong Kong	13,692	10,726	13,692	10,726
Listed outside Hong Kong	5,945	120	5,945	120
	19,637	10,846	19,637	10,846
Unlisted	26,814	21,159	26,814	21,159
	46,451	32,005	46,451	32,005

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

14 Financial assets designated at fair value

	Consolidated and Bank 2010 HK$'M	2009 HK$'M
Debt securities	6,560	–
Issued by:		
Banks and other financial institutions	158	–
Corporate entities	6,402	–
	6,560	–
Analysed by place of listing:		
Unlisted	6,560	–

15 Advances to customers

(a) Advances to customers

Consolidated

	2010 HK$'M	Restated 2009 HK$'M
Gross advances to customers	326,868	229,777
Trade bills	9,230	2,386
	336,098	232,163
Less : Impairment charges		
– individually assessed (note 16(a))	(775)	(1,203)
– collectively assessed (note 16(a))	(473)	(503)
	334,850	230,457
Of which:		
Balances under collateralised reverse repurchase agreements	6,728	–

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

15 Advances to customers *(continued)*

(a) Advances to customers (continued)

Bank

	2010 *HK$'M*	*2009* *HK$'M*
Gross advances to customers	317,509	225,467
Trade bills	9,230	2,386
	326,739	227,853
Less : Impairment charges		
– individually assessed (note 16(a))	(774)	(1,196)
– collectively assessed (note 16(a))	(374)	(421)
	325,591	226,236
Of which:		
Balances under collateralised reverse repurchase agreements	6,728	–

(b) Impaired advances to customers

Consolidated

	2010 *HK$'M*	*Restated* *2009* *HK$'M*
Gross impaired advances to customers	1,152	1,980
Impairment charges – individually assessed	(775)	(1,203)
	377	777
Gross impaired advances to customers as a % of gross advances to customers	0.34%	0.85%
Fair value of collateral held against the covered portion of impaired advances to customers	185	238
Covered portion of impaired advances to customers	116	173
Uncovered portion of impaired advances to customers	1,036	1,807

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

15 Advances to customers (continued)

(b) Impaired advances to customers (continued)

Bank

	2010	2009
	HK$'M	HK$'M
Gross impaired advances to customers	1,088	1,932
Impairment charges – individually assessed	(774)	(1,196)
	314	736
Gross impaired advances to customers as a % of gross advances to customers	0.33%	0.85%
Fair value of collateral held against the covered portion of impaired advances to customers	157	234
Covered portion of impaired advances to customers	105	170
Uncovered portion of impaired advances to customers	983	1,762

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)

15 Advances to customers (continued)

(c) Net investment in finance leases

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

Consolidated

	2010			2009		
	Present value of the minimum lease payments receivable HK$'M	*Interest income relating to future periods HK$'M*	*Total minimum lease payments HK$'M*	*Present value of the minimum lease payments receivable HK$'M*	*Interest income relating to future periods HK$'M*	*Total minimum lease payments HK$'M*
Within 1 year	164	9	173	14	1	15
After 1 year but within 5 years	90	3	93	6	1	7
After 5 years	4	1	5	2	–	2
	258	13	271	22	2	24
Impairment charges:						
– individually assessed	–			–		
Net investment in finance leases	258			22		

Bank

	2010			2009		
	Present value of the minimum lease payments receivable HK$'M	*Interest income relating to future periods HK$'M*	*Total minimum lease payments HK$'M*	*Present value of the minimum lease payments receivable HK$'M*	*Interest income relating to future periods HK$'M*	*Total minimum lease payments HK$'M*
Within 1 year	4	–	4	14	1	15
After 1 year but within 5 years	1	–	1	6	1	7
After 5 years	–	–	–	2	–	2
	5	–	5	22	2	24
Impairment charges:						
– individually assessed	–			–		
Net investment in finance leases	5			22		

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

16 Movement in impairment charges on advances to banks and customers

(a) Advances to customers

Consolidated

		2010	
	Individually assessed HK$'M	*Collectively assessed HK$'M*	*Total HK$'M*
At 1 January 2010, as previously stated	1,196	421	1,617
Effect of merger of a commonly controlled entity	7	82	89
At 1 January 2010, as restated	1,203	503	1,706
Amounts written off	(1,064)	–	(1,064)
Recoveries of advances written off in previous years	241	–	241
Net charge/(release) to the income statement (note 6(a))	419	(30)	389
Unwind of discount on loan impairment charges (note 4(a))	(24)	–	(24)
At 31 December 2010 (note 15(a))	775	473	1,248

		2009 Restated	
	Individually assessed HK$'M	*Collectively assessed HK$'M*	*Total HK$'M*
At 1 January 2009, as previously stated	1,276	431	1,707
Effect of merger of a commonly controlled entity	30	14	44
At 1 January 2009, as restated	1,306	445	1,751
Amounts written off	(1,364)	–	(1,364)
Recoveries of advances written off in previous years	244	–	244
Net charge to the income statement (note 6(a))	1,055	58	1,113
Unwind of discount on loan impairment charges (note 4(a))	(38)	–	(38)
At 31 December 2009 (note 15(a))	1,203	503	1,706

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

16 Movement in impairment charges on advances to banks and customers (continued)

(a) Advances to customers (continued)

Bank

	2010 Individually assessed HK$'M	2010 Collectively assessed HK$'M	2010 Total HK$'M
At 1 January 2010	1,196	421	1,617
Amounts written off	(912)	–	(912)
Recoveries of advances written off in previous years	217	–	217
Net charge/(release) to the income statement	297	(47)	250
Unwind of discount on loan impairment charges	(24)	–	(24)
At 31 December 2010 (note 15(a))	774	374	1,148

	2009 Individually assessed HK$'M	2009 Collectively assessed HK$'M	2009 Total HK$'M
At 1 January 2009	1,276	431	1,707
Amounts written off	(1,176)	–	(1,176)
Recoveries of advances written off in previous years	225	–	225
Net charge/(release) to the income statement	909	(10)	899
Unwind of discount on loan impairment charges	(38)	–	(38)
At 31 December 2009 (note 15(a))	1,196	421	1,617

(b) Placements with banks and other financial institutions

Consolidated and Bank

	Individually assessed 2010 HK$'M	Individually assessed 2009 HK$'M
At 1 January	–	2
Charge to the income statement (note 6(a))	3	2
Unwind of discount on loan impairment charges (note 4(a))	(1)	(4)
At 31 December (note 11(a))	2	–

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

17 Investment securities

	Consolidated		Bank	
	2010 HK$'M	2009 HK$'M	2010 HK$'M	2009 HK$'M
Available-for-sale securities				
Treasury bills (including Exchange Fund Bills)	30,898	49,895	30,898	49,895
Certificates of deposit held	15,098	11,807	15,098	11,807
Debt securities	78,827	77,044	78,827	77,044
Equity shares	241	110	241	80
Less: impairment charges	(6)	(17)	(6)	(17)
	125,058	138,839	125,058	138,809
Loans and receivables – Debt securities	9,999	6,666	8,480	4,293
Less: impairment charges	(38)	(33)	(38)	(33)
	135,019	145,472	133,500	143,069
Issued by:				
Central governments and central banks	41,651	54,887	41,651	54,887
Public sector entities	2,423	2,924	2,423	2,924
Banks and other financial institutions	75,755	78,568	75,755	76,807
Corporate entities	15,190	9,093	13,671	8,451
	135,019	145,472	133,500	143,069
By place of listing:				
Listed in Hong Kong	4,746	4,218	4,746	4,188
Listed outside Hong Kong	26,893	12,850	26,893	12,850
	31,639	17,068	31,639	17,038
Unlisted	103,380	128,404	101,861	126,031
	135,019	145,472	133,500	143,069

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

18 Financial instruments reclassification summary

In 2008, the Bank reclassified certain financial assets classified as held for trading into the available-for-sale category as they were no longer considered to be held for the purpose of selling or repurchasing in the near term. At the time of transfer, the Bank identified the rare circumstances permitting such a transfer as the impact of the credit crisis in financial markets, particularly from the beginning of 2008, which significantly impacted the liquidity in certain markets. The Bank also reclassified certain eligible financial assets from the trading category to loans and receivables as set out below. No assets were reclassified in 2010 and 2009.

In 2010, all the remaining financial assets, which had been reclassified in 2008, were derecognized during the year.

The following table provides details of the remaining balance of assets reclassified during 2008 as at 31 December 2009:

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

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

(i) Consolidated

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

	Immediate holding company		*Fellow subsidiaries*	
	2010	*2009*	*2010*	*2009*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
Operating income	741	1,047	228	97
Operating expenses	1,208	819	513	326

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

	2010		*2009*	
	Immediate holding company	*Fellow subsidiaries*	*Immediate holding company*	*Fellow subsidiaries*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
Assets				
Unlisted financial assets designated at fair value	–	344	–	–
Unlisted available-for-sale debt securities	–	2,965	–	3,455
Positive fair values of trading derivatives	1,490	2	2,123	–
Positive fair values of hedging derivatives	291	–	74	–
Liabilities				
Other debt securities in issue, measured at amortised cost	–	1,028	–	974
Negative fair values of trading derivatives	1,666	199	1,021	–
Negative fair values of hedging derivatives	666	90	223	–

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

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

(ii) The Bank

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

	Immediate holding company		Fellow subsidiaries		Subsidiaries of the Bank	
						Restated
	2010	2009	2010	2009	2010	2009
	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M
Operating income	784	1,047	184	97	440	86
Operating expenses	1,208	819	513	326	–	–

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

	2010			2009		
	Immediate holding company	Fellow subsidiaries	Subsidiaries of the Bank	Immediate holding company	Fellow subsidiaries	Subsidiaries of the Bank
	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M	HK$'M
Assets						
Unlisted financial assets designated at fair value	–	344	–	–	–	–
Unlisted available-for-sale debt securities	–	2,965	–	–	2,292	908
Placements with a subsidiary	–	–	7,510	–	–	–
Subordinated loan	–	–	293	–	–	130
Positive fair values of trading derivatives	1,490	2	–	2,123	–	–
Positive fair values of hedging derivatives	291	–	–	74	–	–
Liabilities						
Other debt securities in issue, measured at amortised cost	–	1,028	–	–	974	–
Negative fair values of trading derivatives	1,666	199	–	757	–	–
Negative fair values of hedging derivatives	666	90	–	223	–	–

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

20 Investments in subsidiaries of the Bank

	Bank 2010 HK$'M	Bank 2009 HK$'M
Unlisted shares, at cost less impairment charges, if any	1,092	2,808

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 and securities	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	10,000,000 ordinary shares of HK$1 each	100%	Equity capital markets, corporate finance and institutional brokerage
Prime Credit Limited ("PCL")	Hong Kong	400,000 ordinary shares of $100 each	100%	Provision of banking and related financial services

On 1 July 2010, the Bank acquired 100 per cent of the share capital of PCL from a fellow subsidiary company at a cost of HK$204 million. The Bank and its subsidiaries have applied the Accounting Guideline No.5 – "Merger Accounting for Common Control Combinations" issued by the HKICPA in accounting for the acquisition of PCL. In accordance with the principles of merger accounting, the consolidated financial statements including the comparative figures for the prior periods, have been presented as if the acquisition of PCL by the Bank had occurred from the date when PCL first came under the control of Standard Chartered PLC Group.

The consolidated balance sheet as at 31 December 2009 has been presented as follows:

	The Bank and its subsidiaries	PCL	Adjustments	Consolidated
Goodwill and intangible assets	1,230	2	505	1,737
Other assets and liabilities	37,520	663	(204)	37,979
Net assets	38,750	665	301	39,716
Share capital	97	40	(40)	97
Merger reserve	–	–	645	645
Retained earnings and other reserves	38,626	625	(304)	38,947
	38,723	665	301	39,689
Non-controlling interests	27	–	–	27
	38,750	665	301	39,716

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

20 Investments in subsidiaries of the Bank (continued)

Adjustments:

The above adjustments represent the elimination of the share capital and pre-acquisition reserves of PCL; the recognition of the goodwill created on initial acquisition of PCL by Standard Chartered PLC Group, a liability of HK$204 million for the investment in PCL and a merger reserve of HK$645 million.

The consolidated income statement for the year ended 31 December 2009 is as follows:

	The Bank and its subsidiaries	*PCL*	*Adjustments*	*Consolidated*
Profit attributable to the equity shareholders of the Bank	4,889	286	–	5,175

The consolidated balance sheet as at 31 December 2010 is as follows:

	The Bank and its subsidiaries	*PCL*	*Adjustments*	*Consolidated*
Investment in PCL	204	–	(204)	–
Goodwill and intangible assets	1,186	34	505	1,725
Other assets and liabilities	36,487	761	–	37,248
Net assets	37,877	795	301	38,973
Share capital	97	40	(40)	97
Retained earnings (including merger reserve) and other reserves	37,711	755	341	38,807
	37,808	795	301	38,904
Non-controlling interests	69	–	–	69
	37,877	795	301	38,973

Adjustments:

The above adjustments represent the elimination of the investment in and share capital of PCL; the recognition of the goodwill created on initial acquisition of PCL by Standard Chartered PLC Group and a merger reserve of HK$645 million.

The consolidated income statement for the year ended 31 December 2010 is:

	The Bank and its subsidiaries	*PCL*	*Adjustments*	*Consolidated*
Profit attributable to the equity shareholders of the Bank	5,753	432	–	6,185

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

21 Interest in associates

Consolidated

	2010 HK$'M	2009 HK$'M
Share of net assets	2,796	1,878
Goodwill	1,717	1,717
	4,513	3,595

Bank

	2010 HK$'M	2009 HK$'M
Unlisted investments, at cost less impairment losses, if any	1,755	1,117
Listed investment, at cost less impairment losses, if any	1,607	1,607
	3,362	2,724

The associated companies of the Bank and its subsidiaries are:

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	781,413,755 ordinary shares of VND10,000 each	15%	Provision of banking and related financial services
China Bohai Bank Company Limited ("Bohai")	The People's Republic of China	8,500,000,000 ordinary shares of RMB1 each	20%	Provision of banking and related financial services
Merchant Solutions Private Limited ("MS")	Singapore	560,000 "A" shares and 440,000 "B" shares	44%	Credit card merchant acquiring business

Shareholdings in associated companies include a listed investment of HK$2,298 million (2009: HK$2,399 million). At the balance sheet date, the investment based on quoted market prices was valued at HK$1,220 million (2009: HK$1,831 million). Impairment testing on the investment has been carried out and this demonstrates that there is no impairment.

In respect of the year ended 31 December 2010, the share of the results of MS and ACB was included in these financial statements based on accounts drawn up to 30 September 2010, but taking into account any changes in the subsequent period from 1 October 2010 to 31 December 2010 that would materially affect the results. Bohai's result was included in the financial statements based on accounts drawn up to 30 November 2010. The Bank and its subsidiaries have taken advantage of the provision contained in HKAS 28 "Investments in Associates" whereby it is permitted to include the attributable share of associates' results based on accounts drawn up to a non-coterminous period and where the difference is not greater than three months.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

21 Interest in associates (continued)

Summary of financial information of associates

	Assets HK$'M	Liabilities HK$'M	Equity HK$'M	Revenue HK$'M	Profit HK$'M
2010					
100 per cent	373,688	358,511	15,177	10,334	1,831
Effective interest of the Bank and its subsidiaries	71,079	68,283	2,796	1,758	326

	Assets HK$'M	Liabilities HK$'M	Equity HK$'M	Revenue HK$'M	Profit HK$'M
2009					
100 per cent	198,225	187,983	10,242	7,880	1,137
Effective interest of the Bank and its subsidiaries	35,866	33,988	1,878	1,330	164

22 Fixed assets

(a) *Consolidated*

	2010				
	Buildings and leasehold land held for own use HK$'M	Equipment, furniture & fixtures HK$'M	Sub-total HK$'M	Investment properties HK$'M	Total fixed assets HK$'M
Cost:					
At 1 January 2010					
As previously reported	2,660	513	3,173	518	3,691
Effect of merger of a commonly controlled entity	73	–	73	–	73
As restated	2,733	513	3,246	518	3,764
Additions	97	84	181	–	181
Disposals	(77)	(238)	(315)	–	(315)
Reclassifications	(30)	30	–	–	–
Transfer from property held for sale	139	–	139	–	139
At 31 December 2010	2,862	389	3,251	518	3,769
Accumulated depreciation:					
At 1 January 2010					
As previously reported	436	338	774	34	808
Effect of merger of a commonly controlled entity	18	–	18	–	18
At 1 January 2010, as restated	454	338	792	34	826
Charge for the year (note 4(g))	95	94	189	11	200
Written back on disposals	(64)	(235)	(299)	–	(299)
Transfer from property held for sale	7	–	7	–	7
At 31 December 2010	492	197	689	45	734
Net book value:					
At 31 December 2010	2,370	192	2,562	473	3,035

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

22 Fixed assets (continued)

(a) Consolidated (continued)

	2009				
	Buildings and leasehold land held for own use HK$'M	Equipment, furniture & fixtures HK$'M	Sub-total HK$'M	Investment properties HK$'M	Total fixed assets HK$'M
Cost:					
At 1 January 2009, as previously stated	2,664	515	3,179	501	3,680
Effect of merger of a commonly controlled entity	75	4	79	–	79
As restated	2,739	519	3,258	501	3,759
Additions	107	28	135	17	152
Disposals	(64)	(93)	(157)	–	(157)
Reclassifications	(49)	49	–	–	–
Acquisition of business (note 25)	–	10	10	–	10
At 31 December 2009	2,733	513	3,246	518	3,764
Accumulated depreciation:					
At 1 January 2009, as previously stated	401	310	711	23	734
Effect of merger of a commonly controlled entity	18	3	21	–	21
At 1 January 2009, as restated	419	313	732	23	755
Charge for the year (note 4(g))	99	111	210	11	221
Written back on disposals	(64)	(86)	(150)	–	(150)
At 31 December 2009	454	338	792	34	826
Net book value:					
At 31 December 2009	2,279	175	2,454	484	2,938

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

22 Fixed assets (continued)

(b) Bank

	2010				
	Buildings and leasehold land held for own use HK$'M	Equipment, furniture & fixtures HK$'M	Sub-total HK$'M	Investment properties HK$'M	Total fixed assets HK$'M
Cost:					
At 1 January 2010	2,634	494	3,128	518	3,646
Additions	18	75	93	–	93
Disposals	(75)	(227)	(302)	–	(302)
Reclassifications	(30)	30	–	–	–
Transfer from property held for sale	139	–	139	–	139
At 31 December 2010	2,686	372	3,058	518	3,576
Accumulated depreciation:					
At 1 January 2010	436	324	760	34	794
Charge for the year	92	88	180	11	191
Written back on disposals	(62)	(224)	(286)	–	(286)
Transfer from property held for sale	7	–	7	–	7
At 31 December 2010	473	188	661	45	706
Net book value:					
At 31 December 2010	2,213	184	2,397	473	2,870

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

22 Fixed assets (continued)

(b) Bank (continued)

	2009				
	Buildings and leasehold land held for own use HK$'M	Equipment, furniture & fixtures HK$'M	Sub-total HK$'M	Investment properties HK$'M	Total fixed assets HK$'M
Cost:					
At 1 January 2009	2,662	500	3,162	501	3,663
Additions	82	25	107	17	124
Disposals	(61)	(80)	(141)	–	(141)
Reclassifications	(49)	49	–	–	–
At 31 December 2009	2,634	494	3,128	518	3,646
Accumulated depreciation:					
At 1 January 2009	401	303	704	23	727
Charge for the year	96	101	197	11	208
Written back on disposals	(61)	(80)	(141)	–	(141)
At 31 December 2009	436	324	760	34	794
Net book value:					
At 31 December 2009	2,198	170	2,368	484	2,852

Buildings and leasehold land held for own use:

	Consolidated		Bank	
	2010 HK$'M	Restated 2009 HK$'M	2010 HK$'M	2009 HK$'M
Leasehold in Hong Kong, at cost				
– long-term leases	34	41	–	–
– medium-term leases	2,174	2,118	2,157	2,104
– short-term leases	162	120	56	94
	2,370	2,279	2,213	2,198

Investment properties:

	Consolidated and Bank	
	2010 HK$'M	2009 HK$'M
Freehold outside Hong Kong	473	484

The investment property is stated at depreciated cost less impairment. The fair value of the investment property was HK$541 million (2009: HK$592 million). The valuation of the investment property was carried out by an independent firm which has among its staff, members of the Royal Institute of Chartered Surveyors with recent experience in the location and category of the property being valued.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

23 Goodwill and intangible assets

(a) Consolidated

	2010		
	Capitalised software and other intangible assets HK$'M	*Goodwill HK$'M*	*Total HK$'M*
Cost:			
At 1 January 2010, as previously stated	357	982	1,339
Effect of a merger of a commonly controlled entity	9	505	514
At 1 January 2010, as restated	366	1,487	1,853
Additions	88	24	112
Disposals	(81)	–	(81)
At 31 December 2010	373	1,511	1,884
Accumulated amortisation:			
At 1 January 2010	109	–	109
Effect of a merger of a commonly controlled entity	7	–	7
At 1 January 2010, as restated	116	–	116
Charge for the year (note 4(g))	93	–	93
Written back on disposal	(50)	–	(50)
At 31 December 2010	159	–	159
Carrying amount:			
At 31 December 2010	214	1,511	1,725

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

23 Goodwill and intangible assets (continued)

(a) Consolidated (continued)

	2009 Restated		
	Capitalised software and other intangible assets HK$'M	*Goodwill HK$'M*	*Total HK$'M*
Cost:			
At 1 January 2009, as previous stated	287	729	1,016
Effect of a merger of a commonly controlled entity	40	505	545
At 1 January 2009, as restated	327	1,234	1,561
Additions	130	253	383
Disposals	(91)	–	(91)
At 31 December 2009	366	1,487	1,853
Accumulated amortisation:			
At 1 January 2009, as previous stated	81	–	81
Effect of a merger of a commonly controlled entity	35	–	35
At 1 January 2009, as restated	116	–	116
Charge for the year (note 4(g))	80	–	80
Written back on disposal	(80)	–	(80)
At 31 December 2009	116	–	116
Carrying amount:			
At 31 December 2009	250	1,487	1,737

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

23 Goodwill and intangible assets (continued)

(b) Bank

	2010		
	Capitalised software and other intangible assets HK$'M	*Goodwill HK$'M*	*Total HK$'M*
Cost:			
At 1 January 2010	288	729	1,017
Additions	73	–	73
Disposals	(81)	–	(81)
At 31 December 2010	280	729	1,009
Accumulated amortisation:			
At 1 January 2010	96	–	96
Charge for the year	77	–	77
Written back on disposal	(50)	–	(50)
At 31 December 2010	123	–	123
Carrying amount:			
At 31 December 2010	157	729	886

	2009		
	Capitalised software and other intangible assets HK$'M	*Goodwill HK$'M*	*Total HK$'M*
Cost:			
At 1 January 2009	287	729	1,016
Additions	59	–	59
Disposals	(58)	–	(58)
At 31 December 2009	288	729	1,017
Accumulated amortisation:			
At 1 January 2009	81	–	81
Charge for the year	62	–	62
Written back on disposal	(47)	–	(47)
At 31 December 2009	96	–	96
Carrying amount:			
At 31 December 2009	192	729	921

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

23 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:

	Consolidated		*Bank*	
		Restated		
	2010	*2009*	*2010*	*2009*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
Lending	611	611	611	611
Private Banking	118	118	118	118
Standard Chartered Securities (Hong Kong) Limited	253	253	–	–
Prime Credit Limited ("PCL")	529	505	–	–
	1,511	1,487	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 estimates for the purpose of assessing impairment on acquired goodwill. These calculations use cash flow projections based on budgets and forecasts approved by management covering one year and extrapolated for a further 19 years using steady growth rates.

In assessing impairment of goodwill, the Bank assumed growth at a steady rate in line with long-term forecast GDP growth. A discount rate of 15.8 per cent (2009: 13.9 per cent) was used.

24 Other assets

	Consolidated		*Bank*	
		Restated		
	2010	*2009*	*2010*	*2009*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
Prepayments and accrued income	4,875	3,546	4,617	3,334
Acceptances and endorsements	4,611	3,772	4,611	3,772
Positive fair values of hedging derivatives	1	50	1	3
Property held for sale	–	132	–	132
Others	1,322	903	766	800
	10,809	8,403	9,995	8,041

As of 31 December 2010, the property held for sale previously included in "Other assets" was reclassified to "Buildings and leasehold land held for own use" under "Fixed assets". Depreciation expense of HK$6 million was recognized upon reclassification.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

25 Business combinations

2010 acquisitions

On 12 April 2010 and 18 June 2010, Prime Credit Limited ("PCL") (which became a wholly owned subsidiary of the Bank on 1 July 2010) acquired the personal loan portfolios of GE Capital Trade Services Limited and GE Capital (Hong Kong) Limited ("GECHK") respectively. On 3 July 2010, PCL also acquired the other consumer finance businesses of GECHK.

Goodwill of HK$24 million was recognised and HK$14 million of customer relationship intangibles identified.

If the acquisitions had occurred on 1 January 2010, the operating income of the Bank and its subsidiaries would have been approximately HK$18,554 million and profit before taxation would have been approximately HK$7,466 million.

The assets and liabilities arising from the acquisitions were as follows:

	Fair value HK$'M	*Acquirees' carrying amount HK$'M*
Cash and balances with banks and other financial institutions	958	958
Advances to customers	5,542	5,580
Intangibles other than goodwill	14	–
Other assets	6	6
Total assets	6,520	6,544
Other liabilities	12	12
Total liabilities	12	12
Net assets acquired	6,508	6,532
Purchase consideration settled in cash	(6,532)	
Cash and cash equivalents acquired	958	
Cash outflow on acquisitions	(5,574)	
Purchase consideration – cash paid	6,532	
Less: Fair value of net assets acquired	(6,508)	
Goodwill	24	
Intangible assets acquired:		
Customer relationships	14	
Contribution from acquisitions to 31 December 2010:		
Operating income	94	
Profit before taxation	59	

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

25 Business combinations (continued)

2010 acquisitions (continued)

The fair value amounts contain some provisional balances which will be finalised within 12 months of the acquisition dates.

The fair value of advances to customers is HK$5,542 million. The gross contractual amount due is HK$5,622 million, of which HK$80 million is the best estimate of the contractual cash flows not expected to be collected.

Goodwill arising on the above acquisitions is attributable to the synergies expected to arise from their integration with the Bank and its subsidiaries.

2009 acquisition

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

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

If the acquisition had occurred on 1 January 2009 the operating income of the Bank and its subsidiaries would have been approximately HK$17,156 million (restated) and profit before taxation would have been approximately HK$5,912 million (restated).

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

25 Business combinations (continued)

2009 acquisition (continued)

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

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

26 Deposits from customers

	Consolidated		Bank	
		Restated		
	2010	2009	2010	2009
	HK$'M	HK$'M	HK$'M	HK$'M
Current accounts	74,727	68,780	74,727	68,780
Savings accounts	303,112	286,310	303,112	286,310
Time, call and notice deposits	183,370	156,840	182,906	155,717
Deposits and balances of central banks	12,068	13,243	12,068	13,243
	573,277	525,173	572,813	524,050

27 Debt securities in issue

	Consolidated and Bank	
	2010	2009
	HK$'M	HK$'M
Certificates of deposit, measured at amortised cost	–	1,063

28 Financial liabilities designated at fair value

	Consolidated and Bank	
	2010	2009
	HK$'M	HK$'M
Structured customer deposits	3,052	7,566

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 or foreign currency risk and derivatives have been transacted with the intention of significantly reducing exposure to market changes;

At 31 December 2010, the contractual amount payable at maturity of these financial liabilities exceeded the carrying amount by HK$45 million (2009: the carrying amount of these financial liabilities exceeded the contractual amount payable at maturity by HK$49 million). This change is attributable to changes in market rates.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

29 Taxation in the balance sheet

Deferred tax assets and liabilities:

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

Consolidated

	Depreciation allowances in excess of related depreciation HK$'M	*Impairment losses on financial assets HK$'M*	*Structured investments HK$'M*	*Others HK$'M*	*Total HK$'M*
			2010		
Deferred tax arising from:					
At 1 January 2010, as previously stated	(5)	(70)	(305)	(69)	(449)
Effect of merger of a commonly controlled entity	–	(13)	–	(3)	(16)
At 1 January 2010, as restated	(5)	(83)	(305)	(72)	(465)
Charge/(release) to income statement (note 7(a))	2	5	305	(144)	168
Release to reserves	–	–	–	(36)	(36)
At 31 December 2010	(3)	(78)	–	(252)	(333)
			2009 Restated		
At 1 January 2009, as previously stated	(5)	(65)	–	(65)	(135)
Effect of merger of a commonly controlled entity	1	(2)	–	–	(1)
At 1 January 2009, as restated	(4)	(67)	–	(65)	(136)
Release to income statement (note 7(a))	(1)	(16)	(305)	(19)	(341)
Charge to reserves	–	–	–	12	12
At 31 December 2009	(5)	(83)	(305)	(72)	(465)

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

29 Taxation in the balance sheet (continued)

Bank

	Depreciation allowances in excess of related depreciation HK$'M	Impairment losses on financial assets HK$'M	Structured investments HK$'M	Others HK$'M	Total HK$'M
			2010		
Deferred tax arising from:					
At 1 January 2010	(5)	(70)	(305)	(108)	(488)
Charge/(release) to income statement	2	8	305	(101)	214
Release to reserves	–	–	–	(38)	(38)
At 31 December 2010	(3)	(62)	–	(247)	(312)
			2009		
At 1 January 2009	(5)	(65)	–	(102)	(172)
Release to income statement	–	(5)	(305)	(59)	(369)
Charge to reserves	–	–	–	53	53
At 31 December 2009	(5)	(70)	(305)	(108)	(488)

	Consolidated 2010 HK$'M	Consolidated Restated 2009 HK$'M	Bank 2010 HK$'M	Bank 2009 HK$'M
Analysed by:				
Net deferred tax asset recognised on the balance sheet	(350)	(504)	(312)	(488)
Net deferred tax liability recognised on the balance sheet	17	39	–	–
	(333)	(465)	(312)	(488)

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

30 Trading liabilities

	Consolidated and Bank	
	2010	2009
	HK$'M	HK$'M
Short positions in securities	36,196	28,378
Negative fair values of derivatives	250	658
	36,446	29,036

31 Other liabilities

	Consolidated		Bank	
		Restated		
	2010	2009	2010	2009
	HK$'M	HK$'M	HK$'M	HK$'M
Accruals and deferred income	3,121	3,218	2,719	2,909
Provision for liabilities and charges	2,267	1,556	2,267	1,556
Negative fair values of hedging derivatives	54	31	49	14
Acceptances and endorsements	4,611	3,772	4,611	3,772
Others	6,427	4,496	6,071	4,281
	16,480	13,073	15,717	12,532

32 Employee retirement benefits

The Bank and its subsidiaries make contributions to two defined benefit retirement schemes, namely Standard Chartered Bank Hong Kong Retirement Scheme ("SCB Scheme") and Cazenove Hong Kong Retirement Scheme ("Cazenove Scheme") which covers 21% (2009 restated: 24%) of the Bank and its subsidiaries' employees. The schemes are administered by trustees, with the assets held separately from those of the Bank and its subsidiaries.

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

	SCB Scheme		Cazenove Scheme	
	2010	2009	2010	2009
	HK$'M	HK$'M	HK$'M	HK$'M
Fair value of plan assets	1,927	1,799	75	70
Present value of wholly or partly funded obligations	(1,807)	(1,712)	(56)	(54)
Net asset recognised in the balance sheet (included in "Other assets")	120	87	19	16

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

32 Employee retirement benefits (continued)

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

	SCB Scheme		Cazenove Scheme	
	2010 HK$'M	2009 HK$'M	2010 HK$'M	2009 HK$'M
At the beginning of the year	1,712	1,890	54	–
Acquisition	–	–	–	66
Current service cost	95	94	6	11
Interest cost	43	21	1	1
Benefits paid	(79)	(124)	(4)	(5)
Actuarial losses/(gains)	36	(169)	(1)	(19)
At the end of the year	1,807	1,712	56	54

(c) Movements in the fair value of assets:

	SCB Scheme		Cazenove Scheme	
	2010 HK$'M	2009 HK$'M	2010 HK$'M	2009 HK$'M
At the beginning of the year	1,799	1,467	70	–
Acquisition	–	–	–	52
Contributions	56	102	5	6
Expected return on assets	115	93	4	4
Benefits paid	(79)	(124)	(4)	(5)
Actuarial gains on plan assets	36	261	–	13
At the end of the year	1,927	1,799	75	70

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

	SCB Scheme		Cazenove Scheme	
	2010 HK$'M	2009 HK$'M	2010 HK$'M	2009 HK$'M
At the beginning of the year	87	(423)	16	–
Acquisition	–	–	–	(14)
Contributions	56	102	5	6
Expense recognised in the income statement (note 4(g))	(23)	(22)	(3)	(8)
Actuarial gains to pension reserve	–	430	1	32
At the end of the year	120	87	19	16

As at 31 December 2010, the schemes did not invest in the Bank's own financial instruments and properties (2009: HK$Nil). The Bank and its subsidiaries expect to contribute approximately HK$63 million to the schemes in 2011.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

32 Employee retirement benefits (continued)

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

	SCB Scheme		Cazenove Scheme	
	2010	2009	2010	from 30 January 2009 to 31 December 2009
	HK$'M	HK$'M	HK$'M	HK$'M
Current service cost	95	94	6	11
Interest cost	43	21	1	1
Actuarial expected return on plan assets	(115)	(93)	(4)	(4)
	23	22	3	8

The actual return on plan assets (taking into account all changes in the fair value of the plan assets excluding contributions paid and received) was a net income of HK$156 million (2009: net income of HK$371 million).

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

	SCB Scheme		Cazenove Scheme	
	2010	2009	2010	2009
Discount rate	2.70%	2.60%	2.70%	2.60%
Expected rate of return on plan assets	6.50%	6.50%	6.50%	6.50%
Future salary increases	3.50%	3.50%	3.50%	3.50%

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

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

	SCB Scheme		Cazenove Scheme	
	2010	2009	2010	2009
Equities	53%	50%	61%	64%
Bonds	45%	46%	35%	31%
Cash	2%	4%	4%	5%
	100%	100%	100%	100%

33 Subordinated liabilities

	Consolidated and Bank	
	2010	2009
	HK$'M	HK$'M
US$300 million Floating Rate Step-Up Notes 2017(1)	2,314	2,306
US$750 million 5.875% Fixed Rate Notes 2020(2)	5,741	–
	8,055	2,306

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

33 Subordinated liabilities (continued)

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

(1) Interest rate at three-months US dollar LIBOR plus 0.25 per cent, payable quarterly, to the call option date on 13 April 2012. Thereafter, it will be reset to three-months US dollar LIBOR plus 0.75 per cent, payable quarterly.

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

34 Share capital

	2010 and 2009	
	No. of shares in millions	*HK$'M*
Authorised:		
'A' ordinary shares of HK$0.05 each	780	39
'B' ordinary shares of HK$0.05 each	1,231	62
	2,011	101
Preference shares of HK$1.00 each	3,800	3,800
	5,811	3,901

	2010 and 2009	
	No. of shares in millions	*HK$'M*
Issued and fully paid:		
'A' ordinary shares of HK$0.05 each	706	35
'B' ordinary shares of HK$0.05 each	1,231	62
	1,937	97
Preference shares of HK$1.00 each	–	–
	1,937	97

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

35 Reserves

Nature and purpose of reserves

(i) Share premium

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

(ii) Capital redemption reserve

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

(iii) Available-for-sale investment reserve

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

(iv) Cash flow hedge reserve

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

(v) Pension reserve

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

(vi) Exchange reserve

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

(vii) Revaluation reserve

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

(viii) Merger reserve

The merger reserve arises on the acquisition of Prime Credit Limited ("PCL"). On 1 July 2010, the Bank acquired 100 per cent of the share capital of PCL at a cost of HK$204 million. (Notes 2 and 20).

(ix) 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 recognized as an expense with the corresponding amount credited to the share option equity reserve.

The HKMA requires the Bank to maintain a minimum level of impairment allowances which is in excess of the impairment allowances required under Hong Kong Financial Reporting Standards. Of the retained earnings as at 31 December 2010, an amount of HK$1,366 million (2009: HK$1,041 million) has been reserved for this purpose.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

36 Cash and cash equivalents

	2010 HK$'M	Restated 2009 HK$'M
(a) Components of cash and cash equivalents in the cash flow statement		
Cash and balances with banks and other financial institutions	29,856	8,941
Trading assets with original maturity within three months	18,503	1,837
Placements with banks and other financial institutions with original maturity within three months	33,718	68,053
Investment securities with original maturity within three months	–	1,263
Amounts due from immediate holding company and fellow subsidiaries with original maturity within three months	42,231	8,311
	124,308	88,405

	2010 HK$'M	Restated 2009 HK$'M
(b) Reconciliation with the consolidated balance sheet		
Cash and balances with banks and other financial institutions	29,902	8,957
Placements with banks and other financial institutions	97,167	144,968
Trading assets	48,719	32,654
Investment securities	135,019	145,472
Amounts due from immediate holding company and fellow subsidiaries	54,325	72,914
Overdrafts included in "deposits and balances of banks and other financial institutions"	(46)	(16)
Overdrafts included in "amounts due to immediate holding company"	(98)	(798)
Amounts shown in the balance sheet	364,988	404,151
Less: amounts with an original maturity of beyond three months	(240,680)	(315,746)
Cash and cash equivalents in the consolidated cash flow statement	124,308	88,405

37 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.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Derivative financial instruments (continued)

(a) Notional amounts of derivatives

Derivatives are financial instruments that derive their value in reference to changes in interest or exchange rates, credit risk, financial instrument prices and indices. The notional amounts of these instruments indicate the volume of transactions outstanding and do not represent amounts at risk.

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

Consolidated

	2010			
	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	–	390	401,522	401,912
Cross currency swaps	11,757	389	7,643	19,789
Options purchased	–	8,573	428	9,001
Options written	–	10,375	1,645	12,020
Interest rate contracts				
Forwards	–	3,054	–	3,054
Swaps	51,519	1,803	15,669	68,991
Options purchased	–	32	350	382
Options written	–	1,930	350	2,280
Other derivatives	–	3	642	645
	63,276	26,549	428,249	518,074
	2009 Restated			
Exchange rate contracts				
Forwards	–	299	366,017	366,316
Cross currency swaps	1,793	–	1,128	2,921
Options purchased	–	9,717	–	9,717
Options written	–	13,608	–	13,608
Interest rate contracts				
Forwards	–	2,591	–	2,591
Swaps	33,136	7,720	2,118	42,974
Options purchased	–	38	–	38
Options written	–	6,612	–	6,612
Other derivatives	–	4	392	396
	34,929	40,589	369,655	445,173

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Derivative financial instruments (continued)

Bank

	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
		2010		
Exchange rate contracts				
Forwards	–	390	401,522	401,912
Cross currency swaps	11,757	389	7,643	19,789
Options purchased	–	8,573	428	9,001
Options written	–	10,375	1,645	12,020
Interest rate contracts				
Forwards	–	3,054	–	3,054
Swaps	50,319	1,803	15,669	67,791
Options purchased	–	32	350	382
Options written	–	1,930	350	2,280
Other derivatives	–	3	642	645
	62,076	26,549	428,249	516,874
		2009		
Exchange rate contracts				
Forwards	–	299	366,017	366,316
Cross currency swaps	–	–	2,921	2,921
Options purchased	–	9,717	–	9,717
Options written	–	13,608	–	13,608
Interest rate contracts				
Forwards	–	2,591	–	2,591
Swaps	31,706	7,720	955	40,381
Options purchased	–	38	–	38
Options written	–	6,612	–	6,612
Other derivatives	–	4	392	396
	31,706	40,589	370,285	442,580

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Derivative financial instruments (continued)

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

Consolidated

	2010 Fair value assets HK$'M	2010 Fair value liabilities HK$'M	2010 Credit risk weighted amount HK$'M	Restated 2009 Fair value assets HK$'M	Restated 2009 Fair value liabilities HK$'M	Restated 2009 Credit risk weighted amount HK$'M
Exchange rate contracts	2,382	2,309	1,104	2,274	1,347	550
Interest rate contracts	174	609	142	425	576	78
Other derivatives	8	7	5	23	10	24
	2,564	2,925	1,251	2,722	1,933	652

Bank

	2010 Fair value assets HK$'M	2010 Fair value liabilities HK$'M	2010 Credit risk weighted amount HK$'M	2009 Fair value assets HK$'M	2009 Fair value liabilities HK$'M	2009 Credit risk weighted amount HK$'M
Exchange rate contracts	2,382	2,309	1,104	2,274	1,347	550
Interest rate contracts	174	604	142	425	295	74
Other derivatives	8	7	5	23	10	24
	2,564	2,920	1,251	2,722	1,652	648

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

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

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

The following is a summary of the fair values of derivatives held for hedging purposes by product type entered into by the Bank and its subsidiaries as at 31 December 2010:

As 31 December 2010

Consolidated

	Assets (Included in Other assets and Amounts due from immediate holding company) HK$'M	Liabilities (Included in Other liabilities and Amounts due to immediate holding company and fellow subsidiaries) HK$'M
Exchange rate contracts	251	331
Interest rate contracts	41	479
	292	810

Bank

	Assets (Included in Other assets and Amounts due from immediate holding company) HK$'M	Liabilities (Included in Other liabilities and Amounts due to immediate holding company and fellow subsidiaries) HK$'M
Exchange rate contracts	251	331
Interest rate contracts	41	474
	292	805

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

37 Derivative financial instruments (continued)

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

As 31 December 2009

Consolidated

	Restated Assets (Included in Other assets and Amounts due from immediate holding company) HK$'M	Restated Liabilities (Included in Other liabilities and Amounts due to immediate holding company) HK$'M
Exchange rate contracts	47	–
Interest rate contracts	77	254
	124	254

Bank

	Assets (Included in Other assets and Amounts due from immediate holding company) HK$'M	Liabilities (Included in Other liabilities and Amounts due to immediate holding company) HK$'M
Interest rate contracts	77	237

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 2010, the net negative fair value of derivatives held as fair value hedges was HK$424 million (2009: negative HK$48 million) comprising assets of HK$260 million (2009: HK$95 million) and liabilities of HK$684 million (2009: HK$143 million). The losses on the hedging instruments were HK$929 million (2009: losses of HK$81 million). The gains on the hedged item attributable to the hedged risk were HK$924 million (2009: gains of HK$79 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 2010, the net negative fair value of derivatives held as cash flow hedges was HK$94 million (2009 restated: negative HK$82 million) comprising assets of HK$32 million (2009: HK$29 million) and liabilities of HK$126 million (2009 restated: HK$111 million). The derivatives will mature within 5 years (2009: within 5 years) from the balance sheet date. During the year, there was no ineffectiveness recognised in the income statement that arose from cash flow hedges (2009: HK$ Nil).

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 Contingent liabilities and commitments

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

	Consolidated		*Bank*	
		Restated		
	2010	*2009*	*2010*	*2009*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
Direct credit substitutes	14,325	26,402	14,437	26,537
Transaction-related contingencies	19,608	13,994	19,608	13,994
Trade-related contingencies	24,713	20,518	24,713	20,518
Forward asset purchases	2,283	851	2,283	851
Forward forward deposits placed	700	3,791	700	3,791
Other commitments:				
which are not unconditionally cancellable:				
with original maturity of not more than one year	4,653	1,743	4,653	1,743
with original maturity of more than one year	19,356	10,127	19,356	10,127
which are unconditionally cancellable	283,048	248,015	282,548	247,745
	368,686	325,441	368,298	325,306
Credit risk weighted amount	35,012	29,109	35,179	29,311

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 fixed asset purchases not provided for in the financial statements were as follows:

	Consolidated and Bank	
		Restated
	2010	*2009*
	HK$'M	*HK$'M*
Contracted for	11	44
Authorised but not contracted for	12	13
	23	57

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

38 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:

	Consolidated		*Bank*	
		Restated		
	2010	*2009*	*2010*	*2009*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
Within 1 year	692	608	671	592
After 1 year but within 5 years	972	816	962	808
After 5 years	31	40	31	40
	1,695	1,464	1,664	1,440

(d) Contingencies

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

39 Risk management

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

Risk management framework

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

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

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

- Balancing risk and reward: risk is taken in support of the requirements of the Bank's stakeholders, in line with the Bank's strategy and within its risk appetite;

- Responsibility: it is the responsibility of all employees to ensure that risk-taking is disciplined and focused. The Bank takes account of its social, environmental and ethical responsibilities in taking risk to produce a return;

- Accountability: risk is taken only within agreed authorities and where there is appropriate infrastructure and resource. All risk-taking must be transparent, controlled and reported;

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

Risk management framework (continued)

- Anticipation: the Bank seeks to anticipate future risks and maximise awareness of all risks; and

- Competitive advantage: the Bank seeks competitive advantage through efficient and effective risk management and control.

(a) Credit risk

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

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

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

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

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(a) Credit risk (continued)

Credit rating and measurement

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

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

The Group's credit grades are not intended to replicate external credit grades although, as the factors used to grade a borrower may be similar, a borrower rated poorly by an external rating agency is typically rated in the lower rank of the Group's internal credit grades.

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

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

Risk measurement models are approved by the responsible risk committee, on the recommendation of the Group Model Assessment Committee ('MAC'). The MAC supports risk committees in ensuring risk identification and measurement capabilities are objective and consistent, so that risk control and risk origination decisions are properly informed. Prior to review by the MAC, all IRB models are validated in detail by a model validation team, which is separate from the teams which develop and maintain the models. Models undergo a detailed review at least annually. Such reviews are also triggered if the performance of a model deteriorates materially.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(a) Credit risk (continued)

Credit Approval

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

Concentration risk

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

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

Credit monitoring

The Bank and its subsidiaries regularly monitor credit exposures and external trends which may impact risk management outcomes.

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

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(a) Credit risk (continued)

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

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

Credit mitigation

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

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

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

Traded Products

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

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

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(a) Credit risk (continued)

Maximum exposure to credit risk

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

Consolidated

	2010 HK$'M	Restated 2009 HK$'M
Balances with banks and other financial institutions	28,595	7,600
Placements with banks and other financial institutions	97,167	144,968
Hong Kong SAR Government certificates of indebtedness	31,581	26,461
Trading assets	48,719	32,654
Financial assets designated at fair value	6,560	–
Investment securities	135,019	145,472
Advances to customers	334,850	230,457
Amounts due from immediate holding company	33,665	54,406
Amounts due from fellow subsidiaries	20,660	18,508
Other assets	10,809	8,271
Financial guarantees and other credit related contingent liabilities	58,646	60,914
Loan commitments and other credit related commitments	26,992	16,512
	833,263	746,223

Bank

	2010 HK$'M	Restated 2009 HK$'M
Balances with banks and other financial institutions	28,595	7,531
Placements with banks and other financial institutions	96,900	144,947
Hong Kong SAR Government certificates of indebtedness	31,581	26,461
Trading assets	48,719	32,701
Financial assets designated at fair value	6,560	–
Investment securities	133,500	143,069
Advances to customers	325,591	226,236
Amounts due from immediate holding company	33,361	54,267
Amounts due from fellow subsidiaries	20,374	17,101
Amounts due from subsidiaries of the Bank	8,854	1,947
Other assets	9,995	7,909
Financial guarantees and other credit related contingent liabilities	58,758	61,049
Loan commitments and other credit related commitments	26,992	16,512
	829,780	739,730

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(a) Credit risk (continued)

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

Credit quality

(i) Analysis of the loan portfolio

Consolidated

	2010		Restated 2009	
	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	333,067	97,068	228,051	144,784
– past due but not impaired	1,879	36	2,132	–
– impaired, net of individually assessed impairment charges	377	63	777	184
Less: collectively assessed impairment charges	(473)	–	(503)	–
	334,850	97,167	230,457	144,968
Collateral held against (Note):				
– impaired advances	116	–	173	–
– past due but not impaired advances	1,361	–	1,586	–

Bank

	2010		2009	
	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	324,046	96,801	223,955	144,763
– past due but not impaired	1,605	36	1,966	–
– impaired, net of individually assessed impairment charges	314	63	736	184
Less: collectively assessed impairment charges	(374)	–	(421)	–
	325,591	96,900	226,236	144,947
Collateral held against (Note):				
– impaired advances	105	–	170	–
– past due but not impaired advances	1,188	–	1,483	–

Note: The collateral has been capped at the amount of outstanding balances and does not include any collateral over and above outstanding exposures.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(a) Credit risk (continued)

(i) Analysis of the loan portfolio (continued)

The following tables set out an analysis of the internal credit gradings for advances which are not past due and for which no individual impairment provision has been raised. The credit gradings set out in the tables below are based on a probability of default measure as set out on page 76.

Consolidated

	2010		*Restated 2009*	
	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	191,262	93,562	136,610	143,199
6 to 8	98,374	3,413	60,376	1,509
9 to 11	42,300	68	29,947	51
12	1,131	25	1,118	25
	333,067	97,068	228,051	144,784

Bank

	2010		*2009*	
	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	191,211	93,295	136,552	143,178
6 to 8	93,035	3,413	58,823	1,509
9 to 11	38,911	68	27,519	51
12	889	25	1,061	25
	324,046	96,801	223,955	144,763

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

Consolidated

	2010		*Restated 2009*	
	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	1,651	36	1,824	–
– 31-60 days	109	–	158	–
– 61-90 days	58	–	59	–
– 91-120 days	34	–	44	–
– 121-150 days	27	–	47	–
	1,879	36	2,132	–

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(a) Credit risk (continued)

(i) Analysis of the loan portfolio (continued)

Bank

	2010		*2009*	
	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	1,424	36	1,710	–
– 31-60 days	74	–	130	–
– 61-90 days	46	–	35	–
– 91-120 days	34	–	44	–
– 121-150 days	27	–	47	–
	1,605	36	1,966	–

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

Consolidated

	2010			
	Treasury bills HK$'M	*Debt securities HK$'M*	*Equity shares HK$'M*	*Total HK$'M*
Impaired securities	–	38	6	44
Impairment provisions	–	(38)	(6)	(44)
Net impaired securities	–	–	–	–
Securities neither past due nor impaired	56,063	135,041	235	191,339

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

Bank

	2010			
	Treasury bills HK$'M	*Debt securities HK$'M*	*Equity shares HK$'M*	*Total HK$'M*
Impaired securities	–	38	6	44
Impairment provisions	–	(38)	(6)	(44)
Net impaired securities	–	–	–	–
Securities neither past due nor impaired	56,063	133,522	235	189,820

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(a) Credit risk (continued)

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

Bank (continued)

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

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

Consolidated

	2010		2009	
	Treasury bills HK$'M	*Debt securities HK$'M*	*Treasury bills HK$'M*	*Debt securities HK$'M*
AAA	–	19,226	–	12,867
AA - to AA +	56,063	83,232	68,367	79,836
A - to A +	–	24,240	–	12,868
Lower than A-	–	750	–	792
Unrated	–	7,593	–	6,109
	56,063	135,041	68,367	112,472

Bank

	2010		2009	
	Treasury bills HK$'M	*Debt securities HK$'M*	*Treasury bills HK$'M*	*Debt securities HK$'M*
AAA	–	19,226	–	12,867
AA - to AA +	56,063	83,232	68,367	78,075
A - to A +	–	24,240	–	12,868
Lower than A-	–	750	–	792
Unrated	–	6,074	–	5,242
	56,063	133,522	68,367	109,844

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(a) Credit risk (continued)

Repossessed Collateral

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

	Consolidated		*Bank*	
	2010	*2009*	*2010*	*2009*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
		Restated		
Property, plant and equipment	64	91	58	89

As at 31 December 2010, the repossessed assets taken by the Bank and its subsidiaries amounted to HK$41 million (2009: HK$60 million).

As at 31 December 2010, the repossessed assets taken by the Bank amounted to HK$38 million (2009: HK$60 million).

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

Renegotiated loans

As at 31 December 2010, there were no renegotiated loans and advances to banks (2009: HK$ Nil).

As at 31 December 2010, renegotiated advances to customers which were neither past due nor impaired amounted to HK$65 million (2009: HK$91 million).

(b) Market risk management

Market risk

The Bank recognises market risk as the potential loss of earnings or economic value due to adverse changes in financial market rates or prices. The Bank's exposure to market risk arises principally from customer-driven transactions. The objective of the Bank's market risk policies and processes is to obtain the best balance of risk and return whilst meeting customers' requirements.

The Bank transacts in the money market, foreign exchange markets, equity markets, and capital markets giving rise to market risk exposures. Financial instruments transacted include debt and other securities and certain off-balance sheet ("derivatives") financial instruments. Derivatives are contracts with characteristics and value derived from underlying financial instruments, interest and exchange rates or indices. They include futures, forwards, swaps, and options transactions in the foreign exchange and interest rate markets. The Bank enters into derivative contracts in the normal course of business to meet customer demand and for hedging purposes. Derivative contracts entered into by the Bank are primarily over-the-counter derivatives which the mark-to-market values are readily determinable by reference to independent prices and valuation quotes.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(b) Market risk management (continued)

The Bank has established market risk management policies and framework, including limits setting, monitoring and reporting and control procedures, which are reviewed regularly by the Risk Committee. Market risk limits are proposed by the business within the terms of agreed policy. The Market Risk department approves the limits within delegated authorities and monitors exposures against these limits. Additional limits are placed on specific instruments and position concentrations where appropriate. Sensitivity measures are used in addition to VaR as risk management tools. For example, interest rate sensitivity is measured in terms of exposure to a one basis point increase in yields.

Value at Risk

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.

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

Stress Testing

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

VaR is complemented by weekly stress testing of market risk exposures to highlight potential risk that may arise from extreme market events that are rare but plausible. Stress testing is an integral part of the market risk management framework and considers both historical market events and forward looking scenarios. A consistent stress testing methodology is applied to trading and non-trading books. The stress testing methodology assumes that scope for management action would be limited during a stress event, reflecting the decrease in liquidity that often occurs.

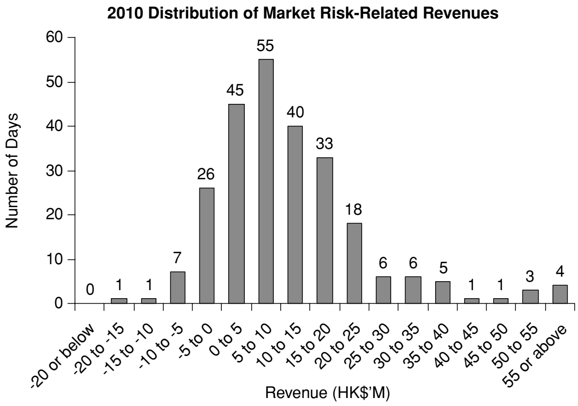
Stress scenarios are regularly updated to reflect changes in risk profile and economic events. The Risk Committee reviews stress test results on a regular basis. Ad hoc scenarios are also prepared reflecting specific market conditions and for particular concentrations of risk that arise within the business.

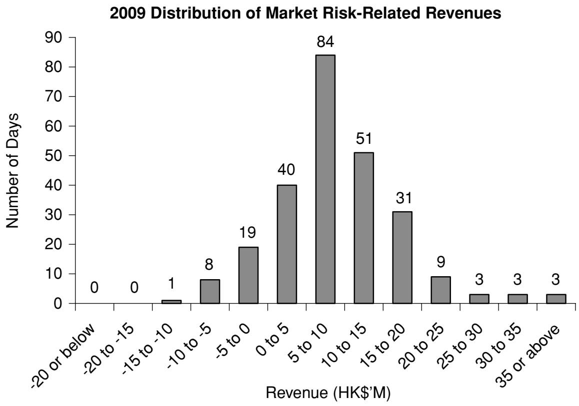
Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(b) Market risk management (continued)





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

Value at risk (HK$'M):	*2010*				*2009*			
	Average	*High*	*Low*	*Actual**	*Average*	*High*	*Low*	*Actual**
Interest rate risk ^	34.5	47.1	26.3	46.4	61.3	72.6	41.5	56.8
Foreign exchange risk	2.4	14.1	0.3	4.5	2.0	10.1	0.5	0.7
Total ^^	34.7	47.4	26.4	46.6	61.3	72.6	41.6	56.8

Trading (VaR at 97.5%, 1 day)

Value at risk (HK$'M):	*2010*				*2009*			
	Average	*High*	*Low*	*Actual**	*Average*	*High*	*Low*	*Actual**
Interest rate risk ^	5.8	22.8	3.1	5.6	11.5	23.4	5.4	12.6
Foreign exchange risk	2.4	14.1	0.3	4.5	2.0	10.1	0.5	0.7
Total ^^	6.7	23.8	3.3	7.8	11.8	24.3	5.5	13.3

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

Value at risk (HK$'M):	*2010*				*2009*			
	Average	*High*	*Low*	*Actual**	*Average*	*High*	*Low*	*Actual**
Interest rate risk ^	33.9	46.7	26.0	46.0	59.6	72.0	37.6	53.8

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(b) Market risk management (continued)

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

	2010 *HK$'M*	*2009* *HK$'M*
Trading		
Interest rate risk	4.6	2.2
Foreign exchange risk	7.7	7.2
Total	12.3	9.4
Non-Trading		
Interest rate risk	5.1	7.7

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

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

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

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

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(c) 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. Market Risk department approves foreign exchange limits within delegated authorities and monitors exposures against these limits. The net option position is calculated on the basis of the delta-weighted positions of all foreign exchange option contracts.

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:

	Consolidated		*Bank*	
	2010	*2009*	*2010*	*2009*
	HK$'M	*HK$'M*	*HK$'M*	*HK$'M*
US dollars exposure				
Spot assets	278,985	228,051	278,984	228,051
Spot liabilities	(225,106)	(186,265)	(225,106)	(186,265)
Forward purchases	192,556	163,395	192,556	163,395
Forward sales	(246,149)	(204,926)	(246,149)	(204,926)
Net option position	112	–	112	–
Net long non-structural position	398	255	397	255

	Consolidated and Bank	
	2010	*2009*
	HK$'M	*HK$'M*
Chinese renminbi exposure		
Spot assets	22,165	3,587
Spot liabilities	(31,889)	(3,606)
Forward purchases	49,258	802
Forward sales	(37,053)	(853)
Net option position	(114)	–
Net long/(short) non-structural position	2,367	(70)

	Consolidated and Bank	
	2010	*2009*
	HK$'M	*HK$'M*
Euro exposure		
Spot assets	20,068	49,527
Spot liabilities	(17,987)	(14,286)
Forward purchases	15,248	13,190
Forward sales	(17,297)	(48,341)
Net option position	1	–
Net long non-structural position	33	90

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(c) Foreign exchange risk (continued)

	Consolidated and Bank	
	2010	2009
	HK$'M	HK$'M
Australian dollars exposure		
Spot assets	10,621	13,954
Spot liabilities	(10,473)	(14,177)
Forward purchases	10,023	5,460
Forward sales	(10,541)	(5,104)
Net option position	–	–
Net (short)/long non-structural position	(370)	133

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

	Consolidated and Bank	
	2010	2009
	HK$'M	HK$'M
Chinese Renminbi	2,216	1,196
United Arab Emirates Dirham	474	484
Vietnamese Dong	581	682
US dollars	469	200
	3,740	2,562

(d) Interest rate risk

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

The Bank has established principles, policies and techniques for managing interest rate risk. Interest rate risk management is governed by the ALCO.

(e) Liquidity risk

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(e) Liquidity risk (continued)

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

Financial Markets is responsible for the day-to-day management of all the liquidity risk in the Bank, executing liquidity directives and operating within the liquidity policy and approved limits. Liquidity risk management is centralised in Financial Markets. Liquidity limits are regularly monitored by a Market Risk function that is independent from the business. Liquidity profiles are reviewed by the ALCO on a regular basis.

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(e) Liquidity risk (continued)

(i) Contractual maturity

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

Consolidated

	2010							
	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 and other financial institutions	29,902	–	–	–	–	–	–	29,902
Placements with banks and other financial institutions	398	58,273	19,362	18,923	213	–	(2)	97,167
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	–	31,581	31,581
Trading assets	–	8,928	11,541	12,793	11,309	4,148	–	48,719
Financial assets designated at fair value	–	–	–	–	1,713	4,847	–	6,560
Advances to customers	8,584	57,318	30,974	38,214	88,996	112,012	(1,248)	334,850
Investment securities	1,519	9,667	12,106	65,130	44,380	1,982	235	135,019
Amounts due from group companies	1,693	9,217	19,160	10,229	9,898	3,596	532	54,325
Others	201	2,924	6,562	742	520	–	9,483	20,432
Total Assets	42,297	146,327	99,705	146,031	157,029	126,585	40,581	758,555
Liabilities								
Hong Kong SAR currency notes in circulation	–	–	–	–	–	–	31,581	31,581
Deposits and balances of banks and other financial institutions	9,987	9,180	385	193	–	–	–	19,745
Deposits from customers	380,642	112,593	49,237	30,297	386	122	–	573,277
Trading liabilities	–	36,446	–	–	–	–	–	36,446
Financial liabilities designated at fair value	–	185	289	514	1,070	994	–	3,052
Amounts due to group companies	4,164	17,750	4,975	891	1,738	1,051	–	30,569
Subordinated liabilities	–	–	–	–	–	8,055	–	8,055
Others	4,822	3,558	5,557	2,770	72	59	19	16,857
Total Liabilities	399,615	179,712	60,443	34,665	3,266	10,281	31,600	719,582

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(e) Liquidity risk (continued)

(i) Contractual maturity (continued)

Consolidated (continued)

	2010							
	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*
Of which:								
Certificate of deposits held								
– included in trading assets	–	–	–	193	53	122	–	368
– included in investment securities as available-for-sale securities	–	795	–	12,003	2,300	–	–	15,098
	–	795	–	12,196	2,353	122	–	15,466
Treasury bills (including Exchange Fund Bills)								
– included in trading assets	–	7,185	10,801	7,179	–	–	–	25,165
– included in investment securities as available-for-sale securities	–	1,800	8,268	20,830	–	–	–	30,898
	–	8,985	19,069	28,009	–	–	–	56,063
Debt securities								
– included in trading assets	–	345	350	5,162	11,042	4,019	–	20,918
– included in financial assets designated at fair value	–	–	–	–	1,713	4,847	–	6,560
– included in investment securities classified as:								
– available-for-sale securities	–	7,072	3,334	31,236	37,062	123	–	78,827
– loans and receivables	1,519	–	504	1,061	5,018	1,859	–	9,961
– included in amounts due from fellow subsidiaries classified as:								
– available-for-sale securities	–	–	–	–	–	2,965	–	2,965
– financial assets designated at fair value	–	–	–	–	–	344	–	344
	1,519	7,417	4,188	37,459	54,835	14,157	–	119,575

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(e) Liquidity risk (continued)

(i) Contractual maturity (continued)

Consolidated (continued)

	2009 (restated)							
	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 and other financial institutions	8,957	–	–	–	–	–	–	8,957
Placements with banks and other financial institutions	234	92,404	15,246	36,362	722	–	–	144,968
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	–	26,461	26,461
Trading assets	–	1,293	9,918	12,686	6,874	1,883	–	32,654
Advances to customers	8,029	26,890	17,528	29,288	66,205	84,223	(1,706)	230,457
Investment securities	612	11,497	26,509	75,240	29,716	1,805	93	145,472
Amounts due from group companies	609	20,448	31,363	12,405	4,335	3,754	–	72,914
Others	208	2,262	5,053	523	16	47	9,068	17,177
Total Assets	18,649	154,794	105,617	166,504	107,868	91,712	33,916	679,060
Liabilities								
Hong Kong SAR currency notes in circulation	–	–	–	–	–	–	26,461	26,461
Deposits and balances of banks and other financial institutions	17,148	2,399	368	735	1,776	–	–	22,426
Deposits from customers	357,457	91,671	39,654	36,106	285	–	–	525,173
Trading liabilities	–	28,809	167	60	–	–	–	29,036
Financial liabilities designated at fair value	–	64	382	4,352	2,597	171	–	7,566
Debt securities in issue	–	–	50	1,013	–	–	–	1,063
Amounts due to group companies	2,515	3,444	3,981	425	249	1,256	–	11,870
Subordinated liabilities	–	–	–	–	–	2,306	–	2,306
Others	2,842	2,676	4,736	2,956	201	–	32	13,443
Total Liabilities	379,962	129,063	49,338	45,647	5,108	3,733	26,493	639,344

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(e) Liquidity risk (continued)

(i) Contractual maturity (continued)

Consolidated (continued)

	2009							
	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*
Of which:								
Certificate of deposits held								
– included in trading assets	–	2	47	727	461	–	–	1,237
– included in investment securities as available-for-sale securities	–	2,118	4,320	5,010	359	–	–	11,807
	–	2,120	4,367	5,737	820	–	–	13,044
Treasury bills (including Exchange Fund Bills)								
– included in trading assets	–	664	8,176	9,632	–	–	–	18,472
– included in investment securities as available-for-sale securities	–	3,565	14,463	31,867	–	–	–	49,895
	–	4,229	22,639	41,499	–	–	–	68,367
Debt securities								
– included in trading assets	–	60	1,657	2,285	6,410	1,884	–	12,296
– included in investment securities classified as:								
– available-for-sale securities	–	5,814	7,168	37,425	26,633	4	–	77,044
– loans and receivables	612	–	558	938	2,724	1,801	–	6,633
– included in amounts due from fellow subsidiaries as available-for-sale securities	–	–	–	–	–	3,455	–	3,455
	612	5,874	9,383	40,648	35,767	7,144	–	99,428

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(e) Liquidity risk (continued)

(i) Contractual maturity (continued)

Bank

	2010							
	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 and other financial institutions	29,892	–	–	–	–	–	–	29,892
Placements with banks and other financial institutions	131	58,273	19,362	18,923	213	–	(2)	96,900
Hong Kong SAR Government certificates of indebtedness	–	–	–	–	–	–	31,581	31,581
Trading assets	–	8,928	11,541	12,793	11,309	4,148	–	48,719
Financial assets designated at fair value	–	–	–	–	1,713	4,847	–	6,560
Advances to customers	8,536	56,994	30,496	36,458	85,779	108,476	(1,148)	325,591
Investment securities	–	9,667	12,106	65,130	44,380	1,982	235	133,500
Amounts due from group companies	1,693	9,217	27,596	10,229	9,898	3,597	359	62,589
Others	133	2,924	6,326	386	170	–	8,578	18,517
Total Assets	40,385	146,003	107,427	143,919	153,462	123,050	39,603	753,849
Liabilities								
Hong Kong SAR currency notes in circulation	–	–	–	–	–	–	31,581	31,581
Deposits and balances of banks and other financial institutions	9,987	8,653	385	11	–	–	–	19,036
Deposits from customers	380,642	112,515	48,913	30,235	386	122	–	572,813
Trading liabilities	–	36,446	–	–	–	–	–	36,446
Financial liabilities designated at fair value	–	185	289	514	1,070	994	–	3,052
Amounts due to group companies	4,118	17,569	6,284	673	848	1,051	–	30,543
Subordinated liabilities	–	–	–	–	–	8,055	–	8,055
Others	4,822	3,558	4,838	2,565	38	59	19	15,899
Total Liabilities	399,569	178,926	60,709	33,998	2,342	10,281	31,600	717,425

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(e) Liquidity risk (continued)

(i) Contractual maturity (continued)

Bank (continued)

	2010							
	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*
Of which:								
Certificate of deposits held								
– included in trading assets	–	–	–	193	53	122	–	368
– included in investment securities as available-for-sale securities	–	795	–	12,003	2,300	–	–	15,098
	–	795	–	12,196	2,353	122	–	15,466
Treasury bills (including Exchange Fund Bills)								
– included in trading assets	–	7,185	10,801	7,179	–	–	–	25,165
– included in investment securities as available-for-sale securities	–	1,800	8,268	20,830	–	–	–	30,898
	–	8,985	19,069	28,009	–	–	–	56,063
Debt securities								
– included in trading assets	–	345	350	5,162	11,042	4,019	–	20,918
– included in financial assets designated at fair value	–	–	–	–	1,713	4,847	–	6,560
– included in investment securities classified as:								
– available-for-sale securities	–	7,072	3,334	31,236	37,062	123	–	78,827
– loans and receivables	–	–	504	1,061	5,018	1,859	–	8,442
– included in amounts due from fellow subsidiaries classified as:								
– available-for-sale securities	–	–	–	–	–	2,965	–	2,965
– financial assets designated at fair value	–	–	–	–	–	344	–	344
	–	7,417	4,188	37,459	54,835	14,157	–	118,056

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(e) Liquidity risk (continued)

(i) Contractual maturity (continued)

Bank (continued)

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

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

39 Risk management (continued)

(e) Liquidity risk (continued)

(i) Contractual maturity (continued)

Bank (continued)

	2009							
	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
Of which:								
Certificate of deposits held								
– included in trading assets	–	2	47	727	461	–	–	1,237
– included in investment securities as available-for-sale securities	–	2,118	4,320	5,010	359	–	–	11,807
	–	2,120	4,367	5,737	820	–	–	13,044
Treasury bills (including Exchange Fund Bills)								
– included in trading assets	–	664	8,176	9,632	–	–	–	18,472
– included in investment securities as available-for-sale securities	–	3,565	14,463	31,867	–	–	–	49,895
	–	4,229	22,639	41,499	–	–	–	68,367
Debt securities								
– included in trading assets	–	60	1,657	2,285	6,410	1,884	–	12,296
– included in investment securities classified as:								
– available-for-sale securities	–	5,814	7,168	37,425	26,633	4	–	77,044
– loans and receivables	–	–	558	938	2,724	40	–	4,260
– included in amounts due from fellow subsidiaries as available-for-sale securities	–	–	–	–	–	3,200	–	3,200
	–	5,874	9,383	40,648	35,767	5,128	–	96,800

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(e) Liquidity risk (continued)

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

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

Consolidated

			2010		
	Due within 3 months HK$'M	Due between 3 months and 1 year HK$'M	Due between 1 year and 5 years HK$'M	Due after 5 years HK$'M	Total HK$'M
Deposits and balances of banks and other financial institutions	19,025	193	527	–	19,745
Deposits from customers	90,823	86,412	396,042	–	573,277
Total	109,848	86,605	396,569	–	593,022

			2009 (restated)		
	Due within 3 months HK$'M	Due between 3 months and 1 year HK$'M	Due between 1 year and 5 years HK$'M	Due after 5 years HK$'M	Total HK$'M
Deposits and balances of banks and other financial institutions	22,402	24	–	–	22,426
Deposits from customers	117,252	60,601	347,320	–	525,173
Total	139,654	60,625	347,320	–	547,599

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(e) Liquidity risk (continued)

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

Bank

	2010				
	Due within 3 months HK$'M	Due between 3 months and 1 year HK$'M	Due between 1 year and 5 years HK$'M	Due after 5 years HK$'M	Total HK$'M
Deposits and balances of banks and other financial institutions	19,025	11	–	–	19,036
Deposits from customers	90,421	86,352	396,040	–	572,813
Total	109,446	86,363	396,040	–	591,849

	2009 (restated)				
	Due within 3 months HK$'M	Due between 3 months and 1 year HK$'M	Due between 1 year and 5 years HK$'M	Due after 5 years HK$'M	Total HK$'M
Deposits and balances of banks and other financial institutions	19,928	24	–	–	19,952
Deposits from customers	116,278	60,455	347,317	–	524,050
Total	136,206	60,479	347,317	–	544,002

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(e) Liquidity risk (continued)

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

The following tables show the undiscounted cash flows by remaining contractual maturity on an undiscounted basis for the Bank's financial liabilities. The financial liability balances in the tables will not agree to the balances reported in the balance sheets 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.

Consolidated

	2010						
	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	9,987	9,575	193	–	–	–	19,755
Deposits from customers	380,642	161,989	30,528	444	122	–	573,725
Trading liabilities	–	36,196	–	–	–	–	36,196
Financial liabilities designated at fair value	–	491	520	1,077	1,013	–	3,101
Amounts due to group companies	4,164	21,670	219	890	1,009	–	27,952
Subordinated liabilities	–	2	348	1,438	9,733	–	11,521
Others	4,822	8,594	2,770	66	16	31,600	47,868
	399,615	238,517	34,578	3,915	11,893	31,600	720,118

	2009 (restated)						
	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	17,148	2,767	737	1,776	–	–	22,428
Deposits from customers	357,457	131,624	36,387	293	–	–	525,761
Trading liabilities	–	28,378	–	–	–	–	28,378
Financial liabilities designated at fair value	–	434	4,319	2,609	154	–	7,516
Debt securities in issue	–	51	1,019	–	–	–	1,070
Amounts due to group companies	2,515	6,851	56	–	1,551	–	10,973
Subordinated liabilities	–	3	9	80	2,388	–	2,480
Others	2,842	6,976	2,892	182	–	26,615	39,507
	379,962	177,084	45,419	4,940	4,093	26,615	638,113

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(e) Liquidity risk (continued)

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

Bank

	2010						
	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	9,987	9,046	12	–	–	–	19,045
Deposits from customers	380,642	161,587	30,467	442	122	–	573,260
Trading liabilities	–	36,196	–	–	–	–	36,196
Financial liabilities designated at fair value	–	491	520	1,077	1,013	–	3,101
Amounts due to group companies	4,118	22,798	–	–	1,009	–	27,925
Subordinated liabilities	–	2	348	1,438	9,733	–	11,521
Others	4,822	7,875	2,566	32	16	31,600	46,911
	399,569	237,995	33,913	2,989	11,893	31,600	717,959

	2009						
	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	17,192	2,385	377	–	–	–	19,954
Deposits from customers	357,457	130,878	36,014	289	–	–	524,638
Trading liabilities	–	28,378	–	–	–	–	28,378
Financial liabilities designated at fair value	–	434	4,319	2,609	154	–	7,516
Debt securities in issue	–	51	1,019	–	–	–	1,070
Amounts due to group companies	2,515	7,343	56	–	1,551	–	11,465
Subordinated liabilities	–	3	9	80	2,388	–	2,480
Others	2,842	6,739	2,799	–	–	26,480	38,860
	380,006	176,211	44,593	2,978	4,093	26,480	634,361

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(e) Liquidity risk (continued)

(iv) Derivative financial instruments on an undiscounted basis

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

Consolidated

	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*
			2010			
Derivative financial instruments	223,956	172,393	13,276	2,465	–	412,090
			2009 Restated			
Derivative financial instruments	243,503	119,960	2,140	1,905	–	367,508

Bank

	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*
			2010			
Derivative financial instruments	223,956	172,388	13,276	2,465	–	412,085
			2009			
Derivative financial instruments	243,503	119,921	2,003	1,782	–	367,209

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(f) Operational risk

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

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

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

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

(g) Capital management

The HKMA sets and monitors capital requirements for the Bank and certain of its subsidiaries specified by the HKMA. In implementing current capital requirements, the HKMA requires the Bank to maintain a prescribed ratio of total capital to total risk-weighted assets. The Bank calculated its consolidated capital adequacy ratios as at 31 December 2010 and 2009 in accordance with the Banking (Capital) Rules of the Hong Kong Banking Ordinance which became effective on 1 January 2007.

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

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

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

The Bank and its individually regulated subsidiary have complied with all externally imposed capital requirements throughout the years ended 31 December 2010 and 2009.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

39 Risk management (continued)

(g) Capital management (continued)

For the capital ratios as at 31 December 2010 and 2009, the Bank uses the advanced internal ratings-based approach and standardized approach to calculate its credit risk for non-securitization exposures. The Bank adopts the internal ratings-based (securitization) approach to calculate its credit risk for securitization exposures.

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

The Bank's consolidated capital as at 31 December 2010 and 2009 consists of core capital after deductions of HK$32,148 million (2009: HK$32,655 million) and supplementary capital after deductions of HK$5,579 million (2009: Nil). Supplementary capital includes subordinated debt, available-for-sale investment reserve and collective impairment allowances for impaired assets.

40 Fair value information

(a) Financial instruments carried at fair value

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

Valuation methodologies

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

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Fair value information (continued)

(a) 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 2010.

Consolidated

	2010 HK$'M Level 1	Level 2	Level 3	Total
Trading assets				
– Trading securities	45,175	1,276	–	46,451
– Placement with banks and other financial institutions	–	333	–	333
– Advances to customers	–	1,155	–	1,155
– Positive fair values of derivatives	86	694	–	780
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	–	1,490	–	1,490
– Positive fair values of hedging derivatives	–	291	–	291
Amounts due from fellow subsidiaries				
– Unlisted available-for-sale debt securities	–	–	2,965	2,965
– Unlisted financial assets designated at fair value	–	–	344	344
– Positive fair values of trading derivatives	2	–	–	2
Financial assets designated at fair value				
– Debt securities	–	4,175	2,385	6,560
Available-for-sale securities				
– Treasury bills (including Exchange Fund Bills)	30,898	–	–	30,898
– Certificates of deposit held	–	15,098	–	15,098
– Debt securities	23,329	55,445	53	78,827
– Equity shares, net of impairment	11	–	224	235
Other assets				
– Positive fair values of hedging derivatives	–	1	–	1
Total assets measured at fair value	99,501	79,958	5,971	185,430
Trading liabilities				
– Short positions in securities	36,196	–	–	36,196
– Negative fair values of derivatives	6	244	–	250
Financial liabilities designated at fair value				
– Structured customer deposits	–	3,052	–	3,052
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	1	1,665	–	1,666
– Negative fair values of hedging derivatives	–	666	–	666
Amounts due to fellow subsidiaries				
– Negative fair values of trading derivatives	–	199	–	199
– Negative fair values of hedging derivatives	–	90	–	90
Other liabilities				
– Negative fair values of hedging derivatives	–	54	–	54
Total liabilities measured at fair value	36,203	5,970	–	42,173

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Fair value information (continued)

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

Consolidated (continued)

	2009 (Restated) HK$'M			
	Level 1	*Level 2*	*Level 3*	*Total*
Trading assets				
– Trading securities	30,118	1,887	–	32,005
– Placement with banks and other financial institutions	–	38	–	38
– Advances to customers	–	136	–	136
– Positive fair values of derivatives	–	475	–	475
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	7	2,116	–	2,123
– Positive fair values of hedging derivatives	–	74	–	74
Amounts due from fellow subsidiaries				
– Unlisted available-for-sale debt securities	–	1,163	2,292	3,455
Available-for-sale securities				
– Treasury bills (including Exchange Fund Bills)	49,895	–	–	49,895
– Certificates of deposit held	–	11,807	–	11,807
– Debt securities	10,928	66,063	53	77,044
– Equity shares, net of impairment	55	–	38	93
Other assets				
– Positive fair values of hedging derivatives	–	50	–	50
Total assets measured at fair value	91,003	83,809	2,383	177,195
Trading liabilities				
– Short positions in securities	28,378	–	–	28,378
– Negative fair values of derivatives	5	653	–	658
Financial liabilities designated at fair value				
– Structured customer deposits	–	7,566	–	7,566
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	3	1,018	–	1,021
– Negative fair values of hedging derivatives	–	223	–	223
Other liabilities				
– Negative fair values of hedging derivatives	–	31	–	31
Total liabilities measured at fair value	28,386	9,491	–	37,877

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Fair value information (continued)

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

Bank

	2010 HK$'M			
	Level 1	*Level 2*	*Level 3*	*Total*
Trading assets				
– Trading securities	45,175	1,276	–	46,451
– Placement with banks and other financial institutions	–	333	–	333
– Advances to customers	–	1,155	–	1,155
– Positive fair values of derivatives	86	694	–	780
Amounts due from immediate holding company				
– Positive fair values of trading derivatives	–	1,490	–	1,490
– Positive fair values of hedging derivatives	–	291	–	291
Amounts due from fellow subsidiaries				
– Unlisted available-for-sale debt securities	–	–	2,965	2,965
– Unlisted financial assets designated at fair value	–	–	344	344
– Positive fair values of trading derivatives	2	–	–	2
Financial assets designated at fair value				
– Debt securities	–	4,175	2,385	6,560
Available-for-sale securities				
– Treasury bills (including Exchange Fund Bills)	30,898	–	–	30,898
– Certificates of deposit held	–	15,098	–	15,098
– Debt securities	23,329	55,445	53	78,827
– Equity shares, net of impairment	11	–	224	235
Other assets				
– Positive fair values of hedging derivatives	–	1	–	1
Total assets measured at fair value	99,501	79,958	5,971	185,430
Trading liabilities				
– Short positions in securities	36,196	–	–	36,196
– Negative fair values of derivatives	6	244	–	250
Financial liabilities designated at fair value				
– Structured customer deposits	–	3,052	–	3,052
Amounts due to immediate holding company				
– Negative fair values of trading derivatives	1	1,665	–	1,666
– Negative fair values of hedging derivatives	–	666	–	666
Amounts due to fellow subsidiaries				
– Negative fair values of trading derivatives	–	199	–	199
– Negative fair values of hedging derivatives	–	90	–	90
Other liabilities				
– Negative fair values of hedging derivatives	–	49	–	49
Total liabilities measured at fair value	36,203	5,965	–	42,168

There were no significant transfers between level 1 and level 2 instruments in 2010.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Fair value information (continued)

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

Bank (continued)

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

There were no significant transfers between level 1 and level 2 instruments in 2009.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Fair value information (continued)

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

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

Consolidated and Bank

	2010 HK$'M			
	Financial assets designated at fair value	Amounts due from fellow subsidiaries	Available-for-sale securities	Total level 3 assets
Financial assets				
At 1 January 2010	–	2,292	91	2,383
Total gains or losses recognised in the income statement	12	14	–	26
Total gains or losses recognised in available-for-sale investment reserve	–	129	(21)	108
Purchases	2,821	1,565	207	4,593
Sales	–	–	–	–
Settlements	(448)	(691)	–	(1,139)
At 31 December 2010	2,385	3,309	277	5,971
Total gains recognised in the income statement relating to assets held at 31 December 2010	3	–	–	3

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Fair value information (continued)

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

Sensitivities in respect of the fair values of level 3 assets are as follows:

Consolidated and Bank

	2010 HK$'M					
	Financial instruments designated at fair value			Available-for-sale securities		
	Net exposure	Favourable changes	Unfavourable changes	Net exposure	Favourable changes	Unfavourable changes
Amounts due from fellow subsidiaries	344	345	343	2,965	2,977	2,953
Debt securities	2,385	2,397	2,373	53	55	51
Equity shares	–	–	–	224	247	201
	2,729	2,742	2,716	3,242	3,279	3,205

Consolidated and Bank

	2009 HK$'M		
	Available-for-sale securities		
	Net exposure	Favourable changes	Unfavourable changes
Amounts due from fellow subsidiaries	2,292	2,313	2,271
Debt securities	53	55	51
Equity shares	38	42	34
	2,383	2,410	2,356

Where the fair value of financial instruments are measured using valuation techniques that incorporate one or more significant input which are based on unobservable market data, we apply stresses on these unobservable parameter inputs. A 10 per cent increase or decrease in correlation and credit sensitivities has been used to generate a range of reasonably possible alternative valuations. As of 31 December 2010, these stresses could have increased or decreased the fair values of financial instruments designated at fair value by HK$13 million (2009: Nil) and available-for-sale securities by HK$37 million (2009: HK$27 million).

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

40 Fair value information (continued)

(b) Instruments carried at amortized cost

All financial instruments are stated at fair value or amounts not materially different from their fair value as at 31 December 2010 and 2009.

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

Cash and balances with banks and other financial institutions

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

Placements with banks and other financial institutions

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

Advances to customers

Advances are net of provisions for impairment. The estimated fair value of advances represents the discounted amount of future cash flows expected to be received, including assumptions relating to prepayment rates and, where appropriate, credit spreads. Expected cash flows are discounted at current market rates to determine fair value.

Deposits 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 discounting cash flows using the prevailing market rates for debts with a similar credit risk and remaining maturity.

Debt securities in issue and subordinated liabilities

The aggregate fair values are calculated based on quoted market prices. For those securities where quoted market prices are not available, a discounted cash flow model is used based on a current market related yield curve appropriate for the remaining term to maturity.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

41 Assets pledged as security for liabilities

Liabilities of the Bank amounting to HK$48,977 million (2009: HK$28,378 million) are secured by the deposit of assets, including assets pledged in respect of sale and repurchase agreements, to cover short positions and to facilitate settlement processes with clearing houses. The amount of assets pledged by the Bank to secure these liabilities is HK$48,880 million (2009: HK$28,378 million). These assets mainly comprise of debt securities and treasury bills.

In respect of reverse repurchase agreements, the fair value of collateral held by the Bank which was permitted to be sold or repledged amounted to HK$36,893 million (2009: Nil). The fair value of such collateral actually sold or repledged by the Bank amounted to HK12,684 million (2009:Nil).

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

42 Material related party transactions

In addition to the transactions and balances disclosed elsewhere in these financial statements, the Bank and its subsidiaries entered into the following material related party transactions. The transactions of the Bank are materially the same as for those appearing in the consolidated financial statements in 2010 and 2009.

(a) Key management personnel remuneration

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

	Consolidated	
	2010	*2009*
	HK$'M	*HK$'M*
Short-term employee benefits	85	89
Post-employment benefits	5	4
Equity compensation benefits	30	16
	120	109

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(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.

	Consolidated	
	2010	*2009*
	HK$'M	*HK$'M*
Loan balances:		
At 1 January	852	853
At 31 December	1,240	852
Average balance during the year	827	817
Income earned	9	12

(c) Share based payments

The Group operates a number of share based payment schemes for its directors and employees. The scheme lives referred to below relate to the remaining period in which options may be granted under the scheme by the Bank and its subsidiaries' ultimate holding company Standard Chartered PLC (SC PLC).

1997/2006 Restricted Share Scheme (RSS)

The RSS is used as a vehicle for deferring part of the annual performance awards for certain employees and as an incentive plan to motivate and retain high performing staff. Except where used for bonus deferral purposes, executive directors are not generally eligible to participate in the RSS. However upon recruitment to the Group, awards may be made on an exceptional basis, for example to newly appointed directors to compensate for share awards forfeited on leaving their previous employer. For RSS awards used for any other purpose the maximum value of shares awarded in any year to any individual may not exceed two times their base salary. Generally half of the award vests two years after the date of grant and the balance after three years. However, the deferred element of 2009 and 2010 annual performance awards will vest in three equal tranches over one, two and three years.

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.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(c) Share based payments (continued)

2001 Performance Share Plan (2001 PSP)

The 2001 PSP is designed to be an intrinsic part of total remuneration for the Bank and its subsidiaries' executive directors and for a small number of the Bank and its subsidiaries' most senior executives. It is an internationally competitive long-term incentive plan that focuses executives on meeting and exceeding the long-term performance targets of the Bank and its subsidiaries.

Half of the awards are dependent upon the Group's total shareholder return performance compared to that of a group of peers at the end of a three-year period. The other half is subject to an earnings per share target for Standard Chartered PLC Group applied over the same three-year period.

Awards of nil price options to acquire shares are granted to the executives and will normally be exercisable between three and ten years after the date of grant if the individual is still employed by the Bank and its subsidiaries. There is provision for earlier exercise in certain limited circumstances.

2007 Supplementary Restricted Share Scheme (2007 SRSS)

The Bank and its subsidiaries operate a Supplementary Restricted Share Scheme which is similar to the RSS. The scheme is principally used for Global Markets. It was used in 2010 to defer one third of an employee's 2009 Annual Performance Award which vests after one year. Otherwise half of the award vests two years after the date of grant and the balance after three years. Executive directors are specifically prohibited from the plan; no new shares can be issued to satisfy awards; and there is no individual annual limit.

2004 Deferred Bonus Plan

Under the 2004 Deferred Bonus Plan, shares are conditionally awarded as part of the executive directors' annual performance award.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(c) Share based payments (continued)

All Employee Sharesave Schemes (Sharesave)

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

1997/2006 Restricted Share Scheme (RSS)

Valuation

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

	2010				*2009*		
Grant Date	*16 December*	*21 September*	*18 June*	*11 March*	*15 September*	*23 June*	*11 March*
Share price at grant date	£17.66	£19.12	£17.40	£17.40	£14.44	£11.75	£8.10
Shares granted	6,899	75,121	171,601	1,346,239	15,832	12,214	1,638,953
Vesting period (years)	2/3	2/3	2/3	2/3	2/3	2/3	2/3
Expected dividends (yield) (%)	3.7	3.7	3.9	3.9	3.45	3.73	3.73
Fair value (£)	16.11	17.46	15.80	15.80	13.27	10.72	7.39

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

A reconciliation of movements for the year ended 31 December 2010 and 2009 is shown below:

	2010	*2009*
	No. of shares	*No. of shares*
Outstanding at 1 January	2,326,460	1,057,773
Granted	1,599,860	1,666,999
Additional shares for SC PLC rights issue[1]	129,769	–
Lapsed	(138,878)	(55,517)
Exercised	(437,994)	(342,795)
Outstanding at 31 December	3,479,217	2,326,460
Weighted average remaining contractual life	5.53 years	5.59 years
Exercisable at 31 December	249,193	307,338

[1] For grants awarded prior to the announcement of the rights issue on 13 October 2010 which have not been exercised or lapsed the number of options granted have been increased by 3.8 per cent to ensure option holders were compensated for the dilutive impact of the rights issue.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(c) Share based payments (continued)

2000 Executive Share Option Scheme (2000 ESOS)

No share awards were granted in 2010 or 2009.

A reconciliation of option movements for the year ended 31 December 2010 and 2009 is shown below:

	2010		*2009*	
	No. of shares	*Weighted average exercise price*	*No. of shares*	*Weighted average exercise price*
Outstanding at 1 January	1,239,834	£7.15	1,501,848	£7.14
Additional Shares for SC PLC rights issue[1]	27,030	£6.61	–	–
Lapsed	(70,488)	£7.62	–	–
Exercised	(467,555)	£7.55	(262,014)	£7.10
Outstanding at 31 December	728,821	£6.59	1,239,834	£7.15
Exercisable at 31 December	728,821	£6.59	1,239,834	£7.15

[1] The exercise price for grants awarded prior to the announcement of the rights issue on 13 October 2010 which have not been exercised or lapsed, have been decreased by 3.8 per cent and the number of options granted have been increased to ensure option holders were compensated for the dilutive impact of the rights issue.

	2010			*2009*		
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*
£5.82/£7.89 (2009: £6.044/£9.099)	£6.59	728,821	1.82	£7.15	1,239,834	2.4 years

2001 Performance Share Plan (2001 PSP)

Valuation

The fair value of awards 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 Bank and its subsidiaries. Half the award is dependent on a TSR performance condition and half dependent on an EPS performance condition. The fair value of the TSR component is derived by discounting 50 per cent of the award that is subject to the TSR condition by the loss of expected dividends over the performance period together with the probability to meeting the TSR condition, which is calculated by the area under the TSR vesting schedule curve. The EPS fair value is derived by discounting 50 per cent of the awards by the loss of expected dividends over the performance period. In respect of the EPS component only, the number of shares expected to vest is adjusted for actual performance when calculating the charge for the year.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(c) Share based payments (continued)

	2010		2009	
Grant Date	*21 September*	*11 March*	*23 June*	*11 March*
Share price at grant date	£19.12	£17.40	£11.75	£8.10
Shares granted	3,922	119,376	6,382	418,154
Vesting period (years)	3	3	3	3
Expected dividends (yield) (%)	3.76	3.51	3.41	3.41
Fair value (EPS) (£)	8.55	7.85	5.40	3.73
Fair value (TSR) (£)	3.36	3.08	2.13	1.46

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

A reconciliation of movements for the year ended 31 December 2010 and 2009 is shown below:

	2010	2009
	No. of shares	*No. of shares*
Outstanding at 1 January	963,140	670,858
Granted	123,298	424,536
Additional shares for SC PLC rights issue[1]	33,023	–
Lapsed	(110,001)	(44,410)
Exercised	(119,813)	(87,844)
Outstanding at 31 December	889,647	963,140
Weighted average remaining contractual life	7.66 years	8.15 years
Exercisable at 31 December	157,446	66,243

[1] For grants awarded prior to the announcement of the rights issue on 13 October 2010 which have not been exercised or lapsed the number of options granted have been increased by 3.8 per cent to ensure option holders were compensated for the dilutive impact of the rights issue.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(c) *Share based payments (continued)*

2007 Supplementary Restricted Share Scheme (2007 SRSS)

Valuation

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

	2010				2009			
Grant Date	16 December	21 September	18 June	11 March	3 December	15 September	23 June	11 March
Share price at grant date	£17.66	£19.12	£17.40	£17.40	£15.51	£14.44	£11.75	£8.10
Shares granted	13,689	156,549	124,307	763,196	46,821	144,013	41,189	1,149,734
Vesting period (years)	2/3	2/3	2/3	1/2/3	2/3	2/3	2/3	2/3
Expected dividends (yield) (%)	3.7	3.7	3.9	2.7/3.9	3.45	3.45	3.73	3.73
Fair value (£)	16.11	17.46	15.80	16.93/15.80	14.25	13.27	10.72	7.39

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

A reconciliation of movements for the year to 31 December 2010 and 2009 is shown below:

	2010	2009
	No. of shares	No. of shares
Outstanding at 1 January	1,551,151	233,036
Granted	1,057,741	1,381,757
Additional shares for SC PLC rights issue[1]	92,352	–
Lapsed	(87,493)	(51,909)
Exercised	(97,537)	(11,733)
Outstanding at 31 December	2,516,214	1,551,151
Weighted average remaining contractual life	5.7 years	6.17 years
Exercisable at 31 December	41,929	–

[1] For grants awarded prior to the announcement of the rights issue on 13 October 2010 which have not been exercised or lapsed the number of options granted have been increased by 3.8 per cent to ensure option holders were compensated for the dilutive impact of the rights issue.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(c) Share based payments (continued)

2004 Deferred Bonus Plan

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

A reconciliation of share movements for the year ended 31 December 2010 and 2009 is shown below:

	2010	*2009*
	No. of shares	*No. of shares*
Outstanding at 1 January	–	24,485
Shares vested	–	–
Shares awarded	12,187	–
Rights issue	462	–
Shares lapsed	–	(816)
Shares exercised	–	(23,669)
Outstanding at 31 December	12,649	–

Notes:

a) The market value of Standard Chartered PLC shares on the date of awards (9 March 2010) was £17.19 (6 March 2009: £6.98).

b) The shares vest one year after the date of award.

c) A notional scrip dividend accrues on the shares held in the Trust. The dividend is normally delivered in the form of shares and is released on vesting.

2004 Sharesave

Valuation

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

	2010	*2009*
Grant Date	*11 October*	*9 October*
Share price at grant date	£18.70	£15.57
Exercise price	£15.19	£11.46
Shares granted	342,820	825,238
Vesting period (years)	3/5	3/5
Expected volatility (%)	46-56	44-53
Expected option life (years)	3.33-5.33	3.33-5.33
Risk free rate (%)	0.9-1.6	1.8-2.5
Expected dividends (yield) (%)	3.5-3.8	3.2-3.3
Fair value (£)	7.0-7.2	6.2-6.4

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

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(c) Share based payments (continued)

A reconciliation of option movements for the year ended 31 December 2010 and 2009 is shown below:

	2010		2009	
	No. of shares	Weighted average exercise price	No. of shares	Weighted average exercise price
Outstanding at 1 January	2,164,679	£10.37	2,294,281	£9.66
Granted	342,820	£15.19	825,238	£11.46
Additional shares for SC PLC rights issue[1]	67,368	£11.37	–	–
Lapsed	(619,253)	£9.21	(487,286)	£10.16
Exercised	(329,315)	£9.85	(467,554)	£9.04
Outstanding at 31 December	1,626,299	£11.50	2,164,679	£10.37
Exercisable at 31 December	154,877	£10.20	143,580	£9.06

1 The exercise price for grants awarded prior to the announcement of the rights issue on 13 October 2010 which have not been exercised or lapsed, have been decreased by 3.8 percent and the number of options granted have been increased to ensure option holders were compensated for the dilutive impact of the rights issue.

	2010			2009		
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
£8.32/£14.63 (2009: £6.50/£10.88)	£11.50	1,626,299	2.44 years	£10.37	2,164,679	2.2 years

(d) Loans to officers

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

	2010 HK$'M	2009 HK$'M
Aggregate amount of relevant loans by the Bank outstanding at 31 December	105	33
Maximum aggregate amount of relevant loans by the Bank outstanding during the year	113	76

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

42 Material related party transactions (continued)

(e) Related party transactions with associates

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

	2010 *HK$'M*	*2009* *HK$'M*
Amounts due from associates	362	245
Deposits from associates	245	96
Interest income	1	1

43 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 a form of Indian Depository Receipts.

44 Significant accounting estimates and judgements

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

Pensions

Actuarial assumptions are made in valuing future defined pension obligations as set out in note 32 and are updated periodically.

Taxes

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

Fair value of financial instruments

Fair value is the amount for which an asset could be exchanged or a liability settled, between knowledgeable willing parties in an arm's length transaction. Notes 2(i) and 40 provide further information on the Bank's fair value accounting policy and process.

Notes to the financial statements (continued)

(Expressed in millions of Hong Kong dollars)

44 Significant accounting estimates and judgements (continued)

Impairment of financial assets

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

Goodwill impairment

An annual assessment is made, as set out in note 23, as to whether the current carrying value of goodwill is impaired.

45 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting period ended 31 December 2010

Up to the date of issue of the financial statements, the IASB and HKICPA have issued a number of amendments, new standards and interpretations which are not yet effective for the accounting year ended 31 December 2010 and which have not been adopted in these financial statements.

These include:

– HKAS 12 (amendment), "Income taxes"

– HKAS 24 (revised), "Related party disclosures"

– HKAS 32 (amendment), "Classification of rights issues"

– HK (IFRIC) 19, "Extinguishing financial liabilities with equity instruments"

– HK (IFRIC) 14 (amendment), "Prepayments of a minimum funding requirement"

– Third improvements to Hong Kong Financial Reporting Standards (2010)

– HKFRS 7 (amendment), "Financial Instruments: Disclosure"

– HKFRS 9 (amendment), "Financial instruments"

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

46 Comparative figures

Accounting Guideline No. 5 – "Merger Accounting for Common Control Combinations" issued by the HKICPA, has been applied for the acquisition of Prime Credit Limited ("PCL"). As a result, the comparative figures have been presented as if the acquisition of PCL by the Bank had occurred from the date when PCL first came under the control of Standard Chartered PLC Group.

In addition, in 2010, certain income from allocations of Financial Markets products had been reclassified from "Net trading income" to "Fee and commission income". An amount of HK$587 million has therefore been reclassified in 2009 to conform to the current year presentation. This reclassification provides a better reflection of the underlying transactions.

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 Guideline on a Sound Remuneration System issued by the HKMA, the following disclosures are made:

a) The design and implementation of the remuneration systems:

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 and the major characteristics of the remuneration system.

b) Aggregate quantitative information on remuneration for senior management and key personnel (note 1) for the year ended 31 December 2010 are as follows:

	Amount (HKD'000)	*Number of Beneficiaries*
Fixed remuneration	20,668	10
Variable remuneration		
• Cash	24,184	10
• Share-linked instruments	21,402	10
Total	66,254	10
Amounts of deferred remuneration		
• Vested	4,985	9
• Non-vested	42,134	10
Total	47,119	10
Amounts of deferred remuneration:		
• awarded in 2010	21,402	10
• paid out in 2010	(12,140)	5
• reduced through performance adjustments in 2010	(1,266)	8

No senior management or key personnel has been awarded with new sign-on or severance payments in 2010.

Note 1: As defined in CG5 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 main 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.