



恒生銀行
HANG SENG BANK

Annual Report 2015

2015年年報

The printed version of Hang Seng Bank's Annual Report 2015 will replace this version in late March 2016.

恒生銀行2015年年報之印刷本將於2016年3月下旬取代此版本。

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* Where possible, percentages in this section have been rounded to the nearest percentage point to facilitate easy reading. Percentage-based indicators remain at 1 or 2 decimal places as appropriate.

The abbreviations 'HK\$m' and 'HK\$bn' represent millions and billions of Hong Kong dollars respectively.

CORPORATE PROFILE

Founded in 1933, Hang Seng is one of Hong Kong's largest listed companies. Our market capitalisation as at 31 December 2015 was HK\$282.0 billion.

With more than 10,000 employees, we serve over half the adult population of Hong Kong – more than 3 million people – through about 250 service outlets. We also maintain branches in Macau and Singapore and a representative office in Taipei.

Established in 2007 and headquartered in Shanghai, our wholly owned mainland China subsidiary Hang Seng Bank (China) Limited operates a network of around 50 outlets in Beijing, Shanghai, Guangzhou, Shenzhen, Fuzhou, Nanjing, Dongguan, Hangzhou, Ningbo, Tianjin, Kunming, Xiamen, Chengdu, Jinan, Foshan, Zhongshan, Huizhou, Zhuhai, Jiangmen and Shantou.

Hang Seng is a principal member of the HSBC Group, one of the world's largest banking and financial services organisations.

RATINGS

MOODY'S		
Hang Seng Bank	Long-term Bank Deposit (local and foreign currency)	Aa2
	Short-term Bank Deposit (local and foreign currency)	Prime-1
	Outlook	Stable
Hang Seng China	Long-term Bank Deposit (local and foreign currency)	A2
	Short-term Bank Deposit (local and foreign currency)	Prime-1
	Outlook	Stable

STANDARD & POOR'S		
Hang Seng Bank	Long-term Counterparty Credit (local and foreign currency)	AA-
	Short-term Counterparty Credit (local and foreign currency)	A-1+
	Outlook	Stable
Hang Seng China	Long-term Counterparty Credit (local and foreign currency)	AA-
	Short-term Counterparty Credit (local and foreign currency)	A-1+
	Outlook	Stable

RESULTS IN BRIEF

	2015	2014	Change %
For the year			
	HK\$m	HK\$m	
Operating profit excluding loan impairment charges	20,541	20,594	-
Operating profit	19,433	19,450	-
Profit before tax ¹	30,488	18,049	69
Profit attributable to shareholders ¹	27,494	15,131	82
	%	%	
Return on average ordinary shareholders' equity ¹	20.7	13.4	
Cost efficiency ratio	33.8	31.8	
Average liquidity coverage ratio (quarter ended 31 Dec 2015) ²	195.0	N/A	
Average liquidity coverage ratio (quarter ended 30 Sep 2015) ²	237.2	N/A	
Average liquidity coverage ratio (quarter ended 30 Jun 2015) ²	221.6	N/A	
Average liquidity coverage ratio (quarter ended 31 Mar 2015) ²	167.4	N/A	
Average liquidity ratio	N/A	34.7	
	HK\$	HK\$	%
Earnings per share ¹	14.22	7.91	80
Dividends per share	8.70 #	5.60	55

	At 31 December 2015	At 31 December 2014	Change
At year-end			
	HK\$m	HK\$m	%
Shareholders' funds	141,981	139,193	2
Total assets	1,334,429	1,263,990	6
	%	%	
Capital ratios under Basel III			
- Common Equity Tier 1 ("CET1") Capital Ratio	17.7	15.6	
- Tier 1 Capital Ratio	19.1	15.6	
- Total Capital Ratio	22.1	15.7	

Including special interim dividend of HK\$3.00 per share

¹ Excluding the financial impact of Industrial Bank-related items in both years		
<i>Reported results for 2015 include a gain on partial disposal of the ordinary shares of Industrial Bank of HK\$10,636m and dividend of HK\$119m (HK\$107m after tax). Reported results for 2014 include an impairment loss of HK\$2,103m on the Bank's investment in Industrial Bank and dividend of HK\$1,190m (HK\$1,071m after tax). Figures quoted as 'excluding the financial impact of Industrial Bank-related items in both years' have been adjusted for the above item. Excluding the financial impact of Industrial Bank-related items in both years, key financial results and performance metrics are set out below for comparison purpose:</i>		
	2015	2014
<i>Profit before tax (HK\$m)</i>	19,733	18,962
<i>Profit attributable to shareholders (HK\$m)</i>	16,751	16,163
<i>Earnings per share (HK\$)</i>	8.60	8.45
<i>Return on average ordinary shareholders' equity (%)</i>	13.8	14.3

² The Banking (Liquidity) Rules ('BLR'), effective on 1 January 2015, signified the implementation of Liquidity Coverage Ratio ('LCR') for category 1 Institution under Basel III liquidity standards in Hong Kong. The average Liquidity Coverage Ratios reported for the quarters ended 31 Dec, 30 Sep, 30 June and 31 March 2015 under Basel III are therefore not directly comparable with the average liquidity ratio reported for the year ended 31 Dec 2014, which was calculated in accordance with the Fourth Schedule of the Hong Kong Banking Ordinance.

FIVE-YEAR FINANCIAL SUMMARY

	2011 (restated)	2012 (restated)	2013	2014	2015
For the year	HK\$bn	HK\$bn	HK\$bn	HK\$bn	HK\$bn
Operating profit	14.1	15.5	18.4	19.5	19.4
Profit before tax ¹	19.2	22.0	28.5	18.0	30.5
Profit attributable to shareholders ¹	16.8	19.3	26.7	15.1	27.5
At year-end	HK\$bn	HK\$bn	HK\$bn	HK\$bn	HK\$bn
Shareholders' funds	79.6	92.3	107.8	139.2	142.0
Issued and paid up capital	9.6	9.6	9.6	9.7	9.7
Total assets	975.7	1,077.1	1,143.7	1,264.0	1,334.4
Total liabilities	896.1	984.8	1,035.9	1,124.8	1,192.4
Per share	HK\$	HK\$	HK\$	HK\$	HK\$
Earnings per share ¹	8.80	10.11	13.95	7.91	14.22
Dividends per share	5.20	5.30	5.50	5.60	8.70 #
Ratios	%	%	%	%	%
Return on average ordinary shareholders' equity ¹	22.6	22.8	25.4	13.4	20.7
Post-tax return on average total assets	1.8	1.9	2.4	1.3	2.1
Capital ratios under Basel III					
- Common Equity Tier 1 ("CET1") Capital Ratio	-	-	13.8	15.6	17.7
- Tier 1 Capital Ratio	-	-	13.8	15.6	19.1
- Total Capital Ratio	-	-	15.8	15.7	22.1
Capital ratios under Basel II					
- Core capital ratio	11.6	12.2	-	-	-
- Capital adequacy ratio	14.3	14.0	-	-	-
Cost efficiency ratio	35.3	34.9	32.4	31.8	33.8

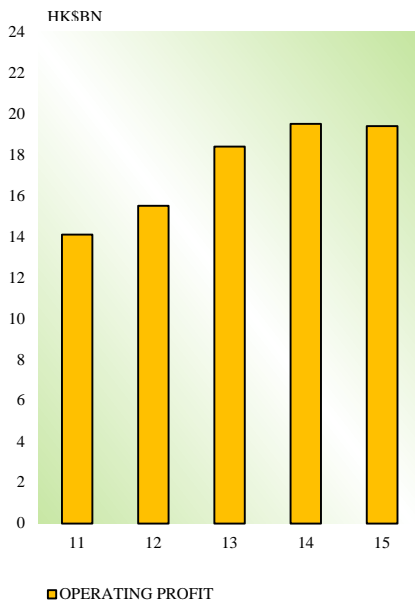
Including special interim dividend of HK\$3.00 per share

¹ Excluding the financial impact of Industrial Bank-related items in both years

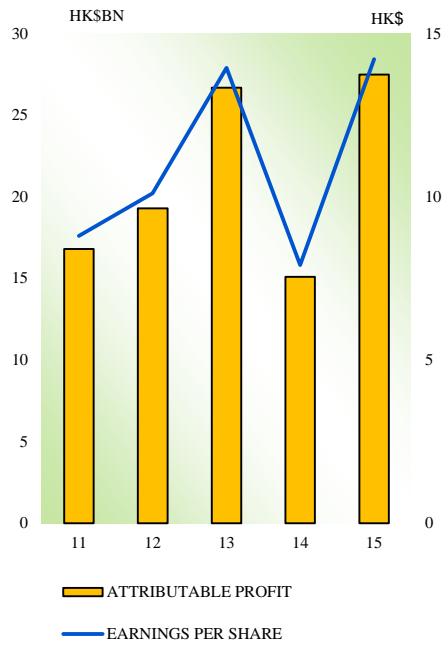
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	2015	2014
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Profit attributable to shareholders (HK\$bn)	16.8	16.2
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Return on average ordinary shareholders' equity (%)	13.8	14.3

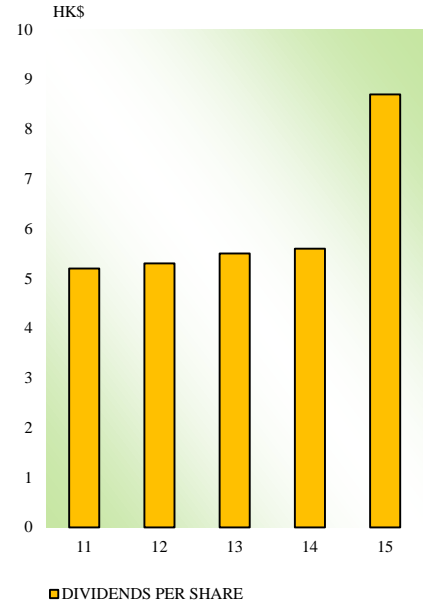
RESULTS



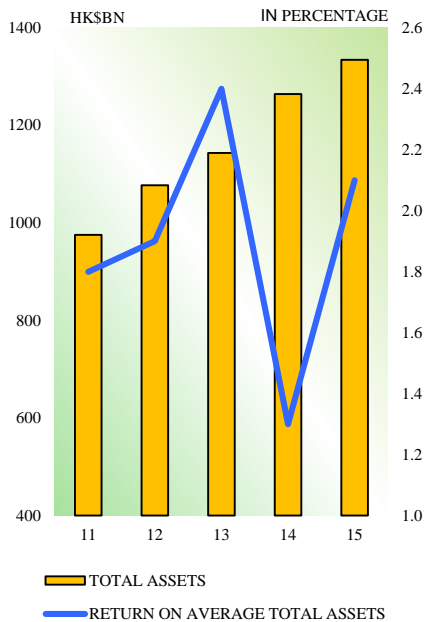
ATTRIBUTABLE PROFIT AND EARNINGS PER SHARE



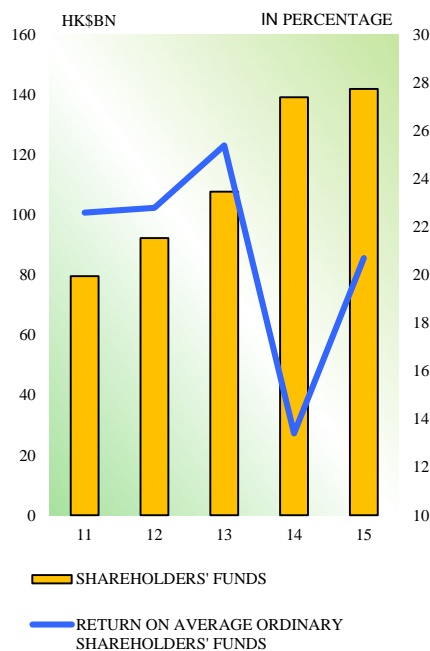
DIVIDENDS PER SHARE



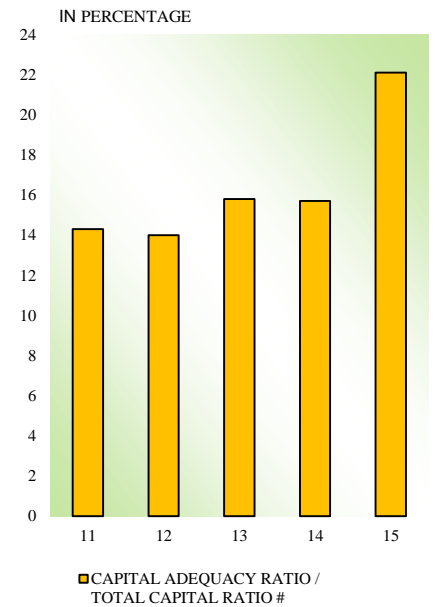
TOTAL ASSETS AND RETURN ON AVERAGE TOTAL ASSETS



SHAREHOLDERS' FUNDS AND RETURN ON AVERAGE ORDINARY SHAREHOLDERS' EQUITY



CAPITAL ADEQUACY RATIO / TOTAL CAPITAL RATIO



On 1 January 2013, the Hong Kong Monetary Authority ("HKMA") implemented the first phase of the Basel III capital framework in Hong Kong. The capital disclosures effective from 2013 under Basel III are, therefore, not directly comparable with the disclosure prepared under Basel II basis before.

CHAIRMAN'S STATEMENT

The complex picture of global recovery that developed in 2015 created challenging operating conditions for business. While improved economic indicators in the US led the Federal Reserve to begin raising interest rates, the slowing of external trade activity in Hong Kong and lower economic growth in mainland China, along with the uneven pace of fiscal reform across the eurozone, kept overall growth in the region modest. Falling prices for commodities and weak trade demand resulted in slower activity in many emerging market economies.

Against this backdrop, Hang Seng Bank achieved respectable full-year results for 2015. Profit attributable to shareholders rose by 82% to HK\$27,494m and earnings per share increased by 80% to HK\$14.22 per share. Excluding the financial impact of Industrial Bank-related items in both years, attributable profit rose by 4% and earnings per share increased by 2%.

The Directors have declared a fourth interim dividend of HK\$2.40 per share. Following the successful disposal of the majority of our shareholding interest in Industrial Bank in May 2015, the Directors have also declared a special interim dividend of HK\$3.00 per share. This brings the total distribution for 2015 to HK\$8.70 per share, compared with HK\$5.60 in 2014.

Economic Environment

In Hong Kong, robust consumer spending and the strong labour market supported domestic demand, which was the primary driver of the 2.5% increase in gross domestic product recorded for the first three quarters of 2015. External trade, however, remained weak, in part reflecting the continuing challenges to growth faced by several of the world's major economies. We expect Hong Kong's GDP to grow by 1.8-2.4% in 2016.

Ongoing economic deleveraging on the Mainland had a moderating effect on its 2015 GDP growth rate which, at 6.9%, was down from 7.3% in 2014. However, while traditional drivers of the economy have slowed, consumption has been resilient, indicating a shift towards a more service-oriented economy. The People's Bank of China has cut its required reserve ratio and benchmark interest rates and is expected to maintain steady economic growth. Our forecast for 2016 GDP growth on the Mainland is 6.7%.

The effects of Mainland economic transition and the normalisation of US monetary policy are likely to create ongoing challenges to the pace of economic development in Asia in the year ahead. At the same time, the 'One Belt, One Road' initiative, the further opening up of financial markets on the Mainland and efforts to further internationalise the renminbi should provide new opportunities to grow our business.

I would like to express my heartfelt appreciation to all staff, the Bank's senior management and my fellow Board members for their invaluable contributions in the development and execution of our long-term growth objectives. I also wish to offer sincere thanks to our customers and shareholders for their continuing loyalty and trust.

With premium customer service at the heart of our strategy for sustainable growth, we will continue to invest capital and other resources in reinforcing our market position, enhancing efficiency and increasing value for shareholders.

Raymond Ch'ien

Chairman

Hong Kong, 22 February 2016

CHIEF EXECUTIVE'S REPORT

In a challenging operating environment, Hang Seng Bank made good progress with our customer-focused strategy and recorded good growth in 2015.

Supported by well-integrated retail and commercial banking positioning, we maintained balanced growth in our core businesses and sustained profitability to enhance returns for shareholders.

The partial disposal of our shareholding in Industrial Bank provided us with a stronger capital base that supports our growth strategy and our ability to meet evolving regulatory requirements. We continued to maintain a strong liquidity position.

We acquired new clients in target segments and strengthened customer engagement by upgrading our Prestige and Preferred Banking Centres and Business Banking Centres. Leveraging data analytics, we enriched our product suite and enhanced our mobile and digital platforms to offer customers a more personalised experience and greater convenience and choice for financial management.

Increased cross-border and cross-business collaboration enabled us to capture more onshore and offshore business opportunities, resulting in growth in transaction banking and wealth management activities. In July, we became the first foreign bank to apply for the establishment of a majority-foreign-owned joint venture fund management company in Qianhai under Supplement X to the Closer Economic Partnership Arrangement. We were also among the first group of financial institutions to receive approval to register a northbound fund under the Mainland-Hong Kong Mutual Recognition of Funds initiative. Our new branch in Jinan has extended our service capabilities in the economically significant Bohai Economic Rim region.

We strengthened our health-and-wealth proposition by further leveraging our exclusive partnership arrangement with Bupa, supporting sustained growth in wealth management income.

Financial Performance

Attributable profit grew by 82% to HK\$27,494m and earnings per share increased by 80% to HK\$14.22 per share. Profit before tax rose by 69% to HK\$30,488m.

Excluding the financial impact of Industrial Bank-related items in both years, attributable profit and profit before tax both increased by 4% and earnings per share were up 2%.

Operating profit excluding loan impairment charges was HK\$20,541m and operating profit was HK\$19,433m – both broadly in line with 2014. However, excluding dividend income received from Industrial Bank in 2015 and 2014, operating profit excluding loan impairment charges rose by 5% to HK\$20,422m and operating profit was up 6% at HK\$19,314m.

Net interest income increased by HK\$1,294m, or 7%, to HK\$21,165m, with growth in both average customer lending and average customer deposits. The additional interest earned from the 10% rise in average interest-earning assets more than offset the impact of the narrowing of net interest margin, which was down seven basis points at 1.83%.

Non-interest income fell by 4% to HK\$9,882m, due mainly to the drop of HK\$1,068m, or 88%, in dividend income from Industrial Bank compared with the previous year. Excluding Industrial Bank dividend income in both years, non-interest income increased by 7% to HK\$9,763m, with upbeat investor sentiment in the first half of 2015 driving growth in income from securities-related business.

Our cost efficiency ratio was 33.8%, compared with 31.8% in 2014, due partly to the drop in dividend income received from Industrial Bank.

On 31 December 2015, our total capital ratio was 22.1%, compared with 15.7% at the end of 2014. Our common equity tier 1 and tier 1 capital ratios were 17.7% and 19.1% respectively, compared with

15.6% for both ratios a year earlier. These improvements reflect the net effect of the increase in our capital base following the partial disposal of our holding in Industrial Bank and an 8% rise in risk-weighted assets.

A Customer-centred Strategy for Sustainable Growth

The effects of economic slowdown on the Mainland, normalisation of monetary policy in the US and ongoing uncertainty in the eurozone are creating increasingly challenging conditions for business.

We will continue to strengthen our competitiveness by leveraging our strong brand, network, customer base and cost effectiveness. Differentiation of our offerings for different target segments will help us deepen client engagement and reach new customers.

The close integration of our cross-border and cross-business infrastructure will enable us to sustain quality growth and reinforce our leading position in our core businesses by providing customers with total banking solutions.

Intensification of capital, liability and liquidity management will help us meet changing regulatory requirements and manage the impact of market volatility.

Deeper engagement with clients and strengthened data analytics will support our development of tailored financial solutions and facilitate portfolio management for different customer segments in response to increasing market complexity. We will continue to expand our online and digital platforms to enhance efficiency and convenience for our increasingly mobile and tech-savvy client base.

We will further strengthen credit risk management and maintain high standards of corporate governance.

In continuing to promote a performance-driven culture that places strong emphasis on talent management, our people strategy will ensure staff receive the training and support they need to build strong connections with customers.

Our diverse range of corporate sustainability programmes remains a key element of our commitment to promoting the well-being of the communities that support us.

I wish to thank my colleagues for their dedication in helping us move forward with our strategic initiatives to deliver service excellence to our customers, achieve sustainable growth and increase value for shareholders.

Rose Lee

Vice-Chairman and Chief Executive

Hong Kong, 22 February 2016

BUSINESS REVIEW

We experienced complex operating conditions in 2015. International economic uncertainty, intense market competition and the slower pace of growth in mainland China created new challenges. At the same time, favourable cross-border policy developments and further steps to promote the internationalisation of the renminbi presented new opportunities for business.

Leveraging our leading market position in Hong Kong, close cross-border connectivity and trusted brand, we took further steps to enhance the customer experience. New investment in our digital platforms, upgrades to our physical outlets and the launch of new health-and-wealth products helped us strengthen ties with existing clients and more effectively reach new customers in target groups.

We grew gross loans and advances by 5% year on year to HK\$691bn while continuing to uphold good asset quality. Customer deposits, including certificates of deposit and other debt securities in issue, grew by 4% to HK\$998bn.

Retail Banking and Wealth Management

Retail Banking and Wealth Management recorded a 7% increase in profit before tax to HK\$9,250m. Operating profit excluding loan impairment charges grew by 9% to HK\$9,709m. Operating profit was up 8% at HK\$9,089m.

The upgrade of our service channels, our exclusive partnership with Bupa and our strong cross-border capabilities further reinforced our ability to provide financial solutions that meet the diverse needs of different customer segments. The expansion of our digital services enhanced customer convenience and increased the number of potential points of client contact. Improved data analytics helped us identify new opportunities to deepen customer relationships. We achieved good growth in our customer base, with the number of Prestige Banking and Preferred Banking clients increasing by 5% in Hong Kong and 45% on the Mainland year on year.

New initiatives to sustain balance sheet growth generated a 9% increase in net interest income to HK\$11,281m. Customer deposits and customer lending rose by 4% and 9% respectively compared with a year earlier.

Non-interest income increased by 4% to HK\$5,056m, due mainly to a 17% increase in net fee income.

We upgraded our online banking platform and launched a new personal mobile banking app to better serve the needs of customers, particularly younger and tech-savvy clients. Year on year, the number of e-Banking customers rose by 7% and 24% in Hong Kong and on the Mainland respectively. In September, the Bank's wholly owned subsidiary Hang Seng Investment Management launched its own website to provide investors with easy access to timely information and further strengthen the link between wealth management expertise and the Hang Seng brand in the minds of customers.

Wealth management

Wealth management income grew by 3% to HK\$6,708m.

Backed by our trusted brand, strong customer analytics capabilities and time-to-market advantage, we capitalised on the positive investor outlook in the first half of the year to grow investment income by 20%. The active securities market helped drive securities turnover and income up by 49% and 38% respectively. Income from other investment products grew by 9%. The Hang Seng H-Share Index exchange-traded fund (ETF) achieved year-on-year growth of 127% in terms of total asset value and, as at 31 December 2015, Hang Seng Investment Management was the largest provider of ETFs in Hong Kong in terms of assets under management. The enhancement of service platforms and product features helped boost trading volume, resulting in a 74% increase in turnover of equity structured notes and investments and a 180% rise in secondary trading of bonds.

Supported by our well-integrated cross-border infrastructure, our investment services experience and expertise in Hong Kong enabled us to respond swiftly to new opportunities for business created by favourable policy developments. We were the first foreign company to apply to establish a majority foreign-owned joint venture fund management company on the Mainland under Supplement X to the Closer Economic Partnership Arrangement, and the Hang Seng China H-Share Index Fund was among the first batch of northbound funds to be approved under the Mainland-Hong Kong Mutual Recognition of Funds (MRF) initiative. We also began distributing the HSBC JinTrust Large Cap Equity Securities Fund – one of the MRF’s first southbound funds – through our extensive network in Hong Kong.

Insurance income was down by 12%, due mainly to lower returns on the insurance funds investment portfolio. In addition to taking more steps to optimise the mix of life insurance product offerings we offer to customers, we further leveraged the competitive advantages created through our partnership arrangement with international healthcare insurer Bupa by rolling out our Hang Seng Bupa PreciousHealth Series of insurance products on the Mainland.

Consumer finance

Revenue from credit card business and personal lending continued to report satisfactory growth in Hong Kong. Our high quality credit card customer base and effective use of marketing underpinned a 9% increase in card spending. By deepening our knowledge of customers’ profiles, behaviours and needs, we were able to expand the personal loans portfolio by 17% compared with the end of 2014.

In challenging operating conditions, we grew our mortgage balances by 9% and 26% in Hong Kong and on the Mainland respectively. We maintained our top-three market position in terms of new mortgage registrations in Hong Kong.

Commercial Banking

Commercial Banking achieved an 8% year-on-year increase in profit before tax to HK\$5,212m. Operating profit excluding loan impairment charges rose by 6% to HK\$5,736m. Operating profit was up 8% at HK\$5,212m.

Net interest income increased by 8% to HK\$5,929m. Successful deposit acquisition strategies focusing on target customers and segments and strengthened cash management capabilities drove a 26% increase in current and savings balances, and a 10% rise in average customer deposits. We grew customer lending by 3% while continuing to maintain asset quality.

Non-interest income rose by 2% to HK\$2,288m. Enriched product offerings and sales distribution initiatives supported growth across a diverse range of revenue streams. We achieved a 12% rise in insurance income, leveraging partly on our partnership arrangement with Bupa. Effective marketing and enhancements to our products and services for clients with cross-border financial needs underpinned a 13% rise in remittance income. Securities brokerage income grew by 41%, due mainly to increased trading activities and the buoyant stock market in the first half of the year. This broad-based growth more than offset the 36% decline in structured investment income, which was mainly due to the depreciation in the renminbi reducing customer appetite for related structured products.

Loan impairment charges were down by 11% compared with the end of 2014. Our continued vigilance in managing credit risk led to lower impairment charges in the second half of 2015 compared with the first half, and loan impairment charges were contained at 0.42% against gross customer advances. We will continue to enhance our portfolio management to improve overall return on risk assets.

Further improvements to our Business Banking Centres and our service proposition drove a 19% increase in deposits business and an 11% rise in total operating income generated from SMEs. Mainland companies represented 51% of newly acquired SME customers in 2015. The Hong Kong General Chamber of Small and Medium Business presented us with a ‘Best SME’s Partner Award’ for the 10th consecutive year.

We enhanced transactional efficiency with the launch of new services including e-Cheques which can be issued and deposited via the Business e-Banking platform and a host-to-host solution that provides a secure, efficient and automated platform to support various payments. Our efforts to provide customer service excellence led to us being recognised as ‘Best Hong Kong Bank Provider of Cash Management Services’ by *CFO Innovation Asia* and ‘Hong Kong Domestic Trade Finance Bank of the Year’ by *Asian Banking & Finance*.

Global Banking and Markets

Global Banking and Markets reported a 4% year-on-year decrease in profit before tax to HK\$4,506m. Operating profit excluding loan impairment charges fell by 5% to HK\$4,466m. Operating profit was down 4% at HK\$4,502m.

Global Banking

Global Banking recorded a 4% increase in profit before tax to HK\$1,856m. Operating profit excluding loan impairment charges rose by 2% to HK\$1,821m. Operating profit was up 4% at HK\$1,857m.

Total operating income rose by 5% to HK\$2,276m. Non-interest income increased by 45% to HK\$388m, due mainly to a rise in transaction-related income and corporate wealth management business. With weakening demand for loans and the narrowing of the interest margin in the second half of the year, net interest income was in line with 2014 at HK\$1,888m.

Customer lending grew by 1%, reflecting our prudent credit risk management strategy in the uncertain economic conditions. Customer deposits were up 2%.

Global Markets

Global Markets reported a 9% decline in profit before tax to HK\$2,650m. Operating profit fell by 9% to HK\$2,645m.

Net interest income fell by 23% to HK\$1,610m, with narrower interbank placement spreads limiting the opportunities for effective deployment of new and maturing proceeds.

In the low interest rate environment, we put additional focus on growing non-fund income, including by enhancing cross-selling initiatives in collaboration with Retail Banking and Wealth Management and Commercial Banking. A 21% rise in total trading income underpinned the 21% increase in non-interest income to HK\$1,526m.

Hang Seng Indexes

Wholly owned subsidiary Hang Seng Indexes Company Limited (Hang Seng Indexes) furthered its commitment to meeting the needs of customers in a rapidly changing market environment. A total of 21 new indexes were launched in 2015, encompassing both benchmarking indexes and indexes designed to track index-linked investment products.

With increasing investor focus on the interplay between A-share and H-share price differentials, Hang Seng Indexes launched a ‘smart’ version of the Hang Seng China Enterprises Index (HSCEI) in June, which uses a monthly switching mechanism based on the relative prices of the A-shares and H-shares of each HSCEI constituent company to determine which share class should be included in the index.

Four new exchange-traded products based on the Hang Seng Futures Index Series, the Hang Seng Composite SmallCap Index and the HSCEI Short Index were listed in 2015. These new listings took the number of Hang Seng Family of Indexes-linked exchange-traded products worldwide to 36. Hang Seng Indexes exchange-traded funds and notes are collectively listed on 16 different stock exchanges around the world. As at the end of 2015, the assets under management of these products had reached US\$24 billion – representing a 41% increase compared with the previous year.

The total number of futures and options contracts traded on the Hang Seng Index and the Hang Seng China Enterprises Index in 2015 was over 81 million, and the open interest of the futures and options of these two indexes on 31 December 2015 was more than 2 million, representing an increase of 30% compared with a year earlier.

Hang Seng Indexes now compiles 448 indexes – 77 real-time and 371 daily indexes – under 92 different index series, including 15 cross-border series.

Business Review Key Initiatives

Harnessing technology for on-the-move financial management

Our diverse customer base encompasses a broad range of preferences when it comes to financial management. Our efforts to enhance client choice over when and where they manage their financial needs include upgrading our physical outlets and investing in new technology to support our website and mobile banking platforms. Our extensive network of service channels offers customers flexibility and convenience in accomplishing their financial objectives. It also plays an important part in reflecting our brand values and reinforcing our reputation for service excellence.

Creating partnerships for cross-border growth

Our well-integrated cross-border infrastructure gives us a strong competitive advantage in responding rapidly to new opportunities created by financial reform on the Mainland. In partnership with Shenzhen Qianhai Financial Holdings Co. Ltd, we were the first foreign company to apply to establish a majority foreign-owned joint venture fund management company on the Mainland under Supplement X to the Closer Economic Partnership Arrangement. The joint venture company will provide an important channel to share our professional fund product and asset management services with individual and institutional Mainland customers.

Leading the way in investment management services

An investment management leader and currently the largest issuer of exchange-traded funds in Hong Kong in terms of assets under management, we are rolling out more services for customers on the Mainland. Working with China Construction Bank (CCB) as our Mainland partner, we obtained approval in December 2015 to register the Hang Seng China H-Share Index Fund (Fund) in the first batch of northbound funds under the Mainland-Hong Kong Mutual Recognition of Funds initiative. The Fund will be distributed by Hang Seng China and CCB. We are also working to broaden choice for customers in Hong Kong by identifying a range of southbound funds for distribution through our outlets.

Reaching out to better serve Mainland customers

We continue to take steps to enhance the productivity of our Mainland branches and sub-branches, and use our good cross-border connectivity to bring a wide range of financial services to Mainland customers. Opened in April 2015, our Jinan Branch is the third Hang Seng China branch in the Bohai Economic Rim area and extends our ability to reach clients in this economically important region. We also continue to leverage the competitive advantages provided by our strategic partnerships and our wealth management expertise in Hong Kong to enhance health-and-wealth offerings for Mainland customers, including the launch of Bupa medical insurance products through Hang Seng China branches in major cities.

Recognition

Hang Seng Bank

Best Bank – Domestic (Hong Kong) (for 16th consecutive year)

The Asset

Best Bank in Hong Kong

Global Finance

Best SME's Partner Award

The Hong Kong General Chamber of Small and Medium Business

Hong Kong Domestic Trade Finance Bank of the Year

Asian Banking & Finance

Trusted Brands Gold Award – Bank (Hong Kong)

Reader's Digest

Trusted Brands Gold Award – Credit Card Issuing Bank (Hong Kong)

Reader's Digest

Hang Seng Bank (China)

Most Trustworthy Bank

CFO World

Best Foreign Bank

CNFOL.COM

Best Cross Border Trade Settlement

CFO World

Best Brand Building Foreign Bank

21st Century Business Herald

MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL REVIEW

FINANCIAL PERFORMANCE

Income Statement

Summary of financial performance

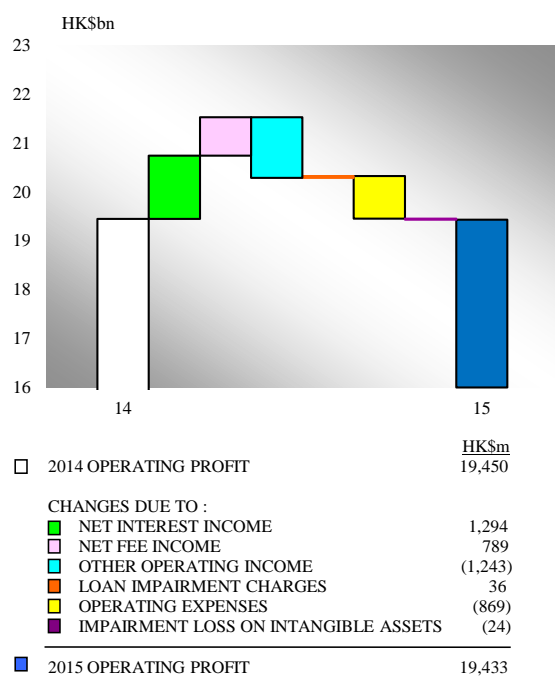
Figures in HK\$m

	2015	2014
Total operating income	44,015	42,949
Operating expenses	10,482	9,613
Operating profit	19,433	19,450
Profit before tax	30,488	18,049
Profit attributable to shareholders	27,494	15,131
Earnings per share (in HK\$)	14.22	7.91

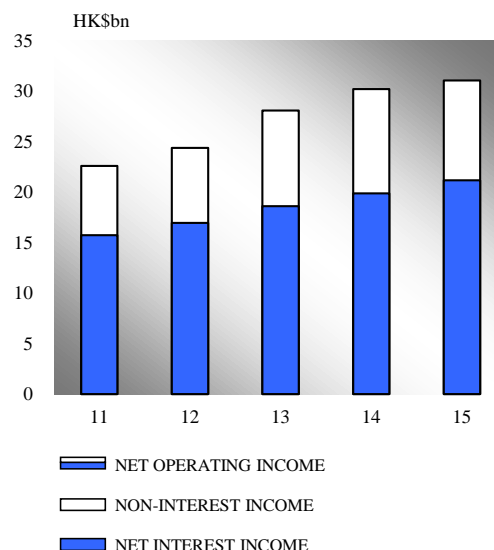
Hang Seng Bank Limited ('the Bank') and its subsidiaries ('the Group') reported a profit attributable to shareholders of HK\$27,494m for 2015, up 82% compared with 2014. Earnings per share were up 80% at HK\$14.22. The result included a disposal gain of HK\$10,636m on the partial disposal of Industrial Bank in 2015 and an impairment charge of HK\$2,103m on the Bank's investment in Industrial Bank in 2014.

Operating profit excluding loan impairment charges was HK\$20,541m and operating profit was HK\$19,433m, both broadly in line with 2014. Robust growth in net interest income and net fee income was offset by lower dividend income of HK\$1,068m following our partial disposal of Industrial Bank and an increase in operating expenses to support business growth. Excluding the financial impact of Industrial Bank-related items in both years, operating profit excluding loan impairment charges, operating profit and attributable profit rose by 5%, 6% and 4% respectively.

OPERATING PROFIT ANALYSIS



NET OPERATING INCOME (Before loan impairment charges)



Net interest income rose by HK\$1,294m, or 7%, to HK\$21,165m, driven mainly by the 10% increase in average interest-earning assets.

Figures in HK\$m

	<u>2015</u>	<u>2014</u>
Net interest income/(expense) arising from:		
- financial assets and liabilities that are not at fair value through profit and loss	22,642	21,888
- trading assets and liabilities	(1,450)	(2,014)
- financial instruments designated at fair value	<u>(27)</u>	<u>(3)</u>
	<u>21,165</u>	<u>19,871</u>
Average interest-earning assets	1,156,534	1,047,154
Net interest spread	1.71 %	1.77 %
Net interest margin	1.83 %	1.90 %

The Bank's continuing efforts to expand and diversify lending and attract new deposits drove increases in average loans and deposits as well as financial investments.

Average interest-earning assets increased by HK\$109bn, or 10%, compared with last year. The increase in average interest-earning assets reflected the Bank's continued effort to strengthen its asset and liability management and maintained a sustained growth strategy to expand its average customer lending and deposits. Average customer lending increased by 8%, with notable growth in corporate and commercial and mortgage lending, while average financial investments increased by 20%.

Net interest margin narrowed by seven basis points to 1.83% whilst the net interest spread decreased by six basis points to 1.71%. Average loan spread on customer lending reduced, notably on corporate and commercial term lending. Lower balance sheet management income was recorded, reflecting lower reinvestment yield and limited opportunity for deployment of new and maturing proceeds as a result of the compression of the average interest spread on RMB assets due to the drop in RMB market interest rates. However, these were partly offset by improved customer deposit spreads from an increase in current account and low cost savings balances.

The contribution from net free funds fell by one basis point to 0.12%, reflecting the modest decrease in the average market interest rate.

Net interest income in the second half of 2015 grew by HK\$283m, or 3%, compared with the first-half, due mainly to a 4% increase in average interest earning assets and more calendar days in the second-half. However, net interest margin and net interest spread in the second half were under continuous downward pressure in the wake of continued challenging market conditions.

The HSBC Group reports interest income and interest expense arising from financial assets and financial liabilities held for trading as 'Net trading income'. Income arising from financial instruments designated at fair value through profit and loss is reported as 'Net income from financial instruments designated at fair value' (other than for debt securities in issue and subordinated liabilities, together with derivatives managed in conjunction with them).

The table below presents the net interest income of Hang Seng Bank, as included in the HSBC Group accounts:

<i>Figures in HK\$m</i>	<u>2015</u>	<u>2014</u>
Net interest income and expense reported as 'Net interest income'		
- Interest income	26,743	26,037
- Interest expense	(4,135)	(4,155)
- Net interest income	22,608	21,882
Net interest income and expense reported as 'Net trading income'	(1,450)	(2,014)
Net interest income and expense reported as 'Net income from financial instruments designated at fair value'	7	3
Average interest-earning assets	1,116,125	1,013,705
Net interest spread	1.91 %	2.05 %
Net interest margin	2.03 %	2.16 %

Net fee income increased by HK\$789m, or 13%, to HK\$7,038m when compared with 2014.

Securities broking and related services income rose significantly by 38%, reflecting higher stock market turnover in Hong Kong and favourable investment market sentiment in the first half of 2015. Income from retail investment funds and the related fee income also increased by 5%.

Account services and remittances fee income grew by 12% and 10% respectively, reflecting the Group's strong transactional capabilities.

Card services income was 9% higher than 2014, supported by the 9% increase in cardholder spending, 6% increase in merchant acquiring business as well as a 2% increase in the number of cards in circulation.

Credit facilities fee income rose by 4%, due mainly to higher fees from increased corporate lending.

Trade-related service income was down by 6%, reflecting the decrease in average trade finance lending business.

Net trading income increased by HK\$86m, or 4%, to HK\$2,030m when compared with 2014.

Foreign exchange income rose by HK\$276m, or 15%, contributed by increased customer flows and higher interest income from funding swaps[†] activities, partly offset by reduced demand for foreign exchange derivative products. Debt securities recorded a higher revaluation gain of HK\$10m, mainly reflecting the movement in market interest rates. The increases were offset in part by the revaluation loss on interest rate derivatives, as well as in equities and other trading reflecting the unfavourable movement of equity options trading in life insurance business investment portfolio.

[†] *Global Markets employs foreign exchange swaps for its funding activities, which involves swapping a currency ('original currency') into another currency ('swap currency') at the spot exchange rate for short-term placement and simultaneously entering into a forward exchange contract to convert the funds back to the original currency on maturity of the placement. In accordance with HKAS 39, the exchange difference of the spot and forward contracts is required to be recognised as a foreign exchange gain/loss, while the corresponding interest differential between the original and swap funding is reflected in net interest income.*

Net income/(loss) from financial instruments designated at fair value recorded net loss of HK\$118m, compared with a net gain of HK\$1,201m for 2014, reflecting the fair value changes of assets held by the life insurance business due mainly to unfavourable equity market movements in 2015. To the extent that this fair value gain/(loss) is attributable to policyholders, there is an offsetting movement reported under ‘net insurance claims and benefits paid and movement in liabilities to policyholders’ or ‘movement in present value of in-force long-term insurance business (‘PVIF’)’.

Dividend income was HK\$142m compared with HK\$1,210m in 2014, mainly due to the partial disposal of the ordinary shares of Industrial Bank in 2015.

Other operating income rose by HK\$2,218m, or 131% compared with 2014, primarily due to the 197% increase in the movement in PVIF. During 2015, there was an update in the discount rate used for valuing insurance liabilities, resulting in an increase in PVIF. New business written throughout the year together with the unfavourable change in market conditions also contributed to the increase in PVIF.

Analysis of income from wealth management business

Figures in HK\$m

	<u>2015</u>	<u>2014</u>
Investment income:		
- retail investment funds	1,763	1,681
- structured investment products [†]	660	746
- securities broking and related services	1,829	1,322
- margin trading and others	100	102
	<u>4,352</u>	3,851
Insurance income:		
- life insurance	3,123	3,489
- general insurance and others	259	219
	<u>3,382</u>	3,708
Total	<u>7,734</u>	<u>7,559</u>

[†] *Income from structured investment products includes income reported under net fee income on the sales of third-party structured investment products. It also includes profits generated from the selling of structured investment products in issue, reported under net trading income.*

Wealth management business income maintained growth momentum and grew by 2% when compared with last year. Investment income rose by 13%, mainly contributed by the 38% increase in securities broking and related services income and 5% increase in retail investment funds related income on the back of favourable investment sentiment in the first half of 2015. Insurance business income fell by 9% when compared with last year.

Analysis of insurance business income

Figures in HK\$m

	2015	2014
Life insurance:		
- net interest income and fee income	3,230	3,048
- investment returns on life insurance funds (including share of associate's profit and surplus on property revaluation backing insurance contracts)	(152)	1,339
- net insurance premium income	9,845	10,779
- net insurance claims and benefits paid and movement in liabilities to policyholders	(12,968)	(12,742)
- movement in present value of in-force long-term insurance business	3,168	1,065
	3,123	3,489
General insurance and others	259	219
Total	<u>3,382</u>	<u>3,708</u>

Life insurance business income decreased by HK\$366m, or 10%, to HK\$3,123m.

Net interest income and fee income from the life insurance investment portfolio grew 6%, reflecting the increase in life insurance funds investment portfolio.

Investment returns on life insurance funds recorded a loss of HK\$152m compared with a gain of HK\$1,339m for 2014, reflecting the unfavourable equity market performance. To the extent that the investment return is attributable to policyholders, there is an offsetting movement reported under 'net insurance claims and benefits paid and movement in liabilities to policyholders' or PVIF.

Gross insurance premium income, before deducting the reinsurance premium, rose by 8%, as a result of increases in new business premium from sales of high net-worth and traditional whole life products, partly offset by lower new business premiums from deferred annuity products. Net insurance premium income, after deducting the reinsurance premium, fell by 9%, mainly due to increased reinsurance premium for new reinsurance arrangement for the in-force portfolio.

During 2015, there was an update to the discount rate used for valuing insurance liabilities, resulting in an increase in net insurance claims and benefits paid and movement in liabilities to policyholders, with a corresponding increase in PVIF.

The movement in PVIF increased by 197%, mainly attributable to the combined effect of the liability discount rate update, unfavourable change in market conditions and new business written throughout the year.

General insurance income increased by 18% as a result of higher distribution commission income.

Loan impairment charges decreased by HK\$36m, or 3%, to HK\$1,108m.

Figures in HK\$m

	<u>2015</u>	<u>2014</u>
Net charge for impairment of loans and advances to customers:		
Individually assessed impairment allowances:		
- new allowances	594	699
- releases	(50)	(131)
- recoveries	(16)	(36)
	<u>528</u>	<u>532</u>
Net charge for collectively assessed impairment allowances	<u>580</u>	<u>612</u>
Loan impairment charges	<u>1,108</u>	<u>1,144</u>

Individually assessed impairment charges maintained relatively stable at HK\$528m, mainly due to lower new impairment charges partly offset by lesser releases and recoveries from commercial banking customers.

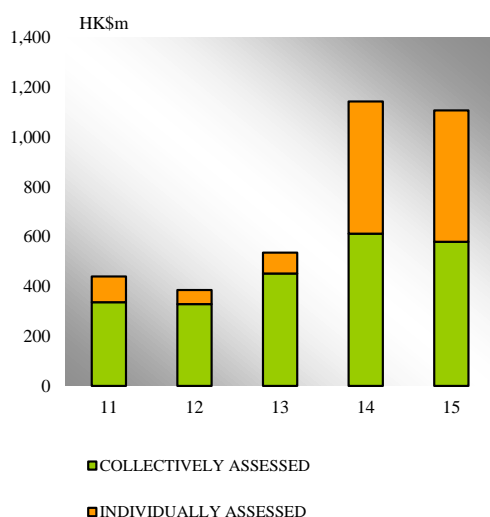
Collectively assessed loan impairment charges decreased by HK\$32m, or 5%, to HK\$580m. Higher charges on credit card and personal loan portfolios were recorded as a result of the growth in loan portfolios. Impairment allowance for loans not individually identified as impaired recorded a net release compared with a net charge in 2014, mainly due to lower average historical loss rate.

Overall credit quality remained relatively stable with gross impaired loans and advances as a percentage of gross loans and advances to customers standing at 0.40% at the end of 2015, compared with 0.32% at the end of 2014. The Group maintains a cautious outlook on the credit environment and continues to focus on maintaining high level of asset quality.

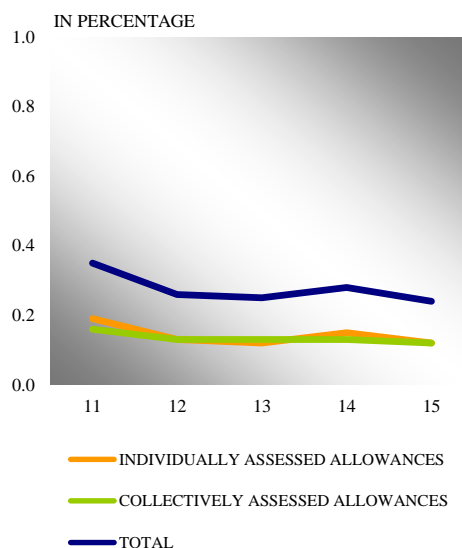
Total loan impairment allowances as a percentage of gross loans and advances to customers are as follows:

	<u>At 31 December 2015</u>	<u>At 31 December 2014</u>
	%	%
Loan impairment allowances:		
- individually assessed	0.12	0.15
- collectively assessed	0.12	0.13
Total loan impairment allowances	<u>0.24</u>	<u>0.28</u>

LOAN IMPAIRMENT CHARGES



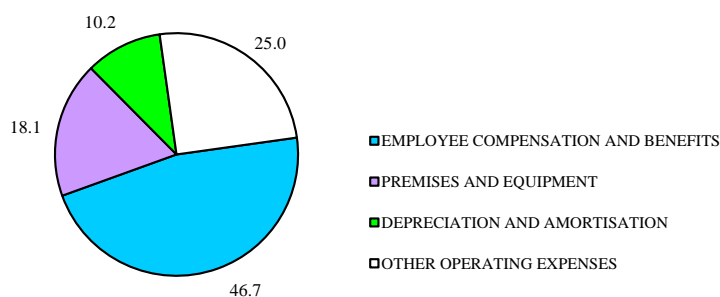
LOAN IMPAIRMENT ALLOWANCES AS A PERCENTAGE OF GROSS LOANS AND ADVANCES TO CUSTOMERS



Operating expenses increased by HK\$869m, or 9%, compared with 2014, reflecting the Bank's continued investments in technology, services channels and branch network to deepen customer relationship and support business growth.

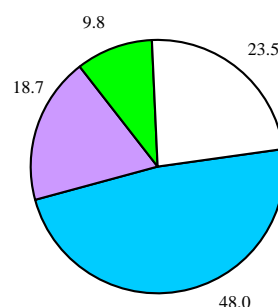
OPERATING EXPENSES FOR 2015

IN PERCENTAGE



OPERATING EXPENSES FOR 2014

IN PERCENTAGE



Employee compensation and benefits increased by HK\$277m, or 6%, mainly in staff salaries and other costs, reflecting the annual salary increment and higher performance-related remuneration. General and administrative expenses were up 12%, due mainly to the rise in IT and processing charges, premises maintenance and marketing expenditure. Depreciation charges were up 15%, reflecting higher depreciation charges on business premises following the upward commercial property revaluation and branch renovation costs.

Full-time equivalent staff numbers by region

	<u>2015</u>	<u>2014</u>
Hong Kong and others	8,306	8,278
Mainland	1,835	1,914
Total	<u>10,141</u>	<u>10,192</u>

At 31 December 2015, the Group's number of full-time equivalent staff was down by 51 compared with the end of 2014.

The Bank continued to focus on enhancing operational efficiency while maintaining growth momentum. With the increase in operating expenses outpacing the growth in net operating income before loan impairment charges, the cost efficiency ratio rose by 2.0 percentage points, to 33.8% when compared with 2014. Excluding the dividends received from Industrial Bank for both years, the cost efficiency ratio rose by 0.8 percentage points.

Operating profit decreased by HK\$17m, to HK\$19,433m.

Profit before tax rose by 69% to HK\$30,488m after taking the following major items into account:

- a **gain on partial disposal of Industrial Bank** of HK\$10,636m in 2015 and an impairment loss of HK\$2,103m of Industrial Bank in 2014;
- a HK\$62m increase in **gains less losses from financial investments and fixed assets**, representing a gain of HK\$6m recorded in 2015 compared with a loss of HK\$56m in 2014, the combined effect of an impairment loss on Yantai Bank and higher disposal gain of equity investments in 2014;
- a HK\$260m, or 50% decrease in **net surplus on property revaluation**; and
- a HK\$85m, or 36% decrease in **share of profits from associates**, mainly from a property investment company.

Net surplus on property revaluation decreased by 50% to HK\$261m when compared with 2014.

<i>Figures in HK\$m</i>	<u>2015</u>	<u>2014</u>
Surplus of revaluation on investment properties	<u>261</u>	<u>521</u>

The Group's premises and investment properties were revalued at 30 November 2015 and updated for any material changes at 31 December 2015 by DTZ Debenham Tie Leung Limited. The valuation was carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of the valuation of property was market value which is consistent with the definition of fair value under HKFRS 13 'Fair Value Measurement' and takes into account the highest and best use of the property from the perspective of market participants. The highest and best use takes into account the use of the property that is physically possible, legally permissible and financially feasible as described in HKFRS 13. The net revaluation surplus for Group premises amounted to HK\$1,878m was credited to the premises revaluation reserve. The related deferred tax provision for Group premises was HK\$314m. Revaluation gains of HK\$261m on investment properties (excluding the revaluation gain on properties backing insurance contracts) were recognised through the income statement.

Segmental Analysis

The table below sets out the profit before tax contributed by the business segments for the years stated.

<i>Figures in HK\$m</i>	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Other	Total
Year ended					
31 December 2015					
Profit before tax	<u>9,250</u>	<u>5,212</u>	<u>4,506</u>	<u>11,520</u>	<u>30,488</u>
Share of profit before tax	<u>30.3 %</u>	<u>17.1 %</u>	<u>14.8 %</u>	<u>37.8 %</u>	<u>100.0 %</u>
Share of profit before tax (excluding Industrial Bank- related items)	<u>46.9 %</u>	<u>26.4 %</u>	<u>22.8 %</u>	<u>3.9 %</u>	<u>100.0 %</u>
Year ended					
31 December 2014 (restated)					
Profit/(loss) before tax	<u>8,625</u>	<u>4,827</u>	<u>4,692</u>	<u>(95)</u>	<u>18,049</u>
Share of profit/(loss) before tax	<u>47.8 %</u>	<u>26.7 %</u>	<u>26.0 %</u>	<u>(0.5 %)</u>	<u>100.0 %</u>
Share of profit before tax (excluding Industrial Bank- related items)	<u>45.5 %</u>	<u>25.5 %</u>	<u>24.7 %</u>	<u>4.3 %</u>	<u>100.0 %</u>

Retail Banking and Wealth Management ('RBWM') reported profit before tax of HK\$9,250m in 2015, a 7% increase compared with year end of 2014. Operating profit excluding loan impairment charges reached HK\$9,709m, an increase of 9%. Operating profit grew by 8% to HK\$9,089m.

Net interest income grew 9% against 2014 to HK\$11,281m, supported by balance sheet growth. Customer deposits and the lending portfolio recorded growth of 4% and 9% respectively compared to 2014 year-end.

Non-interest income grew by 4% to HK\$5,056m and wealth management business income rose by 3% to HK\$6,708m compared to 2014. With initiatives to provide sales and services based on our customers' needs, we were able to drive net fee income growth but partly outweighed by lower return on the insurance funds investment portfolio.

Unsecured lending continued to be a key revenue driver. With effective marketing campaigns and a good quality credit card customer base, card spending achieved year-on-year growth of 9% in Hong Kong. Total cards in circulation rose by 2% year-on-year to 2.56 million and we were the second and third-largest card issuer for VISA and MasterCard cards respectively in Hong Kong for 2015. Supported by customer analytics to target our existing customer base and an enhanced online application process, we were able to grow our personal loan portfolio by 17% year-on-year in Hong Kong.

Amid the slowdown of the property market in the second half of 2015, our mortgage business maintained its top-three position in Hong Kong, with a market share of 17% in terms of new mortgage registrations. Mortgage balances grew by 9% in Hong Kong and 26% on the Mainland compared to 2014 year-end.

Amid favorable investment market sentiment in the first half of 2015, we capitalised on our time-to-market products and services to grow investment income by 20% against 2014. Benefitting from substantial growth in equities market transaction volume, securities turnover and revenue increased significantly by 49% and 38% respectively. Income from other investment products, mainly retail investment funds and structured products, grew by 9% against 2014. We captured cross-border opportunities unleashed by ongoing policy relaxation on the Mainland, obtaining approval from China Securities Regulatory Commission to distribute the Hang Seng China H-share Index Fund manufactured by Hang Seng Investment Management Limited under the Mutual Recognition of Funds scheme and signing a joint venture ('JV') agreement with Shenzhen Qianhai Financial Holdings Co. Ltd. to prepare for establishing a JV fund management company on the Mainland.

Insurance income decreased by 12% against 2014, due mainly to lower investment returns from our portfolio. We diversified the life insurance product mix to create more balanced business growth. Our Universal Life

Insurance Plan offers customers a flexible solution that caters to both their wealth management and protection needs. The distribution of the Hang Seng Bupa PreciousHealth Series has strengthened our ability to provide tailored ‘wealth-and-health’ solutions to customers since its launch in late 2014 in Hong Kong and in 2015 on the Mainland.

In Hong Kong, we enhanced our customer proposition by leveraging our diverse portfolio of products focusing on wealth management needs and the premium banking experience offered at our upgraded Prestige and Preferred Banking Centres. Our branch refurbishment exercise, which included the renovation of our Hong Kong main branch, has strengthened our brand image and enhanced customer perceptions, providing support for ongoing business growth. On the Mainland, we launched Preferred Banking propositions to strengthen relationships with mass affluent customers. The Prestige and Preferred Banking customer base in Hong Kong and on the Mainland grew by 5% and 45% respectively year-on-year.

We continued to enhance features on our digital channels, with the aims of improving the customer experience and capturing new business opportunities. We revamped our online banking platform and launched a new personal banking app. The number of e-Banking customers rose by 7% and 24% year-on-year in Hong Kong and on the Mainland respectively. We are among the first batch of banks in Hong Kong to launch an e-Cheque issuance service, providing e-Banking customers with a secure, efficient and environmentally friendly online payment option.

Commercial Banking (‘CMB’) achieved growth of 8% in profit before tax to HK\$5,212m. Operating profit excluding loan impairment charges was up 6% to HK\$5,736m. Operating profit grew by 8% to HK\$5,212m.

Net interest income grew by 8%, driven mainly by increases in both average customer advances and deposits. Focused deposit acquisition strategies supported by strengthened cash management capabilities led to a 26% rise in current and savings balances.

We recorded steady growth of 2% in non-interest income, attributable mainly to effective sales distribution efforts and enriched product offerings in various revenue streams. Insurance income recorded satisfactory growth of 12%. Securities trading income rose by 41%, driven by increased trading activities alongside growth in stock market transaction volume during the first half of 2015. Remittance income was up by 13%, as a result of targeted products and propositions that enhanced our cross-border payment capabilities and effective marketing programmes that deepened our wallet share with cross-border customers. This broad-based growth, more than offset the 36% decline in structured investment income, which was due mainly to depreciation in the renminbi reducing customer appetite for related structured products.

Growth in small and medium-sized enterprises (‘SME’) business continued to be a driver of our revenue. Acquiring quality new customers remained a major focus for our SME business. Mainland customers represented 51% of newly acquired SME customers in 2015. Our SME deposits were up by 19% while total operating income increased by 11%, mainly led by growth in foreign exchange, remittances and life insurance. The upgrade of our Sheung Wan Business Banking Centre in March 2015 served to further enhance the customer experience. We received a ‘Best SME’s Partner Award’ from The Hong Kong General Chamber of Small and Medium Business for the 10th consecutive year.

We enhanced our transaction banking services to provide more efficient financial management solutions for our customers. The launch of a new host-to-host solution provided customers with a secure and seamless channel to help enhance their operational efficiency. We are among the first batch of banks in Hong Kong to provide e-Cheque issuance service. Commercial customers can make use of this new online payment service to issue and deposit paperless cheques through our secure and efficient online banking platform, Business e-Banking. We were awarded ‘Best Hong Kong Bank Provider of Cash Management Services’ by *CFO Innovation Asia* and ‘Hong Kong Domestic Trade Finance Bank of the Year’ by *Asian Banking & Finance*.

Syndicated lending also contributed to the growth in our business. We ranked third in the Mandated Arranger League Table for Hong Kong and Macau Syndicated Loans in terms of number of deals in 2015 according to Thomson Reuters LPC data.

Initiatives to connect customers with business opportunities in Greater China remained as one of our business priorities – including enriched cross-border trade propositions through improved efficiency in trade processing centres, more timely cross-border payment services such as the cut-off time extension of renminbi remittances and closer cooperation of Hong Kong and Mainland relationship teams in supporting cross-border customers with presence in both locations. The opening of our Jinan branch in April 2015 will enable us to better serve the growing financial services demand from commercial customers in the Bohai Economic Rim region.

The credit environment on the Mainland remained challenging. We continued to be proactive and vigilant in credit risk management to uphold our asset quality. Overall credit quality remained resilient in 2015 and we recorded a decreasing trend in loan impairment charges.

Global Banking and Markets ('GBM') recorded a 4% decrease in profit before tax to HK\$4,506m. Operating profit excluding loan impairment charges was down by 5% to HK\$4,466m. Operating profit dropped 4% to HK\$4,502m.

Global Banking ('GB') achieved a 5% increase in total operating income to HK\$2,276m. With weakened loan demand and narrowed interest margin in the second half of 2015, net interest income was broadly in-line with the previous year. Non-interest income grew by 45% year-on-year with increase in credit-related fees and card merchant income. Operating profit excluding loan impairment charges increased by 2% to HK\$1,821m while profit before tax grew by 4%.

In view of the uncertain economic conditions, we adopted a prudent credit strategy and recorded a 1% increase in customer loans. Customer deposits grew by 2% as we actively promoted payment and cash management solutions with the aim of growing operational deposits.

Global Markets ('GM') recorded a 9% decrease in profit before tax to HK\$2,650m. Operating profit fell by 9% to HK\$2,645m.

Net interest income fell by 23% to HK\$1,610m, with limited opportunities for the deployment of new and maturing proceeds resulting from a narrowed interbank placement spread as compared with 2014.

Non-interest income increased by HK\$266m to HK\$1,526m. Total trading income increased by HK\$271m, or 21%, to HK\$1,571m. Foreign exchange trading income rose by 55% year-on-year, supported by an increase in foreign exchange and foreign exchange derivatives activity.

Under the challenging and low interest rate environment, we placed increased focus on growing non-fund income. Through product enhancements and closer collaboration to identify the specific needs of customers, we increased cross-selling of GM products to RBWM and CMB clients.

In the second half of the year, renminbi liberalisation was stepped up a gear by the Mainland authorities. The People's Bank of China announced a move to improve the pricing mechanism of the daily fixing rate by making reference to the previous day's closing rate as well as taking into account foreign exchange market supply-demand and major global currency movements. In response to this development, we took steps to provide timely information and products to help corporate customers meet their hedging needs in the volatile foreign exchange market.

In response to the Mutual Recognition of Funds ('MRF'), we provided support for fund sales and development to capture opportunities from increasing customer demand for cross-border transaction services and renminbi-denominated products.

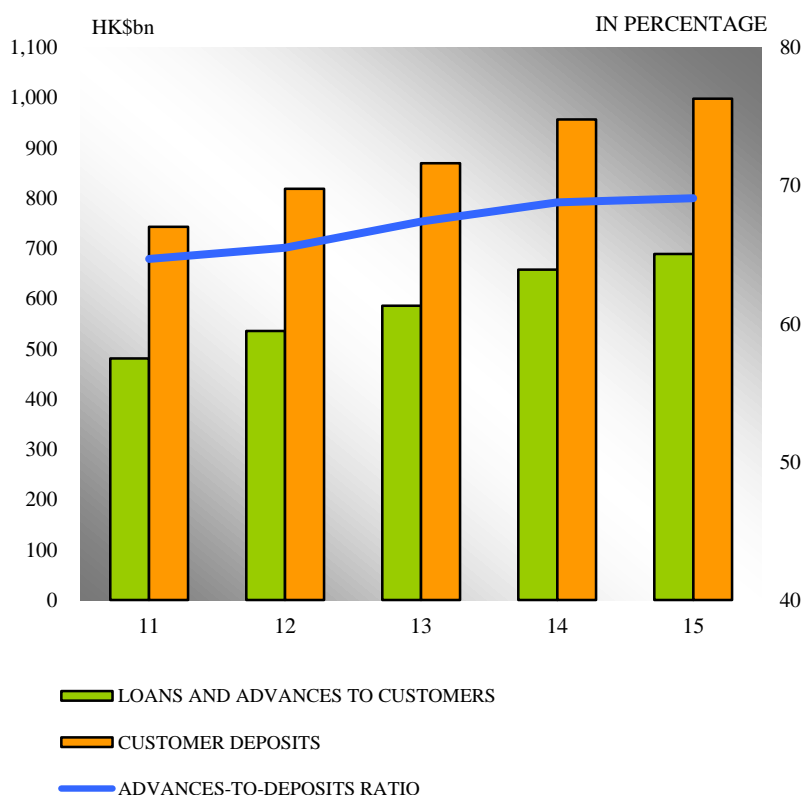
In May 2015, the Bank officially joined OTC Clearing Hong Kong Limited as a direct member for central clearing of its over-the-counter derivatives. This strengthened our market standing as Hong Kong's leading domestic bank.

Balance sheet

Total assets rose by HK\$70bn, or 6%, to HK\$1,334bn, on the back of the Group's strategy to enhance profitability through sustainable growth. Customer loans and advances grew by HK\$31bn, or 5%, to HK\$689bn, principally in mortgages, corporate and commercial lending and trade finance. We maintained our strong position in the residential mortgage sector and market share in terms of new mortgage registrations. Residential mortgages increased by 10% when compared with 2014 year-end. Trade finance lending grew by 13% as a result of the Group strategically positioning itself to focus on core trade business and serve growing demand from customers for renminbi-related financial solutions. Overall credit quality remained sound with total gross impaired loans and advances as a percentage of gross loans and advances standing at 0.40% at the end of 2015, and 0.32% at the end of December 2014. Customer deposits, including certificates of deposit and other debt securities in issue, rose by HK\$41bn, or 4%, to HK\$998bn. At 31 December 2015, the advances-to-deposits ratio was 69.1%, compared with 68.8% at 31 December 2014.

At 31 December 2015, shareholders' funds were HK\$142bn, an increase of HK\$3bn, or 2%. Retained profits rose by HK\$17bn, resulting from the 2015 attributable profit after the appropriation of 2015 interim dividends paid during the year. The premises revaluation reserve increased by HK\$1,090m, or 7%, reflecting an increase in the fair value of the Group's premises. The available-for-sale investment reserve decreased by HK\$15bn, or 89%, against the end of 2014, mainly reflecting our partial disposal of Industrial Bank.

LOANS AND ADVANCES TO CUSTOMERS AND CUSTOMER DEPOSITS



Assets Deployment

Figures in HK\$m

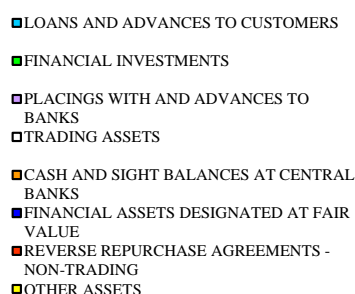
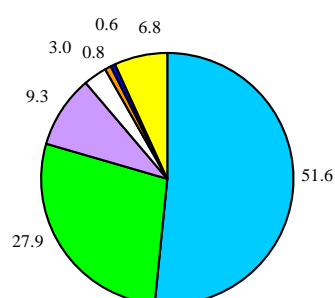
	2015	%	2014	%
Cash and sight balances at central banks	10,118	0.8	11,311	0.9
Placings with and advances to banks	123,990	9.3	145,731	11.5
Trading assets	40,373	3.0	41,823	3.3
Financial assets designated at fair value	7,903	0.6	11,112	0.9
Reverse repurchase agreements – non-trading	-	-	1,296	0.1
Loans and advances to customers	688,946	51.6	658,431	52.1
Financial investments	372,272	27.9	318,032	25.2
Other assets	90,827	6.8	76,254	6.0
Total assets	1,334,429	100.0	1,263,990	100.0

Return on average total assets 2.1% 1.3%

Return on average total assets
(excluding Industrial Bank-related items) 1.3% 1.3%

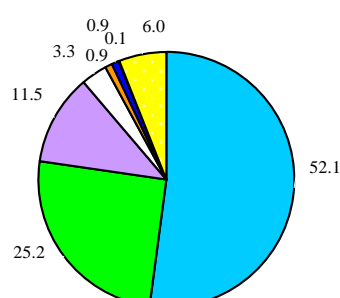
ASSETS DEPLOYMENT FOR 2015

IN PERCENTAGE



ASSETS DEPLOYMENT FOR 2014

IN PERCENTAGE



Loans and Advances to Customers

Gross loans and advances to customers grew by HK\$30bn, or 5%, to HK\$691bn compared with the end of 2014.

Loans and advances for use in Hong Kong rose by 6%. Lending to the industrial, commercial and financial sectors grew by 3%. Lending to property development increased by 5% while lending to property investment fell by 3%. Lending to wholesale and retail trade remained broadly flat notwithstanding the weak performance in retail sales industry. Lending to manufacturing sector maintained relatively stable, due to loan repayment. The increase in lending to transport and transport equipment mainly reflecting new drawdown. Growth in lending to 'Other' was attributable to working capital financing for certain large corporate customers.

Lending to individuals increased by 10% compared with the year-end. The Bank was able to maintain its market share for the mortgage business and grew its residential mortgage lending by 10% compared with the end of 2014. With effective marketing campaigns, credit card advances increased by 7%, supported by a 9% increase in cardholder spending and a 2% increase in the number of cards in circulation. Other loans to individuals grew by 16%, reflecting the success of the Bank in expanding its consumer finance business.

Trade finance increased by 13% against the year-end as a result of the Group's strategic repositioning to focus on core trade business.

Loans and advances for use outside Hong Kong fell by 2% compared with the end of 2014, mainly attributable to the repayment of loans granted by Hong Kong Office. Lending by Hang Seng China increased by 3% to HK\$67bn, mainly in mortgage lending reflecting our prudent risk management strategy in the light of the more challenging credit environment.

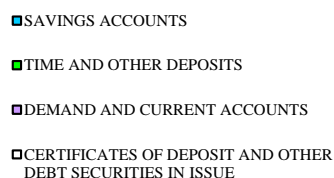
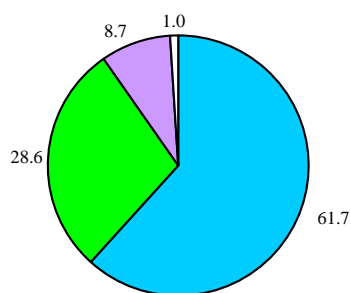
Customer Deposits

Customer deposits, including current, savings and other deposits accounts, certificates of deposit and other debt securities in issue increased by HK\$41bn, or 4% to HK\$998bn compared with the end of 2014. Structured deposits, certificates of deposit and other debt securities in issue decreased due to the redemption of certificates of deposit.

At 31 December 2015, the advances-to-deposits ratio was 69.1%, compared with 68.8% at 31 December 2014.

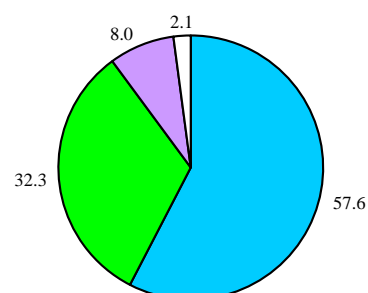
CUSTOMER DEPOSITS FOR 2015

IN PERCENTAGE



CUSTOMER DEPOSITS FOR 2014

IN PERCENTAGE



Subordinated Liabilities

The outstanding subordinated loans serve to help the Bank maintain a balanced capital structure and support business growth.

Shareholders' funds

<i>Figures in HK\$m</i>	<i>At 31 December 2015</i>	<i>At 31 December 2014</i>
Share capital	9,658	9,658
Retained profits	105,363	88,064
Other equity instruments	6,981	6,981
Premises revaluation reserve	16,777	15,687
Cash flow hedging reserve	(9)	(11)
Available-for-sale investment reserve		
- on debt securities	23	261
- on equity securities	1,916	16,751
Other reserves	1,272	1,802
Total reserves	132,323	129,535
Shareholders' funds	141,981	139,193
Return on average ordinary shareholders' equity	20.7%	13.4%

Shareholders' funds grew by HK\$3bn to HK\$142bn at 31 December 2015. Retained profits rose by HK\$17bn, mainly reflecting the growth in current year attributable profit, including the gain on partial disposal of Industrial Bank, after the appropriation of interim dividends paid during the year. The premises revaluation reserve increased by HK\$1bn, reflecting an increase in fair value of the Group's premises.

The available-for-sale investment reserve for equity securities decreased by HK\$15bn compared with 2014 year end, reflecting the partial disposal of the Bank's investment in Industrial Bank during the year.

The return on average ordinary shareholders' equity was 20.7%, compared with 13.4% for 2014. Excluding the financial impact of Industrial Bank-related items in both years, the return on average ordinary shareholders' equity was 13.8%, compared with 14.3% for 2014.

There was no purchase, sale or redemption by the Bank, or any of its subsidiaries, of the Bank's listed securities during 2015.

Management Discussion and Analysis

(Figures expressed in millions of Hong Kong dollars unless otherwise indicated)

Risk Management

All the Group's activities involve the analysis, measurement, evaluation, acceptance and management of some degree of risk or combination of risks. The principal types of risk faced by the Group are credit risk, liquidity risk, market risk, insurance risk, operational risk and reputational risk.

The Group's risk management policy is designed to identify and analyse risks, to set appropriate risk limits and to monitor these risks exposures continually by means of reliable and up-to-date management information systems. The Group's risk management framework/policies and risk appetite statement or major risk limits are approved by the Board of Directors and they are monitored and reviewed regularly by various Board or management committees, including the Executive Committee, Risk Committee, Asset and Liability Management Committee ("ALCO") and Risk Management Committee ("RMC").

Robust risk governance and accountability are embedded throughout the Group through an established framework that ensures appropriate oversight of and accountability for the effective management of risk at all levels of the organization and across all risk types.

The Board has ultimate responsibility for approving the Group's risk appetite statement and the effective management of risk. The Risk Committee advises the Board on risk appetite and its alignment with strategy, risk governance and internal controls and high-level risk related matters.

The ongoing monitoring, assessment and management of the risk environment and the effectiveness of risk management policies resides with the Risk Management Committee.

Risk appetite statement is a key component of risk management framework. The Group's Risk Appetite Statement for 2015 was approved by the Board as advised by the Risk Committee, which describes the types and amount of risk that the Bank is prepared to accept in achieving our medium and long-term strategic goals.

The RMC regularly reviews and monitors the Group's risk appetite profile against the limits set out in the Risk Appetite Statement and determine appropriate management action in case of deviation from approved limits. The risk appetite profile is also reported to the Risk Committee and Board from Chief Risk Officer including material deviation and management action where required.

For new products and services, in addition to the existing due diligence process, a Product Oversight Committee reporting to the RMC and comprising senior executives from Risk, Legal, Compliance, Finance, and Operations/IT, is responsible for reviewing and approving the launch of such new products and services. Each new service and product launch is also subject to an operational risk self-assessment process, which includes identification, evaluation and mitigation of risk arising from the new initiative. Internal Audit is consulted on the internal control aspect of new products and services in development prior to implementation.

Description of risks - banking operations

(audited)

Risks	Arising from	Measurement, monitoring and management of risk
Credit risk		
The risk of financial loss if a customer or counterparty fails to meet an obligation under a contract.	Credit risk arises principally from direct lending, trade finance and leasing business, but also from certain other products such as guarantees and derivatives.	Credit risk: <ul style="list-style-type: none">- is measured as the amount which could be lost if a customer or counterparty fails to make repayments. In the case of derivatives, the measurement of exposure takes into account the current mark to market value to the Group of the contract and the expected potential change in that value over time caused by movements in market rates;- is monitored within limits, approved by individuals within a framework of delegated authorities. These limits represent the peak exposure or loss to which the Group could be subjected should the customer or counterparty fail to perform its contractual obligations; and- is managed through a robust risk control framework which outlines clear and consistent policies, principles and guidance for risk managers.

Management Discussion and Analysis (continued)

Risk Management (continued)

Risks	Arising from	Measurement, monitoring and management of risk
Liquidity and funding risk		
The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due or that it can only do so at excessive cost.	<p>Liquidity risk arises from mismatches in the timing of cash flows.</p> <p>Funding risk arises when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.</p>	<p>Liquidity and funding risk:</p> <ul style="list-style-type: none"> - is measured using internal metrics including stressed operational cash flow projections, coverage ratio and advances to core funding ratios; - is monitored against the Group's liquidity and funding risk framework and overseen by the Group's ALCO and the RMC; and - is managed on a standalone basis with no reliance on any Group entity (unless pre-committed) or central bank unless this represents routine established business as usual market practice.
Market risk		
The risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce our income or the value of our portfolios.	<p>Exposure to market risk is separated into two portfolios:</p> <ul style="list-style-type: none"> - Trading portfolios comprise positions arising from market-making and warehousing of customer derived positions. - Non-trading portfolios comprise positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, financial investments designated as available-for-sale and held-to-maturity, and exposures arising from our insurance operations. 	<p>Market risk:</p> <ul style="list-style-type: none"> - is measured in terms of value at risk ("VAR"), which is used to estimate potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence, augmented with stress testing to evaluate the potential impact on portfolio values of more extreme, though plausible, events or movements in a set of financial variables; - is monitored using measures including the sensitivity of net interest income and the sensitivity of structural foreign exchange which are applied to the market risk positions within each risk type; and - is managed using risk limits approved by the Group. These limits are allocated across business lines and to the Group's legal entities.
Operational risk		
The risk to achieving our strategy or objectives as a result of inadequate or failed internal processes, people and systems or from external events.	Operational risk arises from day to day operations or external events, and is relevant to every aspect of our business.	<p>Operational risk:</p> <ul style="list-style-type: none"> - is measured using both the scenario analysis process and the risk and control assessment process, which assess the level of risk and effectiveness of controls; - is monitored using key indicators and other internal control activities; and - is primarily managed by business and functional managers. They identify and assess risks, implement controls to manage them and monitor the effectiveness of these controls utilising the operational risk management framework. The Operational Risk function is responsible for the framework and for overseeing the management of operational risks within businesses and functions.
Other material risks		
Reputational risk		
The risk that illegal, unethical or inappropriate behaviour by the Group itself, members of staff or clients or representatives of the Group will damage Hang Seng's reputation, leading, potentially, to a loss of business, fines or penalties.	Reputational risk encompasses negative reaction not only to activities which may be illegal or against regulations, but also to activities that may be counter to societal standards, values and expectations. It arises from a wide variety of causes, including how we conduct our business and the way in which clients to whom we provide financial services, and bodies who represent Hang Seng, conduct themselves.	<p>Reputational risk:</p> <ul style="list-style-type: none"> - is measured by reference to our reputation as indicated by our dealings with all relevant stakeholders, including media, regulators, customers and employees; - is monitored through a reputational risk management framework, taking into account the results of the compliance risk monitoring activity outlined above; and - is managed by every member of staff and is covered by a number of policies and guidelines. There is a clear structure of committees and individuals charged with mitigating reputational risk, including the Group Reputational Risk Policy Committee and regional/business equivalents.

Management Discussion and Analysis (continued)

Risk Management (continued)

Risks	Arising from	Measurement, monitoring and management of risk
Pension risk		
The risk that contributions from Group companies and members fail to generate sufficient funds to meet the cost of accruing benefits for the future service of active members, and the risk that the performance of assets held in pension funds is insufficient to cover existing pension liabilities.	Pension risk arises from investments delivering an inadequate return, economic conditions leading to corporate failures, adverse changes in interest rates or inflation, or members living longer than expected (longevity risk). Pension risk includes operational risks listed above.	<p>Pension risk:</p> <ul style="list-style-type: none"> - is measured in terms of the schemes' ability to generate sufficient funds to meet the cost of their accrued benefits; - is monitored through the specific risk appetite that has been developed at Group level; and - is managed locally through the appropriate pension risk governance structure and through the Bank Investment Committee.

Our insurance manufacturing subsidiaries are separately regulated from our banking operations. Risks in the insurance entities are managed using methodologies and processes appropriate to insurance activities, but remain subject to oversight at Group level. Our insurance operations are also subject to the operational and other material risks presented in relation to the banking operations, and these are covered by the Group's risk management processes.

Description of risks – insurance manufacturing operations

Risks	Arising from	Measurement, monitoring and management of risk
Insurance risk		
The risk that, over time, the cost of acquiring and administering a contract, claims and benefits may exceed the aggregate amount of premiums received and investment income.	The cost of claims and benefits can be influenced by many factors, including mortality and morbidity experience, lapse and surrender rates and, if the policy has a savings element, the performance of the assets held to support the liabilities.	<p>Insurance risk:</p> <ul style="list-style-type: none"> - is measured in terms of life insurance liabilities; - is monitored by the RMC, which reviews the risk profile of the insurance operations against a risk appetite for insurance business; and - is managed both centrally and locally using product design, underwriting, reinsurance and claims-handling procedures.

Financial risks		
Our ability to effectively match the liabilities arising under insurance contracts with the asset portfolios that back them are contingent on the management of financial risks such as market, credit and liquidity risks, and the extent to which these risks are not borne by the policyholders.	<p>Exposure to financial risks arises from:</p> <ul style="list-style-type: none"> - market risk of changes in the fair values of financial assets or their future cash flows from fluctuations in variables such as interest rates, foreign exchange rates and equity prices; - credit risk and the potential for financial loss following the default of third parties in meeting their obligations; and 	<p>Financial risks:</p> <ul style="list-style-type: none"> - are measured separately for each type of risk: <ul style="list-style-type: none"> - market risks are measured in terms of exposure to fluctuations in key financial variables; - credit risk is measured as the amount which could be lost if counterparty fails to make required payments; and - liquidity risk is measured using internal metrics including stressed operational cash flow projections; - are monitored within limits approved by individuals within a framework of delegated authorities; - are managed through a robust risk control framework which outlines clear and consistent policies, principles and guidance for risk managers. Subsidiaries manufacturing products with guarantees are usually exposed to falls in market interest rates and equity prices to the extent that the market exposure cannot be managed by utilising any discretionary participation (or bonus) features within the policy contracts they issue; and - can be mitigated through sharing of risk with policyholders under the discretionary participation features for participating products.
Liabilities to policyholders under unit-linked contracts move in line with the value of the underlying assets, and as such the policyholder bears the majority of the financial risks.	<ul style="list-style-type: none"> - liquidity risk of entities not being able to make payments to policyholders as they fall due as there are insufficient assets that can be realised as cash. 	
Contracts with discretionary participating feature ("DPF") share the performance of the underlying assets between policyholders and the shareholder in line with the type of contract and the specific contract terms.		

Management Discussion and Analysis (continued)

Risk Management (continued)

The following information described the Group's management and control of risks, in particular, those associated with its use of financial instruments ("financial risks"). Major types of risks to which the Group was exposed include credit risk, liquidity risk, market risk, insurance risk and operational risk.

(a) Credit Risk (audited)

Credit risk is the risk that financial loss arises from the failure of a customer or counterparty to meet its obligations under a contract. It arises principally from lending, trade finance, and treasury businesses. The Group has dedicated standards, policies and procedures in place to control and monitor risk from all such activities.

There are dedicated functions, reported to Chief Risk Officer, responsible for centralised management of credit risk through:

- formulating credit policies on approval process, post disbursement monitoring, recovery process and large exposure;
- issuing guidelines on lending to specified market sectors, industries and products; the acceptability of specific classes of collateral or risk mitigations and valuation parameters for collateral;
- undertaking an independent review and objective assessment of credit risk for all commercial non-bank credit facilities in excess of designated amount prior to the facilities being committed to customers;
- controlling exposures to selected industries, counterparties, countries and portfolio types etc by setting limits;
- maintaining and developing credit risk rating/facility grading process to categorise exposures and facilitate focused management;
- reporting to senior executives and various committees on aspects of the Group loan portfolio;
- managing and directing credit-related systems initiatives; and
- providing advice and guidance to business units on various credit-related issues.

Impaired loan management and recovery

The Group undertakes ongoing credit analysis and monitoring at several levels. Special attention is paid to problem loans. Loan impairment allowances are made promptly where necessary and need to be consistent with established guidelines. Recovery units are established by the Group to provide the customers with intensive support in order to maximise recoveries of doubtful debts. Management regularly performs an assessment of the adequacy of the established impairment provisions by conducting a detailed review of the loan portfolio, comparing performance and delinquency statistics against historical trends and undertaking an assessment of current economic conditions.

Risk rating framework

A risk rating framework on counterparty credit risk based on default probability and loss estimates is implemented across the Group. The rating methodology is based upon a wide range of financial analytics. This approach will allow a more granular analysis of risk and trends. The information generated from the risk rating framework is mainly, but not exclusively, applied to credit approval, credit monitoring, pricing, loan classification and capital adequacy assessment. The Group also has control mechanisms in place to validate the performance and accuracy of the risk rating framework.

To measure and manage the risk in these exposures, both to individually assessed customers and to those aggregated into portfolios, the Group employs diverse risk rating systems and methodologies.

Collateral and other credit enhancements

The Group has implemented guidelines on the acceptability of specific classes of collateral or credit risk mitigation, and determined the valuation parameters. Such parameters are established prudently and are reviewed regularly in light of changing market environment and empirical evidence. Security structures and legal covenants are subject to regular review to ensure that they continue to fulfil their intended purpose and remain in line with local market practice. While collateral is an important mitigant to credit risk, it is the Group's policy to establish that loans are within the customer's capacity to repay rather than to rely excessively on security. Facilities may be granted on unsecured basis depending on the customer's standing and the type of product. The principal collateral types are as follows:

- in the personal sector, charges over the properties, securities, investment funds and deposits;
- in the commercial and industrial sector, charges over business assets such as properties, stock, debtors, investment funds, deposits and machinery; and
- in the commercial real estate sector, charges over the properties being financed.

Repossessed assets are non-financial assets acquired in exchange for loans in order to achieve an orderly realisation, and are reported in the balance sheet within "Other assets" at the lower of fair value (less costs to sell) and the carrying amount of the loan (net of any impairment allowance). If excess funds arise after the debt has been repaid, they are made available either to repay other secured lenders with lower priority or are returned to the customer. The Group does not generally occupy repossessed properties for its business use.

Management Discussion and Analysis (continued)

Risk Management (continued)

(a) Credit Risk (continued)

Collateral and other credit enhancements (continued)

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured.

Settlement risk

Settlement risk arises where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily Settlement Limits are established to cover the settlement risk arising from the Group's trading transactions on any single day. Settlement risk on many transactions, particularly those involving securities and equities, is substantially mitigated when effected via assured payment systems, or on a delivery-versus-payment basis.

The International Swaps and Derivatives Association ("ISDA") Master Agreement is the Group's preferred agreement for documenting derivative activities. It provides the contractual framework that a full range of over-the-counter ("OTC") products is conducted and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement, if either party defaults or following other pre-agreed termination events.

Concentration of credit risk

Concentration of credit risk exists when changes in geographic, economic or industry factors similarly affect groups of counterparties whose aggregate credit exposure is material in relation to the Group's total exposures. The Group's portfolio of financial instrument is diversified along geographic, industry and product sectors. Analysis of geographical concentration of the Group's assets is disclosed in note 23 to the financial statements and credit risk concentration of respective financial assets is disclosed in notes 28, 29, 31 and 32.

The below analysis shows the exposures to credit risk in accordance with HKFRS 7 "Financial Instruments: Disclosures".

(i) Maximum exposure to credit risk before collateral held or other credit enhancements (audited)

Our credit exposure is spread across a broad range of asset classes, including derivatives, trading assets, loans and advances to customers, loans and advances to banks and financial investments.

The following table presents the maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements (unless such credit enhancements meet accounting offsetting requirements). For financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees and similar contracts granted, it is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments that are irrevocable over the life of the respective facilities, it is generally the full amount of the committed facilities.

	2015	2014
Cash and sight balances at central banks	10,118	11,311
Placings with and advances to banks	123,990	145,731
Trading assets	40,352	41,783
Financial assets designated at fair value	1,136	75
Derivative financial instruments	11,595	7,421
Reverse repurchase agreements - non-trading	-	1,296
Loans and advances to customers	688,946	658,431
Financial investments	367,630	273,983
Other assets	18,876	17,219
Financial guarantees and other credit related contingent liabilities	16,500	14,272
Loan commitments and other credit related commitments	512,729	432,274
	<u>1,791,872</u>	<u>1,603,796</u>

Management Discussion and Analysis (continued)

Risk Management (continued)

(a) Credit Risk (continued)

(ii) Collateral and other credit enhancements

Loans and advances (audited)

Although collateral can be an important mitigant of credit risk, it is the Group's practice to lend on the basis of the customer's ability to meet their obligations out of their cash flow resources rather than rely on the value of security offered. Depending on the customer's standing and the type of product, facilities may be provided unsecured. However, for certain lending decisions a charge over collateral is usually obtained, and is important for the credit decision and pricing, and it is the Bank's practice to obtain that collateral and sell it in the event of default as a source of repayment. Such collateral has a significant financial effect and the objective of the disclosure below is to quantify these forms. We may also manage our risk by employing other types of collateral and credit risk enhancements, such as second charges, other liens and unsupported guarantees, but the valuation of such mitigants is less certain and their financial effect has not been quantified in the loans shown below.

We have quantified below the value of fixed charges we hold over a specific asset (or assets) of a borrower for which we have a practical ability and history of enforcing in satisfying a debt in the event of a borrower failing to meet their contractual obligations and where the asset is cash or can be realised in the form of cash by sale in an established market.

Personal lending (audited)

For personal lending the collateral held has been analysed below separately for residential mortgages and other personal lending due to the different nature of collateral held on the portfolios.

Management Discussion and Analysis (continued)

Risk Management (continued)

(a) Credit Risk (continued)

Residential mortgages (audited)

The following table shows residential mortgage lending including off-balance sheet loan commitments by level of collateralisation.

Residential mortgages

	2015	2014
<u>Unimpaired loans</u>		
Uncollateralised	-	-
Fully collateralised	199,212	184,139
– Less than 25% LTV	36,816	34,694
– 25% to 50% LTV	96,932	100,697
– 51% to 75% LTV	58,026	40,705
– 76% to 90% LTV	5,095	7,383
– 91% to 100% LTV	2,343	660
Partially collateralised		
– Greater than 100% LTV (A)	220	-
– Collateral value on A	219	-
	199,432	184,139
<u>Impaired loans</u>		
Fully collateralised	218	196
– Less than 25% LTV	30	41
– 25% to 50% LTV	157	135
– 51% to 75% LTV	31	19
– 76% to 90% LTV	-	1
– 91% to 100% LTV	-	-
Uncollateralised	-	-
Total	199,650	184,335

The collateral included in the table above consists of fixed first charges on residential real estate.

The loan-to-value ("LTV") ratio in the table above is calculated as the gross on-balance sheet carrying amount of the loan and any off-balance sheet loan commitment at the balance sheet date as a percentage of the current value of collateral. The current value of collateral is determined through a combination of professional valuations, physical inspections or house price indices. The collateral valuation excludes any adjustments for obtaining and selling the collateral.

Other personal lending (audited)

The remainder of our personal lending consists primarily of credit cards, instalment loan, overdraft or revolving loan. Credit cards are generally unsecured. Instalment loan, overdraft and revolving loan could be partially secured by cash or marketable securities.

Management Discussion and Analysis (continued)

Risk Management (continued)

(a) Credit Risk (continued)

Corporate and commercial and financial (non-bank) lending (audited)

For corporate and commercial and financial (non-bank) lending, the collateral held has been analysed below separately for commercial real estate and other corporate and commercial and financial (non-bank) lending due to the different nature of collateral held on the portfolios.

Commercial real estate (audited)

The following table shows commercial real estate lending including off-balance sheet loan commitments by level of collateralisation.

Commercial real estate loans and advances

	2015	2014
Rated - CRR/EL* 1 to 7	95,281	99,330
Uncollateralised	14,419	21,005
Fully collateralised	76,555	76,514
Partially collateralised (A)	4,307	1,811
- Collateral value on A	2,930	1,232
	95,281	99,330
Rated CRR/EL 8		
Uncollateralised	-	-
Fully collateralised	27	13
- Less than 25% LTV	2	3
- 25% to 50% LTV	2	-
- 51% to 75% LTV	23	10
- 76% to 90% LTV	-	-
- 91% to 100% LTV	-	-
Partially collateralised (B)	4	-
- Collateral value on B	1	-
	31	13
Rated CRR/EL 9 to 10		
Uncollateralised	1	7
Fully collateralised	44	31
- Less than 25% LTV	29	11
- 25% to 50% LTV	7	20
- 51% to 75% LTV	8	-
- 76% to 90% LTV	-	-
- 91% to 100% LTV	-	-
Partially collateralised (C)	5	6
- Collateral value on C	4	4
	50	44
Total	95,362	99,387

* For details of CRR/EL, please refer to section (iii) Credit Quality.

The collateral included in the table above consists of fixed first charges on real estate and charges over cash for the commercial real estate sector. The table includes lending to major property developers which is typically secured by guarantees or is unsecured.

The value of commercial real estate collateral is determined through a combination of professional and internal valuations and physical inspection. Due to the complexity of collateral valuations for commercial real estate, local valuation policies determine the frequency of review based on local market conditions. Revaluations are sought with greater frequency where, as part of the regular credit assessment of the obligor, material concerns arise in relation to the transaction which may reflect on the underlying performance of the collateral, or in circumstances where an obligor's credit quality has declined sufficiently to cause concern that the principal payment source may not fully meet the obligation (i.e. the obligor's credit quality classification indicates it is at the lower end e.g. sub-standard, or approaching impaired).

Management Discussion and Analysis (continued)

Risk Management (continued)

(a) Credit Risk (continued)

Other corporate and commercial and financial (non-bank) lending (audited)

The following table shows corporate, commercial and financial (non-bank) lending rated CRR/EL 8 to 10 only including off-balance sheet loan commitments by level of collateralisation.

Corporate, commercial and financial (non-bank) loans and advances

	2015	2014
Rated CRR/EL 8		
Uncollateralised	37	267
Fully collateralised	127	100
– Less than 25% LTV	13	-
– 25% to 50% LTV	88	100
– 51% to 75% LTV	26	-
– 76% to 90% LTV	-	-
– 91% to 100% LTV	-	-
Partially collateralised (A)	247	58
– Collateral value on A	85	38
	<u>411</u>	<u>425</u>
Rated CRR/EL 9 to 10		
Uncollateralised	746	1,237
Fully collateralised	860	102
– Less than 25% LTV	68	-
– 25% to 50% LTV	143	20
– 51% to 75% LTV	397	59
– 76% to 90% LTV	177	23
– 91% to 100% LTV	75	-
Partially collateralised (B)	687	346
– Collateral value on B	557	107
	<u>2,293</u>	<u>1,685</u>
Total	<u>2,704</u>	<u>2,110</u>

The collateral used in the assessment of the above primarily includes first legal charges over real estate and charges over cash in the commercial and industrial sector and charges over cash and marketable financial instruments in the financial sector. Government sector lending is typically unsecured.

It should be noted that the table above excludes other types of collateral which are commonly taken for corporate and commercial lending such as unsupported guarantees and floating charges over the assets of a customer's business. While such mitigants have value, often providing rights in insolvency, their assignable value is insufficiently certain. They are assigned no value for disclosure purposes.

As with commercial real estate the value of real estate collateral included in the table above is generally determined through a combination of professional and internal valuations and physical inspection. The frequency of revaluation is undertaken on a similar basis to commercial real estate loans and advances; however, for financing activities in corporate and commercial lending that are not predominantly commercial real estate-oriented, collateral value is not as strongly correlated to principal repayment performance. Collateral values will generally be refreshed when an obligor's general credit performance deteriorates and it is necessary to assess the likely performance of secondary sources of repayment should reliance upon them prove necessary. For this reason, the table above reports values only for customers with CRR 8 to 10, reflecting that these loans and advances generally have valuations which are of comparatively recent vintage. For the purposes of the table above, cash is valued at its nominal value and marketable securities at their fair value.

Management Discussion and Analysis (continued)

Risk Management (continued)

(a) Credit Risk (continued)

Loans and advances to banks

(audited)

The following table shows loans and advances to banks including off-balance sheet loan commitments by level of collateralisation.

Loans and advances to banks

	2015	2014
Rated CRR/EL 1 to 8		
Uncollateralised	123,990	145,731
Fully collateralised	-	-
Partially collateralised (A)	-	-
- Collateral value on A	-	-
	<u>123,990</u>	<u>145,731</u>
Rated CRR/EL 9 to 10		
Uncollateralised	-	-
Fully collateralised	-	-
Partially collateralised (B)	-	-
- Collateral value on B	-	-
	<u>-</u>	<u>-</u>
	<u>-</u>	<u>-</u>
Total loans and advances to banks	<u>123,990</u>	<u>145,731</u>

Derivatives

(audited)

The International Swaps and Derivatives Association ("ISDA") Master Agreement is our preferred agreement for documenting derivatives activity. It provides the contractual framework within which dealing activity across a full range of over the counter ("OTC") products is conducted, and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or another pre-agreed termination event occurs. It is common, and the Group's preferred practice, for the parties to execute a Credit Support Annex ("CSA") in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between the parties to mitigate the counterparty risk inherent in outstanding positions. The majority of our CSAs are with financial institutional clients.

Management Discussion and Analysis (continued)

Risk Management (continued)

(a) Credit Risk (continued)

Other credit risk exposures (audited)

In addition to collateralised lending described above, other credit enhancements are employed and methods used to mitigate credit risk arising from financial assets. These are described in more detail below.

Government, bank and other financial institution issued securities may benefit from additional credit enhancement, notably through government guarantees that reference these assets. Corporate issued debt securities are primarily unsecured. Debt securities issued by banks and financial institutions include covered bonds, which are supported by underlying pools of financial assets.

Trading assets include loans and advances held with trading intent, the majority of which consist of reverse repos and securities borrowing which by their nature are collateralised. Collateral accepted as security that the Group is permitted to sell or repledge under these arrangements is described in Note 52 "Assets pledged as security for liabilities and collateral accepted as security for assets".

The Group's maximum exposure to credit risk includes financial guarantees and similar arrangements that it issues or enters into, and loan commitments to which it is irrevocably committed. Depending on the terms of the arrangement, the Bank may have recourse to additional credit mitigation in the event that a guarantee is called upon or a loan commitment is drawn and subsequently defaults. The risks and exposures from these are captured and managed in accordance with the Group's overall credit risk management policies and procedures.

Collateral and other credit enhancements obtained (audited)

The Group obtained assets by taking possession of collateral held as security, or calling other credit enhancement.

The carrying amount outstanding as at the year end was as follows:

	2015	2014
Nature of assets:		
Residential properties	30	4
Commercial and industrial properties	3	2
Other	-	-
	<u>33</u>	<u>6</u>

Management Discussion and Analysis (continued)

Risk Management (continued)

(a) Credit Risk (continued)

(iii) Credit quality (audited)

Five broad classifications describe the credit quality of the Group's lending and debt securities portfolios. These classifications each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending business, as well as the external ratings attributed by external agencies to debt securities.

There is no direct correlation between the internal and external ratings at granular level, except insofar as both fall within one of the five classifications.

(unaudited)

Quality classification	Wholesale lending and derivatives internal credit rating	12 month probability of default %	Retail lending internal credit rating	Expected loss %	Debt securities/other external credit rating
Strong	CRR 1 to CRR 2	0-0.169	EL 1 to EL 2*	0-0.999	A- and above
Good	CRR 3	0.170-0.740	EL 3	1.000-4.999	BBB+ to BBB-
Satisfactory	CRR 4 to CRR 5	0.741-4.914	EL 4 to EL 5*	5.000-19.999	BB+ to B and unrated
Sub-standard	CRR 6 to CRR 8	4.915-99.999	EL 6 to EL 8*	20.000-99.999	B- to C
Impaired	CRR 9 to CRR 10	100	EL 9 to EL 10* and all EL 1 to EL 8 exposures past due 90 days and above	100+ or defaulted	Individually identified

* All retail exposures past due 90 days and above are classified as "impaired". The EL percentage is derived through a combination of PD and LGD, and may exceed 100% in circumstances where the LGD is above 100% reflecting the cost recoveries.

Quality classification definitions:

(audited)

- Strong: Exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss. Retail accounts operate within product parameters and only exceptionally show any period of delinquency.

- Good: Exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adopted of recovery processes.

- Satisfactory: Exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk. Retail accounts typically show only short periods of delinquency, with losses expected to be minor following the adoption of recovery process.

- Sub-standard: Exposures require varying degrees of special attention and default risk of greater concern. Retail accounts show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate through security realisation or other recovery processes.

- Impaired: Exposures have been assessed, individually or collectively, as impaired. The Group observes the conservative disclosure convention, reflected in the quality classification definitions above, that all retail accounts delinquent by 90 days or more are considered impaired. Such accounts may occur in any retail expected loss ("EL") grade, whereby in the higher quality grades the grading assignment will reflect the offsetting of the impact of delinquency status by credit risk mitigation in one form or another.

The Group's policy in respect of impairment on loans and advances and debt securities is set out in note 3 on the financial statements. Analysis of impairment allowances as at 31 December 2015 and the movement of such allowances during the year are disclosed in note 31.

Management Discussion and Analysis (continued)

Risk Management (continued)

(a) Credit Risk (continued)

(iii) Credit quality (audited)

Granular risk rating scales: (unaudited)

The customer risk rating ("CRR") 10-grade scale summaries to a more granular underlying 23-grade scale of obligor probability of default. The Group's wholesale customers are rated using the 10 or 23-grade scale, depending on which regulatory approach is adopted for the assets in question. The expected loss ("EL") 10-grade scale for retail business summarises a more granular scale combining obligor and facility/product risk factors in a composite measure, used Group-wide. The external ratings cited above have for clarity of reporting been assigned to the quality classifications defined for internally-rated exposures, although there is no fixed correlation between internal and external ratings.

Impairment is not measured for financial investments held in trading portfolios or designated at fair value, as assets in such portfolios are managed according to movements in fair value, and the fair value movement is taken directly through the income statement. Consequently, all such balances are reported under "neither past due nor impaired".

Distribution of financial instruments by credit quality (audited)

	Neither past due nor impaired				Past due but not impaired	Impaired	Impairment allowances	Total
	Strong	Good*	Satisfactory	Sub-standard				
2015								
Items in the course of collection from other banks	6,235	-	687	-	-	-	-	6,922
Trading assets:								
- treasury and eligible bills	21,405	-	-	-	-	-	-	21,405
- debt securities	15,025	-	1,650	-	-	-	-	16,675
- loans and advances to banks	266	2,000	-	-	-	-	-	2,266
- loans and advances to customers	6	-	-	-	-	-	-	6
	<u>36,702</u>	<u>2,000</u>	<u>1,650</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>40,352</u>
Financial assets designated at fair value:								
- treasury and eligible bills	1,070	-	-	-	-	-	-	1,070
- debt securities	64	2	-	-	-	-	-	66
- loans and advances to banks	-	-	-	-	-	-	-	-
- loans and advances to customers	-	-	-	-	-	-	-	-
	<u>1,134</u>	<u>2</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,136</u>
Derivatives	7,681	1,196	2,551	167	-	-	-	11,595
Reverse repurchase agreements – non-trading	-	-	-	-	-	-	-	-
Loans and advances held at amortised cost:								
- sight balances at central banks	4,859	-	-	-	-	-	-	4,859
- placings with and advances to banks	119,423	4,063	504	-	-	-	-	123,990
- loans and advances to customers	328,419	202,971	147,684	3,848	4,902	2,737	(1,615)	688,946
	<u>452,701</u>	<u>207,034</u>	<u>148,188</u>	<u>3,848</u>	<u>4,902</u>	<u>2,737</u>	<u>(1,615)</u>	<u>817,795</u>
Financial investments:								
- treasury and similar bills	152,014	-	-	-	-	-	-	152,014
- debt securities	205,068	7,907	2,641	-	-	-	-	215,616
	<u>357,082</u>	<u>7,907</u>	<u>2,641</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>367,630</u>
Other assets:								
- acceptances and endorsements	827	2,448	2,446	3	-	-	-	5,724
- other	2,499	565	3,110	8	48	-	-	6,230
	<u>3,326</u>	<u>3,013</u>	<u>5,556</u>	<u>11</u>	<u>48</u>	<u>-</u>	<u>-</u>	<u>11,954</u>

Management Discussion and Analysis (continued)

Risk Management (continued)

(a) Credit Risk (continued)

	Neither past due nor impaired				Past due but not impaired	Impaired	Impairment allowances	Total
	Strong	Good*	Satisfactory	Sub-standard				
2014								
Items in the course of collection from other banks	4,625	-	557	-	-	-	-	5,182
Trading assets:								
- treasury and eligible bills	24,228	-	-	-	-	-	-	24,228
- debt securities	11,875	-	1,624	-	-	-	-	13,499
- loans and advances to banks	1	4,000	-	-	-	-	-	4,001
- loans and advances to customers	55	-	-	-	-	-	-	55
	<u>36,159</u>	<u>4,000</u>	<u>1,624</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>41,783</u>
Financial assets designated at fair value:								
- treasury and eligible bills	-	-	-	-	-	-	-	-
- debt securities	71	3	1	-	-	-	-	75
- loans and advances to banks	-	-	-	-	-	-	-	-
- loans and advances to customers	-	-	-	-	-	-	-	-
	<u>71</u>	<u>3</u>	<u>1</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>75</u>
Derivatives	4,561	1,226	1,571	63	-	-	-	7,421
Reverse repurchase agreements – non-trading	1,296	-	-	-	-	-	-	1,296
Loans and advances held at amortised cost:								
- sight balances at central banks	6,295	-	-	-	-	-	-	6,295
- placings with and advances to banks	139,328	6,141	262	-	-	-	-	145,731
- loans and advances to customers	316,935	198,878	136,538	1,269	4,534	2,115	(1,838)	658,431
	<u>462,558</u>	<u>205,019</u>	<u>136,800</u>	<u>1,269</u>	<u>4,534</u>	<u>2,115</u>	<u>(1,838)</u>	<u>810,457</u>
Financial investments:								
- treasury and similar bills	107,503	-	-	-	-	-	-	107,503
- debt securities	157,242	6,132	3,106	-	-	-	-	166,480
	<u>264,745</u>	<u>6,132</u>	<u>3,106</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>273,983</u>
Other assets:								
- acceptances and endorsements	866	1,918	2,909	22	-	-	-	5,715
- other	2,468	597	3,157	6	94	-	-	6,322
	<u>3,334</u>	<u>2,515</u>	<u>6,066</u>	<u>28</u>	<u>94</u>	<u>-</u>	<u>-</u>	<u>12,037</u>

* Includes HK\$8,241 million (2014: HK\$6,135 million) of debt securities that have been classified as BBB- to BBB+ for the Group in 2015, based on Standard and Poor's ratings or their equivalent to the respective issues of the financial securities. If major rating agencies have different ratings for the same debt securities, the securities are reported against the lower rating. In the absence of such issue ratings, the ratings designated for the issuers are reported.

Management Discussion and Analysis (continued)

Risk Management (continued)

(a) Credit Risk (continued)

Aging analysis of financial instruments which were past due but not impaired (audited)

Examples of exposures designated past due but not impaired include loans that have missed the most recent payment date but on which there is no evidence of impairment; loans fully secured by cash collateral; residential mortgages in arrears more than 90 days, but where the value of collateral is sufficient to repay both the principal debt and all potential interest for at least one year; short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty.

	Up to 29 days	30- 59 days	60- 89 days	90- 180 days	Over 180 days	Total
2015						
Items in the course of collection from other banks	-	-	-	-	-	-
Trading assets:						
- treasury and eligible bills	-	-	-	-	-	-
- debt securities	-	-	-	-	-	-
- loans and advances to banks	-	-	-	-	-	-
- loans and advances to customers	-	-	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Financial assets designated at fair value:						
- treasury and eligible bills	-	-	-	-	-	-
- debt securities	-	-	-	-	-	-
- loans and advances to banks	-	-	-	-	-	-
- loans and advances to customers	-	-	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Derivatives	-	-	-	-	-	-
Reverse repurchase agreements – non-trading	-	-	-	-	-	-
Loans and advances held at amortised cost:						
- sight balances at central banks	-	-	-	-	-	-
- placings with and advances to banks	-	-	-	-	-	-
- loans and advances to customers [#]	4,338	388	176	-	-	4,902
	<u>4,338</u>	<u>388</u>	<u>176</u>	<u>-</u>	<u>-</u>	<u>4,902</u>
Financial investments:						
- treasury and similar bills	-	-	-	-	-	-
- debt securities	-	-	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Other assets:						
- acceptances and endorsements	-	-	-	-	-	-
- other	19	6	11	10	2	48
	<u>19</u>	<u>6</u>	<u>11</u>	<u>10</u>	<u>2</u>	<u>48</u>

Management Discussion and Analysis (continued)

Risk Management (continued)

(a) Credit Risk (continued)

	Up to 29 days	30- 59 days	60- 89 days	90- 180 days	Over 180 days	Total
2014						
Items in the course of collection from other banks	-	-	-	-	-	-
Trading assets:						
- treasury and eligible bills	-	-	-	-	-	-
- debt securities	-	-	-	-	-	-
- loans and advances to banks	-	-	-	-	-	-
- loans and advances to customers	-	-	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Financial assets designated at fair value:						
- treasury and eligible bills	-	-	-	-	-	-
- debt securities	-	-	-	-	-	-
- loans and advances to banks	-	-	-	-	-	-
- loans and advances to customers	-	-	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Derivatives	-	-	-	-	-	-
Reverse repurchase agreements – non-trading	-	-	-	-	-	-
Loans and advances held at amortised cost:						
- sight balances at central banks	-	-	-	-	-	-
- placings with and advances to banks	-	-	-	-	-	-
- loans and advances to customers [#]	3,990	324	220	-	-	4,534
	<u>3,990</u>	<u>324</u>	<u>220</u>	<u>-</u>	<u>-</u>	<u>4,534</u>
Financial investments:						
- treasury and similar bills	-	-	-	-	-	-
- debt securities	-	-	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Other assets:						
- acceptances and endorsements	-	-	-	-	-	-
- other	53	7	6	13	15	94
	<u>53</u>	<u>7</u>	<u>6</u>	<u>13</u>	<u>15</u>	<u>94</u>

[#] The majority of the loans and advances to customers that are operating within revised terms following restructuring are excluded from this table.

Management Discussion and Analysis (continued)

Risk Management (continued)

(a) Credit Risk (continued)

Impaired loans and advances (audited)

The Group's policy for recognising and measuring impairment allowances on both individually assessed advances and those which are collectively assessed on a portfolio basis is described in note 3(d) to the financial statements.

Analysis of impairment allowances at 31 December 2015 and the movement of such allowances during the year are disclosed in note 31 to the financial statements.

Impaired loans and advances are those that meet any of the following criteria:

- wholesale loans and advances classified as CRR 9 or CRR 10. These grades are assigned when the bank considers that either the customer is unlikely to pay its credit obligations in full, without recourse to security, or when the customer is past due 90 days or more on any material credit obligation to the Group;
- retail loans and advances:
 - classified as EL 9 or EL 10; or
 - classified as EL 1 to EL 8 with 90 days and over past due; or
 - that have been with either 90 days and over past due or with economic loss incurred by the Group irrespective of the delinquency status.
- renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet its contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment. For loans that are assessed for impairment on a collective basis, the evidence to support reclassification as no longer impaired typically comprises a history of payment performance against the original or revised terms, depending on the nature and volume of renegotiation and the credit risk characteristics surrounding the renegotiation. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case by case basis.

Management Discussion and Analysis (continued)

Risk Management (continued)

(a) Credit Risk (continued)

Impairment assessment (audited)

It is Group's policy that each operating company in the Group creates impairment allowances for impaired loans promptly and appropriately.

For details of our impairment policies on loans and advances and financial investments, see notes 3(d) and 3(s) to the financial statements.

Impairment and credit risk mitigation

The existence of collateral has an impact when calculating impairment on individually assessed impaired loans. When we no longer expect to recover the principal and interest due on a loan in full or in accordance with the original terms and conditions, it is assessed for impairment. If exposures are secured, the current net realisable value of the collateral will be taken into account when assessing the need for an impairment allowance. No impairment allowance is recognised in cases where all amounts due are expected to be settled in full on realisation of the security.

Personal lending portfolios are generally assessed for impairment on a collective basis as the portfolios typically consist of large groups of homogeneous loans. Two methods are used to calculate allowances on a collective basis: a roll-rate methodology or a more basic formulaic approach based on historical losses.

The historical loss methodology is typically used to calculate collective impairment allowances for secured, or low default portfolios such as mortgages, until the point at which they are individually identified and assessed as impaired. For loans which are collectively assessed using historical loss methodology, the historical loss rate is derived from the average contractual write-off net of recoveries over a defined period. The net contractual write-off rate is the actual amount of loss experienced after the realisation of collateral and receipt of recoveries.

A roll-rate methodology is more commonly adopted for unsecured portfolios when there are sufficient volumes of empirical data to develop robust statistical models.

The nature of the collective allowance assessment prevents individual collateral values or LTV ratios from being included within the calculation. However, the loss rates used in the collective assessment are adjusted for the collateral realisation experiences which will vary depending on the LTV composition of the portfolio.

For wholesale loans and secured personal lending that calculating impairment on individually assessed impaired loans, historical loss methodologies are applied to estimate impairment losses which have been incurred but not reported. Loss rates are derived from the observed contractual write-off net of recoveries over a defined period of at least 60 months. The net contractual write-off rate is the actual amount of loss experienced after realisation of collateral and receipt of recoveries. These historical loss rates are adjusted by an economic factor which adjusts the historical averages to better represent current economic conditions affecting the portfolio. In order to reflect the likelihood of a loss event not being identified and assessed an emergence period assumption is applied. This reflects the period between a loss occurring and its identification. The emergence period is estimated by local management for each identified portfolio. The factors that may influence this estimation include economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. A fixed range for the period between a loss occurring and its identification is not defined across the Group and as it is assessed empirically on a periodic basis, it may vary over time as these factors change.

Management Discussion and Analysis (continued)

Risk Management (continued)

(b) Liquidity and funding risk (audited)

The purpose of liquidity and funding management is to ensure sufficient cash flows to meet all financial commitment and to capitalise on opportunities for business expansion. This includes the Group's ability to meet deposit withdrawals either on demand or at contractual maturity, to repay borrowings as they mature, to comply with the statutory liquidity ratio, and to make new loans and investments as opportunities arise. The Group maintains a stable and diversified funding base of core retail and corporate customer deposits as well as portfolios of highly liquid assets.

As part of our Asset, Liability and Capital Management structure, we have established Asset and Liability Management Committee ("ALCO") at Group level and in major operating entities. The terms of reference of all ALCOs include the monitoring and control of liquidity and funding. Management of liquidity is carried out both at Group and Bank levels as well as in individual branches and subsidiaries. The Group requires branches and subsidiaries to maintain a strong liquidity position and to manage the liquidity structure of their assets, liabilities and commitments so that cash flows are approximately balanced and all funding obligations are met when due.

It is the responsibility of the Group's management to ensure compliance with local regulatory requirements and limits set by ALCO. Liquidity is managed on a daily basis by the Bank's treasury functions and overseas treasury sites.

The Board is ultimately responsible for determining the types and magnitude of liquidity risk that the Group is able to take and ensure that there is an appropriate organisation structure for managing this risk. Under authorities delegated by the Executive Committee, the Group ALCO is responsible for managing all Asset, Liability and Capital Management issues including liquidity and funding risk management.

The Group ALCO delegates to the Group Tactical Asset and Liability Management Committee ("TALCO") the task of reviewing various analyses of the Group pertaining to site liquidity and funding. TALCO's primary responsibilities include but are not limited to:

- reviewing the funding structure of operating entities and the allocation of liquidity among them;
- reviewing operating entities' list of liquid securities and documented proof that a deep and liquid market exists; and
- monitoring liquidity and funding limit breaches and providing direction to those operating entities that have not been able to rectify breaches on a timely basis.

Compliance with liquidity and funding requirements is monitored by the ALCO and is reported to the Risk Management Committee ("RMC"), Executive Committee, Risk Committee and the Board of Directors on a regular basis. This process includes:

- maintaining compliance with relevant regulatory requirements of the reporting entity;
- projecting cash flows under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet liquidity and advances to core funding ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- managing the concentration and profile of debt maturities;
- managing contingent liquidity commitment exposures within pre-determined limits;
- managing debt financing plans;
- monitoring of depositor concentration in order to avoid undue reliance on large individual depositors and ensuring a satisfactory overall funding mix; and
- maintaining liquidity and contingency funding plans. These plans identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises, while minimising adverse long-term implications for the business.

Management Discussion and Analysis (continued)

Risk Management (continued)

(b) Liquidity and funding risk (continued)

The management of liquidity and funding risk

Inherent liquidity risk ("ILR") categorisation (audited)

The Group places its significant operating entities into one of two categories (normal risk and higher risk) to reflect the assessment of their inherent liquidity risk, considering political, economic and regulatory factors within the host country and factors specific to the significant operating entities themselves, such as the local market, market share and balance sheet strength. The categorisation involves management judgement and is based on the perceived liquidity risk of the significant operating entity relative to other entities in the Group. The categorisation is intended to reflect the possible impact of a liquidity event, not the probability of an event. The categorisation is part of the Group risk appetite and is used to determine the prescribed stress scenario that the Group requires its significant operating entities to be able to withstand and manage.

Core deposits

A key assumption of our internal framework is the categorisation of customer deposits into core and non-core based on our expectation of the behaviour of these deposits during a liquidity stress. This characterisation takes into account the Group's inherent liquidity risk categorisation of the operating entity originating the deposit, the nature of the customer, the size of customer's total balance and pricing of the deposit. The core deposit base in each operating entity is considered to be a long-term source of funding and therefore is assumed not to be withdrawn in the liquidity stress scenario that we use to calculate our principal liquidity risk metrics.

The three filters considered in assessing whether a deposit in any operating entity is core/non-core are:

- price: any deposit priced significantly above market or benchmark rates is generally treated as entirely non-core;
- size: depositors with total balances above certain monetary thresholds, the excess balances are classified as non-core. Thresholds are established by considering the business line and inherent liquidity risk categorisation; and
- line of business: the element of any deposit remaining after the application of the price and size filter is assessed on the basis of the line of business and inherent liquidity risk categorisation to which the deposit is associated.

Repo transactions and bank deposits cannot be categorised as core deposits.

Advances to core funding ratio

The Group's liquidity and funding risk management framework ("LFRF") employs two key measures to define, monitor and control the liquidity and funding risk of each of the Group's operating entities. The advances to core funding ratio is used to monitor the structural long-term funding position, and the stressed coverage ratio, incorporating Group standard stress scenarios, is used to monitor the resilience to severe liquidity stresses.

Core customer deposits are an important source of funds to finance lending to customers, and mitigate against reliance on short-term wholesale funding. Limits are placed on operating entities to restrict our ability to increase loans and advances to customers without corresponding growth in core customer deposits or long-term debt funding with a residual maturity beyond one year. This measure is referred to as the "advances to core funding" ratio.

Advances to core funding ratio limits are set by the ALCO for the most significant operating entities. The ratio describes current loans and advances to customers as a percentage of the total of core customer deposits and term funding with a remaining term to maturity in excess of one year. In general, customer loans are assumed to be renewed and are included in the numerator of the advances to core funding ratio, irrespective of the contractual maturity date. Reverse repurchase arrangements are excluded from the advances to core funding ratio.

Management Discussion and Analysis (continued)

Risk Management (continued)

(b) Liquidity and funding risk (continued)

Stressed coverage ratio

Stressed coverage ratios tabulated below are derived from stressed cash flow scenario analyses and express the stressed cash inflows as a percentage of stressed cash outflows over one-month and three-month time horizons.

The stressed cash inflows include:

- inflows (net of assumed haircuts) expected to be generated from the realisation of liquid assets; and
- contractual cash inflows from maturing assets that are not already reflected as a use of liquid assets.

In line with the approach adopted for the advances to core funding ratio, customer loans are, in general, assumed not to generate any cash inflows under stress scenarios and are therefore excluded from the numerator of the stressed coverage ratios, irrespective of the contractual maturity date.

A stressed coverage ratio of 100% or higher reflects a positive cumulative cash flow under the stress scenario being monitored. Group operating entities are required to maintain a ratio of 100% or greater up to three months under the Group standard stress scenario defined by the inherent risk categorisation of the operating entity concerned.

Advances to core funding ratios and the stressed one-month and three-month coverage ratios for the Group for 2015 and 2014 are provided in the following table based on month end figures.

	Advances to core funding ratio (unaudited)		Stressed one month covering ratio (unaudited)		Stressed three month covering ratio (unaudited)	
	2015 %	2014 %	2015 %	2014 %	2015 %	2014 %
Year-end	86.1	85.8	156.6	145.7	149.2	142.8
Maximum	91.2	88.8	162.3	150.6	157.4	145.6
Minimum	84.3	84.5	132.1	135.7	130.8	135.1
Average	86.4	86.3	150.3	142.7	146.2	140.0

Stressed scenario analysis (audited)

The Group uses a number of standard and local stress scenarios designed to model:

- institution-specific crisis scenarios;
- general market crisis scenarios; and
- combined scenarios.

These scenarios are modelled by the relevant operating entities. The appropriateness of the assumptions for each scenario is reviewed regularly and formally approved by the ALCO, RMC, Risk Committee and the Board annually as part of the liquidity and funding risk appetite approval process.

Stressed cash outflows are determined by applying a standard set of prescribed stress assumptions to the Group's cash flow model. In addition to the standard stress scenarios, individual operating entities are required to design their local scenarios to reflect specific local market conditions, products and funding bases.

Management Discussion and Analysis (continued)

Risk Management (continued)

(b) Liquidity and funding risk (continued)

Liquid assets (unaudited)

Stressed scenario analysis and the numerator of the coverage ratio include the assumed cash inflows that would be generated from the realisation of liquid assets, after applying the appropriate stressed haircut. These assumptions are made based on management's expectation of when an asset is deemed to be realisable.

Liquid assets are unencumbered assets that meet the Group's definition of liquid assets and are either held outright or as a consequence of a reverse repo transaction with a residual contractual maturity beyond the time horizon of the stressed coverage ratio being monitored.

The Group's liquidity framework defines the asset classes that can be assessed locally as high quality and realisable within one month and between one month and three months. ALCO has to be satisfied that any asset which may be treated as liquid in accordance with the Group's liquid asset policy will remain liquid under the stress scenario being managed to.

Inflows from the utilisation of liquid assets within one month can generally only be based on confirmed withdrawable central bank deposits, gold or the sale or repo of government and quasi-government exposures generally restricted to those denominated in the sovereign's domestic currency. Covered bonds are also included but inflows assumed for these assets are capped.

Inflows after one month are also reflected for high quality non-financial and non-structured corporate bonds and equities within the most liquid indices.

Internal categorisation	Cash inflow recognised	Asset classes	Eligibility Criteria
Level 1	Within one month	<ul style="list-style-type: none"> - Central government - Central bank (including confirmed withdrawable reserves) - Supranationals - Multilateral development banks 	0% and 20% Risk Weighted
Level 2	Within one month but capped	<ul style="list-style-type: none"> - Local and regional government - Public sector entities - Secured covered bonds and pass-through ABSs - Gold 	20% Risk Weighted
Level 3	From one to three months	<ul style="list-style-type: none"> - Unsecured non-financial entity securities - Equities listed on recognised exchanges and within liquid indices 	Internally rated 2.2 CRR or better

Any entity owned and controlled by central or local/regional government but not explicitly guaranteed is treated as a public sector entity. Any exposure explicitly guaranteed is reflected as an exposure to the ultimate guarantor.

The table below shows the estimated liquidity value (before assumed haircuts) of assets categorised as liquid used for the purposes of calculating the three-month stressed coverage ratios, as defined under the LFRF.

Any unencumbered asset held as a consequence of a reverse repo transaction with a residual contractual maturity within the stressed coverage ratio time period and unsecured interbank loans maturing within three months are not included in liquid assets, as these assets are reflected as contractual cash inflows.

Liquid assets are held and managed on a standalone operating entity basis. Most of the liquid assets shown are held directly by each operating entity's Balance Sheet Management function, primarily for the purpose of managing liquidity risk, in line with the LFRF.

Liquid assets of the Group (unaudited)

	2015	2014
Level 1	228,520	167,150
Level 2	27,250	16,973
Level 3	3,395	3,585
	<u>259,165</u>	<u>187,708</u>

Management Discussion and Analysis (continued)

Risk Management (continued)

(b) Liquidity and funding risk (continued)

Wholesale debt monitoring (unaudited)

Where wholesale debt term markets are accessed to raise funding, ALCO is required to ensure that there is no concentration of maturities of these term debts.

Sources of funding (unaudited)

The Group's primary sources of funding are customer current accounts and customer savings deposits payable on demand or at short notice. The Group also accesses wholesale funding markets by issuing senior unsecured debt securities (publicly and privately) and borrowing from the secured repo markets against high quality collateral, in order to supplement our customer deposits, change the currency mix and maturity profile, and maintain a presence in local wholesale markets.

Liquidity behaviouralisation (unaudited)

Liquidity behaviouralisation is applied to reflect our assessment of the expected period for which we are confident that we will have access to our liabilities, even under a severe liquidity stress scenario, and the expected period for which we must assume that we will need to fund our assets. Behaviouralisation is applied when the contractual terms do not reflect the expected behaviour. Liquidity behaviouralisation policy is reviewed and approved by ALCO.

Contingent liquidity risk (unaudited)

Operating entities provide customers with committed and standby facilities. These facilities increase the funding requirements of the Group when customers drawdown. The liquidity risk associated with the potential drawdown on non-cancellable committed facilities is factored into our stressed scenarios and limits are set for these facilities.

Currency mismatch (unaudited)

The Group allows currency mismatches to provide some flexibility in managing the balance sheet structure and to carry out foreign exchange trading, on the basis that there is sufficient liquidity in the swap market to support currency conversion in periods of stress. The Group sets limits on cash flow projection for all material currencies based on liquidity in the swap markets. These limits are approved and monitored by ALCO.

Encumbered and unencumbered assets (unaudited)

An asset is defined as encumbered, from a liquidity perspective, if it has been pledged as collateral against an existing liability, and as a result is no longer available to the bank to secure funding, satisfy collateral needs or be sold to reduce the funding requirement. An asset is therefore categorised as unencumbered if it has not been pledged against an existing liability.

Additional contractual obligations (Unaudited)

Most of the Group's derivative transactions are exchange rate contracts and interest rate contracts. Under the terms of our current collateral obligations under derivative contracts (which are ISDA compliant CSA contracts), in the event of a three-notch downgrade in credit ratings, the additional collateral required to post is immaterial.

Management Discussion and Analysis (continued)

Risk Management (continued)

(b) Liquidity and funding risk (continued)

Forward-looking framework

(Unaudited)

From 1 January 2016 the Group will implement a new liquidity and funding risk management framework. Our new internal framework uses the Liquidity Coverage Ratio (“LCR”) and Net Stable Funding Ratio (“NSFR”) regulatory framework as a foundation, but adds additional metrics/limits and overlays to address the risks that the Group considers are not adequately reflected by the regulatory framework.

The key aspects of the new internal liquidity and funding risk management framework are:

I. Standalone management of liquidity and funding by operating entity.

II. Operating entity classification by (‘ILR’) categorisation.

III. Minimum operating entity LCR requirement dependent on ILR categorisation (EU LCR Delegated Regulation basis, being the implementation of the Basel III framework within Europe and therefore applicable to the HSBC Group);

IV. Minimum operating entity NSFR requirement dependent on ILR categorisation (Based on the final regulations published by the Basel Committee on Banking Supervision in October 2014, pending finalisation of the regulation within Europe that will be applicable to the HSBC Group);

V. Legal entity depositor concentration limit.

VI. Operating entity three-month and twelve-month cumulative rolling term contractual maturity limits covering deposits from banks, deposits from non-bank financials and securities issued; and

VII. Annual Individual Liquidity Adequacy Assessment (‘ILAA’) by operating entity. The ILAA process has been designed to identify liquidity and funding risks that are not reflected in the liquidity and funding risk management framework and where additional limits may be assessed to be required locally, and to validate the Risk Tolerance at the operating entity level.

Our new liquidity and funding risk management framework and the risk tolerance (limits) were approved by the RMC, and by the Board on the basis of the recommendation given by the Risk Committee.

The decision to create an internal framework based around the external regulatory framework was driven by the need to ensure that the external and internal frameworks are directionally aligned and to ensure that the Group’s internal funds transfer pricing framework incentivises the Global Business Lines within each operating entity to collectively ensure compliance with both the external (regulatory) and the internal Risk Tolerance.

Management Discussion and Analysis (continued)

Risk Management (continued)

(b) Liquidity and funding risk (continued)

Liquidity regulation

(unaudited)

The Banking (Liquidity) Rules ('BLR'), effective on 1 January 2015, signified the implementation of Liquidity Coverage Ratio ('LCR') for category 1 Institution under Basel III liquidity standards in Hong Kong. The liquidity information disclosures reported for the quarters ended 31 December, 30 September, 30 June and 31 March 2015 under Basel III are therefore not directly comparable with the disclosures reported for the year ended 31 December 2014.

The Group is required under rule 11(1) of BLR to calculate its LCR on a consolidated basis. During the year of 2015, the Group is required to maintain an LCR of not less than 60%, increasing to not less than 100% by January 2019. The Net Stable Funding Ratio is expected to be implemented in Hong Kong from 1 January 2018. The average LCR for the reportable period is as follows:

	Quarter ended 31 December 2015	Quarter ended 30 September 2015	Quarter ended 30 June 2015	Quarter ended 31 March 2015
Average Liquidity Coverage Ratio	<u>195.0%</u>	<u>237.2%</u>	<u>221.6%</u>	<u>167.4%</u>

The liquidity position of the Group remained strong in 2015. The average LCR ranged from 167.4% to 237.2% for the reportable quarters. The increase in average LCR for the second and third quarters mainly reflecting the increase in high quality liquid assets ("HQLA") as a result of redeployment of the sale proceeds from the partial disposal of the Bank's investment in Industrial Bank.

To comply with the Banking (Disclosure) Rules, the details of liquidity information can be found in the Regulatory Disclosures section of our website www.hangseng.com.

The average liquidity ratio, for the year ended 31 December 2014, calculated in accordance with the Fourth Schedule of the Hong Kong Banking Ordinance is as follows:

Average liquidity ratio of the Bank and its subsidiaries designated by the HKMA	<u>2014</u> <u><u>34.7%</u></u>
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The composition of Group's HQLA as defined under Schedule 2 of the BLR is shown as below. The majority of the HQLA held by the Group are Level 1 assets which mainly consist of government debt securities.

	Weighted amount (Average value)			
	Quarter ended 31 December 2015	Quarter ended 30 September 2015	Quarter ended 30 June 2015	Quarter ended 31 March 2015
Level 1 assets	246,678	224,759	215,120	166,084
Level 2A assets	13,645	13,864	10,177	7,391
Level 2B assets	782	1,140	1,214	1,097
Total weighted amount of HQLA	<u>261,105</u>	<u>239,763</u>	<u>226,511</u>	<u>174,572</u>

Management Discussion and Analysis (continued)

Risk Management (continued)

(b) Liquidity and funding risk (continued) (audited)

The below tables are an analysis of undiscounted cash flows on the Group's financial liabilities including future interest payments on the basis of their earliest possible contractual maturities.

The balances in the below tables will not agree with the balances in the balance sheet as the tables incorporate, on an undiscounted basis, all cash flows relating to principal and all future coupon payments (except for trading liabilities and trading derivatives). Also, loans commitments and financial guarantee contracts are generally not recognised on the balance sheet. Trading liabilities and trading derivatives have been included in the "On demand" time bucket, and not by contractual maturity, because trading liabilities are typically held for short periods of time. The undiscounted cash flows on hedging derivative liabilities are classified according to their contractual maturities.

Cash flows payable in respect of customer accounts are primarily contractually repayable on demand or at short notice. However, in practice, short-term deposit balances remain stable as inflows and outflows broadly match and a significant portion of loans commitments expire without being drawn upon. The undiscounted cash flows potentially payable under loan commitments and financial guarantee are classified on the basis of the earliest date they can be called.

	Repayable on demand	Three months or less but not on demand	Over three months but within one year	Over one year but within five years	Over five years	Total
At 31 December 2015						
Current, savings and other deposit accounts	704,866	217,132	37,287	1,207	-	960,492
Repurchase agreements – non-trading	-	2,316	-	-	-	2,316
Deposits from banks	6,654	12,128	-	-	-	18,782
Financial liabilities designated at fair value	2	17	48	3,592	501	4,160
Trading liabilities	62,917	-	-	-	-	62,917
Derivative financial instruments	9,395	130	115	377	5	10,022
Certificates of deposit and other debt securities in issue	-	31	53	5,255	-	5,339
Other financial liabilities	6,568	9,937	1,321	14	3	17,843
Subordinated liabilities	-	27	79	423	2,514	3,043
	<u>790,402</u>	<u>241,718</u>	<u>38,903</u>	<u>10,868</u>	<u>3,023</u>	<u>1,084,914</u>
Loan commitments	304,879	59,338	57	-	-	364,274
Financial guarantee and credit risk related guarantee contracts	14,497	100	1	-	-	14,598
	<u>319,376</u>	<u>59,438</u>	<u>58</u>	<u>-</u>	<u>-</u>	<u>378,872</u>
At 31 December 2014						
Current, savings and other deposit accounts	630,303	219,498	45,757	3,304	-	898,862
Repurchase agreements – non-trading	-	-	-	-	-	-
Deposits from banks	3,797	3,171	2,127	-	-	9,095
Financial liabilities designated at fair value	2	13	39	3,105	493	3,652
Trading liabilities	72,587	-	-	-	-	72,587
Derivative financial instruments	5,914	133	142	317	11	6,517
Certificates of deposit and other debt securities in issue	-	22	7,201	5,440	-	12,663
Other financial liabilities	6,706	8,507	1,903	30	46	17,192
Subordinated liabilities	-	46	139	742	6,186	7,113
	<u>719,309</u>	<u>231,390</u>	<u>57,308</u>	<u>12,938</u>	<u>6,736</u>	<u>1,027,681</u>
Loan commitments	283,366	43,461	129	-	-	326,956
Financial guarantee and credit risk related guarantee contracts	11,906	101	-	-	-	12,007
	<u>295,272</u>	<u>43,562</u>	<u>129</u>	<u>-</u>	<u>-</u>	<u>338,963</u>

Management Discussion and Analysis *(continued)*

Risk Management *(continued)*

(c) Market risk

(unaudited)

Market risk is the risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce our income or the value of our portfolios.

There were no significant changes to our policies and practices for the management of market risk in 2015.

Exposure to market risk is separated into two portfolios:

- Trading portfolios comprise positions arising from market-making and warehousing of customer-derived positions.
- Non-trading portfolios comprise positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, and financial investments designated as available-for-sale.

Where appropriate, the Group applies similar risk management policies and measurement techniques to both trading and non-trading portfolios. The Group's objective is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the status as a professional banking and financial services organisation.

The nature of the hedging and risk mitigation strategies range from the use of traditional market instruments, such as interest rate swaps, to more sophisticated hedging strategies to address a combination of risk factors arising at portfolio level.

Market risk governance

(unaudited)

Market risk is managed and controlled through limits approved by the Group's Risk Management Committee. These limits are allocated across business lines and to the Group's legal entities, including Hang Seng Bank (China) Limited.

The management of market risk is principally undertaken in Global Markets using risk limits allocated from the risk appetite, which is subject to the Board's approval. Limits are set for portfolios, products and risk types where appropriate, with market liquidity and business need being primary factors in determining the level of limits set.

An independent market risk management and control function is responsible for measuring, monitoring and reporting market risk exposures against the prescribed limits on a daily basis.

Model risk is governed through Model Oversight Committee ("MOC") at the Wholesale Credit and Market Risk ("WCMR") level. The MOC has direct oversight on traded risk models utilised for risk measurement and management and stress testing to ensure that they remain within our risk appetite and business plans.

Our control of market risk in the trading and non-trading portfolios is based on a policy of restricting trading within a list of permissible instruments authorised for each business lines, of enforcing new product approval procedures, and of restricting trading in the more complex derivative products only to business lines with appropriate levels of product expertise and robust control systems.

Monitoring and limiting market risk exposures

The Group's objective is to manage and control market risk exposures while maintaining a market profile consistent with the Group's risk appetite.

The Group uses a range of tools to monitor and limit market risk exposures including sensitivity analysis, value at risk ("VAR"), and stress testing.

Management Discussion and Analysis *(continued)*

Risk Management *(continued)*

(c) Market risk *(continued)*

Sensitivity analysis (unaudited)

Sensitivity analysis measures the impact of individual market factor movements on specific instruments or portfolios including interest rates, foreign exchange rates and equity prices. The Group uses sensitivity measures to monitor the market risk positions within each risk type, for example, the present value of a basis point movement in interest rates for interest rate risk.

Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

Value at risk ("VAR") (audited)

VAR is a technique that estimates the potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. The use of VAR is integrated into market risk management and is calculated for all trading positions regardless of how the Group capitalises those exposures. Where there is no approved internal model, the Group uses the appropriate local rules to capitalise exposures.

In addition, the Group calculates VAR for non-trading portfolios in order to have a complete picture of market risk. Where VAR is not calculated explicitly, alternative tools are used.

Standard VAR is calculated at a 99% confidence level for a one-day holding period while stressed VAR uses a 10-day holding period and a 99% confidence interval based on a continuous one-year historical significant stress period. The VAR models used by the Group are based predominantly on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking into account inter-relationships between different markets and rates such as interest rates and foreign exchange rates. The models also incorporate the effect of option features on the underlying exposures.

The historical simulation models used incorporate the following features:

- historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities;
- potential market movements utilised for VAR are calculated with reference to those historical data; and
- Standard VAR is calculated to a 99% confidence level and use a one-day holding period scaled to 10 days.

The nature of the VAR models means that an increase in observed market volatility will lead to an increase in VAR without any changes in the underlying positions.

Management Discussion and Analysis (continued)

Risk Management (continued)

(c) Market risk (continued)

VAR model limitations

Although a valuable guide to risk, VAR should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a holding period assumes that all positions can be liquidated or the risks offset during that period. This may not fully reflect the market risk arising at times of severe illiquidity, when the holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99% confidence level, by definition does not take into account losses that might occur beyond this level of confidence;
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and
- Standard VAR is unlikely to reflect loss potential on exposures that only arise under significant market movements.

Risk not in VAR ("RNIV") framework (unaudited)

The Group's VAR model is designed to capture significant basis risks such as asset swap spreads and cross-currency basis. Other basis risks which are not completely covered in VAR, such as the LIBOR tenor basis, are complemented by RNIV calculations and are integrated into the capital framework.

The RNIV framework aims to manage and capitalise material market risks that are not adequately covered in the VAR model. In such instances the RNIV framework uses stress tests to quantify the capital requirement. On average in 2015, the capital requirement derived from these stress tests represented 1.5% of the total internal model-based market risk requirement.

RNIV is not viewed as being a material component of the Group's market risk capital requirement. Risks covered by RNIV represent 1.5% of market risk RWAs for models with regulatory approval.

Risk factors are reviewed on a regular basis and either incorporated directly in the VAR models, where possible, or quantified through the VAR-based RNIV approach or a stress test approach within the RNIV framework. The severity of the scenarios is calibrated to be in line with the capital adequacy requirements.

Management Discussion and Analysis (continued)

Risk Management (continued)

(c) Market risk (continued)

Stress testing

(unaudited)

Stress testing is an important tool that is integrated into the Group's market risk management tool to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables. In such abnormal scenarios, losses can be much greater than those predicted by VAR modelling.

Stress testing is implemented at the legal entity and the overall Group levels. Scenarios are tailored in order to capture the relevant events or market movements. A scoring framework is in place for management to effectively assess the severity of the potential stress losses and the likelihood of occurrence of the stress scenarios.

The process is governed by the HSBC Stress Testing Review Group forum which the Group being a participating member determines the scenarios to be applied at portfolio and consolidated level, as follows:

- single risk factor stress scenarios that are unlikely to be captured within the VAR models, such as the break of a currency peg;
- technical scenarios consider the largest move in each risk factor without consideration of any underlying market correlation;
- hypothetical scenarios consider potential macroeconomic events, for example, the slowdown in mainland China and the potential effects of a sovereign debt default, including its wider contagion effects; and
- historical scenarios incorporate historical observations of market movements during previous periods of stress which would not be captured within VAR.

Market Risk Reverse stress tests are undertaken based upon the premise that there is a fixed loss. The stress test process identifies which scenarios lead to this loss. The rationale behind the reverse stress test is to understand scenarios which are beyond normal business settings that could have contagion and systemic implications.

Stressed VAR and stress testing, together with reverse stress testing, provide management with insights regarding the "tail risk" beyond VAR for which the Group appetite is limited.

Trading portfolios

(audited)

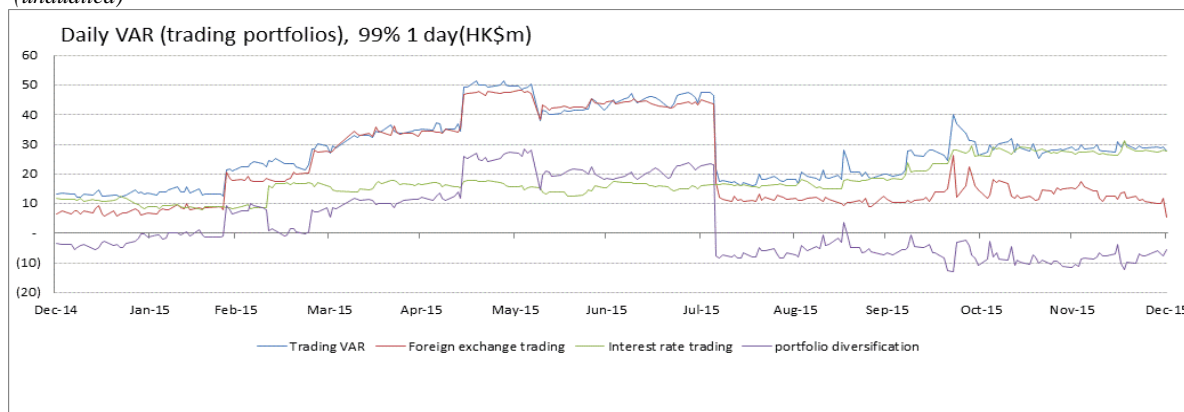
VAR of the trading portfolios

Trading VAR predominantly resides within Global Markets. The VAR for trading activity at 31 December 2015 was higher than at 31 December 2014, mainly driven by interest rate exposures arising from foreign exchange forward trading activities. Foreign exchange trading VAR had increased from February 2015 to July 2015 due to the temporary foreign exchange exposures relating to the disposal of Industrial Bank's shareholdings.

The daily levels of total trading VAR over the last year are set out in the graph below.

Daily VAR (trading portfolios), 99% 1 day (HK\$m)

(unaudited)



Management Discussion and Analysis (continued)

Risk Management (continued)

(c) Market risk (continued)

The Group's trading VAR for the year is shown in the table below.

Trading, 99% 1 day (audited)

	At 31 December 2015	Minimum during the year	Maximum during the year	Average for the year
VAR				
Trading	28	12	52	29
Foreign exchange trading	5	5	48	22
Interest rate trading	28	8	32	18
Portfolio diversification (unaudited)	(5)	-	-	(11)
Stressed VAR				
Trading	188	25	219	136
Foreign exchange trading	3	1	226	78
Interest rate trading	222	22	246	110

	At 31 December 2014	Minimum during the year	Maximum during the year	Average for the year
VAR				
Trading	13	4	17	9
Foreign exchange trading	7	1	11	6
Interest rate trading	12	3	14	8
Portfolio diversification (unaudited)	(5)	-	-	(4)
Stressed VAR				
Trading	40	23	157	65
Foreign exchange trading	18	1	32	17
Interest rate trading	64	26	173	77

Management Discussion and Analysis (continued)

Risk Management (continued)

(c) Market risk (continued)

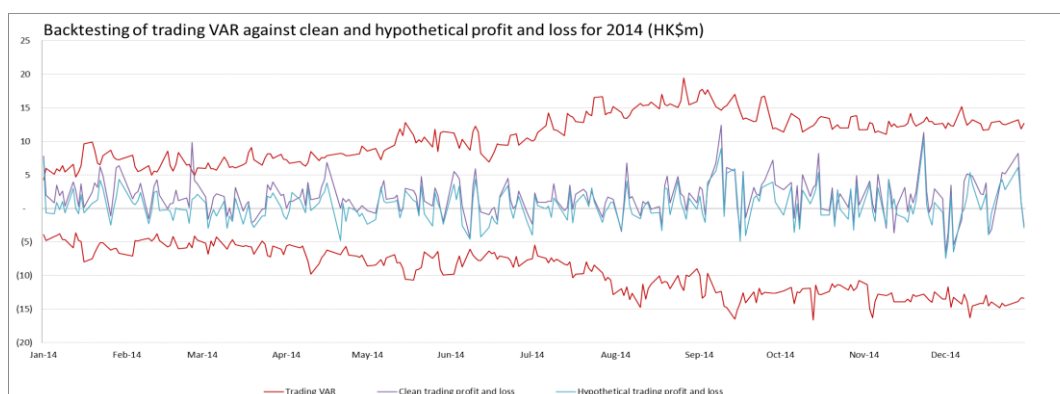
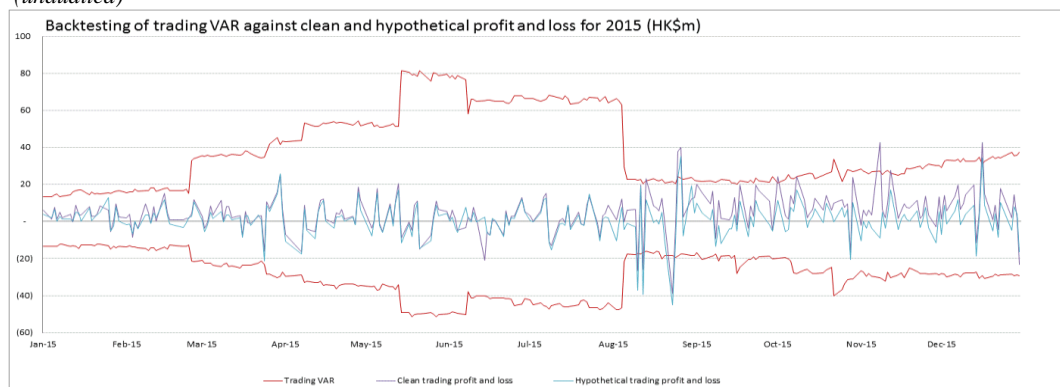
Backtesting (unaudited)

In 2015, there were three loss exceptions and eight profit exceptions for the Group during the year.

The loss exceptions were mainly triggered by the volatile RMB and HKD markets observed in August 2015. On the other hand, the profit exceptions were mainly driven by intraday profit arising from trading activities.

The graph below shows the daily trading VAR against clean and hypothetical profit and loss for the Group during 2015.

Backtesting of trading VAR against clean and hypothetical profit and loss for the Group (HK\$m) (unaudited)



The Group routinely validates the accuracy of the VAR models by back-testing both clean and hypothetical profit and loss against the trading VAR numbers. Hypothetical profit and loss excludes non-modelled items such as fees, commissions and revenues of intra-day transactions from the actual reported profit and loss, while clean profit and loss includes both.

The Group would expect on average to see two or three profits, and two or three losses, in excess of VAR at the 99% confidence level over a one-year period. The actual number of profits or losses in excess of VAR over this period can therefore be used to gauge how well the models are performing. To ensure a conservative approach in calculating our risk exposures, it is important to note that profits in excess of VAR are only considered when back-testing the accuracy of models and are not used to calculate the VAR numbers used for risk management or capital purposes.

Management Discussion and Analysis (continued)

Risk Management (continued)

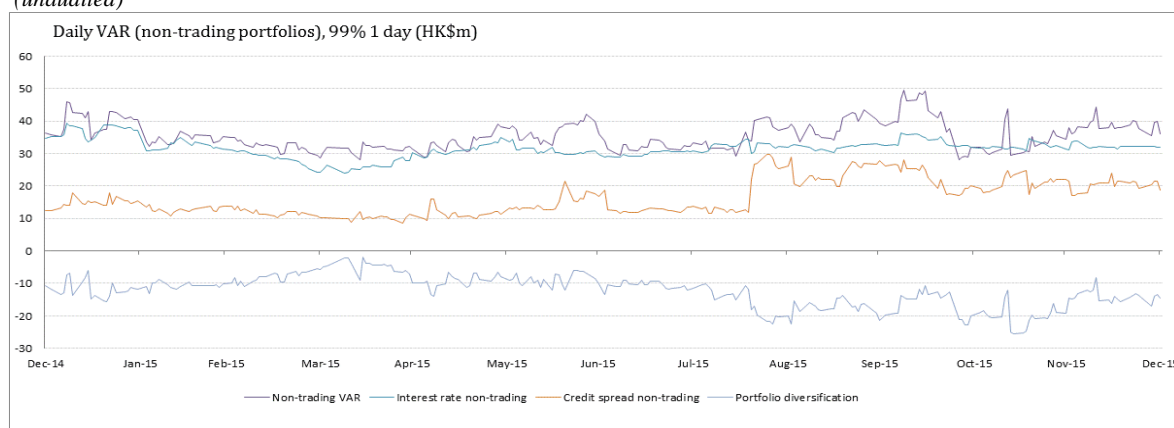
(c) Market risk (continued)

Non-trading portfolios (unaudited)

VAR of the non-trading portfolios

Non-trading VAR of the Group predominantly relates to Balance Sheet Management ("BSM"). Contributions to non-trading VAR are driven by interest rates and credit spread risks. There is no commodity risk in the non-trading portfolios. The daily levels of total non-trading VAR over the last year are set out in the graph below.

Daily VAR (non-trading portfolios), 99% 1 day (HK\$m) (unaudited)



The Group's non-trading VAR for the year is shown in the table below.

Non-trading VAR, 99% 1 day (audited)

	At 31 December 2015	Minimum during the year	Maximum during the year	Average for the year
VAR				
Non-trading	36	28	50	36
Interest rate non-trading	32	24	39	32
Credit spread non-trading (unaudited)	19	9	30	16
Portfolio diversification (unaudited)	(15)	-	-	(12)
	At 31 December 2014	Minimum during the year	Maximum during the year	Average for the year
VAR				
Non-trading	36	22	47	34
Interest rate non-trading	35	20	42	32
Credit spread non-trading (unaudited)	12	7	23	15
Portfolio diversification (unaudited)	(11)	-	-	(13)

In measuring, monitoring and managing risk in our non-trading portfolios, VAR is just one of the tools used. The management of interest rate risk in the banking book is described further in "Non-trading interest rate risk" below, including the role of BSM.

Non-trading VAR excludes equity risk on available-for-sale securities, structural foreign exchange risk, and interest rate risk on fixed rate securities issued by HSBC Holdings, the management of which is described in the relevant sections below.

Management Discussion and Analysis *(continued)*

Risk Management *(continued)*

(c) Market risk *(continued)*

Non-trading VAR, 99% 1 day (continued) *(audited)*

The Group's control of market risk in the non-trading portfolios is based on transferring the assessed market risk of non-trading assets and liabilities created outside BSM or Global Markets, to the books managed by BSM, provided the market risk can be neutralised. The net exposure is typically managed by BSM through the use of fixed rate government bonds (liquid asset held in available-for-sale books) and interest rate swaps. The interest rate risk arising from fixed rate government bonds held within available-for-sale portfolios is reflected within the Group's non-trading VAR. Interest rate swaps used by BSM are typically classified as either a fair value hedge or a cash flow hedge and included within the Group's non-trading VAR. Any market risk that cannot be neutralised in the market is managed by local ALCO in segregated ALCO books.

Credit spread risk for available-for-sale debt securities *(unaudited)*

The risk associated with movements in credit spreads is primarily managed through sensitivity limits, stress testing and VAR. The credit spread VAR is derived from a one-day movement in credit spreads over a two-year period, calculated to a 99% confidence interval.

The credit spread VAR on our available-for-sale debt securities was HK\$19 million (2014: HK\$12 million) at 31 December 2015. The increase in credit spread VAR was due mainly to the larger available-for-sale portfolio as a result of more commercial surplus.

Interest rate exposure *(audited)*

Interest rate risks comprise those originating from Global Markets activities, both trading and non-trading portfolios which include structural interest rate exposures. Global Markets manages interest rate risks within the limits approved by the RMC and under the monitoring of both ALCO and RMC.

Trading interest rate risk *(audited)*

The Group's control of market risk is based on restricting individual operations to trading within VAR and underlying sensitivity limits including foreign exchange position limits, present value of a basis point limits and option limits, and a list of permissible instruments authorised by the RMC, and enforcing rigorous new product approval procedures. In particular, trading in the derivative products is supported by robust control systems whereas more complicated derivatives are mainly traded on back-to-back basis. Analysis of VAR for trading portfolio is disclosed in "Value at Risk" section.

Non-trading interest rate risk *(audited)*

Non-trading interest rate risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes.

Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas, such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand, such as current accounts, and the re-pricing behaviour of managed rate products.

In order to manage this risk optimally, non-trading interest rate risks is transferred to BSM or to separate books managed under the supervision of the Asset, Liability and Capital Management Committee ('ALCO'). The transfer of market risk to books managed by BSM or supervised by ALCO is usually achieved by a series of internal deals between the business units and these books. When the behavioural characteristics of a product differ from its contractual characteristics, the behavioural characteristics are assessed to determine the true underlying interest rate risk. ALCO regularly monitors all such behavioural assumptions and interest rate risk positions, to ensure they comply with interest rate risk limits established by senior management.

Management Discussion and Analysis *(continued)*

Risk Management *(continued)*

(c) Market risk *(continued)*

Sensitivity of net interest income

A principal part of the Group's management of non-trading interest rate risk in non-trading portfolios is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling).

The table below sets out the impact on future net interest income of a 100 basis points parallel fall or rise in all-in yield curves at the beginning of year from 1 January 2016 and 25 basis points parallel fall or rise in all-in yield curves at the beginning of each quarter during the 12 month period from 1 January 2016.

Assuming no management actions, such a series of incremental parallel rises in all-in yield curves would increase planned net interest income for the year ending 31 December 2016 by HK\$2,754 million for 100 basis points case and by HK\$1,914 million for 25 basis points case, while such a series of incremental parallel falls in all-in yield curves would decrease planned net interest income by HK\$3,707 million for 100 basis points case and by HK\$2,479 million for 25 basis points case. These figures incorporate the impact of any option features in the underlying exposures and take into account the change in pricing of retail products relative to change in market interest rates.

Management Discussion and Analysis (continued)

Risk Management (continued)

(c) Market risk (continued)

Projected Net Interest Income (audited)

The sensitivity of projected net interest income is described as follows:

	100bp parallel increase	100bp parallel decrease	25bp increase at the beginning of each quarter	25bp decrease at the beginning of each quarter
Change in 2016 projected net interest income				
- HKD	844	(2,062)	622	(1,371)
- US\$	891	(1,023)	582	(663)
- other	1,019	(622)	710	(445)
Total	<u>2,754</u>	<u>(3,707)</u>	<u>1,914</u>	<u>(2,479)</u>
Change in 2015 projected net interest income				
- HKD	1,543	(1,960)	1,053	(1,625)
- US\$	753	(648)	511	(606)
- other	686	(670)	543	(451)
Total	<u>2,982</u>	<u>(3,278)</u>	<u>2,107</u>	<u>(2,682)</u>

The interest rate sensitivities set out in the table above represent the effect of the pro forma movements in net interest income based on the projected yield curve scenarios and the Group's current interest rate risk profile. This effect, however, does not incorporate actions that would be taken by BSM or in the business units to mitigate the impact of this interest rate risk. In reality, BSM seeks proactively to change the interest rate risk profile to minimise losses and optimise net revenues. The net interest income sensitivity calculations assume that interest rates of all maturities move by the same amount in the "up-shock" scenario. Rates are not assumed to become negative in the "down-shock" scenario which may, in certain currencies, effectively result in non-parallel shock. In addition, the net interest income sensitivity calculations take account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates over which the entity has discretion in terms of the timing and extent of rate changes.

Sensitivity of reserves (audited)

The Group monitors the sensitivity of reported reserves to interest rate movements at least on a quarterly basis by assessing the expected reduction in valuation of available-for-sale portfolios and cash flow hedges due to parallel movements of plus or minus 100 basis points in all-in yield curves. The table below describes the sensitivity to these movements at the balance sheet dates indicated below and the maximum and minimum month figures during the year:

	At 31 December 2015	Maximum impact	Minimum impact
+ 100 basis points parallel move in all-in yield curves	(1,410)	(1,410)	(998)
As a percentage of shareholders' funds at 31 December 2015 (%)	(1.0)	(1.0)	(0.7)
- 100 basis points parallel move in all-in yield curves	471	526	361
As a percentage of shareholders' funds at 31 December 2015 (%)	0.3	0.4	0.3
	At 31 December 2014	Maximum impact	Minimum impact
+ 100 basis points parallel move in all-in yield curves	(1,031)	(1,031)	(663)
As a percentage of shareholders' funds at 31 December 2014 (%)	(0.7)	(0.7)	(0.5)
- 100 basis points parallel move in all-in yield curves	455	461	311
As a percentage of shareholders' funds at 31 December 2014 (%)	0.3	0.3	0.2

The sensitivities included in the table are illustrative only and are based on simplified scenarios. Moreover, the table shows only those interest rate risk exposures arising in available-for-sale portfolios and from cash flow hedges. These particular exposures form only a part of the Group's overall interest rate exposures.

Management Discussion and Analysis (continued)

Risk Management (continued)

(c) Market risk (continued)

Foreign exchange exposure (audited)

The Group's foreign exchange exposures mainly comprise foreign exchange dealing by Global Markets and currency exposures originated by its banking business. The latter are transferred to Global Markets where they are centrally managed within foreign exchange position limits approved by the RMC. The net options position is calculated on the basis of delta-weighted positions of all foreign exchange options contracts.

The Group's gross structural foreign exchange exposure is represented by the net asset value of the Group's foreign currency investments in subsidiaries, branches and associates, and the fair value of the Group's certain long-term foreign currency equity investments. The Group's structural foreign currency exposures are managed by the Group's ALCO with the primary objective of ensuring, where practical, that the Group's and the Bank's capital ratios are protected from the effect of changes in exchange rates.

At 31 December 2015, the Chinese renminbi ("RMB"), was the currency in which the Group had non-structural foreign currency positions that were not less than 10% of the total net position in all foreign currencies. The Group also had a RMB structural foreign currency position, which was not less than 10% of the total net structural position in all foreign currencies.

The tables below summarise the net structural and non-structural foreign currency positions of the Group.
(unaudited)

	USD	RMB	Other foreign currencies	Total foreign currencies
2015				
Non-structural position				
Spot assets	204,267	148,933	137,573	490,773
Spot liabilities	(169,779)	(128,759)	(66,796)	(365,334)
Forward purchases	320,566	153,574	35,151	509,291
Forward sales	(355,062)	(170,630)	(106,024)	(631,716)
Net options position	212	(328)	121	5
Net long/(short) non- structural position	<u>204</u>	<u>2,790</u>	<u>25</u>	<u>3,019</u>
Structural position	<u>-</u>	<u>15,238</u>	<u>816</u>	<u>16,054</u>
2014				
Non-structural position				
Spot assets	188,559	163,709	83,596	435,864
Spot liabilities	(157,303)	(159,501)	(64,874)	(381,678)
Forward purchases	325,133	147,597	69,666	542,396
Forward sales	(347,341)	(151,149)	(88,460)	(586,950)
Net options position	205	(276)	74	3
Net long/(short) non- structural position	<u>9,253</u>	<u>380</u>	<u>2</u>	<u>9,635</u>
Structural position	<u>-</u>	<u>52,993</u>	<u>669</u>	<u>53,662</u>

Equities exposure (audited)

The Group's equities exposures in 2015 and 2014 are mainly long-term equity investments which are reported as "Financial investments" set out in note 32 to the financial statements. Equities held for trading purpose are included under "Trading assets" set out in note 28 to the financial statements. These are subject to trading limit and risk management control procedures and other market risk regime.

Management Discussion and Analysis (continued)

Risk Management (continued)

(d) Insurance risk

(audited)

Risk management objectives and policies for management of insurance risk

Through its insurance subsidiaries, the Group offers comprehensive insurance products, including life and non-life insurance, to both personal and commercial customers. These insurance operating subsidiaries are subject to the supervision of the Office of the Commissioner of Insurance and are required to observe the relevant compliance requirements stipulated by the Insurance Commissioner.

The Group is exposed to the uncertainty surrounding the timing and severity of insurance claims under its insurance contracts. The Group also has exposure to market risk through its insurance and investment activities.

The Group manages its insurance risk through asset and liability management, underwriting limits, approval procedures for transactions that involve new products or that exceed set limits, risk diversification, pricing guidelines, reinsurance and monitoring of emerging issues, taking into account where appropriate local market conditions and regulatory requirements that apply.

The Group uses several methods to assess and monitor insurance risk exposures for both individual types of risks insured and overall risks. These methods include internal risk measurement models, sensitivity analyses, scenario analyses and stress testing.

The Group measures the risk profile of the insurance manufacturing businesses using an economic capital, where assets and liabilities are measured on a market value basis and a capital requirement is held to ensure that there is less than a 1-in-200 chance of insolvency over the next year, given the risks that the businesses are exposed to. The methodology for the economic capital calculation is largely aligned to the new pan European Solvency II insurance capital regulations, which are applicable from 2016.

The majority of the risk in the insurance business derives from manufacturing activities and can be categorised as insurance risk and financial risk. Insurance risk is the risk, other than financial risk, of loss transferred from the holder of the insurance contract to the insurer. The principal insurance risk faced by the group is that, over time, the combined cost of claims, benefits, administration and acquisition of the contracts may exceed the aggregate amount of premiums received and investment income. The cost of claims and benefits can be influenced by many factors, including mortality and morbidity experience, lapse and surrender rates and, if the policy has discretionary participation features or guaranteed cash benefit, the performance of the assets held to support the liabilities. The severity of the claims and benefits, as well as the timing, is therefore uncertain. Contracts under which the transfer of insurance risk from the policyholder to the group is not significant are classified as investment contracts. Financial risks include market risk, credit risk and liquidity risk.

The theory of probability is applied to the pricing and provisioning for a portfolio of insurance contracts. The principal risk is that the timing and severity of claims is different from expected. Insurance events are, by their nature, incorporated with a certain degree of randomness, and the actual number and size of events during any one year may vary from those estimated using established statistical techniques.

Asset/liability management

The Group actively manages its assets using an approach that considers asset quality, risk profile, diversification, asset/liability matching, liquidity and target investment return. The goal of the investment process is to achieve the target level of investment return with minimum volatility. The Investment Committee of the Group's insurance subsidiary review and approve the investment policy including asset allocation, investment guidelines and limits on a periodic basis, while the Asset and Liability Management Committee provides oversight of the asset/liability management process.

The Group establishes the investment policy for each major insurance product category according to specific product requirements and local regulatory requirement. The investment policy defines the asset allocations and restrictions with an aim to achieve the target investment return in the long term. The estimates and assumptions used in determining the approximate amounts and timing of payments to or on behalf of policyholders for insurance liabilities are regularly re-evaluated. Actual results may deviate from the estimate and assumption and could impact the Group's ability to achieve its asset/liability management goals and objectives.

Management Discussion and Analysis (continued)

Risk Management (continued)

(d) Insurance risk (continued)

The following table shows the composition of assets and liabilities for each major insurance product category.

Balance sheet of insurance subsidiaries by type of contract

	Linked contracts ¹	Non-linked contracts ²	Other assets ³	Total
2015				
Financial assets:				
- financial assets designated at fair value	216	7,626	62	7,904
- derivatives	-	293	-	293
- financial investments	-	79,649	6,825	86,474
- other financial assets	17	4,818	740	5,575
Total financial assets	233	92,386	7,627	100,246
Reinsurance assets	-	5,818	-	5,818
Present value of in-force				
long-term insurance contracts	-	-	11,431	11,431
Other assets	-	5,289	1,504	6,793
Total assets	233	103,493	20,562	124,288
Liabilities under investment contracts				
designated at fair value	159	344	-	503
Liabilities under insurance contracts	71	101,746	-	101,817
Deferred tax	-	-	1,686	1,686
Other liabilities	-	-	1,599	1,599
Total liabilities	230	102,090	3,285	105,605
Shareholders' equity	-	-	18,683	18,683
Total liabilities and shareholders' equity	230	102,090	21,968	124,288
2014				
Financial assets:				
- financial assets designated at fair value	232	10,880	-	11,112
- derivatives	-	86	-	86
- financial investments	-	66,734	6,292	73,026
- other financial assets	15	9,596	1,523	11,134
Total financial assets	247	87,296	7,815	95,358
Reinsurance assets	-	2,820	-	2,820
Present value of in-force				
long-term insurance contracts	-	-	8,263	8,263
Other assets	-	4,321	1,446	5,767
Total assets	247	94,437	17,524	112,208
Liabilities under investment contracts				
designated at fair value	160	335	-	495
Liabilities under insurance contracts	86	92,356	-	92,442
Deferred tax	-	-	1,453	1,453
Other liabilities	-	-	749	749
Total liabilities	246	92,691	2,202	95,139
Shareholders' equity	-	-	17,069	17,069
Total liabilities and shareholders' equity	246	92,691	19,271	112,208

¹ Comprises life linked insurance contracts and linked investment contracts

² Comprises life non-linked insurance contracts and non-linked investment contracts

³ Comprises shareholder assets

Management Discussion and Analysis *(continued)*

Risk Management *(continued)*

(d) Insurance risk *(continued)*

Underwriting strategy

The Group's underwriting strategy seeks diversity to ensure a balanced portfolio and is based on a large portfolio of similar risks over a number of years and, as such, it is believed that this reduces the variability of the outcome.

Reinsurance strategy

The Group reinsures a portion of the insurance risks it underwrites in order to control its exposures to losses and protect capital resources. These reinsurance agreements transfer part of the risk and limit the exposure from each life insured. The amount of each risk retained depends on the Group's evaluation of the specific risk, subject in certain circumstances, to maximum limits based on characteristics of coverage. Under the terms of the reinsurance agreements, the reinsurer agrees to reimburse the ceded amount in the event the claim is paid.

Nature of risks covered

The following gives an assessment of the nature of risks inherent in the Group's main products.

(i) Long-term insurance contracts - non-linked products

The basic feature of long-term non-linked insurance business is to provide guaranteed death benefit determined at the time of policy issue. For insurance products with a savings element, guaranteed surrender and maturity benefit are usually provided. Most of the Group's non-linked products include a discretionary participating feature which allows policyholders to participate in the profits of the life fund. These plans offer a discretionary annual bonus in the form of dividend payable to the policyholders on each policy anniversary date.

In particular, a major block of non-linked products provides policyholders with an option to receive monthly guaranteed and discretionary bonus during a predefined period before maturity.

The principles for the distribution of profits among the policyholders are:

- (i) to recognise the financial condition of the Group's insurance subsidiaries;
- (ii) to take into consideration the reasonable expectation of policyholders and to provide a smooth and stable return over the long term; and
- (iii) to balance the interests between the shareholders and policyholders.

Investment risks are managed through matching assets and liabilities. Investment strategy is to predominantly invest in high quality bonds with some portion in growth assets for return enhancement. Mortality risks are managed through reinsurance and proper underwriting.

The Group has contractual discretion on the dividend declared. In practice the Group considers policyholders' reasonable expectations when declaring dividend levels. It is the Group's intention to maintain a smooth and stable dividend scale which is set based on the long-term expected investment return. An annual review is performed to confirm whether the current dividend scale is supportable taking into account the actual and expected experiences on investment return, policy persistency, claims and expenses.

Management Discussion and Analysis *(continued)*

Risk Management *(continued)*

(d) Insurance risk *(continued)*

(ii) Long-term insurance contracts - linked products

The Group writes linked life insurance policies, which provide policyholders with life insurance protection and investment in a variety of funds. Premiums received are deposited into the chosen funds after deduction of premium fees. Other charges for the cost of insurance and administration will be deducted from the funds accumulated.

Although the policyholders bear the market risk on linked products, the Group assumes reputational risk for any undue market risk taken by the policyholders. Consequently, it is in the Group's interest to ensure that the policyholders' exposure to market risk is consistent with any market risk information that the Group has communicated to the policyholders.

Claims and expenses experiences are reviewed regularly to ensure current charges are sufficient to cover the costs.

(iii) Long-term investment contracts - non-linked products

The Group underwrites retirement fund business which gives rise to contracts that are classified as investment contracts. Under each retirement scheme, employers and employees are given a choice of funds to place their contributions. The accumulated fund balance will be payable to scheme members upon retirement or termination of employment. The Group provides capital and minimum return guarantees on these funds. Guaranteed risks are managed through investment in good quality fixed rate bonds. Investment strategy is set with the objective of providing return that is sufficient to meet at least the minimum guarantee.

(iv) Long-term investment contracts - linked products

The Group underwrites retirement fund business which gives rise to contracts that are classified as investment contracts. Under each retirement scheme, employers and employees are given a choice of funds to place their contributions. The accumulated fund balance will be payable to scheme members upon retirement or termination of employment. Although the scheme members bear the market risk on linked products, the Group assumes reputational risk for any undue market risk taken by the scheme members. Consequently, it is in the Group's interest to ensure that the scheme members' exposure to market risk is consistent with any market risk information that the Group has communicated to the scheme members.

Insurance risk is principally measured in terms of liabilities under the contracts in force. Details of the analysis of life insurance liabilities are disclosed in note 45. Since the Group is not exposed to significant insurance risk on investment contracts, they have not been included in the insurance risk management analysis.

Management Discussion and Analysis *(continued)*

Risk Management *(continued)*

(d) Insurance risk *(continued)*

Concentration of insurance risks

Within the insurance process, concentrations of insurance risk may arise where a particular event or series of events could impact the Group's liabilities. Such concentrations may arise from a single insurance contract or through a number of related contracts, and related circumstances where liabilities could arise.

The Group is subject to concentration risk arising from claims relating to common carriers, epidemics, natural disasters, etc, that affect the lives of the policyholders insured by the Group. To mitigate some of these risks, catastrophe reinsurance arrangements have been made by the Group.

For contracts where death is the insured risk, the most significant factors that could increase the overall frequency of claims are epidemics (such as acquired immunodeficiency syndrome ("AIDS"), severe acute respiratory syndrome ("SARS") or a human form of avian flu) or widespread changes in lifestyle, resulting in earlier or more claims than expected. For contracts where survival is the insured risk, the most significant factor is improvement in medical science and social conditions that would increase longevity. The insurance contracts issued by the Group are issued in Hong Kong.

To determine the concentration of insurance risks, analyses are performed to investigate the potential financial impact on the Group. Total loss is estimated based on the chosen stress level. Details of the Group's reinsurance strategy are disclosed in the above.

Life business tends to be longer-term in nature than non-life business and frequently involves an element of savings and investment in the contract. An analysis of life insurance liabilities are therefore an appropriate overall measure of insurance exposure, because provisions for life contracts are typically set by reference to expected future cash outflows relating to the underlying policies. Details of the analysis of life insurance liabilities are disclosed in note 45 to the financial statements.

Management Discussion and Analysis (continued)

Risk Management (continued)

(d) Insurance risk (continued)

Financial risks

Transactions in financial instruments may result in the Group assuming financial risks. These include market risk, credit risk and liquidity risk. Each of these financial risks is described below, together with a summary of the ways in which the Group manages these risks.

The Group is also exposed to investment return guarantee risk for certain investment contracts issued to policyholders. The risk is that the yield on the assets held by the Group to meet these guarantees may fall short of the guaranteed return. The framework for the management of this risk is to adopt a matching approach whereby assets held are managed to meet the liability to policyholders. An additional provision is established where analysis indicates that, over the life of the contracts, the returns from the designated assets may not be adequate to cover the related liabilities.

The balance sheet of insurance manufacturing subsidiaries by type of contract above analyses the assets held in our insurance manufacturing subsidiaries at 31 December 2015, and provides a view of the exposure to financial risk.

For linked contracts, which pay benefits to policyholders determined by reference to the value of the investments supporting the policies, the group typically designates assets at fair value. For non-linked contracts, the classification of the assets is driven by the nature of the underlying contract.

Approximately 86.3% (2014: 76.6%) of financial assets were invested in debt securities at 31 December 2015, with 6.8% (2014: 11.6%) invested in equity securities.

Under linked contracts, premium income less charges levied is invested in a portfolio of assets. The group manage the financial risks of this product on behalf of the policyholders by holding appropriate assets in segregated funds or portfolios to which the liabilities are linked. These assets represented 0.2% (2014: 0.3%) of the total financial assets of the group's insurance manufacturing subsidiary at the end of 2015.

The remaining financial risks are managed either solely on behalf of the shareholder, or jointly on behalf of the shareholder and policyholders where the discretionary participation mechanism exists.

Market risk

Market risk can be described as the risk of change in fair value of a financial instrument due to change in interest rate, equity prices and foreign currency exchange rates. Each of these categories is discussed further below.

Interest rate risk

The insurance subsidiaries of the Group are exposed to interest rate risk because there is a chance that the yields earned on its debt securities holding are lower than the investment returns implied by the guarantees payable to policyholders. The held-to-maturity debt securities account for a significant portion of the debt securities holding which is managed to match expected liability payments. The Group monitors this exposure through periodic reviews of its asset and liability position. Estimates of cash flows, as well as the impact of interest rate fluctuations relating to the investment portfolio and insurance reserves, are modelled and reviewed regularly. The overall objective of these strategies is to manage the net changes in the value of assets and liabilities arising from interest rate movements.

For participating products, interest rate risk can also be mitigated through sharing of risk with policyholders under the discretionary participation feature.

Management Discussion and Analysis (continued)

Risk Management (continued)

(d) Insurance risk (continued)

Interest rate risk (continued)

An immediate and permanent movement in interest yield curves as at 31 December 2015 in all territories in which the Group's insurance subsidiaries operate would have the following impact on the aggregated profit after tax for the year and shareholders' equity at that date:

	2015		2014	
	Impact on profit after tax for the year	Impact on shareholders' equity	Impact on profit after tax for the year	Impact on shareholders' equity
+ 100 basis points parallel shift in yield curves	3	(295)	427	84
- 100 basis points parallel shift in yield curves	(247)	91	(491)	(93)

The interest rate sensitivities set out above are illustrative only and employ simplified scenarios. It should be noted that the effects may not be linear and therefore the results cannot be extrapolated. The effects are calculated taking into account the sharing of investment returns with policyholders through the discretionary participating feature. Other than that, they do not incorporate other actions that could be taken by management to mitigate the effect of the interest rate movements, nor do they take into account any resultant changes in policyholder behaviour.

Equity price risk

The portfolio of marketable securities (including collective investment schemes) backing non-linked insurance contracts and shareholders' fund, which the insurance subsidiaries of the Group carries in the balance sheet at fair value, has exposure to price risk. This risk is defined as the potential loss in market value resulting from an adverse change in prices. The risks are mainly mitigated through tactic asset allocation or hedging strategy and sharing the risk with policyholders through the discretionary participation feature. The Group's objective is to earn competitive returns by investing in a diversified portfolio of high quality and liquid securities. Portfolio characteristics are analysed regularly and equity price risk is regularly reviewed. The Group's investment portfolios are diversified across countries and industries, and concentrations in any one company or industry are limited by parameters established by senior management, as well as by statutory requirements.

The following table illustrates the impact on the aggregated profit after tax for the year and shareholders' equity of a reasonably possible 10 per cent variance in equity prices:

	2015		2014	
	Impact on profit after tax for the year	Impact on shareholders' equity	Impact on profit after tax for the year	Impact on shareholders' equity
10 per cent increase in equity prices	251	251	337	337
10 per cent decrease in equity prices	(196)	(196)	(300)	(300)

These equity sensitivities are illustrative only and employ simplified scenarios. It should be noted that the effects may not be linear and therefore the results cannot be extrapolated. The impact is estimated taking into account the sharing of risk through the discretionary participation feature.

Foreign currency risk

The assets and liabilities of the insurance subsidiaries of the Group are mainly denominated in USD, RMB and Hong Kong dollar ("HKD"). The Group adopts a policy of predominately matching the assets with liabilities in the same currency, effectively reducing the foreign currency exchange rate exposure. Limits are set to ensure that the net foreign currency exposure is kept to an acceptable level. The Group uses foreign exchange contracts to manage its foreign currency risk. Most of the foreign exchange contracts have maturities of less than one year after the balance sheet date.

Management Discussion and Analysis (continued)

Risk Management (continued)

(d) Insurance risk (continued)

Credit risk

The insurance subsidiaries of the Group's credit risk is primarily attributable to the portfolio of debt securities and loans and receivables. This risk is defined as the potential loss in market value resulting from adverse changes in a borrower's ability to repay the debt. The Group's objective is to earn relative competitive returns by investing in a diversified portfolio of securities. Management has a credit policy in place. Limits are established to manage credit quality and concentration risk. The following table presents the analysis of treasury bills, other eligible bills and debt securities within the Group's insurance operations.

Treasury bills, other eligible bills and debt securities in insurance operations

	Neither past due nor impaired			Past due but not impaired	Impaired	Impairment allowances	Total
	Strong	Medium	Sub- standard				
2015							
Supporting liabilities under non-linked insurance and investment contracts							
Financial assets designated at fair value:							
- treasury and other eligible bills	1,008	-	-	-	-	-	1,008
- debt securities	64	2	-	-	-	-	66
	<u>1,072</u>	<u>2</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,074</u>
Financial investments:							
- treasury and other similar bills	-	-	-	-	-	-	-
- debt securities	70,154	9,495	-	-	-	-	79,649
	<u>70,154</u>	<u>9,495</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>79,649</u>
Supporting shareholders funds							
Financial assets designated at fair value:							
- treasury and other eligible bills	62	-	-	-	-	-	62
- debt securities	-	-	-	-	-	-	-
	<u>62</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>62</u>
Financial investments:							
- treasury and other similar bills	-	-	-	-	-	-	-
- debt securities	6,772	25	-	-	-	-	6,797
	<u>6,772</u>	<u>25</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,797</u>
Total							
Financial assets designated at fair value:							
- treasury and other eligible bills	1,070	-	-	-	-	-	1,070
- debt securities	64	2	-	-	-	-	66
	<u>1,134</u>	<u>2</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,136</u>
Financial investments:							
- treasury and other similar bills	-	-	-	-	-	-	-
- debt securities	76,926	9,520	-	-	-	-	86,446
	<u>76,926</u>	<u>9,520</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>86,446</u>

Management Discussion and Analysis (continued)

Risk Management (continued)

(d) Insurance risk (continued)

	Neither past due nor impaired			Past due but not impaired	Impaired	Impairment allowances	Total
	Strong	Medium	Sub- standard				
2014							
Supporting liabilities under non-linked insurance and investment contracts							
Financial assets designated at fair value:							
- treasury and other eligible bills	-	-	-	-	-	-	-
- debt securities	70	5	-	-	-	-	75
	<u>70</u>	<u>5</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>75</u>
Financial investments:							
- treasury and other similar bills	-	-	-	-	-	-	-
- debt securities	58,263	8,471	-	-	-	-	66,734
	<u>58,263</u>	<u>8,471</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>66,734</u>
Supporting shareholders funds							
Financial assets designated at fair value:							
- treasury and other eligible bills	-	-	-	-	-	-	-
- debt securities	-	-	-	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Financial investments:							
- treasury and other similar bills	-	-	-	-	-	-	-
- debt securities	6,229	40	-	-	-	-	6,269
	<u>6,229</u>	<u>40</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,269</u>
Total							
Financial assets designated at fair value:							
- treasury and other eligible bills	-	-	-	-	-	-	-
- debt securities	70	5	-	-	-	-	75
	<u>70</u>	<u>5</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>75</u>
Financial investments:							
- treasury and other similar bills	-	-	-	-	-	-	-
- debt securities	64,492	8,511	-	-	-	-	73,003
	<u>64,492</u>	<u>8,511</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>73,003</u>

Management Discussion and Analysis (continued)

Risk Management (continued)

(d) Insurance risk (continued)

The Group also has insurance and other receivables subject to credit risk. The most significant of these arise from the inability to honour their debtor balances when due and their share of liabilities under insurance contracts. To mitigate the risk of reinsurers, the Group has established certain business and financial guidelines for reinsurer approval, incorporating ratings by major agencies and considering currently available market stability of reinsurers and other sources and the settlement trend of amounts due from reinsurers. The split of liabilities ceded to reinsurers and outstanding reinsurance recoveries was as follows:

Reinsurers' share of liabilities under insurance contracts

	Neither past due nor impaired			Past due but not impaired	Impaired	Impairment allowances	Total
	Strong	Medium	Sub- standard				
2015							
Linked insurance contracts	-	-	-	-	-	-	-
Non-linked insurance contracts	<u>5,782</u>	-	-	-	-	-	<u>5,782</u>
Total	<u>5,782</u>	-	-	-	-	-	<u>5,782</u>
Reinsurance Debtors	5	-	-	31	-	-	36
2014							
Linked insurance contracts	-	-	-	-	-	-	-
Non-linked insurance contracts	<u>2,776</u>	-	-	-	-	-	<u>2,776</u>
Total	<u>2,776</u>	-	-	-	-	-	<u>2,776</u>
Reinsurance Debtors	4	-	-	40	-	-	44

Management Discussion and Analysis (continued)

Risk Management (continued)

(d) Insurance risk (continued)

Liquidity risk

The Group has to meet daily calls on its cash resources, notably from claims arising on its insurance and investment contracts and early surrender of policies for surrender value. There is a risk that cash will not be available to settle liabilities when due at a reasonable cost. The Group manages this risk by monitoring and setting an appropriate level of operating funds to settle these liabilities. The risk monitoring includes stress testing and the Group's credit rating. Investment portfolios are also structured with regard to the liquidity requirements of each underlying fund, and early surrender penalties and market adjustment clauses are used to defray costs of unexpected cash requirements.

The following table shows the expected maturity of insurance contract liabilities at balance sheet dates:

Expected maturity of insurance contract liabilities

	Expected cash flows (undiscounted)				Total
	Within 1 year	Over 1 year but within 5 years	Over 5 years but within 15 years	Over 15 years	
2015					
Non-linked insurance	10,681	41,821	80,246	64,721	197,469
Linked insurance	7	33	93	389	522
	<u>10,688</u>	<u>41,854</u>	<u>80,339</u>	<u>65,110</u>	<u>197,991</u>
2014					
Non-linked insurance	7,918	36,983	84,607	59,937	189,445
Linked insurance	9	40	110	502	661
	<u>7,927</u>	<u>37,023</u>	<u>84,717</u>	<u>60,439</u>	<u>190,106</u>

Remaining contractual maturity of investment contract liabilities

	Linked investment contracts	Non-linked investment contracts	Total
2015			
Remaining contractual maturity:			
- due within 1 year	2	-	2
- due over 1 year but within 5 years	-	-	-
- due over 5 years but within 10 years	-	-	-
- due over 10 years	-	-	-
- undated	157	344	501
	<u>159</u>	<u>344</u>	<u>503</u>
2014			
Remaining contractual maturity:			
- due within 1 year	2	-	2
- due over 1 year but within 5 years	-	-	-
- due over 5 years but within 10 years	-	-	-
- due over 10 years	-	-	-
- undated	158	335	493
	<u>160</u>	<u>335</u>	<u>495</u>

Management Discussion and Analysis (continued)

Risk Management (continued)

(d) Insurance risk (continued)

Present value of in-force long-term insurance business ("PVIF")

The Group's life insurance business is accounted for using the embedded value approach, which, inter alia, provides a comprehensive framework for the evaluation of insurance and related risks. The value of the PVIF asset before tax at 31 December 2015 was HK\$11,431 million (31 December 2014: HK\$8,263 million). The present value of the shareholders' interest in the profits expected to emerge from the book of in-force policies at balance sheet dates can be stress-tested to assess the sensitivity of the value of life business to adverse movement of different risk factors.

The following table shows the effect on the PVIF at balance sheet date of reasonably possible changes in the main economic and business assumptions:

	2015	2014
+ 100 basis points parallel shift in yield curves	8	516
- 100 basis points parallel shift in yield curves	(301)	(594)

The effects on PVIF shown above are illustrative only and employ simplified scenarios. It should be noted that the effects may not be linear and therefore the results cannot be extrapolated. The effects are calculated taking into account the sharing of investment returns with policyholders through the discretionary participation feature. Other than that, they do not incorporate other actions that could be taken by management to mitigate effects nor do they take into account the consequential changes in policyholder behaviour.

Non-economic assumptions

The sensitivity of profit for the year and net assets to reasonably possible changes in assumptions used in respect of insurance businesses is as follows:

	Impact on 2015 results		Impact on 2014 results	
	Profit for the year	Net assets	Profit for the year	Net assets
10 per cent increase in mortality and/or morbidity rates	(63)	(63)	(66)	(66)
10 per cent decrease in mortality and/or morbidity rates	57	57	65	65
10 per cent increase in lapse rates	(9)	(9)	(13)	(13)
10 per cent decrease in lapse rates	11	11	15	15
10 per cent increase in expense rates	(56)	(56)	(104)	(104)
10 per cent decrease in expense rates	56	56	104	104

Process used to determine assumptions for long-term insurance contracts

The process used to determine the assumptions is intended to result in stable and prudent estimates of future outcome. This is achieved by adopting relatively conservative assumptions which can withstand a reasonable range of fluctuation of actual experience. Annual review of the relevant experience is performed to assess the adequacy of margin between the assumptions adopted and the best estimate of future outcome. The assumptions that are considered include expenses and the probability of claims. Both risk discount rate and investment return assumptions are set on active basis with reference to market risk free yields.

For non-linked life business, the policy reserve is generally calculated on a modified net premium basis. The net premium is the level of premium payable over the premium payment period whose discounted value at the outset of the policy would be sufficient to exactly cover the discounted value of the original guaranteed benefits at maturity or at death if earlier. The net premium is then modified to allow for deferral of acquisition costs. The policy reserve is then calculated by subtracting the present value of future modified net premiums from the present value of the benefits guaranteed at maturity or death up to the balance sheet date, subject to a floor of the cash value. The modified net premium basis makes no allowance for voluntary discontinuance by policyholders as this would generally result in a reduced level of policy reserve.

For linked life business, the policy reserve is generally determined as the total account balance of all in-force policies with an additional provision for the unexpired insurance risk.

Management Discussion and Analysis (continued)

Risk Management (continued)

(d) Insurance risk (continued)

Assumptions

The principal assumptions underlying the calculation of the long-term insurance business provision are:

(i) Mortality

A base mortality table which is most appropriate for each type of contract is selected. An adjustment is included to reflect the Group's own experience with an annual investigation performed to ascertain the appropriateness of overall assumption.

(ii) Morbidity

The morbidity incidence rates, which mainly cover major illness and disability, are generally derived from the reinsurance costs which also form the pricing basis. A loading is generally added as a provision for adverse deviation. An annual investigation is performed to ascertain the appropriateness with the Group's insurance subsidiary's actual experience.

(iii) Discount rates

Rate of interest

	2015	2014
Policies denominated in HKD	2.75%	3.00%
Policies denominated in USD	3.75%	4.00%
Policies denominated in RMB	2.32%, 2.90%, 3.00% and 3.50%	2.32%, 2.90%, and 3.50%
	as varies by product	as varies by product

Under the modified net premium method, the long-term business provision is sensitive to the interest rate used when discounting.

Sensitivity to changes in variables

The Group's insurance subsidiary re-runs its valuation models on various bases. An analysis of sensitivity around various scenarios provides an insight to the key risks which the Group's insurance company is exposed to. The table presented below demonstrates the sensitivity of insured liability estimates to particular movements in assumptions used in the estimation process. Certain variables can be expected to impact on life insurance liabilities more than others, and consequently a greater degree of sensitivity to these variables may be expected.

Impact on reported profit to changes in key variable

	Change in variable %	Change in liabilities 2015	2014
Base run		87,959	82,608
Discount rate	+1	(2,189)	(1,452)
Discount rate	-1	8,649	5,839
Mortality/Morbidity	+10	99	32
Mortality/Morbidity	-10	(60)	(19)

The analysis above has been prepared for a change in variable with all other assumptions remaining constant and ignores changes in values of the related assets.

For the sensitivity in discount rate, an absolute +/-1% of the discount rate is used. For the Mortality/ Morbidity sensitivity, a relative +/-10% (i.e. multiply the assumption by 110% or 90%) is used.

Management Discussion and Analysis (continued)

Risk Management (continued)

(e) Operational risk

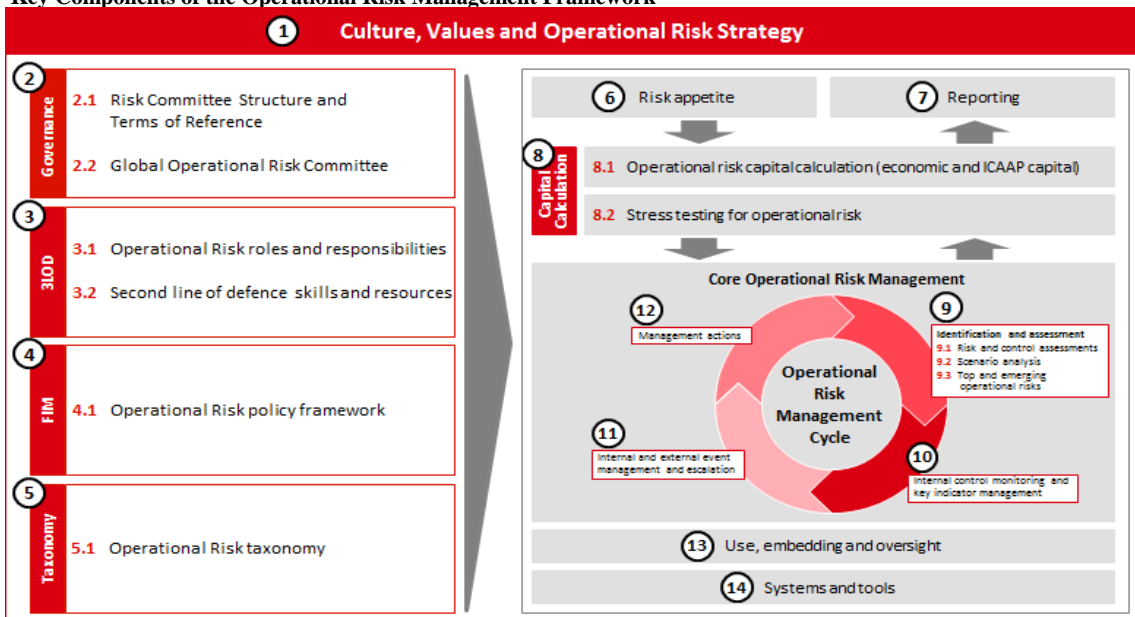
Operational risk is relevant to every aspect of our business and covers a wide spectrum of issues, in particular legal, compliance, security and fraud. Losses arising from breaches of regulation and law, unauthorised activities, error, omission, inefficiency, fraud, systems failure or external events all fall within the definition of operational risk.

Responsibility for minimising operational risk lies with HASE’s management and staff in particular every employee plays a role in managing operational risk at HASE. Accountability for managing and controlling risks lies directly with individual risk owners.

Operational risk management framework (audited)

HASE’s Operational Risk Management Framework (ORMF) is our overarching approach for managing operational risk in accordance with our business and operational risk strategies. The purpose of the ORMF is to make sure we fully identify and manage our operational risks in an effective manner and maintain our targeted levels of operational risk within the Bank’s risk appetite, as defined by the Board. HASE adopts the HSBC Group’s ORMF which comprises the 14 key components set below.

Key Components of the Operational Risk Management Framework



Three lines of defence

The Three Lines of Defence model is essential to delivering strong risk management within the Bank. It defines who is responsible to do what to identify, assess, measure, manage, monitor, and mitigate operational risks, encouraging collaboration and enabling efficient coordination of risk and control activities.

- The first line of defence is accountable for managing and monitoring operational risk in the business.
- The second line is responsible for providing risk oversight, challenge, advice and insights to the business.
- The third line of defence independently assures that the Bank is managing operational risk effectively.

Having a strong Three Lines of Defence model in operation across the Bank enables us to identify and effectively manage operational risks.

Activity to strengthen our operational risk culture and to better embed the use of our ORMF continued in 2015. In particular, we continued to streamline our operational risk management processes, procedures and tool sets to provide more forward-looking risk insights and more effective operation of the ORMF. A diagrammatic representation of the ORMF is presented above.

Articulating our risk appetite for material operational risks helps the organisation understand the level of risk the Bank is willing to accept. The operational risk appetite is approved annually by the Risk Management Committee. Monitoring operational risk exposure against risk appetite on a regular basis and implementing our risk acceptance process drives risk awareness in a forward-looking manner. It assists management in determining whether further action is required.

(e) **Operational risk** *(continued)*

*Key operational risks
(unaudited)*

- *Fraud and financial crime*: the threat of fraud perpetrated by or against our customers, especially in retail and commercial banking, may increase during adverse economic conditions. We have increased monitoring, root cause analysis and review of internal controls to enhance our defences against external attacks and reduce the level of loss in these areas. In addition, Security and Fraud Risk work closely with businesses to continually assess these threats as they evolve and adapt our controls to mitigate them. The Bank is also exposed to potential criminal activities and has invested heavily in improving its customer due diligence and transaction monitoring and screening controls.
- *Regulatory compliance*: our ability to respond to increasing demands or changes in regulatory requirements in the markets in which we operate remains a critical focus for the Bank. A Global Standards programme is being rolled out to ensure implementation of critical regulatory and financial crime compliance requirements. Various conduct and values initiatives have also been initiated to ensure that exposures to mis-selling or market conduct abuses are minimised.
- *Information security*: the security of our information and technology infrastructure is crucial for maintaining our banking applications and processes while protecting our customers and our franchise. A failure of our defences against such attacks could result in financial loss, loss of customer data and other sensitive information which could undermine both our reputation and our ability to retain the trust of our customers.

Management Discussion and Analysis *(continued)*

(Figures expressed in millions of Hong Kong dollars unless otherwise indicated)

Capital Management

(audited)

The Group's objective for managing capital is to maintain a strong capital base to support the development of its business and to meet regulatory capital requirements at all times. The Group recognises the impact of different level of equity capital on shareholder returns and seeks to maintain a prudent balance between advantages and flexibility provided by a strong capital position and higher returns on equity through greater leverage.

An annual Group capital plan is prepared and approved by the Board with the objectives of maintaining an optimal amount of capital and a suitable mix between different components of capital. The Group manages its own capital within the context of the approved annual capital plan, which determines level of risk-weighted asset ("RWA") growth as well as the optimal amount and components of capital required to support planned business growth. As part of the Group's capital management policy, subsidiary with capital generated in excess of planned requirement will return to the Bank, normally by way of dividends. The Group also raised subordinated debt in accordance with HSBC Group's guidelines regarding market and investor concentration, cost, market conditions, timing and maturity profile.

The Bank is primarily a provider of equity capital to its subsidiaries. These investments are substantially funded by the Bank's own capital and profit. The Bank seeks to maintain a prudent balance between the composition of its capital and that of its investment in subsidiaries.

The principal forms of capital are included in the following balances on the consolidated balance sheet: called up share capital, retained profits, other equity instruments, other reserves and subordinated liabilities. Capital also includes the collectively impairment allowances and regulatory reserve for general banking risks as allowed under Banking (Capital) Rules.

Externally imposed capital requirements

(audited)

The HKMA supervises the Group on a consolidated and solo-consolidated basis and, as such, receives information on the capital adequacy of, and sets capital requirements for, the Group as a whole. Individual banking subsidiaries are directly regulated by their local banking supervisors, who set and monitor their capital adequacy requirements. Certain non-banking financial subsidiaries are also subject to the supervision and capital requirements of local regulatory authorities.

The Group uses the advanced internal ratings-based approach ("IRB") to calculate its credit risk for the majority of its non-securitisation exposures. For market risk, the Group uses an internal models approach to calculate its general market risk for the risk categories of interest rate and foreign exchange (including gold bullion) exposures and the standardised (market risk) approach for calculating other market risk positions. For operational risk, the Group uses the standardised (operational risk) approach to calculate its operational risk.

During the year, the Group has complied with all of the externally imposed capital requirements by the HKMA.

Basel III

(unaudited)

The Basel III rules set out the minimum capital requirements, to be phased in sequentially from 1 January 2013, becoming fully effective on 1 January 2019 with ultimate CET1 capital ratio and capital conservation buffer minimum requirements at 4.5% and 2.5% respectively. In addition to the criteria detailed in the Basel III proposals, the BCBS issued further minimum requirements in January 2011 to ensure that all classes of capital instruments are able to absorb losses at the point of non-viability before taxpayers are exposed to loss. Instruments issued on or after 1 January 2013 may only be included in regulatory capital if the new requirements are met. The capital treatment of instruments issued prior to this date that meet the grandfathering conditions will be phased out over a 10-year period commencing on 1 January 2013.

The Banking (Capital) (Amendment) Rules 2012, effective on 1 January 2013, signified the first phase of Basel III requirements in Hong Kong. The changes in minimum capital ratio requirements are phased in from 1 January 2013 to 1 January 2019, while the capital treatment for counterparty credit risk is effective from 1 January 2013.

Management Discussion and Analysis *(continued)*

Capital Management *(continued)*

Basel III *(continued)* *(unaudited)*

The Banking (Capital) (Amendment) Rules 2014 came into effect on 1 January 2015 to implement the Basel III capital buffer requirements in Hong Kong. The changes include the phasing-in from 2016 to 2019 of the Capital Conservation Buffer ("CCB") which is designed to ensure banks build up capital outside periods of stress of 2.5% of RWAs, the Countercyclical Capital Buffer ("CCyB") which is set on an individual country basis and is built up during periods of excess credit growth to protect against future losses, and the Higher Loss Absorbency ("HLA") requirements for Domestic Systemically Important Banks ("D-SIB"). On 27 January 2015 and 14 January 2016, the HKMA announced a CCyB for Hong Kong of 0.625% and 1.25% of RWAs from 1 January 2016 and 1 January 2017 respectively under the phase-in arrangements of Basel III, equivalent to 2.5% once fully phased in. On 16 March 2015 and 31 December 2015, the HKMA announced its designation of the Bank as a D-SIB in Hong Kong and required the Bank to establish 0.375% and 0.75% of risk-weighted assets for HLA from 1 January 2016 and 1 January 2017 respectively under the phase-in arrangement, equivalent to 1.5% on full implementation.

In addition, the Bank will be required to set further buffers to reflect risks not included in the regulatory capital calculation, arising from internal assessment of risks and the results of stress tests. As a consequence of the developments outlined above, there remains uncertainty over the timing and trajectory of implementation of the full Basel III capital requirements and residual uncertainty as to the minimum levels of capital that the Bank will be required to hold.

Leverage ratio *(unaudited)*

The leverage ratio was introduced into the Basel III framework as a non-risk-based backstop limit, to supplement risk-based capital requirements. It aims to constrain the build-up of excess leverage in the banking sector, introducing additional safeguards against model risk and measurement errors. The ratio is a volume-based measure calculated as Basel III tier 1 capital divided by total on- and off-balance sheet exposures. Basel III provides for a transitional period for the introduction of this ratio, comprising a supervisory monitoring period that started in 2011 and a parallel run period from January 2013 to January 2017. The parallel run will be used to assess whether the proposed minimum ratio of 3% is appropriate, with a view to migrating to a Pillar 1 requirement from 1 January 2018.

RWA planning *(unaudited)*

Pre-tax return on RWAs is an operational metric by which the global businesses are managed on a day-to-day basis. The metric combines return on equity and regulatory capital efficiency objectives. RWA targets, approved annually by the Board, are established for our global businesses and regions in accordance with the Group's strategic direction and risk appetite.

Business performance against the targets is monitored through reporting to the Asset and Liability Committee of the Bank. A range of analysis is employed in the RWA monitoring framework to identify the key drivers of movements in the position, such as book size and book quality. Particular attention is paid to identifying and segmenting items within the day-to-day control of the business and those items that are driven by changes in risk models or regulatory methodology.

Capital base *(unaudited)*

The following tables show the capital base, RWAs and capital ratios as contained in the "Capital Adequacy Ratio" return required to be submitted to the HKMA by the Bank on consolidated basis as specified by the HKMA under the requirements of section 3C(1) of the Banking (Capital) Rules.

The Bank and its subsidiaries maintain a regulatory reserve to satisfy the provisions of the Banking Ordinance and local regulatory requirements for prudential supervision purposes. At 31 December 2015, the effect of this requirement is to restrict the amount of reserves which can be distributed to shareholders by HK\$6,610 million (31 December 2014: HK\$6,229 million).

Management Discussion and Analysis (continued)

Capital Management (continued)

Capital base (continued)

The following table sets out the composition of the Group's capital base under Basel III at 31 December 2015 and 31 December 2014. A more detailed breakdown of the capital position is available in the Regulatory Disclosures section of our website www.hangseng.com.

	2015	2014
Common Equity Tier 1 ("CET1") Capital		
Shareholders' equity	120,963	120,407
- Shareholders' equity per balance sheet	141,981	139,193
- Additional Tier 1 ("AT1") perpetual capital instrument	(6,981)	(6,981)
- Unconsolidated subsidiaries	(14,037)	(11,805)
Regulatory deductions to CET1 capital	(30,687)	(47,201)
- Cash flow hedging reserve	(11)	-
- Changes in own credit risk on fair valued liabilities	(6)	(4)
- Property revaluation reserves ¹	(23,135)	(21,784)
- Regulatory reserve	(6,610)	(6,229)
- Intangible assets	(421)	(417)
- Defined benefit pension fund assets	(35)	(35)
- Deferred tax asset net of deferred tax liabilities	(115)	(80)
- Valuation adjustments	(354)	(325)
- Significant capital investments in unconsolidated financial sector entities	-	(8,436)
- Excess AT1 deductions	-	(9,891)
Total CET1 Capital	90,276	73,206
AT1 Capital		
Total AT1 capital before regulatory deductions	6,981	6,981
- Perpetual capital instrument	6,981	6,981
Regulatory deductions to AT1 capital	-	(6,981)
- Significant capital investments in unconsolidated financial sector entities	-	(16,872)
- Excess AT1 deductions	-	9,891
Total AT1 Capital	6,981	-
Total Tier 1 ("T1") Capital	97,257	73,206
Tier 2 ("T2") Capital		
Total T2 capital before regulatory deductions	15,746	17,733
- Term subordinated debt	2,325	5,117
- Property revaluation reserves ¹	10,411	9,803
- Impairment allowances and regulatory reserve eligible for inclusion in T2 capital	3,010	2,813
Regulatory deductions to T2 capital	(315)	(17,187)
- Significant capital investments in unconsolidated financial sector entities	(315)	(17,187)
Total T2 Capital	15,431	546
Total Capital	112,688	73,752

¹ Includes the revaluation surplus on investment properties which is reported as part of retained profits and related adjustments made in accordance with the Banking (Capital) Rules issued by the HKMA.

Management Discussion and Analysis *(continued)*

Capital Management *(continued)*

Risk-weighted assets by risk type

(unaudited)

	2015	2014
Credit risk		
Standardised approach	41,834	37,402
IRB approach	401,539	378,583
Central Clearing Counterparty	4	-
Credit Valuation Adjustment	3,376	2,895
Market risk	13,698	5,749
Operational risk	49,023	45,538
Total	<u>509,474</u>	<u>470,167</u>

Market risk-weighted assets

(unaudited)

	2015	2014
Internal models approach		
Value at Risk ("VAR")	3,553	1,623
Stressed VAR	8,811	3,442
Standardised approach		
Specific interest rate exposures	1,334	684
Equity exposures	-	-
Total	<u>13,698</u>	<u>5,749</u>

Capital ratios (as a percentage of risk-weighted assets)

(unaudited)

The capital ratios on consolidated basis calculated in accordance with the Banking (Capital) Rules are as follows:

	2015	2014
CET1 capital ratio	17.7%	15.6%
Tier 1 capital ratio	19.1%	15.6%
Total capital ratio	22.1%	15.7%

The Basel III rules set out the minimum capital requirements, to be phased in sequentially from 1 January 2013 and become fully effective on 1 January 2019. On a pro-forma basis that takes no account of, for example, any future profits or management action and any change in the current regulations or their application before full implementation, the Group's capital ratios at Basel III end point are the same as above. Given the pro-forma Basel III end point basis position is a mechanical application of the current rules to the capital base as at 31 December 2015, it is not a projection.

Management Discussion and Analysis (continued)

Capital Management (continued)

Principal subsidiaries and basis of consolidation (unaudited)

The basis of consolidation for financial accounting purposes is in accordance with Hong Kong Financial Reporting Standards ("HKFRS"), as described in note 1 to the financial statements.

The basis of consolidation for regulatory purposes is different from that for accounting purposes. Subsidiaries included in the consolidation for regulatory purposes are specified in a notice from the HKMA in accordance with section 3C(1) of the Banking (Capital) Rules.

Subsidiaries not included in consolidation for regulatory purposes are securities and insurance companies that are authorised and supervised by a regulator and are subject to supervisory arrangements regarding the maintenance of adequate capital to support business activities comparable to those prescribed for authorised institutions under the Banking (Capital) Rules and the Banking Ordinance. The capital invested by the Group in these subsidiaries is deducted from the capital base as determined in accordance with Part 3 of the Banking (Capital) Rules.

A list of these subsidiaries is shown below:

	Principal activities	2015		2014	
		Total assets*	Total equity*	Total assets*	Total equity*
Hang Seng (Nominee) Ltd #	Nominee service	N/A	N/A	-	-
Hang Seng Bank (Trustee) Ltd #	Trustee service	N/A	N/A	5	3
Hang Seng Futures Ltd	Futures brokerages	102	102	103	102
Hang Seng Investment Management Ltd	Fund management	946	910	870	557
Hang Seng Investment Services Ltd	Provision of investment commentaries	9	9	9	9
Hang Seng Securities Ltd	Stockbroking	2,493	1,596	4,462	1,329
Hang Seng Insurance Co. Ltd and its subsidiaries	Retirement benefits and life assurance	112,857	9,139	103,945	10,170

* Prepared in accordance with HKFRS

With effect from 1 January 2015, these entities are included in consolidation for regulatory purposes.

For insurance entities, the figures shown above exclude deferred acquisition cost assets as these are derecognised for consolidation purpose due to the recognition of the present value of in-force long-term insurance business ('PVIF') on long-term insurance contracts and investment contracts with discretionary participation features at group level. The PVIF asset of HK\$11,431m (2014: HK\$8,263m) and the related deferred tax liability, however, are recognised at the consolidated group level only, and are therefore also not included in the asset or equity positions for the standalone entities shown above.

As at 31 December 2015, there are no subsidiaries which are included within both the accounting scope of consolidation and the regulatory scope of consolidation but the method of consolidation differs.

There are also no subsidiaries which are included within the regulatory scope of consolidation but not included within the accounting scope of consolidation.

The Group operates subsidiaries in different territories where capital is governed by local rules and there may be restrictions on the transfer of regulatory capital and funds between members of the Group.

Management Discussion and Analysis *(continued)*

Capital Management *(continued)*

Capital instruments *(unaudited)*

The following is a summary of the Group's CET1, AT1 and T2 capital instruments issued by the Bank.

	Amount recognised in regulatory capital	
	2015	2014
CET1 capital instruments		
Ordinary shares:		
1,911,842,736 issued and fully paid ordinary shares	9,658	9,658
AT1 capital instruments		
Perpetual capital instrument (nominal value: US\$900m)	6,981	6,981
T2 capital instruments		
Subordinated loan due 2021 (nominal value: US\$450m)	-	2,790
Subordinated loan due 2022 (nominal value: US\$300m)	2,325	2,327

A description of the main features and the full terms and conditions of the Group's capital instruments can be found in the Regulatory Disclosures section of our website www.hangseng.com.

Leverage ratio *(unaudited)*

The Group is required under section 45A(6) of the Banking (Disclosure) Rules to disclose its leverage ratio calculated on a consolidated basis effective from 31 March 2015. Comparative figures are not required as this is the first year of disclosure.

	At 31 December 2015
Leverage ratio	7.8%
T1 capital	97,257
Exposure measure	1,248,642

Detailed breakdown of the Group's leverage exposure measure and a summary comparison table reconciling the assets of the Group's accounting balance sheet with the leverage exposure measure using the standard templates as specified by the HKMA can be viewed in the Regulatory Disclosures section of our website www.hangseng.com.

Additional information

A full reconciliation between the Group's accounting and regulatory balance sheets can be viewed in the Regulatory Disclosures section of our website www.hangseng.com.

CORPORATE SUSTAINABILITY

Where some see obstacles, others see opportunities – it's all about perspective. As Hong Kong's leading domestic bank, we help customers to enjoy secure and fulfilling lives by working with them to achieve their personal and professional financial goals. By seeking out different perspectives, we are better able to ensure that our business addresses the needs and priorities of our stakeholders.

As a good corporate citizen, we aspire to improve social mobility, build bridges among different groups and celebrate the value of diverse viewpoints, talents and ideas. With a particular focus on young people, our sustainability initiatives encourage participants to explore new ideas, see challenge as an opportunity to learn and grow, and broaden their horizons. By facilitating life-changing experiences, we aim to generate positive energy across all sectors of our community to drive social development.

Inspiring Others

Through our actions, we strive to encourage social inclusion, self-empowerment and a sense of civic pride, and to lead by example in inspiring others to contribute to positive social and environmental change, improve their own sustainability performance and work towards solutions to sustainability challenges.

We have been a constituent stock of the FTSE4Good Global Index since 2001, and, in 2011, became the first local Hong Kong bank to be included as a constituent member of the Dow Jones Sustainability Asia Pacific Index. We have also been a constituent stock of the Hang Seng Corporate Sustainability Index Series since its establishment in 2010.

We were also the first local bank in Hong Kong to use the internationally recognised Global Reporting Initiative (GRI) sustainability reporting guidelines and, for our 2011 Sustainability Report, the first to gain the top A+ rating – a distinction we have maintained in all subsequent reports.

Since 2006, we have provided over HK\$260m in financial support – including around HK\$26m in 2015 – for community development initiatives.

We recognise and respect the unique position of our staff as internal stakeholders and frontline ambassadors of our business. In addition to providing competitive compensation packages and a positive working environment, our efforts to stand out as an employer of choice include providing opportunities for our employees to pursue personal interests, participate in fun recreational events and build strong connections through leisure activities and volunteer work.

In 2015, around 21,000 colleagues and members of their families participated in Bank-organised recreational and leisure activities, including Hang Seng Fun Day at which over 1,300 members of staff together with their families and friends took part in various cultural and arts-themed programmes. Other activities included six sporting competitions (bowling, badminton, football, basketball, table tennis and golf) under the Hang Seng Cup and a talk on marathon running to promote a healthy lifestyle that was well attended by over 300 members of staff.

Empowering Young People

Empowering and inspiring young people lies at the heart of our sustainability programmes. The aspirations, innovations and social engagement of today's younger generations will play a critical role in the future development of our city.

Focusing particularly on socially disadvantaged groups, we work with community partners to provide young people with opportunities to explore their interests, develop their talents and skills, and engage in social interactions that help to build self-esteem and a greater sense of civic responsibility.

In collaboration with the Hong Kong Federation of Youth Groups and the Hong Kong Repertory Theatre, the Hang Seng Call for Young Talent in Theatre aims to build the confidence and team spirit of participating students as well as give them an insight into the workings of the performing arts industry.

Following an open audition process, 40 primary and secondary students were selected to participate in an intensive four-month acting, singing and dance training programme, which culminated in the staging of a two-night run of the original musical, 'Our Time, Our Hong Kong', in front of audiences of around 2,000 people.

Run in partnership with The Hong Kong Family Welfare Society, the Hang Seng – HKFWS Youth Mediation Scheme helps nurture a positive attitude among young people in working to resolve conflicts with their peers and family members. We have committed to training an addition 700 'Peer Mediators' by the end of 2017, taking the total number of those trained since 2014-15 to 1,000. In addition, around 240 primary school teachers are expected to complete introductory mediation training between 2015 and 2017.

Many paths to personal achievement

The Hang Seng Youth Entrepreneurship Scheme offers young ex-offenders and at-risk youths the chance to create a new future for themselves by giving them access to the support they need to turn entrepreneurial ambitions and ideas into solid business proposals. Since mid-2014, over 200 young people have benefited from initiatives such as skills training, business development subsidies and business planning advice, with 10 budding entrepreneurs receiving seed capital and professional guidance on turning their business dreams into reality. Several Bank executives have served as guest speakers and judges to share their experience with those participating in the Scheme, which is organised in partnership with the Society of Rehabilitation and Crime Prevention, Hong Kong.

We are working with the Hong Kong Federation of Youth Groups on the innovative Hang Seng GPS Youth Employment Programme. Targeting low academic achievers, the initiative is the first in Hong Kong to promote the 'gap year' concept among secondary students. Participants put their studies on hold for a year to take up job placements in industries that complement their skills and interests to gain valuable work experience. About 60 students have taken part in the Programme since its launch in 2014.

About 200 Form 4 students were given behind-the-scenes access to companies in four selected Hong Kong industries in 2015 to enable them to make more informed career-planning choices. Organised jointly with The Hong Kong Council of Social Service, the Hang Seng – HKCSS Youth Career Exploration Programme has benefited 550 students since 2013.

We continue to promote the development of useful life skills, positive social values and an international perspective through our long-standing support for initiatives such as the Ming Pao Student Reporter Programme, the Hang Seng Bank – Help the Police Fight Youth Crime Competition and the Hang Seng Leaders to Leaders Lecture Series.

Since 1995, we have allocated more than HK\$65m to various Hong Kong and mainland China university scholarship schemes, benefiting over 2,300 students.

An active way to build civic unity

For the past 25 years, our support for table tennis development has helped bring the community together to participate in healthy activities and build a shared sense of civic pride around outstanding performances by local athletes.

Set up in partnership with the Hong Kong Table Tennis Association in 2001, the Hang Seng Table Tennis Academy nurtures the skills of talented young players with the potential to become future sporting stars. Academy graduates who have attained regional and international success serve as positive role models and inspire young people to embrace perseverance and dedication in striving for

their goals. Over 290,000 participants have benefited from more than 5,200 activities organised by the Academy since its establishment.

Using culture to improve communication

Our efforts to increase young people's exposure to the arts are designed to encourage creativity, promote positive values and spark constructive discussion. Communication and learning through cultural experiences can also help build confidence and increase understanding of social development.

We worked with the Jao Tsung-I Academy to give around 3,000 students from close to 100 secondary schools a greater appreciation for Hong Kong's development through their participation in the Hang Seng – Jao Tsung-I Academy Historical and Cultural Programme, which included a guided tour of a historical photo exhibition and a series of cultural and history exploration activities.

Under the Hang Seng Bank Student Matinees initiative with Hong Kong Repertory Theatre, a total of more than 800 secondary school students attended two exclusive Bank-sponsored performances of a play that invites the audience to contemplate life's journey. The students also participated in four acting workshops to learn basic theatrical and stagecraft skills.

Our sponsorship of Hong Kong Arts Festival and Hong Kong Philharmonic student ticket schemes provided subsidised entry to a variety of performances for more than 25,000 students in 2015.

Championing a Service Culture

We are committed to making our community a better place to live. Improving social well-being and contributing to the development of an inclusive, compassionate and socially aware culture will support our sustainable growth by providing new customers, colleagues and business opportunities in the years ahead.

We encourage our staff to spread concepts of service and giving among the local community by taking part in volunteer work. Focusing particularly on underprivileged children, elderly people and environmental education, we organised about 120 volunteer activities in 2015.

Since 2011, Bank volunteers and their family members have contributed over 110,000 hours of their time to good causes and charitable work in Hong Kong.

Our commitment to serve is also reflected in the close relationships we have established with NGOs and other organisations that are working for the benefit of our community.

Our long-term partnership with The Community Chest of Hong Kong has raised more than HK\$71m, including over HK\$21m through the Dress Casual Day – an annual event that we have participated in since 1994.

Our support for the Hang Seng – Regeneration Society Top Ten Regeneration Warriors Competition promotes positive life values by enabling individuals who have overcome the challenges of chronic illness by maintaining an upbeat attitude and positive outlook to share their stories and experiences with the community.

We also facilitate charitable giving by our customers through our e-Donation service, under which more than HK\$30m has been donated to deserving causes in Hong Kong since December 2001.

An Environmental Steward

The health of our planet and its natural resources has a fundamental impact on all of us and is a collective responsibility that cannot be ignored. We are committed to improving our own performance, raising environmental awareness among our stakeholders, and playing a role in addressing large-scale environmental issues that require a global response.

We take steps to cut our consumption of energy and natural resources, reduce waste, and use environmentally friendly products and certified materials whenever possible. We encourage our customers and suppliers to take similar steps through our services, policies and community engagement initiatives.

We empower our staff to act as ambassadors for the environment by raising their awareness of green issues through volunteer activities. We also support NGO initiatives such as the ‘Power Smart’ Energy Saving Contest organised by Friends of the Earth (HK), which enables schools to borrow monitoring equipment for use in energy-saving classroom projects.

Beginning with our headquarters building in 2005, we have led the way in gaining the internationally recognised ISO 14001 environmental accreditation among local banks. In 2011, we became the first local bank to achieve this certification for all its Hong Kong offices and branches. Over 1.8 million customers now use our paperless e-Statement and e-InvestAdvice services, saving around 48 million sheets of paper a year.

We were awarded the Joint Energy Saving Award and the Silver Award in the Bank and Office industry category at the 2015 CLP GREENPLUS Recognition Award.

Since 2007, the Hang Seng Yunnan Biogas Project has built 4,600 biogas facilities in remote areas of Yunnan Province – including 800 facilities built in 2015. A joint initiative with The Conservancy Association, the Project has improved the lives of nearly 18,000 rural residents by providing them with a free, clean and stable source of energy. The Project has also reduced carbon dioxide emissions by over 48,000 tonnes per year.

The vital need to protect fragile ecosystems and support the conservation of biodiversity is reflected in our financing policies and within our own operations. We stopped serving shark’s fin at Bank functions in 2003 and have removed endangered reef fish from our menus. Since 2011, we have provided a sustainable seafood menu endorsed by WWF (Hong Kong) at our banquet hall.

Environmental Performance Table

	2015[#]	2014[^]	2015 vs 2014 (% change)
Greenhouse gas emissions (kilotonnes CO₂)	25.91	24.71	4.87
Electricity consumption (GWh)	36.43	35.19	3.54
Water consumption (000m³)	66.91	68.48	-2.30
IT/ electrical waste recycled (tonnes)	41.06	61.50	-33.24

Data coverage: Hang Seng Bank’s Hong Kong operations

Key: CO₂: carbon dioxide

GWh: gigawatt hours

m³: cubic metres

[#] From 1 Oct 2014 - 30 Sep 2015

[^] From 1 Oct 2013 - 30 Sep 2014

Corporate Sustainability Key Initiatives

Changing young lives, creating possibilities

Our corporate sustainability activities support long-term social development by creating life-changing opportunities, focusing particularly on underprivileged and at-risk youths. Through initiatives such as the Hang Seng Youth Entrepreneurship Scheme and the Hang Seng GPS Youth Employment Programme, we promote social mobility, encourage a sense of civic responsibility and champion the value of a diverse society. By encouraging young people to pursue their interests, develop their talents and believe in the importance of their own contribution, we are helping to nurture well-rounded individuals with the values and skills to become capable and promising future leaders.

Call for young talent to explore their potential

Empowerment comes in many forms. Participation in the arts not only enables young people to express themselves and explore new ideas, but can also help build self-esteem and teach valuable lessons about focus and commitment. With auditions and a rigorous four-month training schedule that culminates in public theatrical performances, the Hang Seng Call for Young Talent programme challenges participants aged 9 to 15 to show dedication, passion and perseverance in pursuit of a goal, and, through the channel of creative expression, develop the confidence needed to fulfil their aspirations and face life's challenges in the future.

Long-term partnership bears sporting fruit

We believe that long-term partnerships are the best way to create lasting benefits. Our 25-year relationship with Hong Kong Table Tennis Association continues to promote participation in sports as part of a healthy lifestyle and to build community spirit. Since 2001, the Hang Seng Table Tennis Academy (HSTTA) has helped identify and groom young local talent to achieve sporting success. The HSTTA graduates who are now holding their own against the world's leading players bring honour to Hong Kong and inspire others to pursue their ambitions. Since 1991, we have contributed over HK\$38.5m to promote table tennis in Hong Kong through various community-based events. We will provide a further HK\$10.2m in support for the Academy for 2016-18.

Volunteers experience the rewards of giving back

Our commitment to building a better society embraces volunteering as a tool to give back, grow and gain understanding, as well as to build team spirit among Bank staff. In 2015, we launched a new initiative with the Chinese YWCA. Bank staff and young people from ethnic minority groups came together to support the elderly through activities such as home visits, a bowling day and preparation of traditional dishes. Such efforts help build greater understanding between different community groups and demonstrate the strengths of a diverse and inclusive society.

Recognition

Constituent Stock of Dow Jones Sustainability Asia Pacific Index

(for fifth consecutive year)

Dow Jones Sustainability Index

Constituent Stock of FTSE4Good Global Index

(for 14th consecutive year)

FTSE Index

Constituent Stock of Hang Seng Sustainability Index Series

(for sixth consecutive year)

Hang Seng Indexes

Caring Company

(for 13th consecutive year)

Hong Kong Council of Social Service

CORPORATE GOVERNANCE REPORT

CORPORATE GOVERNANCE PRINCIPLES AND PRACTICES

Hang Seng Bank Limited (the “Bank”) is committed to maintaining and upholding high standards of corporate governance with a view to safeguarding the interests of shareholders, customers, employees and other stakeholders. The Bank has followed the module on “Corporate Governance of Locally Incorporated Authorised Institutions” under the Supervisory Policy Manual (“SPM”) issued by the Hong Kong Monetary Authority (“HKMA”). The Bank has also fully complied with all the code provisions and most of the recommended best practices set out in the Corporate Governance Code (“CG Code”) contained in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (“HKEx”) (the “Listing Rules”). The Bank also constantly reviews and enhances its corporate governance framework to ensure that it is in line with international and local corporate governance best practices.

BOARD OF DIRECTORS

The Board has collective responsibilities for promoting the long-term sustainability and success of the Bank by providing entrepreneurial leadership within a framework of prudent and effective controls. In doing so, the Board commits to high standards of integrity and ethics.

According to the Board’s terms of reference, specific matters reserved for the Board’s consideration and decision include:

- strategic plan and objectives
- annual operating plan and performance targets
- annual and interim financial reporting
- capital plans and management
- risk appetite statement and profile update
- internal control and risk management governance
- significant policies and plans
- significant changes to balance sheet management policies
- policies, practices and disclosure on corporate governance
- policies and practices on compliance with legal and regulatory requirements
- appointment and oversight of senior management
- corporate values and standards
- corporate structure
- effective audit functions
- transparency in respect of the structure, operation and risk management
- acquisitions and disposals above predetermined thresholds

Chairman and Chief Executive

The roles of the Chairman and Chief Executive of the Bank are separate, with a clear division of responsibilities set out in the Board's terms of reference.

The Chairman of the Board, who is an Independent Non-executive Director ("INED"), is responsible for the leadership and effective running of the Board and for ensuring that decisions of the Board are taken on a sound and well-informed basis and in the best interest of the Bank. In addition, as the Chairman of the Board, he is also responsible for ensuring that all Directors are properly briefed on all issues currently on hand and receive adequate, accurate and reliable information in a timely manner. The Chairman possesses the requisite experience, competencies and personal qualities to fulfill these responsibilities.

The Chief Executive, who is an Executive Director ("ED"), is responsible for implementing the strategy and policy as established by the Board. The Chief Executive is also responsible for the management and day-to-day running of the Bank's business and operations, as well as leading and chairing the Executive Committee.

Board Composition

As at the date of this Annual Report, the Board comprises 17 Directors, of whom four are EDs and 13 are Non-executive Directors ("NEDs"). Among the 13 NEDs, nine are INEDs. There is a strong independent element on the Board, to ensure the independence and objectivity of the Board's decision-making process as well as the thoroughness and impartiality of the Board's oversight of the Management.

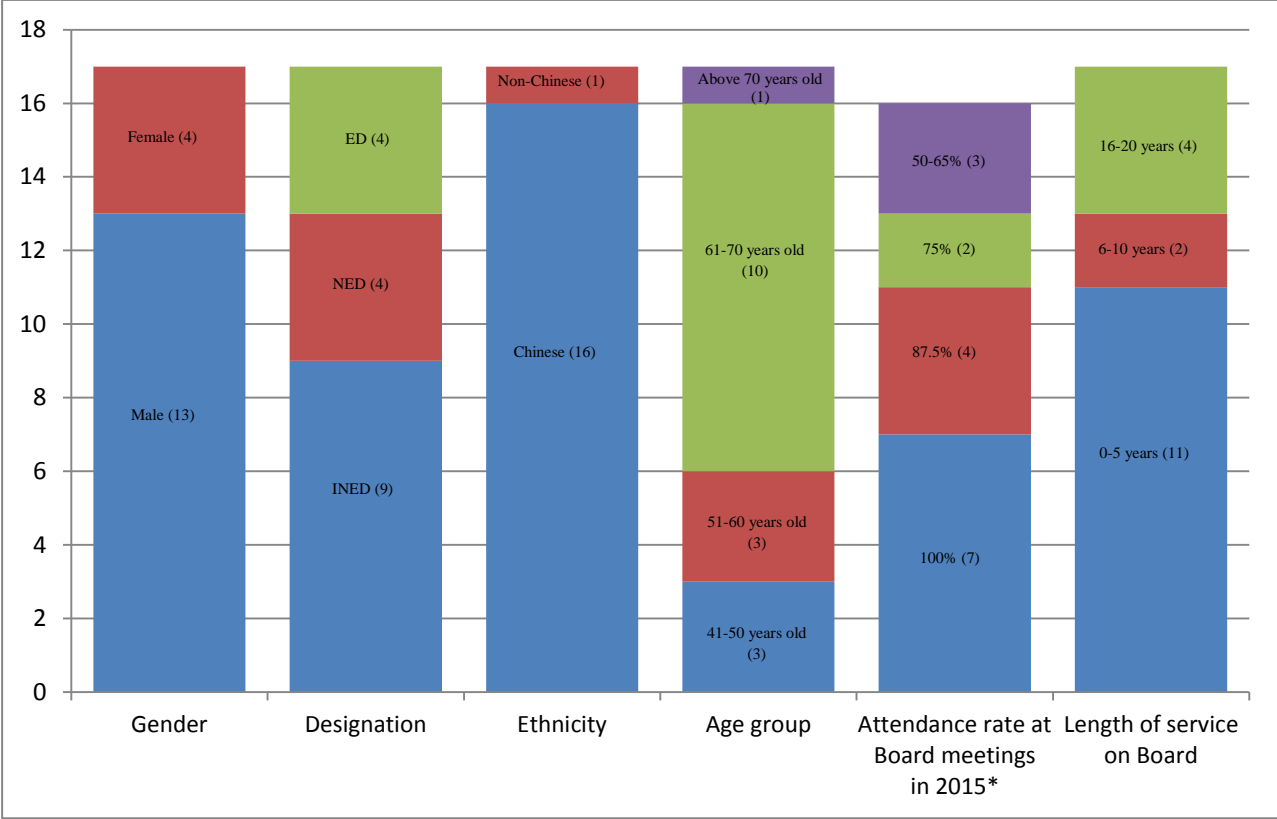
The Board possesses, both as individual Directors and collectively, appropriate experience, competencies and personal qualities, including professionalism and integrity, to discharge its responsibilities adequately and effectively. In addition, the Board collectively has adequate knowledge and expertise relevant to each of the material business activities that the Bank pursues and the associated risks in order to ensure effective governance and oversight.

Members of the Board, who come from a variety of different backgrounds, have a diverse range of business, banking and professional expertise. Biographical details of the Directors, together with information relating to the relationship among them, are set out in the section "Biographical Details of Directors and Senior Management" in this Annual Report.

The Bank remains committed to meritocracy in the Boardroom, which requires a diverse and inclusive culture where Directors believe that their views are heard, their concerns are attended to and they serve in an environment where bias, discrimination and harassment on any matter are not tolerated. The Board has adopted a Board Diversity Policy which has been made available on the Bank's website (www.hangseng.com) for better transparency and governance. Board appointments are based on merit and candidates are considered against objective criteria, having due regard for the benefits of diversity on the Board including, but not limited to, gender, age, cultural and educational background, ethnicity, professional experience, skills, knowledge and length of service.

An analysis of the Board’s current composition is set out in the following chart:

No. of Directors



* Mr Patrick K W Chan was appointed as ED with effect from 19 February 2016. Accordingly, he has not attended any Board meetings in 2015.

The Bank has maintained on its website (www.hangseng.com) and on the website of HKEx (www.hkexnews.hk) an updated list of its Directors identifying their roles and functions and whether they are INEDs. INEDs are also identified as such in all corporate communications that disclose the names of the Bank’s Directors.

Further, the Bank has received from each of the INEDs an annual confirmation of his/her independence. The independence of the INEDs has been assessed in accordance with the guidelines set out in Rule 3.13 of the Listing Rules. Following such assessment, the Board has affirmed that all the INEDs continue to be independent.

Board Process

Board meetings shall be held about six times a year and no less than once every quarter. Additional Board meetings, or meetings of a Board committee established by the Board to consider specific matters, can be convened, when necessary.

Schedule for the regular Board meetings in each year, together with the standing agenda for such meetings, are made available to all Directors before the end of the preceding year. In addition, notice of meetings will be given to all Directors at least 14 days before each regular meeting.

Other than regular meetings, the Chairman also meets with NEDs (including INEDs) without the presence of EDs, to facilitate an open and frank discussion among the NEDs on issues relating to the Bank.

The Board also met with the representatives of HKMA to maintain a regular dialogue with the regulator where HKMA shared with the Board industry-wide issues and HKMA's supervisory focus.

Meeting agenda for regular meetings are set after consultation with the Chairman and the Chief Executive. All Directors are given an opportunity to include matters in the agenda.

Directors make their best efforts to contribute to the formulation of strategy, policies and decision-making by attending the Board meetings in person or via telephone or video-conferencing facilities.

Minutes of Board meetings with details of the matters discussed by the Board and decisions made, including any concerns or views of the Directors, are kept by the Company Secretary and are open for inspection by Directors.

During 2015, the Board held eight meetings (including one meeting with HKMA) and the important matters discussed at Board meetings included:

Strategic Planning

- quarterly update on strategic plan 2013 – 2015

Financial Reporting

- financial statements for the year ended 31 December 2014
- interim financial statements for the six months ended 30 June 2015
- declaration of the fourth interim dividend for year 2014 and first three interim dividends for year 2015
- reports on financial and business performance

Risk Management

- risk appetite statement and profile update
- risk management framework and internal control system assessment
- results of HKMA's supervisor-driven stress tests
- significant policies and plans including, but not limited to, Recovery Plan
- annual review of money laundering reporting officer report
- review of large credit exposures and risk concentrations

Capital Planning

- annual operating plan and capital plan for year 2015
- internal capital target proposals
- internal capital adequacy assessment process

Remuneration

- annual review of the remuneration policy and remuneration system
- annual review of alignment of risk and remuneration
- pay review for 2015 and variable pay for 2014
- review of fees payable to Directors and Board Committee Chairmen/Members of the Bank and its subsidiaries
- performance management for senior management

Directors

- appointment of Director and senior executives
- review of independence of INEDs
- re-election and election of retiring Directors
- terms of appointment of NEDs

Succession Planning

- succession planning for the Board and senior management

Others

- change of external auditor
- proposals relating to the disposal of the Bank's investment in Industrial Bank Co., Ltd.
- connected transactions in relation to building improvement work for the Bank's properties
- proposal to establish a majority-owned fund management joint venture company in Mainland China
- major regulatory changes affecting the Bank

In addition to the regular financial and business performance reports submitted to the Board at its regular meetings, the Board also receives financial and business updates with information on the Bank's latest financial performance and material variance from the Bank's annual operating plan during those months where no Board meetings are held. Directors can therefore have a balanced and understandable assessment of the Bank's performance, position and prospects throughout the year.

The Board reviews and evaluates its work process and effectiveness annually, with a view to identifying areas for improvement and further enhancement. The Board also regularly reviews the time commitment required from NEDs.

All Directors have access to the EDs as and when they consider necessary. They also have access to the Company Secretary who is responsible for ensuring that the Board procedures, and related rules and regulations, are followed.

Under the Articles of Association of the Bank, a Director shall not vote or be counted in the quorum in respect of any contract, arrangement, transaction or other proposal in which he/she or his/her associate(s), is/are materially interested.

The Board has adopted a Policy on Conflicts of Interest. The Policy identifies the relationships, services, activities or transactions in respect of which conflicts of interest may arise and sets out measures for prevention or management of such conflicts. The Policy also contains an objective compliance process for implementing the Policy, which includes notification by a Director of conflicts or potential conflicts, and a review/approval process.

Since 2014, the Board has been applying technology designed specifically around the Board to help the Directors manage their time more efficiently, while staying connected to the Board and other Directors in order to discharge their responsibilities effectively and securely.

Appointment and Re-election of Directors

The Bank uses a formal, considered and transparent procedure for the appointment of new Directors. Before a prospective Director's name is formally proposed, opinions of the existing Directors (including the INEDs) will be solicited. The proposed appointment will first be reviewed by the Nomination Committee, taking into account the balance of skills, knowledge and experience on the Board. Upon recommendation of the Nomination Committee, the proposed appointment will then be reviewed and, if thought fit, approved by the Board after due deliberation.

In accordance with the requirement under the Banking Ordinance, approval from HKMA will also be obtained.

The Bank issues appointment letters to each of the NEDs, setting out the terms and conditions of their appointment, including the time commitment expected of them. Additional time commitment is necessary if the NEDs also serve on committee(s) of the Board.

All new Directors are subject to election by shareholders of the Bank at the next Annual General Meeting ("AGM") after their appointments have become effective. Further, the Bank's Articles of Association provide that all Directors shall be subject to retirement by rotation at least once every three years. Retiring Directors are eligible for re-election at AGMs of the Bank.

According to the policy on the term of appointment of NEDs, term of appointment of each NED is three years except that where a NED has served on the Board for more than nine years, then his/her term of appointment is one year. In renewing the term of appointment of each NED, the Board reviews whether such NED remains qualified for his/her position.

Responsibilities of Directors

All Directors have full and timely access to all relevant information about the Bank so that they can discharge their duties and responsibilities as Directors. In particular, through regular Board meetings and receipt of regular financial and business updates, all Directors are kept abreast of the conduct, business activities and development, as well as regulatory updates applicable to the Bank.

There are established procedures for Directors to seek independent professional advice on matters relating to the Bank where appropriate. All costs associated with obtaining such advice will be borne by the Bank. In addition, each Director has separate and independent access to the Bank's Management.

The Bank has adopted a Code for Securities Transactions by Directors on terms no less exacting than the required standards set out in the Model Code for Securities Transactions by Directors of Listed Issuers (set out in Appendix 10 to the Listing Rules). Specific enquiries have been made with all Directors who have confirmed that they have complied with the Bank's Code for Securities Transactions by Directors throughout the year 2015.

Directors' interests in securities of the Bank and HSBC Holdings plc ("HSBC Group") as at 31 December 2015 have been disclosed in the Report of the Directors set out in this Annual Report.

Appropriate Directors' liability insurance cover has also been arranged to indemnify the Directors for liabilities arising out of corporate activities. The coverage and the sum insured under the policy are reviewed annually. Further, the Bank's Articles of Association provide that Directors are entitled to be indemnified out of the Bank's assets against claims from third parties in respect of certain liabilities.

Induction and Training for Directors

Induction programmes on the following key areas will be arranged for newly appointed Directors so that they can discharge their responsibilities to the Bank properly and effectively:

- business operations
- investments
- risk management framework
- governance structure and practices
- control and support functions
- directors' duties and responsibilities

Further, all Directors are provided with briefings and trainings on an on-going basis as necessary to ensure that they have a proper understanding of the Bank's operations and business and are fully aware of their responsibilities under the applicable laws, rules and regulations including, but not limited to, the Banking Ordinance, Listing Rules, Companies Ordinance, Securities and Futures Ordinance and HKMA's SPMs. Such briefings and trainings are provided at the Bank's expense. The Bank also maintains proper records of the trainings provided to and received by its Directors.

During the year, Directors received briefings or trainings in relation to the following topics:

- general overview of HSBC Group Strategy
- Global Standards (adopted by HSBC Group for the purpose of implementing group-wide anti-money laundering and sanctions policies that are the highest or most effective standards for financial crime compliance)
- anti-money laundering and sanctions awareness
- implementation of Basel III in Hong Kong
- myths and risks in Mainland Banking
- solidification of Board supervision on risk controls and risk culture for "New Normal"
- liquidity and funding risk management framework
- recovery and resolution planning

To summarise, the Directors received trainings on the following key areas to update and develop their skills and knowledge during the year:

Directors	Training areas		
	Corporate Governance	Regulatory matters	Business/Management
INEDs			
Dr Raymond K F Ch'ien	√	√	√
Dr John C C Chan	√	√	√
Dr Henry K S Cheng	√	√	√
Ms L Y Chiang	√	√	√
Dr Fred Zulu Hu	√	√	√
Ms Irene Y L Lee	√	√	√
Dr Eric K C Li	√	√	√
Mr Richard Y S Tang	√	√	√
Mr Michael W K Wu	√	√	√
NEDs			
Ms Sarah C Legg	√	√	√
Dr Vincent H S Lo	√	√	√
Mr Kenneth S Y Ng	√	√	√
Mr Peter T S Wong	√	√	√
EDs*			
Ms Rose W M Lee	√	√	√
Mr Nixon L S Chan	√	√	√
Mr Andrew H C Fung	√	√	√

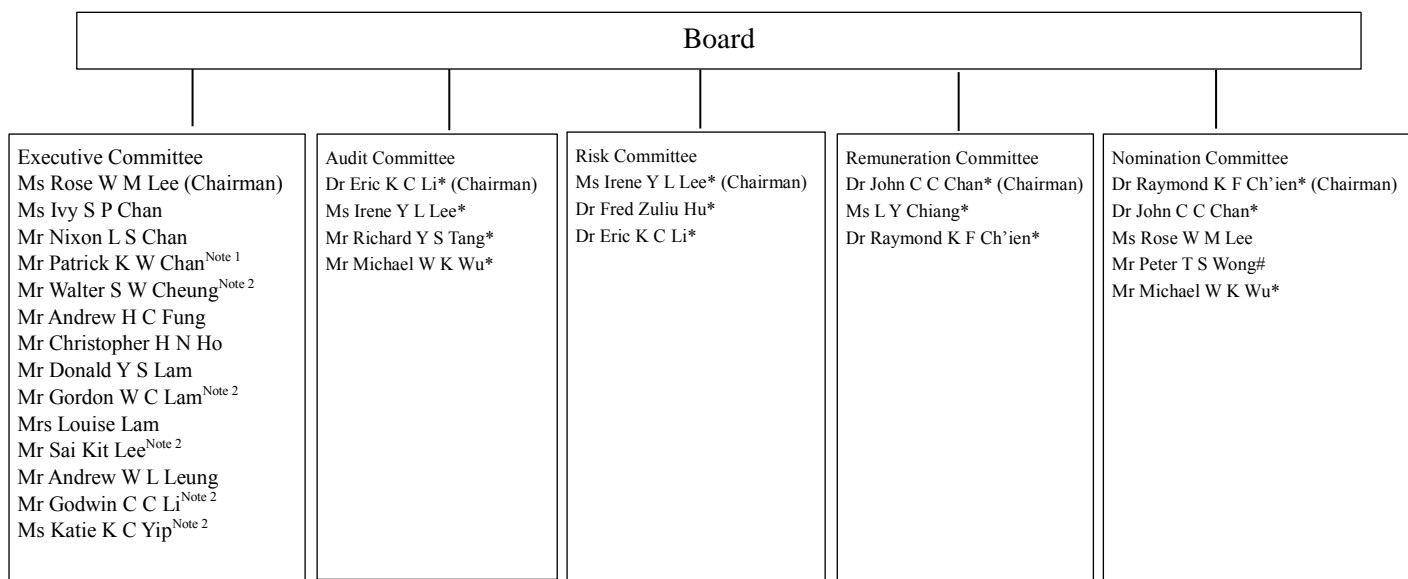
* Mr Patrick K W Chan was appointed as ED with effect from 19 February 2016. Accordingly, his training records have not been included above.

DELEGATION BY THE BOARD

Board Committees

The Board has set up five Committees, namely, the Executive Committee, Audit Committee, Risk Committee, Remuneration Committee and Nomination Committee, to assist it in carrying out its responsibilities.

The current composition of the Board Committees is as follows:



* INED

NED

^{Note 1} Mr Patrick K W Chan was appointed as Executive Committee member with effect from 4 January 2016.

^{Note 2} Mr Walter S W Cheung, Mr Gordon W C Lam, Mr Sai Kit Lee, Mr Godwin C C Li and Ms Katie K C Yip were appointed as Executive Committee members with effect from 29 September 2015.

Each of these Committees has specific written terms of reference, which set out in detail their respective authorities and responsibilities. Each Committee reviews its terms of reference and effectiveness annually. The terms of reference of all the Non-executive Board Committees have been made available on the Bank's website (www.hangseng.com). All Committees, except the Executive Committee and Nomination Committee, comprise solely of INEDs. Majority of the Nomination Committee members are INEDs while the Executive Committee comprises the Bank's EDs and senior executives.

All Committees adopt the same governance processes as far as possible as the Board and report back to the Board on their decisions or recommendations on a regular basis.

Executive Committee

The Executive Committee usually meets once a month and operates as a general management committee under the direct authority of the Board. It exercises the powers, authorities and discretions as delegated by the Board in so far as they concern the management and day-to-day running of the Bank in accordance with its terms of reference and such other policies and directives as the Board may determine from time to time. The Executive Committee also sub-delegates credit, investment and capital expenditure authorities to its members and senior executives.

To further enhance the Bank's risk management framework and in line with best practices, the Bank has set up a Risk Management Committee ("RMC"), chaired by the Bank's Chief Risk Officer, to centralise the risk management oversight function of the Bank and its subsidiaries. The RMC reports directly to the Executive Committee. Its main functions are to review, analyse, evaluate, recognise and manage various risks of the Bank, including all the eight types of risks stipulated in HKMA's SPMs, namely, credit risk, market risk, liquidity risk, interest rate risk, operational risk, legal and compliance risk, reputation risk and strategic risk. In addition, the RMC also covers business (including insurance) risk, pension risk, security and fraud risk, and sustainability risk, and is responsible for endorsement/approval of all risk management related policies. RMC meetings are usually held monthly. Minutes of RMC meetings are provided to the Executive Committee and the Risk Committee for review.

Audit Committee

The Audit Committee meets at least four times a year with the Bank's executives including the Chief Executive, Chief Financial Officer, Chief Risk Officer, Head of Audit, and representatives from the Bank's external auditor. The Committee reviews, among other things, the Bank's financial reporting, the nature and scope of audit reviews, and the effectiveness of the systems of internal control and compliance relating to financial reporting. The Audit Committee is also responsible for making recommendations to the Board on the appointment, re-appointment, removal and remuneration of the Bank's external auditor. In addition, the Audit Committee has established a "Policy for the Reporting of Improprieties" to provide a secured and confidential channel through which all staff members may report incidents of improprieties in a secured and confidential manner so that the same will be timely and thoroughly investigated and appropriate actions can be taken promptly.

The Audit Committee reports to the Board following each Audit Committee meeting, drawing the Board's attention to significant issues or matters of which the Board should be aware, identifying any matters in respect of which it considers that action or improvement is needed, and making relevant recommendations.

During the year, the Audit Committee held five meetings and the major work performed by the Committee was as follows:

- reviewed the financial statements for the year ended 31 December 2014 and the related documents, and the management letters and audit issues noted by the Bank's external auditor
- reviewed the interim financial statements for the six months ended 30 June 2015 and the related documents, and the issues noted by the Bank's external auditor
- reviewed the annual operating plan and capital plan for year 2015
- reviewed the balance sheet management position
- reviewed the revised accounting standards and prospective changes to accounting standards, and the impact on the Bank's financial reporting
- reviewed essential matters or reports relating to financial control and reporting, and discussed the same with the Management
- reviewed the internal audit reports and discussed the same with the Management and Head of Audit
- reviewed and adopted the revised Internal Audit Charter and enhanced Global Internal Audit Standards Manual
- reviewed the update on internal audit plan for 2015 and approved the internal audit plan for 2016
- reviewed the adequacies of resources, qualifications and experience of staff of the Accounting and Financial Reporting function and Internal Audit function, and their training programmes and budgets
- reviewed the proposed change of external auditor and made recommendations to the Board
- reviewed the remuneration and engagement letters of the Bank's external auditor, its independence and objectivity, and the effectiveness of the audit process
- approved the revised Policy for the Reporting of Improprieties, and reviewed the effectiveness of the same and the incidents reported through such channel during the year

- reviewed the Audit Committee's independence and effectiveness in discharging its role and responsibilities and its terms of reference
- exercised oversight over the audit committees of the Bank's principal subsidiaries

The Audit Committee also met with the representatives of the Bank's external auditor and Head of Audit without the presence of the Management in accordance with its terms of reference.

Risk Committee

The Risk Committee, with all members being INEDs, is responsible for the oversight of internal control (other than internal control over financial reporting) and risk management systems of the Bank. This practice is in line with the revised CG Code requirement under the Listing Rules which applies to accounting periods beginning on or after 1 January 2016.

The Risk Committee meets at least four times a year with the Bank's executives including the Chief Executive, Chief Financial Officer, Chief Risk Officer, Head of Audit, Head of Regulatory Compliance, Head of Financial Crime Compliance, and representatives from the Bank's external auditor. The Committee is responsible for, among other things, the Bank's high level risk related matters, risk appetite and tolerance, risks associated with proposed strategic acquisitions or disposals, risk management reports from the Management, effectiveness of the risk management framework and systems of internal control and compliance (other than internal control and compliance regarding financial reporting), and appointment and removal of the Chief Risk Officer.

The Risk Committee reports to the Board following each Risk Committee meeting, drawing the Board's attention to significant issues or matters of which the Board should be aware, identifying any matters in respect of which it considers that action or improvement is needed, and making relevant recommendations.

During the year, the Risk Committee held six meetings (including one meeting with HKMA) and the major work performed by the Committee was as follows:

- reviewed the routine risk reports submitted by the Management including, but not limited to, the Bank's risk management framework and internal control system assessment, risk appetite statement and profile update, results of HKMA's supervisor-driven stress tests, risk maps, top and emerging risks, annual plan and progress update relating to financial crime compliance, regulatory compliance and internal control, and annual money laundering reporting officer report
- reviewed the Large Credit Exposure Policy, internal capital adequacy assessment process and Recovery Plan
- reviewed the report on the alignment of risk and remuneration
- reviewed the management letters and audit issues noted by the Bank's external auditor in the annual audit
- reviewed the enhanced Global Internal Audit Standards Manual and internal audit reports insofar as the same give rise to any risk-related issues
- reviewed the adequacies of resources, qualifications and experience of staff of the Risk and Compliance function, and their training programmes and budgets
- reviewed the revised Policy for the Reporting of Improprieties, and the incidents reported through such channel during the year

- reviewed the Risk Committee's independence and effectiveness in discharging its role and responsibilities and its terms of reference
- exercised oversight over the risk committees of the Bank's principal subsidiaries

The Risk Committee also met with the Bank's Head of Audit and Chief Risk Officer separately without the presence of the Management in accordance with its terms of reference. In addition, the Committee also met with the representatives of HKMA to maintain a regular dialogue with the regulator where HKMA shared with the Committee industry-wide issues and HKMA's supervisory focus.

Remuneration Committee

The Remuneration Committee normally meets twice a year with the Bank's Head of Human Resources. The Committee considers and makes recommendations to the Board on the remuneration policy and structure in order to attract, motivate and retain quality personnel. Pursuant to delegation by the Board, the Committee also determines the remuneration policy, and the specific remuneration packages of all EDs, senior management and key personnel. In addition, it also reviews at least annually and independently of the Management, the adequacy and effectiveness of the Bank's remuneration policy and its implementation, to ensure that the Bank's remuneration policy is consistent with relevant regulatory requirements and promotes effective risk management.

In determining the bank-wide remuneration policy, the Remuneration Committee will take into account the Bank's business objective, people strategy, short-term and long-term performance, business and economic conditions, market practices and risk management needs, in order to ensure the remuneration aligns with business and individual performances, promotes effective risk management, facilitates retention of quality personnel and is competitive in the market. The Committee may invite any Director, executive, consultant or other relevant party to provide advice in this respect.

The Remuneration Committee reports to the Board following each Committee meeting, drawing the Board's attention to significant issues or matters of which the Board should be aware, identifying any matters in respect of which it considers that action or improvement is needed, and making relevant recommendations.

During the year, the Remuneration Committee held two meetings and the major work performed by the Committee was as follows:

- reviewed the fees payable to the Bank's Chairman, and the Directors and Board Committee chairmen/members of the Bank and its subsidiaries, and made its recommendation to the Board
- determined the remuneration packages of the EDs, senior management and key personnel of the Bank, and the Vice-Chairman and Chief Executive of Hang Seng Bank (China) Limited
- reviewed the proposed variable pay for 2014 and pay review proposal for 2015, and recommended the same to the Board for approval
- reviewed the report on the alignment of risk and remuneration
- reviewed the update on remuneration requirements applicable to Material Risk Takers
- reviewed and updated the remuneration policy to further strengthen the governance in response to the tightened regulatory requirements
- reviewed the outcome of the review by the Internal Audit function of the remuneration policy and remuneration system, and the adequacy and effectiveness of its implementation
- reviewed the Remuneration Committee's effectiveness in discharging its role and responsibilities and its terms of reference

Nomination Committee

The Nomination Committee meets at least twice a year. It leads the process for Board appointments and identifies and nominates candidates for appointment to the Board, for the Board's approval. The Committee also considers, among other things, the structure, size and composition of the Board and Non-executive Board Committees, independence of INEDs, re-election of retiring Directors, term of appointment of and time required from NEDs, and appointment to Board Committees.

The Nomination Committee reports to the Board following each Committee meeting, drawing the Board's attention to significant issues or matters of which the Board should be aware, identifying any matters in respect of which it considers that action or improvement is needed, and making relevant recommendations.

During the year, the Nomination Committee held two meetings and the major work performed by the Committee was as follows:

- reviewed the structure, size and composition of the Board and Non-executive Board Committees
- reviewed the succession planning for the Board
- recommended the proposed appointment of an ED to the Board for approval
- reviewed the independence of INEDs
- reviewed the time commitment required from NEDs
- recommended the renewal of terms of appointment of NEDs to the Board for approval
- recommended the re-election of the retiring Directors to the Board for endorsement
- reviewed the Nomination Committee's effectiveness in discharging its role and responsibilities and its terms of reference

Attendance Records

The attendance records of Board and Board Committee meetings held in 2015 are as follows:

Number of Meetings	Meetings held in 2015						
	AGM	Board	Executive Committee	Audit Committee	Risk Committee	Remuneration Committee	Nomination Committee
Directors ^{Note 3}	1	8	13	5	6	2	2
Dr Raymond K F Ch'ien* (Chairman)	1/1	7/8	-	-	-	2/2	2/2
Ms Rose W M Lee (Vice-Chairman and Chief Executive)	1/1	8/8	13/13	-	-	-	2/2
Dr John C C Chan*	1/1	8/8	-	-	-	2/2	2/2
Mr Nixon L S Chan	1/1	8/8	13/13	-	-	-	-
Dr Henry K S Cheng*	1/1	4/8	-	-	-	-	-
Ms L Y Chiang*	1/1	6/8	-	-	-	2/2	-
Mr Andrew H C Fung	1/1	7/8	12/13	-	-	-	-
Dr Fred Zulu Hu*	1/1	5/8	-	-	2/6	-	-
Ms Irene Y L Lee*	1/1	8/8	-	5/5	6/6	-	-
Ms Sarah C Legg [#]	1/1	8/8	-	-	-	-	-
Dr Eric K C Li*	1/1	7/8	-	5/5	6/6	-	-
Dr Vincent H S Lo [#]	1/1	8/8	-	-	-	-	-
Mr Kenneth S Y Ng [#]	1/1	7/8	-	-	-	-	-
Mr Richard Y S Tang*	1/1	8/8	-	5/5	-	-	-
Mr Peter T S Wong [#]	1/1	5/8	-	-	-	-	1/2
Mr Michael W K Wu*	0/1	6/8	-	5/5	-	-	2/2
Senior Management							
Ms Ivy S P Chan	-	-	12/13	-	-	-	-
Mr Christopher H N Ho	-	-	12/13	-	-	-	-
Mr Donald Y S Lam	-	-	10/13	-	-	-	-
Mr Gordon W C Lam ^{Note 4}	-	-	3/4	-	-	-	-
Mrs Louise Lam	-	-	12/13	-	-	-	-
Mr Andrew W L Leung	-	-	11/13	-	-	-	-
Average Attendance Rate	94%	86%	90%	100%	78%	100%	90%

* INEDs

NEDs

^{Note 3} Mr Patrick K W Chan was appointed as ED and Executive Committee member with effect from 19 February 2016 and 4 January 2016 respectively. Accordingly, he has not attended any Board or Executive Committee meetings in 2015.

^{Note 4} Mr Gordon W C Lam was appointed as Executive Committee member with effect from 29 September 2015.

REMUNERATION OF DIRECTORS, SENIOR MANAGEMENT AND KEY PERSONNEL

The Bank's policy on remuneration is to maintain fair and competitive packages based on business needs and industry practice.

Remuneration of Directors

The level of fees paid to NEDs is determined by reference to factors including Directors' workload and commitments and fees paid by comparable institutions.

As regards EDs, the following factors are considered when determining their remuneration packages:

- business objective
- general business and economic conditions
- changes in appropriate markets such as supply/demand fluctuations and changes in competitive conditions
- individual contributions to results as confirmed in the performance appraisal process
- retention consideration and individual potential

No individual Director will be involved in decisions relating to his/her own remuneration.

The current scale of Director's fees, and fees for chairmen and members of the Non-executive Board Committees, namely, Audit Committee, Risk Committee, Remuneration Committee and Nomination Committee, are set out below:

	(HK\$ '000)		(HK\$ '000)
<u>Board of Directors</u> ^{Note 5}		<u>Risk Committee</u>	
Chairman	590	Chairman	260
Non-executive Directors	450	Member	160
<u>Audit Committee</u>		<u>Remuneration Committee/ Nomination Committee</u>	
Chairman	260	Chairman	90
Member	160	Members	60
Members of both Audit Committee and Risk Committee	280		

^{Note 5} In line with the remuneration policy of HSBC Group, no Director's fee is payable to those Directors who are full time employees of the Bank and its subsidiaries.

Information relating to the remuneration of Directors on a named basis for the year ended 31 December 2015 is set out in Note 15 to the Bank's 2015 Financial Statements.

Remuneration of Senior Management and Key Personnel

According to HKMA's SPM CG-5 "Guideline on a Sound Remuneration System", authorised institutions are required to make disclosures in relation to their remuneration systems as appropriate. The Bank has fully complied with HKMA's disclosure requirements set out in Part 3 of the said Guideline.

There were nine employees and six employees being classified as Senior Management^{Note 6} and Key Personnel^{Note 7} respectively during the year.

Aggregate amount of remuneration^{Note 8} of the Senior Management and Key Personnel during the year, split into fixed and variable remuneration, is set out below:

Amount (HK\$ '000)	2015 (15 employees)		2014 (14 employees)	
	Non-deferred	Deferred	Non-deferred	Deferred
Fixed remuneration				
Cash	39,683	-	37,826	-
Shares	3,982	-	3,994	-
Variable remuneration				
Cash	17,789	6,119	18,842	4,880
Shares	6,624	9,812	4,987	8,949

^{Note 6} Senior Management refers to those executives who are either:
(a) EDs; (b) senior executives of the Bank at the rank of Band 1; and if not already covered by the aforesaid, (c) Heads of the Bank's major business lines, namely, Global Banking and Markets, Retail Banking and Wealth Management, and Commercial Banking; (d) Chief Financial Officer; (e) Chief Risk Officer; (f) Chief Operating Officer; (g) Head of Human Resources; and (h) Head(s) of the Bank's principal subsidiary/subsidiaries with offshore operations and with total assets representing more than 5% of the Bank's total assets.

^{Note 7} Key Personnel refers to (a) those executives other than Senior Management, at the rank of Band 3 or above, who are engaged in trading and dealing activities which involve the assumption of material risk or the taking on of material exposures on behalf of the Bank and its subsidiaries, and (b) employees classified as "Code Staff" under the UK Prudential Regulatory Authority Remuneration Code.

^{Note 8} Remuneration refers to all remuneration payable to employees during the year with reference to their tenure as Senior Management and Key Personnel.

Aggregate amount of deferred variable remuneration, split into (a) vested and paid during the year and (b) outstanding and unvested at the end of the year, is set out below:

Amount (HK\$ '000)	2015		2014	
	Awarded for Performance Year 2015	Awarded for Prior Performance Years	Awarded for Performance Year 2014	Awarded for Prior Performance Years
Vested and paid out during the year				
Cash	-	1,095	-	-
Shares	-	6,015	-	4,786
Outstanding and unvested at the end of the year				
Cash	6,119	7,001	4,880	3,165
Shares	9,812	17,591	8,949	16,951

No deferred variable remuneration had been reduced through performance adjustments in 2015 and 2014.

Quantitative information on employees' exposure to implicit adjustments (e.g. fluctuations in the value of shares or performance units) and explicit adjustments (e.g. malus, clawbacks or similar reversals or downward revaluations of awards) of deferred remuneration and retained remuneration is set out below:

(HK\$ '000)	2015	2014
Total amount of outstanding deferred remuneration and retained remuneration exposed to ex post explicit/implicit adjustments	40,523	33,945
Total amount of reductions during the year due to:		
- Ex post explicit adjustments	- 215	-
- Ex post implicit adjustments	- 478	+343

No Senior Management or Key Personnel has been awarded or paid guaranteed bonus, new sign-on or severance payment during the years of 2015 and 2014.

Other relevant remuneration disclosures are set out in Notes 14, 15 and 57(b) to the Bank's 2015 Financial Statements.

ACCOUNTABILITY AND AUDIT

Financial Reporting

The Board aims at making a balanced, clear and comprehensive assessment of the Bank's performance, position and prospects. An annual operating plan is reviewed and approved by the Board on an annual basis. Reports on financial results, business performance and variances against the approved annual operating plan are made available to the Board for regular review and monitoring on a monthly basis.

Strategic planning cycles are generally from three to five years. The Bank's strategic plan for 2016-2018 will be reviewed and approved by the Board in 2016. Progress of the implementation of the key initiatives in the strategic plan is reported to and reviewed by the Board and Executive Committee on a quarterly basis.

The annual and interim results of the Bank are announced in a timely manner within three months and two months respectively after the end of the relevant year or period.

The Directors acknowledge their responsibilities for preparing the accounts of the Bank. As at 31 December 2015, the Directors were not aware of any material uncertainties relating to events or conditions which may cast significant doubt upon the Bank's ability to continue as a going concern. Accordingly, the Bank's Directors have prepared the financial statements of the Bank on a going-concern basis.

The responsibilities of the external auditor with respect to financial reporting are set out in the Independent Auditor's Report attached to the Bank's 2015 Financial Statements.

Internal Controls

System and Procedures

The Board is responsible for internal control of the Bank and its subsidiaries and for reviewing its effectiveness.

The Bank's internal control system comprises a well-established organisational structure and comprehensive policies and standards. Areas of responsibilities for each business and functional unit are clearly defined to ensure effective checks and balances.

Procedures have been designed for safeguarding assets against unauthorised use or disposition; for maintaining proper accounting records; and for ensuring the reliability of financial information used within the business or for publication. The procedures provide reasonable but not absolute assurance against material errors, losses or fraud. Procedures have also been designed to ensure compliance with applicable laws, rules and regulations.

Systems and procedures are in place in the Bank to identify, control and report on the major types of risks the Bank encounters. Business and functional units are responsible for the assessment of individual types of risk arising under their areas of responsibilities, the management of the risks in accordance with risk management procedures and the reporting on risk management. The Bank maintains an effective risk management framework through the setting up of specialised management committees for the oversight and monitoring of major risk areas and the establishment of risk management departments for relevant functions of the Bank. Relevant risk management reports are submitted to Asset and Liability Management Committee, RMC, Executive Committee and Risk Committee, and ultimately to the Board for oversight and monitoring of the respective types of risk. The Bank's risk management policies and major control limits are approved by the Board or its delegated committees, and are monitored and reviewed regularly according to established policies and procedures.

More detailed discussion on the policies and procedures for management of each of the major types of risk the Bank encounters is set out in the "Risk Management" and "Capital Management" sections of the "Management Discussion and Analysis" in this Annual Report, and Supplementary Notes to the Bank's 2015 Financial Statements.

Annual Assessment

A review of the effectiveness of the Bank's internal control system covering all material controls, including financial, operational, compliance, and risk management controls, is conducted annually. The review at the end of 2015 was conducted with reference to the COSO (The Committee of Sponsoring Organisations of the Treadway Commission) internal control framework, which assesses the Bank's internal control system against the five elements of control environment, risk assessment, control activities, information and communication, and monitoring. The review results have been reported to the Audit Committee, Risk Committee and the Board. The Board is satisfied that such system is effective and adequate. In addition, the Bank, through the Audit Committee, has also reviewed the adequacy of resources, qualifications and experience of staff of the Accounting and Financial Reporting function, and their training programmes and budget.

Framework for Disclosure of Inside Information

The Bank has put in place a robust framework for the disclosure of inside information in compliance with the Securities and Futures Ordinance. The framework sets out the procedures and internal controls for the handling and dissemination of inside information in a timely manner so as to allow all the stakeholders to apprehend the latest position of the Bank and its subsidiaries. The framework and its effectiveness are subject to review on a regular basis according to established procedures.

Internal Audit

The primary role of the Internal Audit function is to help the Board and Senior Management to protect the assets, reputation and sustainability of the Bank. The Internal Audit function provides independent and objective assurance as to whether the design and operational effectiveness of the Bank's framework of risk management, control and governance processes, as designed and represented by the Management, is adequate.

The Bank has adopted a risk management and internal control structure, referred to as the "Three Lines of Defence", to ensure it achieves its commercial aims while meeting regulatory and legal requirements and its responsibilities to shareholders, customers and staff. The Internal Audit function's role as the third line of defence is independent of the first and second lines of defence. The Bank's Head of Audit reports to the Chairman and the Audit Committee.

Results of audit work together with an assessment of the overall risk management and control framework are reported to the Audit Committee and the Risk Committee as appropriate. The Internal Audit function also reviews the Management's action plans in relation to audit findings and verifies the adequacy and effectiveness of the mitigating controls before formally closing the issue.

Appointment of PricewaterhouseCoopers as External Auditor

In 2013, HSBC Group, the ultimate holding company of the Bank, announced its intention to appoint PricewaterhouseCoopers as its auditor for the year ending 31 December 2015. The aforesaid appointment of PricewaterhouseCoopers was approved by the shareholders of HSBC Group at its AGM in 2015.

Given the fact that PricewaterhouseCoopers is a professional and qualified audit firm with extensive expertise and experience in the audit of financial institutions and with a view to aligning the audit arrangements between the Bank and HSBC Group for enhanced efficiency and effectiveness of the audit in terms of both cost and audit process, the Audit Committee and the Board of the Bank endorsed and recommended the appointment of PricewaterhouseCoopers as the Bank's auditor to shareholders of the Bank for approval. The Bank's shareholders approved the appointment of PricewaterhouseCoopers as the Bank's external auditor at the Bank's AGM on 7 May 2015.

External Auditor

PricewaterhouseCoopers is the Bank's external auditor. The Audit Committee is responsible for making recommendations to the Board on the appointment, re-appointment, removal and remuneration of the external auditor. The external auditor's independence and objectivity, and the effectiveness of the audit process are also reviewed and monitored by the Audit Committee on a regular basis.

During 2015, fees paid to the Bank's external auditor for audit services amounted to HK\$12.6 million, compared with HK\$11.5 million in 2014. For non-audit services, the fees paid to the Bank's external auditor amounted to HK\$7.2 million, compared with HK\$9.7 million in 2014. In 2015, the significant non-audit service assignments covered by these fees included the following:

Nature of service	Fees paid (HK\$ million)
Other assurance services	6.0
Tax services	<u>1.2</u>
	7.2

Audit Committee

The Audit Committee assists the Board in meeting its responsibilities for ensuring effective systems of internal control and compliance relating to financial reporting, and in meeting its financial reporting obligations.

Risk Committee

The Risk Committee assists the Board in meeting its responsibilities for ensuring effective systems of risk management, internal control and compliance (other than that relating to financial reporting), and in meeting its risk governance obligations.

COMMUNICATION WITH SHAREHOLDERS

Effective Communication

The Bank attaches great importance to communication with shareholders. To this end, a number of means are used to promote greater understanding and dialogue with the investment community. The Bank holds group meetings with analysts in connection with the Bank's annual and interim results. The results announcements are also broadcast live via webcast. Apart from the above, designated senior executives maintain regular dialogue with institutional investors and analysts to keep them abreast of the Bank's development, subject to compliance with the applicable laws and regulations. Including the two results announcements, around a hundred meetings with analysts and fund managers were held in 2015. In addition, the Bank's Vice-Chairman and Chief Executive, and Chief Financial Officer also made presentations and held group meetings with investors at investor forums.

Further, the Bank's website (www.hangseng.com) offers timely access to the Bank's financial information, announcements/ circulars to shareholders and information on the Bank's corporate governance structure and practices. For efficient communication with shareholders and in the interest of environmental preservation, shareholders are encouraged to browse the Bank's corporate communications on the Bank's website, in the place of receiving printed copies of the same.

The AGM provides a useful forum for shareholders to exchange views with the Board. The Bank's Chairman, EDs, Chairmen of the Board Committees and NEDs are available at the AGM to answer questions from shareholders about the business and performance of the Bank. In addition, the Bank's external auditor is also invited to attend the AGM to answer questions about the conduct of the audit, and the preparation and contents of the auditor's report. Separate resolutions are proposed at general meetings for each substantial issue, including the re-election and election (as the case may be) of individual Directors. An explanation of the detailed procedures of conducting a poll will be provided to shareholders at the AGM, to ensure that shareholders are familiar with such procedures.

The Bank's last AGM was held on Thursday, 7 May 2015 at Hang Seng Bank Headquarters, 83 Des Voeux Road Central, Hong Kong. All the resolutions proposed at that meeting were approved by the shareholders by poll voting. Details of the poll results are available under the "Investor Relations" section of the Bank's website (www.hangseng.com).

The next AGM will be held on Friday, 6 May 2016, the notice of which will be sent to shareholders at least 20 clear business days before the said meeting. Shareholders may refer to the section "Corporate Information and Calendar" in this Annual Report for information on other important dates for shareholders in year 2016.

Calling an Extraordinary General Meeting

Shareholder(s) holding not less than five percent of the total voting rights of all the members having a right to vote may request to call an Extraordinary General Meeting of the Bank.

The requisition (a) must state the general nature of the business to be dealt with at the meeting, (b) must be signed by the requisitionist(s), and (c) may either be deposited at the Bank's registered office at 83 Des Voeux Road Central, Hong Kong in hard copy form or sent by email to egmrequisition@hangseng.com. If the resolution is to be proposed as a special resolution, the requisition should include the text of the resolution and specify the intention to propose the resolution as a special resolution. The requisition may consist of several documents in like form, each signed by one or more requisitionist(s).

The requisition must also state (a) the name(s) of the requisitionist(s), (b) the contact details of the requisitionist(s) and (c) the number of ordinary shares of the Bank held by the requisitionist(s).

The Directors must proceed to convene an Extraordinary General Meeting within 21 days from the date of receipt of the requisition. Such meeting should be held on a date not more than 28 days after the date on which the notice convening the meeting is given.

If the Directors fail to convene the Extraordinary General Meeting as aforesaid, the requisitionist(s), or any of them representing more than one-half of the total voting rights of all of them, may themselves convene the meeting. Any meeting so convened shall not be held after the expiration of three months from the date of the deposit of the requisition.

A meeting so convened by the requisitionist(s) shall be convened in the same manner, as nearly as possible, as that in which meetings are to be convened by the Directors.

Any reasonable expenses incurred by the requisitionist(s) by reason of the failure of the Directors to convene a meeting shall be reimbursed to the requisitionist(s) by the Bank.

Putting Forward Proposals at General Meetings

Shareholders representing at least 2.5 percent of the total voting rights of all the members having a right to vote, or, at least 50 shareholders who have a relevant right to vote, may:

- put forward proposal at general meeting
- circulate to other shareholders written statement with respect to matter to be dealt with or other business to be dealt with at general meeting

For further details on shareholder qualifications, and the procedures and timeline, in connection with the above, shareholders are kindly requested to refer to Sections 580 and 615 of the Companies Ordinance (Cap 622, Laws of Hong Kong).

Further, a shareholder may propose a person other than a retiring Director of the Bank for election as a Director of the Bank at a general meeting. For such purpose, the shareholder must send to the Bank's registered address (for the attention of the Bank's Company Secretary) a written notice which identifies the candidate and includes a notice in writing by that candidate of his/her willingness to be so elected. Such notice must be sent within the seven-day period commencing on the day after the despatch of the notice of the meeting, or such other period as may be determined by the Directors from time to time, and ending no later than seven days prior to the date appointed for such meeting. Procedures for shareholders to propose candidates for election as Director of the Bank are also available on the website of the Bank (www.hangseng.com).

Putting Enquiries to the Board

Shareholders may send their enquiries requiring the Board's attention to the Bank's Company Secretary at the Bank's registered address. Questions about the procedures for convening or putting forward proposals at an AGM or Extraordinary General Meeting may also be put to the Company Secretary by the same means.

Shareholders Communication Policy

The Bank has established a Shareholders Communication Policy to set out the Bank's processes to provide shareholders and the investment community with ready, equal and timely information on the Bank for them to make informed assessments of the Bank's strategy, operations and financial performance, and to engage actively with the Bank. The said policy is available on the Bank's website (www.hangseng.com).

MATERIAL RELATED PARTY TRANSACTIONS

Material Related Party Transactions and Contracts of Significance

The Bank's material related party transactions are set out in Note 57 to the 2015 Financial Statements. These transactions include those that the Bank has entered into with its immediate holding company and fellow subsidiary companies in the ordinary course of its interbank activities, including the acceptance and placement of interbank deposits, corresponding banking transactions, off-balance sheet transactions, and the provision of other banking and financial services.

The Bank uses the information technology services of, and shares an automated teller machine network with, The Hongkong and Shanghai Banking Corporation Limited, its immediate holding company. The Bank also shares information technology and certain processing services with fellow subsidiaries on a cost recovery basis. In 2015, the Bank's share of the costs included HK\$365 million for system development, HK\$412 million for data processing, and HK\$279 million for administrative services.

The Bank maintains a staff retirement benefit scheme for which a fellow subsidiary company acts as insurer and administrator. As part of its ordinary course of business with other financial institutions, the Bank also markets Mandatory Provident Fund and life insurance products and distributes retail investment funds for fellow subsidiaries, with a fee income of HK\$139 million and HK\$37 million respectively in 2015. Hang Seng Investment Management Limited, a wholly owned subsidiary of the Bank, manages, in the ordinary course of its business, a fund administered by a fellow subsidiary, to which management fee rebates were made. The rebate for 2015 amounted to HK\$116 million.

These transactions were entered into by the Bank in the ordinary and usual course of business on normal commercial terms, and in relation to those which constituted connected transactions under the Listing Rules, they also complied with applicable requirements under the Listing Rules. The Bank regards its usage of the information technology services of The Hongkong and Shanghai Banking Corporation Limited (amount of information technology services cost incurred for 2015: HK\$386 million) as contracts of significance for 2015.

Continuing Connected Transactions and Connected Transactions

Continuing Connected Transactions

On 21 June 2013, Hang Seng Insurance Company Limited ("HSIC"), a wholly-owned subsidiary of the Bank, entered into the following agreements:

- (i) a management services agreement (“Management Services Agreement”) with HSBC Life (International) Limited (“INHK”) for a term of three years commencing from 22 June 2013, pursuant to which INHK, directly or through one or more of its affiliates, provided certain management services to HSIC.

INHK charged HSIC for the provision of the services on a fully absorbed cost basis plus a mark-up of 5%. These charges were determined following negotiation on an arm’s length basis and in accordance with the policy of the HSBC Group, which took into account the transfer pricing guidelines of UK and the Organisation for Economic Co-operation and Development.

- (ii) an investment management agreement (“Investment Management Agreement”) with HSBC Global Asset Management (Hong Kong) Limited (“AMHK”) for a term of three years commencing from 22 June 2013, pursuant to which AMHK acted as investment manager in respect of certain of HSIC’s assets held from time to time. AMHK has delegated to HSBC Alternative Investments Limited (“HAIL”), an indirect wholly owned subsidiary of HSBC Group, the management of part of such assets by way of a bespoke portfolio.

HSIC paid, on a quarterly basis, to AMHK a fee of between 0.05% and 0.35% per annum (previously between 0.15% and 0.75% per annum) of the mean value of the assets under management, with effect from 1 January 2014. HSIC also paid to HAIL a fee of 0.5% per annum (previously between 0.5% and 0.9% per annum) of the aggregate value of assets under management in a bespoke portfolio, with effect from 1 November 2014. On top of the aforesaid, HSIC also paid to HAIL a performance fee of 10% per annum in respect of the amount by which the return of such portfolio exceeded a benchmark return of 8% per annum (previously a benchmark return of 3.5% above 3-month LIBOR per annum), with effect from 1 November 2014. The above fees have been determined on an arm’s length basis. Subject to the caps under the Investment Management Agreement not being exceeded, HSIC and AMHK may subsequently agree to vary the above fees.

Details of the terms of and the annual caps under the Management Services Agreement and the Investment Management Agreement for the period from 22 June to 31 December 2013, and for the years ended 31 December 2014 and 2015, and for the period from 1 January to 21 June 2016, were announced by the Bank on 21 June 2013.

The Directors believed that the Management Services Agreement would enable HSIC to run at a reasonably low cost structure by leveraging on the shared infrastructure and expertise of INHK. The resulting cost efficiency has contributed to increased competitiveness of HSIC’s manufactured products in the market, which the Directors considered to be essential to the future business growth of HSIC.

The Directors considered that the Investment Management Agreement was based on normal commercial terms comparable with similar investment management agreements.

INHK and AMHK are both indirect wholly-owned subsidiaries of HSBC Group, the ultimate controlling shareholder of the Bank and therefore are connected persons of the Bank. Accordingly, all the aforesaid agreements constituted continuing connected transactions of the Bank. The Bank has complied with the disclosure requirements in accordance with Chapter 14A of the Listing Rules.

For the year ended 31 December 2015, the aggregate amount paid under the Management Services Agreement was HK\$105 million, whereas the aggregate amount paid under the Investment Management Agreement was HK\$38 million, both of which were within the annual caps for the year ended 31 December 2015 of HK\$230 million and HK\$162 million, respectively.

In respect of the aforesaid agreements which constituted the Bank’s continuing connected transactions, all the INEDs of the Bank have reviewed the said transactions and confirmed that the said transactions have been entered into:

- (a) in the ordinary and usual course of business of the Bank and its subsidiaries;
- (b) on normal commercial terms or better; and
- (c) in accordance with the relevant agreements governing the same on terms that are fair and reasonable and in the interests of the shareholders of the Bank as a whole.

Further, the Bank engaged its external auditor to report on the continuing connected transactions of the Bank and its subsidiaries in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised) “Assurance Engagements Other Than Audits or Reviews of Historical Financial Information” and with reference to Practice Note 740 “Auditor’s Letter on Continuing Connected Transactions under the Hong Kong Listing Rules” issued by the Hong Kong Institute of Certified Public Accountants. The Directors confirmed that the external auditor had issued an unqualified letter containing their findings and conclusions in respect of the continuing connected transactions set out in the preceding paragraphs in accordance with Rule 14A.56 of the Listing Rules. A copy of the auditor’s letter has been provided by the Bank to HKEx.

Connected Transactions

(1) First Transaction

On 9 February 2015, the Bank entered into a contract with Pat Davie Limited (“Pat Davie”) under which Pat Davie would complete and provide specified building interior demolition, improvement, installation and fit-out works and services in relation to the Bank’s back office premises situated at 113-115 Argyle Street, Mongkok, Kowloon, Hong Kong, for a maximum consideration (including optional works to be completed at the instruction of the Bank or its agent) of HK\$15 million. The consideration would be paid based on the monthly site progress assessed by the external consultants team engaged by the Bank.

(2) Second Transaction

On 8 May 2015, the Bank entered into another contract with Pat Davie under which Pat Davie would complete and provide specified building interior demolition, improvement, installation and fit-out works and services in relation to the Bank’s back office premises situated at 12/F Main Equipment Room, Hang Seng Tower, 33 Wai Yip Street, Kowloon Bay, Kowloon, Hong Kong, for a maximum consideration (including optional works to be completed at the instruction of the Bank or its agent) of HK\$56 million. The consideration would be paid based on the monthly site progress assessed by the external consultants team engaged by the Bank.

(3) Third Transaction

On 19 June 2015, the Bank entered into a third transaction pursuant to which the Bank has selected Pat Davie as the nominated sub-contractor to complete and provide specified fitting out works and services in relation to the Bank’s back office premises situated at 113-115 Argyle Street, Mongkok, Kowloon, Hong Kong, for a maximum total consideration (including optional works to be completed at the instruction of the Bank or its agent) of HK\$51 million. The consideration would be paid based on the monthly site progress assessed by the external consultants team engaged by the Bank.

Pat Davie was majority owned by Shui On Contractors Limited which in turn is a wholly-owned subsidiary of SOCAM Development Limited (“SOCAM Development”). Dr Vincent H S Lo, the Chairman and Executive Director, and together with his associates, is entitled to control the exercise of more than 30% of the voting power at general meetings, of SOCAM Development. Dr Lo is also a NED of the Bank. As Pat Davie is an associate of Dr Lo, Pat Davie is a connected person of the Bank. Accordingly, the First, Second and Third Transactions constitute connected transactions for the Bank under Chapter 14A of the Listing Rules.

The Directors (including the INEDs) are of the view that the First, Second and Third Transactions were made on normal commercial terms and in the ordinary and usual course of business of the Bank, and that the terms of the First, Second and Third Transactions are fair and reasonable and in the interests of the Bank and its shareholders as a whole.

Details of the First and Second Transactions were announced by the Bank on 8 May 2015, while details of the Third Transaction were announced by the Bank on 19 June 2015.

HUMAN RESOURCES

The human resources policies of the Bank are designed to attract people of the highest calibre and to motivate them to excel in their careers, as well as uphold the Bank's brand equity and culture of quality service.

Employee Statistics

As at 31 December 2015, the Bank's total headcount was 10,141, representing a decrease of 54, or - 0.5%, compared with a year earlier. The total headcount comprised 2,104 executives, 4,568 officers and 3,469 clerical and non-clerical staff.

Employee Remuneration

The Remuneration Committee oversees the Bank's overall reward strategy and ensures all the reward policies are carefully considered in the context of business objective, people strategy, commercial competitiveness and regulatory guidance during their formulation. The Committee may invite any Director, executive, consultant or other relevant party to provide advice in this respect. The fundamental principles, philosophies and processes are documented in the Bank's remuneration policy.

The Bank adopts a Total Reward Approach. In determining the total remuneration for employees, the Bank will make reference to individual's responsibility, capability and risk profile of the job to ensure an appropriate balance between the fixed pay and variable pay.

Fixed pay is determined by taking into account relevant level and composition of pay in the markets in which the Bank operates. Salaries are reviewed in the context of business performance, individual performance and potential, market practice, internal relativities, risk management requirements, competitiveness compared to peers and regulatory requirements.

Bank-wide variable pay budgets are formulated in consideration of the Bank's business performance, people strategy and risk appetite parameters, including operational risk, credit risk, funding/liquidity risk, risk adjusted return and capital strength. This helps to ensure that the variable pay pool is shaped by risk considerations and the Bank's performance is sustainable in the long-term. The ex-ante risk adjustment of remuneration within the Bank is achieved in the way that the Risk Committee of the Bank will advise the Board and/or the Remuneration Committee, as appropriate, on the alignment of risk appetite with performance objectives set in the context of variable incentive and on whether any adjustments for risk need to be applied when considering performance objectives and actual performance. In addition, the overall variable pay funding proposal is refined with reference to the advice of Chief Financial Officer and Chief Risk Officer in respect of the Bank's financial position and performance against its risk appetite profile.

Variable pay is determined with respect to individual's performance against respective financial and non-financial goals and measures including sales quality, customer satisfaction, values and behaviours, adherence to risk and compliance and the relevant governance criteria. Under such arrangement, the performance and remuneration of control function staff is assessed according to a performance scorecard specific to the functional role they undertake which is independent of the businesses they oversee.

Variable pay consists of deferred and non-deferred components in the forms of cash and share award. The Bank adopts a progressive deferral mechanism with higher deferral rates and different forms of deferral by reference to (a) the employee's seniority, role, responsibilities and the potential risks that their activities may create for the Bank; and (b) the total amount of variable remuneration exceeding the prescribed thresholds. The deferred award has a vesting period of three to five years and is subject to malus and clawback under certain specific circumstances with respect to the awardee's conduct or the Bank's performance.

The principles of the remuneration policy are applicable to the Bank and its subsidiaries, subject to the local legislative requirements and market practices, and are proportionate to the scope and complexity of the local business.

Employee Engagement

The Bank strives to build a best place to work by promoting employee engagement and driving a diversity and inclusive culture.

The Global People Survey has been conducted in 2015 and follow up actions have been taken as a continuous effort to drive employee engagement and promote a values-led high performance culture across the Bank. The results showed that the Bank's employee engagement level is above the external best-in-class, employees are recognised for their contribution, strategies are well communicated and implemented, and the corporate values are well embedded in the Bank's culture.

Growth and Development

The Bank is committed to ensuring the competence and ethical behaviour of staff members with due regard to the principles set out in HKMA's SPM CG-6 on "Competence and Ethical Behaviour". The Bank has established policies and procedures for monitoring, developing and maintaining the competence levels and ethical behaviour of staff members. These include clear guidance as set out in various policy manuals, robust performance management system, and training and development solutions provided on a regular and need basis.

In order to fully develop staff competence and potential, the Bank has a comprehensive induction programme that provides new staff with an understanding of the Bank's history, vision, culture, values, risk management and corporate governance. To equip staff members with necessary skills and knowledge to meet future challenges and professional requirements, especially those who are involved in regulated businesses and activities, the Bank offers a wide range of training and development programmes in the areas of sales and relationship management, products, operations, compliance, credit and risk. Apart from these programmes, the Bank has launched an Anti-Money Laundering (AML) and Sanctions training programme for staff in roles deemed to be of "High Risk" to provide them with an in-depth knowledge in detecting, deterring and protecting against financial crime risks. The Bank also offers Professional Qualifications and Education Award Scheme to support staff members to pursue professional or academic qualifications. On average, the Bank's staff members received six days of training in 2015.

The Bank aims to strengthen the leadership pipeline and support the personal growth of staff by providing a broad range of leadership and management development solutions. To ensure sustainability, the Bank has strategies, measures and metrics to plan and manage succession to critical roles, and to facilitate talent feed to the succession pipeline. Line businesses and the Human Resources function are connected to accelerate the development of talents and high potential staff through a mix of on-the-job training, coaching and learning interventions.

In support of the Bank's vision, strategy and values, apart from the existing leadership programmes, a new global cultural change training series have been put in place to strengthen the management philosophy and skills of people managers in driving the Bank's culture, and on the other hand, to motivate and help all employees to live up to the Bank's corporate values in order to help achieve the Bank's long-term strategies and directions.

Recruitment and Retention

Vigorous recruitment activities continued throughout 2015 to support the Bank's strategic business development and for replacement of out-going staff, especially for front line sales positions, experienced professionals and specialists.

Young talents are constantly recruited and groomed through well-structured and intensive development programmes. Further, trainee programmes have been provided for jobs in selected functional areas in order to build pipeline for succession. There were also conscious efforts on retention of talents and key staff through review of career advancement opportunities and remuneration package to ensure market competitiveness.

OTHER INFORMATION

Organisational Structure

Under the Bank's current organisational structure, the Bank's businesses and functions are set out as follows:

Businesses

Retail Banking and Wealth Management
Commercial Banking
Global Banking and Markets

Functions

Audit
Communications
Company Secretarial Services
Corporate Sustainability
Financial Control
Human Resources
Legal
Marketing
Risk and Compliance
Strategic Planning and Corporate Development
Technology and Services

Business Principles and Values

The Bank has a set of well-founded business principles and corporate values guiding staff to keep the highest standards of integrity as well as to comply with the spirit and letter of all laws and regulations when conducting business. "Courageous Integrity" is the guiding principle whereby every employee has the courage to do the right thing without compromising the ethical standards and integrity, and behaves in a "Dependable, Open and Connected" way in everyday work. The Bank advocates the living of values by all staff, promotes their awareness and commitment, and empowers leaders and managers to drive values behaviour in the workplace.

Code of Conduct

To ensure the Bank operates according to the highest standards of ethical conduct and professional competence, all staff are required to strictly follow the Code of Conduct contained in the Bank's Staff Handbook. With reference to the applicable regulatory guidelines and other industry best practices, the Code sets out ethical standards and values to which all the Bank's staff are required to adhere and covers various legal, regulatory and ethical issues. Topics including but not limited to the prevention of bribery, use of information, insider dealing and personal dealings, personal benefits, outside directorships/employment and equal opportunities policy are covered in the Code.

The Bank uses various communication channels to periodically remind staff of the requirement to adhere to the rules and ethical standards set out in the Code of Conduct.

Avoidance of Conflicts of Interest

The Bank has set standards and established policies and procedures to manage actual or potential conflicts of interest of its staff. Stringent internal structures have been designed to ensure adequate segregation of duties and avoid conflicts of interest. Staff working in sensitive or high-risk areas are required to adhere to job-specific rules and undergo training regarding avoidance of conflicts of interest in carrying out their duties.

Health and Safety

The Bank has a demonstrated commitment to occupational health and safety (“OH&S”) in the workplace with employee engagement through committees, forums and working groups in the development of an OH&S Policy and Management System. By successfully implementing the certified BS OHSAS 18001:2007-compliant Safety Management System, the Bank marks its achievement to be the first bank world-wide to conform to this internationally acclaimed best practice aiming at reducing the exposure of the Bank’s staff, contractors and customers to OH&S risks associated with its business activities at premises over which it has control.

The Bank provides a range of training and activities to enhance the knowledge of its staff in OH&S, fire safety, manual operation, and office safety. A number of staff have acquired Qualified First Aider status so as to offer prompt assistance to their colleagues and customers in the event of a medical emergency or accident whilst awaiting the arrival of the ambulance. Some Qualified First Aiders have also been trained to operate the Automated External Defibrillators installed in the Bank premises.

The Bank implements a Contingency Plan for Communicable Disease, which sets out the key issues to be addressed and the actions to be taken by various units in response to the occurrence of a serious communicable disease, and the keeping of adequate stock of face masks to cater for the needs of its staff in response to an outbreak of influenza pandemic. Staff have been made aware through the Bank-wide intranet of the importance of personal hygiene and health, and the contingency measures to be adopted, to enable the Bank to continue with its services to the community during an outbreak of a serious communicable disease.

The Bank operates a Staff Recreation Centre at Kowloon Bay with a variety of facilities for health enhancement and leisure activities to foster work life balance among its staff and their family members.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Board of Directors

Dr Raymond CH'IEN Kuo Fung GBS, CBE, JP
Independent Non-executive Chairman

Aged 64

Joined the Board since August 2007

Other positions held within Hang Seng Group

- ^ **Hang Seng Bank Limited** –
Chairman of Nomination Committee; Member of Remuneration Committee

Other major appointments

Justice of the Peace

- ^ **China Resources Power Holdings Company Limited** – Independent Non-executive Director
- Economic Development Commission of HKSAR Government** – Non-official Member
- Federation of Hong Kong Industries** – Honorary President
- ^ **Swiss Re Limited** – Independent Non-executive Director
- The Hongkong and Shanghai Banking Corporation Limited** –
Independent Non-executive Director
- The Tianjin Municipal Committee of the Chinese People's Political Consultative Conference** –
Member of Standing Committee
- University of Pennsylvania, USA** – Trustee

Past major appointments

- ^ **MTR Corporation Limited** – Non-executive Chairman (2003 – 2015) (*Note 1*)
- ^ **The Wharf (Holdings) Limited** – Independent Non-executive Director (2002 – 2015) (*Note 1*)
- ^ **UGL Limited** – Non-executive Director (2012 – 2014)
- ^ **Convenience Retail Asia Limited** – Independent Non-executive Director (2001 – 2014)
- Hong Kong Mercantile Exchange Limited** – Independent Non-executive Director (2009 – 2013)
- ^ **China.com Inc** – Chairman (1999 – 2013)
- Ascendas China Commercial Fund Management Limited** – Chairman (2011 – 2012)
- ^ **CDC Software Corporation** – Director (2009 – 2012)
- The Hong Kong/European Union Business Cooperation Committee** – Chairman (2005 – 2012)
- ^ **CDC Corporation** – Chairman (1999 – 2011)
- HSBC Private Equity (Asia) Limited** – Chairman (1997 – 2010)
- The APEC Business Advisory Council** – Hong Kong Member (2004 – 2009)
- ^ **Inchcape plc** – Independent Non-executive Director (1997 – 2009)
- ^ **HSBC Holdings plc** – Independent Non-executive Director (1998 – 2007)
- Independent Commission Against Corruption** –
Chairman of Advisory Committee on Corruption (1998 – 2006)
- Executive Council of HKSAR Government** – Member (1997 – 2002)
- Executive Council of Hong Kong, then under British Administration** – Member (1992 – 1997)

Qualification

Doctoral Degree in Economics – University of Pennsylvania, USA

Major awards

Chevalier de l'Ordre du Merite Agricole of France (2008)

Gold Bauhinia Star (1999)

Commander in the Most Excellent Order of the British Empire (1994)

Ms Rose LEE Wai Mun JP
Vice-Chairman and Chief Executive

Aged 63

Joined the Board since March 2012

Other positions held within Hang Seng Group

- ^ **Hang Seng Bank Limited** –
Chairman of Executive Committee; Member of Nomination Committee
- Hang Seng Bank (China) Limited** – Chairman; Member of Executive Committee
- Hang Seng Indexes Company Limited** – Chairman of Hang Seng Index Advisory Committee
- Hang Seng Insurance Company Limited** – Chairman
- Chairman of other subsidiaries in Hang Seng Group

Other major appointments

- Justice of the Peace**
- ^ **CK Hutchison Holdings Limited** – Independent Non-executive Director
- Guangdong's Association for Promotion of Cooperation between Guangdong, Hongkong & Macao** – Executive Vice Chairman of the Finance Professional Committee
- Hang Seng Management College** – Chairman of the Board of Governors
- Hang Seng School of Commerce** – Chairman of the Board of Directors
- Ho Leung Ho Lee Foundation** – Member of Board of Trustees
- Hong Kong Trade Development Council** –
Member of the Financial Services Advisory Committee
- ^ **HSBC Holdings plc** – Group General Manager
- Inaugural Financial Consulting Committee for Authority of Qianhai Shenzhen - Hong Kong Modern Service Industry Cooperation Zone of Shenzhen** – Vice Chairman
- Qianhai & Shekou Area of Shenzhen, China (Guangdong) Pilot Free Trade Zone, and Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone of Shenzhen** –
Member of the Consulting Committee (*Note 1*)
- ^ **Swire Pacific Limited** – Independent Non-executive Director; Member of Remuneration Committee
- The Community Chest of Hong Kong** – Board Member; Second Vice President; Member of Executive Committee; Chairman of the Campaign Committee
- The Hongkong and Shanghai Banking Corporation Limited** – Director
- The Hong Kong Institute of Bankers** – Vice President
- The Hong Kong University of Science and Technology** – Member of the Court
- The University of Hong Kong, New College of Jockey Club Student Village III** –
Member of the Advisory Committee

Past major appointments

- Hutchison Whampoa Limited** – Independent Non-executive Director (2012 – 2015)
- City University of Hong Kong** – Member of the Advisory Committee of the Centre for Transportation, Trade and Financial Studies (2012 – 2013)
- Hong Kong Shipowners' Association** –
Honorary Treasurer; Member of the Executive Committee (2009 – 2013)
- Hong Kong General Chamber of Commerce** –
Vice-Chairman of the China Committee (2006 – 2013)
- Bank of Shanghai** – Director (2006 – 2012)
- Hong Kong Trade Development Council** –
Member of the China Trade Advisory Committee (2007 – 2011)
- HKSAR Government Education and Manpower Bureau** –
Member of the Continuing Education Fund China Business Focus Group (2002 – 2009)
- The Hong Kong Institute of Bankers** –
Member of the China Development Committee (2005 – 2007)
- Hong Kong Monetary Authority** –
Member of the PRC Offshore Financing Consultative Committee (1998 – 2000)

The Hongkong and Shanghai Banking Corporation Limited –

joined Corporate Finance Department of Wardley Limited in 1977, seconded to Area Office China, HSBC in 1979, appointed Deputy Chief Executive, China Business (1994 – 2002), Managing Director of Hongkong Bank China Services Limited (1985 – 2004), Head of Corporate Banking, Hong Kong (2002 – 2004), Head of Corporate and Institutional Banking, Hong Kong (2004 – 2007), Head of Corporate Banking, Hong Kong and China (2007 – 2008), Head of Global Banking, China and Hong Kong (2008 – 2009) and Advisor, China and Hong Kong (2009 – 2012)

Qualification

Bachelor's Degree in Business Administration – The University of Hawaii, USA

Dr John CHAN Cho Chak GBS, JP
Independent Non-executive Director

Aged 72

Joined the Board since August 1995

Other positions held within Hang Seng Group

- ^ **Hang Seng Bank Limited** –
Chairman of Remuneration Committee; Member of Nomination Committee

Other major appointments

Justice of the Peace

- ^ **Guangdong Investment Limited** – Independent Non-executive Director
Long Win Bus Company Limited – Non-executive Director
^ **RoadShow Holdings Limited** – Chairman and Non-executive Director
^ **Swire Properties Limited** – Independent Non-executive Director
The Community Chest of Hong Kong – Board Member; Member of Executive Committee
The Hong Kong University of Science and Technology – Chairman of the Court
The Kowloon Motor Bus Company (1933) Limited – Non-executive Director
^ **Transport International Holdings Limited** –
Deputy Chairman and Independent Non-executive Director

Past major appointments

The Community Chest of Hong Kong –

Third Vice President (2014 – 2015)
Chairman of Public Relations Committee (2014 – 2015)
Vice Patron (2004 – 2011)

Hong Kong Monetary Authority –

Member of The Exchange Fund Advisory Committee (2008 – 2014)

Sir Edward Youde Memorial Fund – Chairman of the Council (2007 – 2013)

The Hong Kong Jockey Club – Chairman (2006 – 2010)

HKSAR Commission on Strategic Development – Non-Official Member (2005 – 2009)

- ^ **Hong Kong Exchanges and Clearing Limited** –

Independent Non-executive Director (2000 – 2003)

Hong Kong Civil Service – Private Secretary to the Governor; Deputy Secretary (General Duties); Director of Information Services; Deputy Chief Secretary; Secretary for Trade and Industry; Secretary for Education and Manpower (1964 – 1978; 1980 – 1993)

Qualifications

Degree of Doctor of Social Sciences (honoris causa) – Lingnan University; The University of Hong Kong; The Hong Kong University of Science and Technology
Degree of Doctor of Business Administration (honoris causa) – International Management Centres
Diploma in Management Studies – The University of Hong Kong
Honours Degree in English Literature – The University of Hong Kong

Major award

Gold Bauhinia Star (1999)

Mr Nixon CHAN Lik Sang

Executive Director and Head of Retail Banking and Wealth Management

Aged 63

Joined the Board since January 2014

Other positions held within Hang Seng Group

- ^ **Hang Seng Bank Limited** – Member of Executive Committee
- Hang Seng Bank (Trustee) Limited** – Director
- Hang Seng Credit Limited** – Director
- Hang Seng Finance Limited** – Director
- Hang Seng Futures Limited** – Director
- Hang Seng Indexes Company Limited** – Member of Hang Seng Index Advisory Committee
- Hang Seng Insurance Company Limited** – Director
- Hang Seng Securities Limited** – Director
- Hang Seng Security Management Limited** – Director
- Haseba Investment Company Limited** – Director

Other major appointments

Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Review Tribunal – Member
Employers' Federation of Hong Kong – Elected Member of General Committee; Chairman of Banking and Financial Services Group
EPS Company (Hong Kong) Limited – Director
Hang Seng Management College – Governor
Hang Seng School of Commerce – Director
TransUnion Limited – Director

Past major appointments

- MasterCard Asia/Pacific Advisory Board** – Director (2012 – 2015)
- Small and Medium Enterprises Committee** – Member (2009 – 2014)
- ^ **Hang Seng Bank Limited** – Head of Corporate and Commercial Banking (2009 – 2011)
- The Hongkong and Shanghai Banking Corporation Limited** – Senior Executive, Commercial Banking (2005 – 2009)
Held various senior positions in commercial banking and personal financial services (1993 – 2005)

Qualification

Bachelor's Degree in Business Administration – The University of Hawaii, USA

Mr Patrick CHAN Kwok Wai
Executive Director and Head of Greater China

Aged 59

Joined the Board since February 2016

Other position held within Hang Seng Group

^ **Hang Seng Bank Limited** – Member of Executive Committee

Other major appointments

Hang Seng Management College – Governor; Chairman of Finance Committee

Hang Seng School of Commerce – Director; Chairman of Finance Committee

Standing Committee on Language Education and Research – Member

The ACCA Hong Kong – Member of Professional Development Sub-committee

The Community Chest of Hong Kong – Board Member

The Foundation of Tsinghua University Center for Advanced Study Co. Ltd. –
Member of Investment Committee

Past major appointments

The Chamber of Hong Kong Listed Companies –

Deputy Chairman of General Committee (2015)

Member of General Committee (2009 – 2015)

^ **Sun Hung Kai Properties Limited** –

Executive Director and Chief Financial Officer (2009 – 2015)

^ **Hang Seng Bank Limited** –

Executive Director and General Manager (2005 – 2009)

Chief Financial Officer (1998 – 2009)

Deputy General Manager (2003 – 2005)

Assistant General Manager and Head of Financial Control Division (1995 – 1998)

^ **Industrial Bank Co., Ltd.** –

Director and Member of Executive Committee (2004 – 2009)

Member of Remuneration Committee (2007 – 2009)

Member of Credit Card Centre Management Committee (2005 – 2009)

Qualifications

Associate Financial Planner – The Institute of Financial Planners of Hong Kong

Associate – The Institute of Chartered Secretaries and Administrators, UK

Fellow – CPA Australia

Fellow – The Association of Chartered Certified Accountants, UK

Fellow – The Hong Kong Institute of Certified Public Accountants

Master of Business Administration – The University of Warwick, UK

Member – The Society of Trust and Estate Practitioners, UK

Dr Henry CHENG Kar Shun GBS
Independent Non-executive Director

Aged 69

Joined the Board since May 2014

Other major appointments

- ^ **Chow Tai Fook Jewellery Group Limited** – Chairman and Executive Director
- ^ **FSE Engineering Holdings Limited** – Chairman and Non-executive Director (*Note 1*)
- ^ **HKR International Limited** – Independent Non-executive Director
- ^ **International Entertainment Corporation** – Chairman and Executive Director
- ^ **New World China Land Limited** – Chairman and Managing Director
- ^ **New World Department Store China Limited** – Chairman and Non-executive Director
- ^ **New World Development Company Limited** – Chairman and Executive Director
- ^ **Newton Resources Ltd** – Chairman and Non-executive Director
- ^ **NWS Holdings Limited** – Chairman and Executive Director
- ^ **SJM Holdings Limited** – Non-executive Director
- The Better Hong Kong Foundation** – Chairman of the Advisory Council
- The Twelfth National Committee of Chinese People’s Political Consultative Conference** –
Standing Committee Member

Past major appointment

- ^ **Lifestyle International Holdings Limited** – Non-executive Director (2004 – 2015)

Qualifications

Honorary Doctor of Business Administration in Hospitality Management –
The Johnson & Wales University, USA
Honorary Doctor of Laws – The University of Western Ontario, Canada
Doctor of Social Sciences (honoris causa) – The University of Hong Kong

Major Award

Gold Bauhinia Star (2001)

Ms CHIANG Lai Yuen JP
Independent Non-executive Director

Aged 50

Joined the Board since September 2010

Other position held within Hang Seng Group

^ **Hang Seng Bank Limited** – Member of Remuneration Committee

Other major appointments

Justice of the Peace

^ **Chen Hsong Holdings Limited** – Executive Director; Chief Executive Officer

Chen Hsong Investments Limited – Director

China Shenzhen Machinery Association – Vice-President

Federation of Shenzhen Industries – Vice-Chairman

Hospital Authority – Board Member

The Hong Kong University of Science and Technology – Member of the Court

The Shenzhen Committee of the Chinese People's Political Consultative Conference –
Member of Standing Committee

The Toys Manufacturers' Association of Hong Kong – Vice-President

Past major appointments

Directorate Salaries and Conditions of Service of HKSAR Government –

Member of Standing Committee (2008 – 2014)

The Hong Kong University of Science and Technology – Member of the Council (2006 – 2012)

The Open University of Hong Kong – Member of the Council (2006 – 2012)

Disciplined Services Salaries and Conditions of Service of HKSAR Government –

Member of Standing Committee (2005 – 2010)

Qualification

Bachelor Degree of Arts – Wellesley College, USA

Major award

"Young Industrialist Awards of Hong Kong" by the Federation of Hong Kong Industries (2004)

Mr Andrew FUNG Hau Chung JP
Executive Director and Head of Global Banking and Markets

Aged 58

Joined the Board since October 2011

Other positions held within Hang Seng Group

- ^ **Hang Seng Bank Limited** – Member of Executive Committee
- Hang Seng Bullion Company Limited** – Director
- Hang Seng Indexes Company Limited** – Member of Hang Seng Index Advisory Committee
- Hang Seng Insurance Company Limited** – Director
- Hang Seng Investment Management Limited** – Director and General Manager
- Hang Seng Investment Services Limited** – Director
- Hang Seng Life Limited** – Director
- Hang Seng Securities Limited** – Executive Director

Other major appointments

Justice of the Peace

Airport Authority Hong Kong – Board Member

Central Policy Unit of HKSAR Government – Associate Member

HKSAR Government Environment Bureau – Member of Energy Advisory Committee

Hong Kong Institute of Certified Public Accountants – Lay Member of the Council

Hospital Authority – Board Member

Independent Commission on Remuneration for Members of the Executive Council and the Legislature, and Officials under the Political Appointment System of HKSAR Government – Member

- ^ **Industrial Bank Co., Ltd.** – Director; Member of Strategic Committee; Member of Remuneration and Evaluation Committee

Labour Department – Member of the Protection of Wages on Insolvency Fund Board

Securities and Futures Commission – Member of Products Advisory Committee

The Community Chest of Hong Kong – Board member

The Liaoning Shenyang Committee of the Chinese People's Political Consultative Conference – Member

Treasury Markets Association – Member of the Executive Board

Past major appointments

The Hong Kong Mortgage Corporation Limited – Director (2010 – 2015)

Business Facilitation Advisory Committee – Non-official member (2009 – 2013)

The Federation of Hong Kong Industries – Member of General Committee (2007 – 2013)

Central Policy Unit of HKSAR Government –

Pan-Pearl River Delta Panel – Member (2011 – 2012)

Hong Kong Trade Development Council –

Member of the Financial Services Advisory Committee (2008 – 2012)

- ^ **Hang Seng Bank Limited** –

Executive Director and Head of Treasury and Investment (2011 – 2012)

General Manager and Head of Treasury and Investment (2009 – 2011)

General Manager and Head of Investment and Insurance (2008 – 2009)

Deputy General Manager and Head of Investment and Insurance (2006 – 2008)

Securities and Futures Commission – Member of Process Review Panel (2006 – 2012)

DBS Bank (Hong Kong) Limited – Managing Director, Advisory Sales, Greater China, Wholesale Banking – Global Financial Markets (2002 – 2006)

- ^ **Commonwealth Bank of Australia, Hong Kong Branch** – Treasurer and Head of Capital Markets, Asia (1996 – 2002)

The Hongkong and Shanghai Banking Corporation Limited –
Head of Hong Kong Dollar Markets (1991 – 1996)

Qualifications

Bachelor of Arts Degree – The University of Hong Kong
Honorary Fellowship – Lingnan University

Dr HU Zulu, Fred

Independent Non-executive Director

Aged 52

Joined the Board since May 2011

Other position held within Hang Seng Group

^ **Hang Seng Bank Limited** – Member of Risk Committee

Other major appointments

China Medical Board – Trustee

^ **Dalian Wanda Commercial Properties Co., Ltd.** –
Independent Non-executive Director

^ **Hong Kong Exchanges and Clearing Limited** –
Independent Non-executive Director

National Center for Economic Research at Tsinghua University –
Director and Professor

Primavera Capital Limited – Founder and Chairman

^ **SCMP Group Limited** – Independent Non-executive Director

^ **Shanghai Pudong Development Bank Co., Ltd.** – External Supervisor

The Nature Conservancy Asia Pacific Region – Co-Chairman

Yale-China Association – Trustee

Past major appointments

Securities and Futures Commission –

Member of Advisory Committee (2009 – 2011)

Goldman Sachs Group Inc. –

Chairman of Greater China (2008 – 2010)

Managing Director (2000 – 2010)

HKSAR Commission on Strategic Development –

Member (2007 – 2009)

^ **Shanghai Pudong Development Bank Co., Ltd.** –

Independent Director (2002 – 2008)

Qualifications

Master of Arts and Doctor of Philosophy in Economics –
Harvard University, USA

Master of Science in Engineering Science – Tsinghua University, PRC

Ms Irene LEE Yun Lien
Independent Non-executive Director

Aged 62

Joined the Board since May 2014

Other positions held within Hang Seng Group

^ **Hang Seng Bank Limited** – Chairman of Risk Committee; Member of Audit Committee

Other major appointments

^ **Cathay Pacific Airways Limited** – Independent Non-executive Director; Chairman of Audit Committee and Remuneration Committee

^ **CLP Holdings Limited** – Independent Non-executive Director; Member of Audit Committee, Finance & General Committee, and Sustainability Committee

^ **Hysan Development Company Limited** – Executive Chairman; Chairman of Nomination Committee and Strategy Committee

^ **HSBC Holdings plc** – Independent Non-executive Director

^ **Noble Group Limited** – Independent Non-executive Director; Member of Audit Committee, Investment & Capital Markets Committee, Nominating Committee and Risk Committee

The Hongkong and Shanghai Banking Corporation Limited – Independent Non-executive Director; Member of Audit Committee

Past major appointments

JP Morgan Australia – Member of Advisory Council (2005 – 2013)

^ **QBE Insurance Group Limited** – Non-executive Director (2002 – 2013)

^ **Keybridge Capital Limited** – Non-executive Chairman (2009 – 2012)
Executive Chairman (2006 – 2009)

The Myer Family Company Pty Limited – Non-executive Director (2009 – 2011)

ING Bank (Australia) Limited – Non-executive Director (2005 – 2011)

Australian Government Takeovers Panel – Member (2001 – 2010)

Sealcorp Holdings Limited – Chief Executive Officer (1998 – 1999)

^ **Commonwealth Bank of Australia** – Head of Corporate Finance (1993 – 1998)

Citicorp Investment Bank Limited in New York, London and Sydney – Executive Director (1977 – 1987)

Qualifications

Bachelor of Arts Degree – Smith College, USA

Barrister-at-Law in England and Wales

Member – The Honourable Society of Gray's Inn, UK

Ms Sarah Catherine LEGG

Non-executive Director

Aged 48

Joined the Board since February 2011

Other major appointments

- ^ **HSBC Holdings plc** – Group General Manager; Group Financial Controller
- The Hong Kong Society for Rehabilitation** – Honorary Vice-President

Past major appointments

The Hong Kong Association of Banks –

Acting Chairman (2015)

Chairman of the Basel Implementation Committee (2012 and 2015)

The Hong Kong Society for Rehabilitation –

Honorary Treasurer (2006 – 2015)

The Hongkong and Shanghai Banking Corporation Limited –

Alternate Chief Executive (2010 – 2015) (*Note 1*)

Chief Financial Officer (2010 – 2015)

Chief Accounting Officer (2006 – 2010)

HSBC Bank (Taiwan) Limited – Director (2011 – 2015)

HSBC Securities Investments (Asia) Limited – Director (2006 – 2015)

HSBC Bank Bahamas Limited – President (2010 – 2014)

HSBC Markets (Bahamas) Limited – President (2010 – 2014)

HSBC Asia Holdings BV – Director (2011 – 2013)

- ^ **HSBC Holdings plc** –

Senior Manager, Finance Transformation (2003 – 2006)

HSBC Bank plc –

Head of Product Control, Global Banking and Markets (1999 – 2003)

Qualifications

Master of Arts – King’s College, Cambridge University, UK

Fellow – Chartered Institute of Management Accountants

Fellow – Association of Corporate Treasurers

Dr Eric LI Ka Cheung GBS, OBE, JP
Independent Non-executive Director

Aged 62

Joined the Board since February 2000

Other positions held within Hang Seng Group

^ **Hang Seng Bank Limited** – Chairman of Audit Committee; Member of Risk Committee

Other major appointments

Justice of the Peace

^ **China Resources Beer (Holdings) Company Limited** –

Independent Non-executive Director; Chairman of Audit Committee

Independent Commission on Remuneration for the Members of the District Councils of HKSAR Government – Chairman

Legal Aid Services Council – Chairman

Li, Tang, Chen & Co, Certified Public Accountants – Senior Partner

Long Win Bus Company Limited – Director

^ **RoadShow Holdings Limited** – Independent Non-executive Director; Chairman of Audit Committee

^ **SmarTone Telecommunications Holdings Limited** –

Independent Non-executive Director; Chairman of Audit Committee

^ **Sun Hung Kai Properties Limited** –

Independent Non-executive Director; Chairman of Audit Committee

The Financial Reporting Council – Member of Honorary Advisory Panel

The Hong Kong Institute of Education – Member of Board of Steward

The Hong Kong Jockey Club – Steward; Chairman of Audit Committee

The Kowloon Motor Bus Company (1933) Limited – Director

The Twelfth National Committee of the Chinese People's Political Consultative Conference – Member

^ **Transport International Holdings Limited** –

Independent Non-executive Director; Chairman of Audit Committee

^ **Wong's International (Holdings) Limited** –

Independent Non-executive Director; Chairman of Audit Committee

Past major appointments

The Hong Kong Institute of Education –

Chairman of Finance Committee; Treasurer of the Council (2009 – 2015)

The Presidium of the Election of Deputies of the Hong Kong Special Administrative Region to the Twelfth National People's Congress – Member (2013)

^ **Bank of Communications Co., Ltd.** –

Independent Non-executive Director; Chairman of Audit Committee (2007 – 2013)

The Financial Reporting Council –

Convenor of Financial Reporting Review Committee (2007 – 2013)

HKSAR Commission on Strategic Development – Member (2007 – 2012)

Hong Kong Monetary Authority – Chairman of Process Review Committee (2007 – 2010)

Meadville Holdings Limited –

Independent Non-executive Director; Chairman of Remuneration Committee (2007 – 2010)

The International Federation of Accountants –

Board Member (2004 – 2006)

The Legislative Council of Hong Kong –

Member (1991 – 2004); Chairman of Public Accounts Committee (1995 – 2004)

Qualifications

BA (Economics) Honours Degree – University of Manchester, UK
Fellow – Hong Kong Institute of Certified Public Accountants (Practising)
Hon Doctor of Laws – University of Manchester, UK
Hon Doctor of Social Sciences – Hong Kong Baptist University
Hon Fellow – The Chinese University of Hong Kong
Hon Fellow – The Hong Kong Polytechnic University

Major awards

Gold Bauhinia Star (2003)
Officer of the Most Excellent Order of the British Empire (1996)

Dr Vincent LO Hong Sui GBS, JP

Non-executive Director

Aged 67

Joined the Board since February 1999

Other major appointments

Justice of the Peace

Business and Professionals Federation of Hong Kong – Honorary Life President

Chongqing Municipal Government – Economic Adviser

Council for the Promotion and Development of Yangtze – President

^ **Great Eagle Holdings Limited** – Non-executive Director

Hong Kong Trade Development Council – Chairman

Shanghai Tongji University; Shanghai University – Advisory Professorship

Shui On Group – Chairman

^ **Shui On Land Limited** – Chairman

^ **SOCAM Development Limited** – Chairman

The Hong Kong University of Science and Technology – Honorary Court Chairman

The Twelfth National Committee of the Chinese People's Political Consultative Conference –
Member

Past major appointments

Airport Authority Hong Kong –

Chairman (2014 – 2015)

Board Member (2013 – 2015)

Lantau Development Advisory Committee of HKSAR Government –

Non-official Member (2014 – 2015)

APEC Business Advisory Council – Hong Kong's Representative (2010 – 2014)

^ **Shui On Land Limited** – Chief Executive Officer (2004 – 2011)

^ **China Telecom Corporation Limited** – Independent Non-executive Director (2002 – 2008)

^ **New World China Land Limited** – Independent Non-executive Director (1999 – 2004)

The Hong Kong University of Science and Technology – Chairman of the Council (1999 – 2002)

Hong Kong General Chamber of Commerce – Chairman (1991 – 1992)

Basic Law Consultative Committee – Executive Committee Member (1985 – 1990)

Qualifications

Doctorate in Business Administration (honoris causa) –
The Hong Kong University of Science and Technology
Doctor of Business (honoris causa) – The University of New South Wales, Australia

Major awards

Lifetime Achievement Award for Leadership in Property Sector by the 4th World Chinese Economic Forum (2012)
“Ernst & Young Entrepreneur Of The Year 2009” in the China Real Estate Sector (2009)
Ernst & Young China Entrepreneur Of The Year 2009 (2009)
Chevalier des Arts et des Lettres by the French Government (2005)
Director of the Year in the category of Listed Company Executive Directors by The Hong Kong Institute of Directors in 2002 (2002)
Businessman of the Year award in the Hong Kong Business Awards 2001 (2001)
Gold Bauhinia Star (1998)

Mr Kenneth NG Sing Yip

Non-executive Director

Aged 65

Joined the Board since March 2014

Other major appointments

Competition Tribunal Users’ Committee of HKSAR Government – Member
Hong Kong General Chamber of Commerce – Vice Chairman of Legal Committee
HSBC Bank (China) Company Limited – Non-executive Director
HSBC Bank (Vietnam) Ltd. – Chairman of Board of Supervision
Standing Committee on Company Law Reform – Member
The Hongkong and Shanghai Banking Corporation Limited – General Counsel, Asia Pacific
The Law Society of Hong Kong – Council Member
The University of Hong Kong –
Member of Asian Institute of International Financial Law Advisory Board of the Faculty of Law

Past major appointments

Board of Review of Inland Revenue Ordinance of HKSAR Government –
Member (2008 – 2014)
^ **Ping An Insurance (Group) Company of China, Ltd.** –
Non-executive Director (2006 – 2013)
The Hongkong and Shanghai Banking Corporation Limited –
Deputy Head of Legal and Compliance Department (1993 – 1998)
Assistant Group Legal Adviser (1987 – 1993)

Qualifications

Bachelor’s Degree and Master’s Degree in Laws (LLB and LLM) – University of London, UK
Bachelor’s Degree in Laws (LLB) – Beijing University, PRC

Mr Richard TANG Yat Sun BBS, JP
Independent Non-executive Director

Aged 63

Joined the Board since August 1995

Other positions held within Hang Seng Group

- ^ **Hang Seng Bank Limited** – Member of Audit Committee
- Hang Seng Bank (China) Limited** – Supervisor

Other major appointments

Justice of the Peace

China Overseas Friendship Association – Executive Director-General

Customs and Excise Service Children’s Education Trust Fund –

Chairman of Investment Advisory Board

Fight Crime Committee – Member

Hong Kong Commercial Broadcasting Company Limited – Director

Hong Kong Institute of Certified Public Accountants – Member of Investigation Panel A

- ^ **King Fook Holdings Limited** – Vice Chairman

- ^ **Miramar Hotel & Investment Company, Limited** – Director

Richcom Company Limited – Chairman and Managing Director

Tang Shiu Kin and Ho Tim Charitable Fund – Advisor

The Twelfth National Committee of the Chinese People’s Political Consultative Conference –
Member

- ^ **Wheelock and Company Limited** – Independent Non-executive Director

Past major appointments

Steering Committee of HKSAR Government Scholarship Fund –

Member (2008 – 2014)

Customs and Excise Service Children’s Education Trust Fund Committee –

Chairman (2006 – 2012)

Hong Kong Institute of Certified Public Accountants –

Member of Disciplinary Panel A (2006 – 2012)

Correctional Services Children’s Education Trust –

Chairman of Investment Advisory Board (2006 – 2011)

Qualifications

Bachelor of Science Degree in Business Administration – Menlo College, California, USA

Master’s Degree in Business Administration – University of Santa Clara, California, USA

Major award

Bronze Bauhinia Star (2000)

Mr Peter WONG Tung Shun JP
Non-executive Director

Aged 64

Joined the Board since May 2005

Other position held within Hang Seng Group

^ **Hang Seng Bank Limited** – Member of Nomination Committee

Other major appointments

Justice of the Peace

^ **Bank of Communications Co., Ltd.** – Non-executive Director

^ **Cathay Pacific Airways Limited** – Independent Non-executive Director

Chongqing Mayor's International Economic Advisory Council – Member

Economic Development Commission of HKSAR Government – Non-official Member

Hong Kong General Chamber of Commerce – Member of General Committee

Hong Kong Monetary Authority – Member of The Exchange Fund Advisory Committee

HSBC Bank (China) Company Limited – Chairman and Non-executive Director; Chairman of Nomination Committee; Member of Remuneration Committee

HSBC Bank Malaysia Berhad – Chairman and Non-executive Director

^ **HSBC Holdings plc** – Group Managing Director; Member of Group Management Board

International Consultative Conference on the Future Economic Development of Guangdong Province – Economic Advisor to the Governor of Guangdong Province of the People's Republic of China

Our Hong Kong Foundation Limited – Special Counsellor (*Note 1*)

The Community Chest of Hong Kong –

Board Member; First Vice President; Chairman of Executive Committee

The Eleventh Hubei Provincial Committee of the Chinese People's Political Consultative Conference – Member; Member of Standing Committee

The Hongkong and Shanghai Banking Corporation Limited –

Deputy Chairman and Chief Executive; Executive Director

The Hong Kong Institute of Bankers – President

The Hong Kong Management Association – Fellow

The Twelfth National Committee of the Chinese People's Political Consultative Conference – Member

Past major appointments

International Advisor to the Mayor of Tianjin (2010 – 2013)

Greater Pearl River Delta Business Council – Member (2006 – 2013)

HSBC Bank (Vietnam) Ltd – Vice-Chairman and Non-executive Director (2010 – 2012)

^ **Ping An Insurance (Group) Company of China, Ltd.** – Non-executive Director (2006 – 2012)

Hong Kong Institute for Monetary Research – Member of the Board of Directors (2010 – 2011)

HSBC Bank Australia Limited – Non-executive Director (2010 – 2011)

^ **Hong Kong Exchanges and Clearing Limited** – Member of Risk Management Committee (2010)

Hong Kong Trade Development Council –

Chairman of Financial Services Advisory Committee (2006 – 2010)

Hong Kong Monetary Authority – Member of Banking Advisory Committee (2005 – 2010)

The Hong Kong Association of Banks – Chairman (2001, 2004, 2006 and 2009)

Qualifications

Bachelor's Degree in Computer Science; MBA in Marketing and Finance; MSc in Computer Science – Indiana University, USA

Mr Michael WU Wei Kuo
Independent Non-executive Director

Aged 45

Joined the Board since September 2010

Other positions held within Hang Seng Group

^ **Hang Seng Bank Limited** – Member of Audit Committee; Member of Nomination Committee

Other major appointments

Hongkong Caterers Limited – Executive Director and Company Secretary

^ **Hongkong Land Holdings Limited** – Non-executive Director

^ **Jardine Matheson Holdings Limited** – Non-executive Director

Maxim’s Caterers Limited – Chairman and Managing Director

The Community Chest of Hong Kong – Board Member; Member of Executive Committee

The Hong Kong University of Science and Technology – Member of the Council

The University of Hong Kong – Member of the Court

Qualification

Bachelor of Science in Applied Mathematics and Economics – Brown University, USA

Major Awards

“Ernst & Young Entrepreneur of The Year 2012 China” - Category Winner (Services) and Country Winner (Hong Kong / Macau Regions) (2012)

Executive Award of the DHL / SCMP Hong Kong Business Awards (2008)

^ The securities of these companies are listed on a securities market in Hong Kong or overseas.

Notes:

- 1 New appointments or cessation of appointments since the date of the Bank's 2015 Interim Report.
- 2 The interests of Directors in shares of the Bank, if any, within the meaning of Part XV of the Securities and Futures Ordinance ("SFO") as at 31 December 2015 are disclosed in the section "Directors' and Alternate Chief Executives' Interests" of the Report of the Directors attached to the Bank's 2015 Annual Report.
- 3 Some Directors (as disclosed in the section "Biographical Details of Directors and Senior Management – Board of Directors" of the Bank's 2015 Annual Report) are also Directors of HSBC Holdings plc ("HSBC") and/or its subsidiaries. HSBC, through its wholly owned subsidiaries, has an interest in the shares of the Bank under the provisions of Divisions 2 and 3 of Part XV of the SFO, the details of which are disclosed in the section "Substantial Interests in Share Capital" of the Report of the Directors attached to the Bank's 2015 Annual Report.
- 4 Save as disclosed in the section "Biographical Details of Directors and Senior Management – Board of Directors" of the Bank's 2015 Annual Report, the Directors (a) have not held any directorships in other publicly listed companies, whether in Hong Kong or overseas, during the last 3 years; (b) do not hold any other positions in the Bank and its subsidiaries; and (c) do not have any other relationships with any Directors, senior management or substantial or controlling shareholders of the Bank, except that Mr Michael W K Wu's spouse is the niece of Dr Vincent H S Lo, a Non-executive Director of the Bank.
- 5 All Directors (except those Directors who are full time employees of the Bank or its subsidiaries) will receive Directors' fees in the amounts approved from time to time by shareholders at the Annual General Meetings of the Bank. The current amounts of Directors' fees have been determined with reference to market rates, directors' workload and required commitment. A Director will also receive a fee for duties assigned to and services provided by him/her as Chairman or member of various Committees of the Bank. Such fees have been determined with reference to the remuneration policy of the Bank.
- 6 No Directors' fees are payable to those Directors who are full time employees of the Bank or its subsidiaries. The salary packages of such Directors have been determined with reference to the remuneration policy of the Bank. Such Directors are also entitled to discretionary bonus.
- 7 The details of the emoluments of the Directors on a named basis are disclosed in Note 15 of the Bank's Financial Statements as contained in the Bank's 2015 Annual Report.
- 8 None of the Directors, except Ms Rose W M Lee, Mr Nixon L S Chan, Mr Patrick K W Chan and Mr Andrew H C Fung, has signed service contracts with the Bank. The term of appointment of Non-executive Directors (including Independent Non-executive Directors) is three years except that where a Non-executive Director (or an Independent Non-executive Director) has served on the Board for more than nine years, then his/her term of appointment is one year.
- 9 Biographical details of Directors of the Bank are also available on the website of the Bank at www.hangseng.com.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Senior Management

Ms Rose LEE Wai Mun JP

Vice-Chairman and Chief Executive

(Biographical details are set out on pages 123-124)

Ms Ivy CHAN Shuk Pui

Chief Risk Officer

Aged 50

Joined the Bank since July 2014

Major positions held within Hang Seng Group

Hang Seng Bank Limited –

Chief Risk Officer; Member of Executive Committee

Hang Seng Security Management Limited – Director

Past major positions

The Hongkong and Shanghai Banking Corporation Limited –

Chief Risk Officer, HSBC Bank (Taiwan) Limited (2010 – 2014)

Senior Manager of Credit Risk Management Department (2005 – 2010)

Senior Relationship Manager of Credit Risk Management Department (2002 – 2005)

Treasury Credit Risk Manager (1997 – 2001)

Various positions in HSBC in the areas of Trade Services, Retail Banking, Corporate Banking
Relationship Manager, Credit Operations (1988 – 1997)

Qualification

Professional Diploma in Company Secretaryship and Administration –

The Hong Kong Polytechnic University

Mr Nixon CHAN Lik Sang

Executive Director and Head of Retail Banking and Wealth Management

(Biographical details are set out on page 125)

Mr Patrick CHAN Kwok Wai

Executive Director and Head of Greater China

(Biographical details are set out on page 126)

Mr Andrew FUNG Hau Chung JP

Executive Director and Head of Global Banking and Markets

(Biographical details are set out on pages 129 to 130)

Mr Christopher HO Hing Nin
Chief Operating Officer

Aged 63

Joined the Bank since July 2009

Major positions held within Hang Seng Group

Hang Seng Bank Limited –

Chief Operating Officer; Member of Executive Committee

Hang Seng Real Estate Management Limited – Director

Hang Seng Security Management Limited – Director

Past major positions

Education Bureau of HKSAR Government –

Member of Banking Industry Training Advisory Committee (2010 – 2014)

Urban Renewal Authority –

Member of Central Oasis Community Advisory Committee (2009 – 2012)

The Hongkong and Shanghai Banking Corporation Limited –

Head of Service Delivery Asia Pacific (2009)

Held various senior positions in banking operations and personal financial services (1992 – 2008)

Qualification

MSc in Management Information Systems – Sheffield Hallam University, UK

Mr Donald LAM Yin Shing
Head of Commercial Banking

Aged 52

Joined the Bank since March 2003

Major positions held within Hang Seng Group

Hang Seng Bank Limited –

Head of Commercial Banking; Member of Executive Committee

Hang Seng Insurance Company Limited – Director

Past major positions

Hang Seng General Insurance (Hong Kong) Company Limited – Director (2008 – 2012)

Hang Seng Bank Limited –

Head of Commercial Banking Relationship Management (2005 – 2006)

Deputy Head of Commercial Banking Relationship Management (2004 – 2005)

Department Head, Commercial Banking Relationship Management Department A (2003 – 2004)

Playmates Holdings Limited – Executive Director and Chief Financial Officer (2001 – 2003)

The Hongkong and Shanghai Banking Corporation Limited –

Senior Marketing and Planning Manager (1999 – 2001)

Held various senior positions in Corporate and Commercial Banking (1987 – 1999)

Qualifications

Associate – The Hong Kong Institute of Bankers

Bachelor of Social Science (1st Class Honor) – The University of Hong Kong

Master of Business Administration – The Chinese University of Hong Kong

Master of Science in e-Commerce – The Chinese University of Hong Kong

Mr Gordon LAM Wai Chung

Vice-Chairman and Chief Executive of Hang Seng Bank (China) Limited

Aged 56

Joined the Bank since October 2012

Major positions held within Hang Seng Group

Hang Seng Bank Limited –

Member of Executive Committee

Hang Seng Bank (China) Limited –

Vice-Chairman and Chief Executive; Chairman of Executive Committee

Past major positions

Hang Seng Bank (China) Limited –

First Deputy Chief Executive and Head of Network (2012 – 2013)

Deputy Chief Executive, Head of Business Development, Corporate and Commercial Banking (2012)

HSBC Bank (China) Company Limited –

Managing Director and Head of Global Banking (2007 – 2011)

Chief Credit Officer (2003 – 2007)

China Banking Regulatory Commission Shanghai Office –

Leader of the Foreign Bank Basel II Working Committee (2007)

The Hong Kong Association of Banks –

Chairman of Preparatory Committee for Hong Kong Commercial Credit Reference Agency (2003)

The Hongkong and Shanghai Banking Corporation Limited –

Senior Manager, Credit Risk Management, Asia Pacific (1988 – 2003)

Hong Kong Chamber of Commerce in China – One of Founding members (1993 – 1994)

Qualification

Bachelor of Business Administration – The Chinese University of Hong Kong

Mrs Louise LAM

Head of Human Resources

Aged 59

Joined the Bank since August 2007

Major positions held within Hang Seng Group

Hang Seng Bank Limited –

Head of Human Resources; Member of Executive Committee

Past major positions

The Hongkong and Shanghai Banking Corporation Limited –

Head of Human Resources Operations, Asia Pacific (2004 – 2007)

Held various senior positions in Human Resources (1990 – 2004)

Government of Ontario, Canada –

Senior Consultant, Organisational Development (1987 – 1990)

Chase Manhattan Bank –

Vice President, Head of Human Resources (1980 – 1987)

Qualification

Bachelor of Social Sciences in Economics and Management Studies – The University of Hong Kong

Mr Andrew LEUNG Wing Lok
Chief Financial Officer

Aged 53

Joined the Bank in July 1997 (left in 2006) and rejoined in July 2009

Major positions held within Hang Seng Group

Hang Seng Bank Limited –

Chief Financial Officer; Member of Executive Committee

Hang Seng Bank (China) Limited – Director

Hang Seng Insurance Company Limited – Director

Hang Seng Investment Management Limited – Director

Past major positions

Hang Seng Bank Limited –

Senior Manager and Deputy Head of China Business (2005 – 2006)

Senior Manager and Deputy Head of Greater China Business (2003 – 2005)

Senior Manager of Corporate Banking (2001 – 2003)

Senior Manager and Deputy Head of Financial Control (1997 – 2001)

Qualifications

Associate – The Hong Kong Institute of Chartered Secretaries

Associate – The Institute of Chartered Secretaries and Administrators, UK

Bachelor of PRC Law – Peking University, PRC

Bachelor of Social Sciences (Major in Management) – The University of Hong Kong

Chartered Professional Accountant (CPA, CMA), Canada

Fellow – The Association of Chartered Certified Accountants, UK

Fellow – The Hong Kong Institute of Certified Public Accountants

Master of Science, Data processing – University of Ulster, UK

Master of Science in Electronic Commerce and Internet Computing – The University of Hong Kong

Note:

Definition of senior management is set out in the “Corporate Governance Report” section in this Annual Report.

REPORT OF THE DIRECTORS

The Directors have pleasure in presenting their report together with the audited financial statements for the year ended 31 December 2015.

Principal Place of Business

The Bank is incorporated and domiciled in Hong Kong and has its registered office and principal place of business at 83 Des Voeux Road Central, Hong Kong.

Principal Activities and Business Review

The Bank and its subsidiaries (the “Group”) are engaged in the provision of banking and related financial services. Further discussion and analysis of these activities as required by Schedule 5 to the Hong Kong Companies Ordinance, including a fair review of the business and a discussion of the principal risks and uncertainties facing the Group, particulars of important events affecting the Group that have occurred since the end of the financial year 2015, and an indication of likely future development in the Group’s business, can be found in the “Five-Year Financial Summary”, “Chairman’s Statement”, “Chief Executive’s Report”, “Management Discussion and Analysis”, “Corporate Sustainability” and “Corporate Governance Report” sections of this Annual Report. The above sections form part of this report.

Profits and Dividends

The consolidated profit of the Bank and its subsidiaries and associates for the year is set out under the consolidated income statement of this Annual Report.

The Directors declared and paid the first to third interim dividends of HK\$3.30 (2014: HK\$3.30) per share totalling HK\$6,309m (2014: HK\$6,309m) during the year. The Directors also declared the fourth interim dividend of HK\$2.40 (2014: HK\$2.30) per share totalling HK\$4,588m (2014: HK\$4,397m) and a special interim dividend of HK\$3.00 per share totalling HK\$5,736m (2014: nil), which will be paid on 29 March 2016.

Major Customers

The Directors believe that the five largest customers of the Bank accounted for less than 30% of the total interest income and other operating income of the Bank for the year.

Subsidiaries

Particulars of the Bank’s principal subsidiaries as at 31 December 2015 are set out in note 34 to the financial statements for the year ended 31 December 2015.

Share Capital

Details of share capital of the Bank during the year are set out in note 48 to the financial statements for the year ended 31 December 2015.

Equity-linked Agreements

For the year ended 31 December 2015, the Bank has not entered into any equity-linked agreement.

Purchase, Sale or Redemption of the Bank’s Listed Securities

There was no purchase, sale or redemption by the Bank, or any of its subsidiaries, of the Bank’s listed securities during the year.

Reserves

Profit attributable to shareholders, before dividends, of HK\$27,494m (2014: 15,131m) has been transferred to reserves. Distributable reserve of the Bank as at 31 December 2015 amounted to HK\$69,780m (2014: HK\$35,544m). Other movements in reserves are set out in the consolidated statement of changes in equity of this Annual Report.

Donations

Charitable donations made by the Bank and its subsidiaries during the year amounted to HK\$21m. For further details of the Bank's corporate social responsibility activities and expenditures, please refer to the "Corporate Sustainability" section of this Annual Report.

Directors

The Directors of the Bank who were in office on the date of this report were Dr Raymond K F Ch'ien, Ms Rose W M Lee, Dr John C C Chan, Mr Nixon L S Chan, Mr Patrick K W Chan, Dr Henry K S Cheng, Ms L Y Chiang, Mr Andrew H C Fung, Dr Fred Zulu Hu, Ms Irene Y L Lee, Ms Sarah C Legg, Dr Eric K C Li, Dr Vincent H S Lo, Mr Kenneth S Y Ng, Mr Richard Y S Tang, Mr Peter T S Wong and Mr Michael W K Wu. Save for Mr Patrick K W Chan, all the Directors served on the Board of the Bank throughout the year.

Mr Patrick K W Chan was appointed as Executive Director with effect from 19 February 2016. Mr Chan will retire under the provisions of the Bank's Articles of Association and, being eligible, offer himself for election at the Bank's Annual General Meeting to be held on 6 May 2016 ("2016 AGM").

The Directors retiring by rotation in accordance with the Bank's Articles of Association are Dr John C C Chan, Dr Eric K C Li and Dr Vincent H S Lo, who, being eligible, offer themselves for re-election at the Bank's 2016 AGM.

No Director proposed for re-election or election (as the case may be) at the forthcoming AGM has a service contract with the Bank which is not determinable by the Bank within one year without payment of compensation (other than statutory compensation).

The biographical details of the Directors of the Bank are set out in the "Biographical Details of Directors and Senior Management" section of this Annual Report.

Directors of Subsidiaries

The list of Directors who have served on the Boards of the Bank's subsidiaries during the year or during the period beginning with the end of the year and ending on the date of this report are provided in the "Directors of Subsidiaries" section of this Annual Report.

Status of Independent Non-executive Directors

The Bank has received from each Independent Non-executive Director an annual confirmation of his/her independence pursuant to Rule 3.13 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") (the "Listing Rules"). The Bank still considers all the Independent Non-executive Directors to be independent.

Directors' and Alternate Chief Executives' Interests

As at 31 December 2015, the interests of the Directors and Alternate Chief Executives in the shares, underlying shares of equity derivatives and debentures of the Bank and its associated corporations (all within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) disclosed in accordance with the Listing Rules were detailed below.

Interests in shares

	Personal Interests (held as beneficial owner)	Family Interests (interests of spouse or child under 18)	Corporate Interests (interests of controlled corporation)	Other Interests	Total Interests	Total Interests as % of the relevant shares in issue/ issued share capital
Number of ordinary shares in the Bank						
<u>Director:</u>						
Dr John C C Chan	1,000 ⁽¹⁾	-	-	-	1,000	0.00
Number of ordinary shares of US\$0.50 each in HSBC Holdings plc						
<u>Directors:</u>						
Dr Raymond K F Ch'ien	57,814	-	-	-	57,814	0.00
Ms Rose W M Lee	353,836	1,616	-	137,241 ⁽³⁾	492,693	0.00
Dr John C C Chan	24,605 ⁽¹⁾	-	-	-	24,605	0.00
Mr Nixon L S Chan	78,566	-	-	26,216 ⁽³⁾	104,782	0.00
Mr Andrew H C Fung	97,241	-	-	29,723 ⁽³⁾	126,964	0.00
Ms Sarah C Legg	187,234	2,695	-	68,781 ⁽³⁾	258,710	0.00
Dr Eric K C Li	-	50,478	-	-	50,478	0.00
Mr Kenneth S Y Ng	356,627	-	-	38,903 ⁽³⁾	395,530	0.00
Mr Peter T S Wong	557,980	21,379	-	2,200,180 ⁽³⁾	2,779,539	0.01
<u>Alternate Chief Executives:</u>						
Mr Christopher H N Ho	117,217	54,507	-	9,604 ⁽³⁾	181,328	0.00
Mr Donald Y S Lam	57,752	-	-	12,635 ⁽³⁾	70,387	0.00
Mr Andrew W L Leung	11,357	-	-	11,318 ⁽³⁾	22,675	0.00
Number of perpetual non-cumulative preference shares of US\$0.01 each in HSBC Holdings plc						
<u>Director:</u>						
Ms Rose W M Lee	-	131,000 ⁽²⁾	-	75,075 ⁽²⁾	206,075	0.14

Interests in debentures of associated corporation of the Bank

Name of debenture	Name of Director	Personal Interests (held as beneficial owner)	Family Interests (interests of spouse or child under 18)	Corporate Interests (interests of controlled corporation)	Other Interests	Total Interests
8.00% perpetual subordinated capital securities, series 2 issued by HSBC Holdings plc	Ms Rose W M Lee	-	US\$3,275,000 ⁽²⁾	-	US\$1,876,875 ⁽²⁾	US\$5,151,875

Notes:

- (1) 1,000 shares in the Bank and 4,371 shares in HSBC Holdings plc were jointly held by Dr John C Chan and his wife.
- (2) Ms Rose W M Lee was a beneficiary of a trust, which had interests in the total principal amount of US\$1,876,875 of the 8.00% perpetual subordinated capital securities, series 2. Her spouse also had interests in the total principal amount of US\$3,275,000 of the 8.00% perpetual subordinated capital securities, series 2. These perpetual subordinated capital securities were exchangeable at the option of HSBC Holdings plc to 75,075 and 131,000 perpetual non-cumulative preference shares respectively of US\$0.01 each in HSBC Holdings plc. Ms Lee's interests set out in the table under "Interests in shares" and the table under "Interests in debentures of associated corporation of the Bank" represented the same interests.
- (3) These included interests in conditional awards of ordinary shares of US\$0.50 each in HSBC Holdings plc under the HSBC Share Plans made in favour of Directors and Alternate Chief Executives.

Conditional Awards of Shares

During the year, the Directors and Alternate Chief Executives as set out below were eligible to be granted conditional awards over ordinary shares of US\$0.50 each in HSBC Holdings plc by that company (being the ultimate holding company of the Bank) under various HSBC Share Plans. The details of the interests of the Directors and Alternate Chief Executives in the conditional awards of ordinary shares in HSBC Holdings plc under the HSBC Share Plans, as at 31 December 2015, were as follows:

	Awards held as at 1 January 2015	Awards made during the Director's/Alternate Chief Executive's term of office in 2015	Awards released during the Director's/Alternate Chief Executive's term of office in 2015	Awards held as at 31 December 2015
<u>Directors:</u>				
Ms Rose W M Lee	100,301	139,903	111,210	137,241 ⁽¹⁾
Mr Nixon L S Chan	24,353	29,108	28,954	26,216 ⁽¹⁾
Mr Andrew H C Fung	33,311	28,673	34,286	29,723 ⁽¹⁾
Ms Sarah C Legg	71,373	66,391	73,513	68,781 ⁽¹⁾
Mr Kenneth S Y Ng	49,558	33,470	46,870	38,903 ⁽¹⁾
Mr Peter T S Wong	1,091,027	448,596	386,842	1,222,917 ⁽¹⁾
<u>Alternate Chief Executives:</u>				
Mr Christopher H N Ho	6,450	5,489	2,935	9,604 ⁽¹⁾
Mr Donald Y S Lam	10,189	17,153	15,527	12,635 ⁽¹⁾
Mr Andrew W L Leung	6,760	6,849	2,988	11,318 ⁽¹⁾

Notes:

(1) This included additional shares arising from scrip dividends.

During the year, Ms Sarah C Legg and Mr Donald Y S Lam also acquired and were awarded ordinary shares of HSBC Holdings plc under the HSBC International Employee Share Purchase Plan. Their interests in ordinary shares of HSBC Holdings plc under this plan have been included in their "Personal Interests" disclosed in the table under "Interests in shares".

All the interests stated above represented long positions. As at 31 December 2015, no short positions were recorded in the Register of Directors' and Alternate Chief Executives' Interests and Short Positions required to be kept under section 352 of the SFO.

Save as disclosed in the preceding paragraphs, neither the Bank nor any of its holding companies or its subsidiaries or fellow subsidiaries was a party to any 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 as at the end of the year or at any time during the year.

No right to subscribe for equity or debt securities of the Bank has been granted by the Bank to, nor have any such rights been exercised by, any person during the year ended 31 December 2015.

Directors' Interests in Transactions, Arrangements or Contracts

No transaction, arrangement or contract (that is significant in relation to the Bank's business), to which the Bank or any of its holding companies or any of its subsidiaries or fellow subsidiaries was a party and in which a Director of the Bank or an entity connected with a Director had, directly or indirectly, a material interest, subsisted as at the end of the year or at any time during the year.

Management Contracts

Save for service contracts, no other contracts, relating to the management and / or administration of the whole or any substantial part of the business of the Bank were entered into or subsisting during the year.

Directors' Interests in Competing Businesses

Pursuant to Rule 8.10 of the Listing Rules, as at the date of this report, the following Directors had declared interests in the following entities which compete or are likely to compete, either directly or indirectly, with the businesses of the Bank:

Mr Andrew H C Fung is a Director, a member of Strategic Committee and a member of Remuneration and Evaluation Committee of Industrial Bank Co., Ltd. ("Industrial Bank"), in which the Bank holds a 0.88% stake. Industrial Bank conducts general banking business in mainland China.

Ms Rose W M Lee is a Group General Manager of HSBC Holdings plc and a Director of The Hongkong and Shanghai Banking Corporation Limited.

Ms Sarah C Legg is a Group General Manager and Group Financial Controller of HSBC Holdings plc.

Mr Kenneth S Y Ng is the General Counsel, Asia Pacific of The Hongkong and Shanghai Banking Corporation Limited and a Director of HSBC Bank (China) Company Limited and certain HSBC Group subsidiaries.

Mr Peter T S Wong is a Group Managing Director and a member of Group Management Board of HSBC Holdings plc. He is also the Deputy Chairman, Chief Executive and Executive Director of The Hongkong and Shanghai Banking Corporation Limited; and Chairman and Non-executive Director of HSBC Bank Malaysia Berhad and HSBC Bank (China) Company Limited, which are wholly-owned subsidiaries of The Hongkong and Shanghai Banking Corporation Limited. He is a Non-executive Director of Bank of Communications Co., Ltd., which conducts general banking business.

HSBC Holdings plc, through its subsidiaries and associated undertakings, including The Hongkong and Shanghai Banking Corporation Limited, the immediate holding company of the Bank, is engaged in providing a comprehensive range of banking, insurance and related financial services.

The entities in which the Directors have declared interests are managed by separate Boards of Directors and management, which are accountable to their respective shareholders.

Further, Industrial Bank has an Audit and Related Party Transaction Control Committee which is responsible for considering all matters concerning audit as well as connected party transactions to be entered into by Industrial Bank as required by the laws of mainland China. The majority of members of Industrial Bank's Audit and Related Party Transaction Control Committee are independent Directors.

The Board of the Bank includes nine Independent Non-executive Directors whose views carry significant weight in the Board's decisions. The Audit Committee and Risk Committee of the Bank, which consist of four and three Independent Non-executive Directors respectively, meet regularly to assist the Board of Directors in reviewing the financial performance, internal control and risk management systems of the Bank and its subsidiaries. The Bank is, therefore, capable of carrying on

its businesses in the best interests of all shareholders as a whole and has put in place adequate mechanisms to ensure that the Directors discharge their duties vis-a-vis all shareholders, including in respect of the Bank's dealings with the businesses in which Directors have declared interests.

Directors' Emoluments

The emoluments of the Directors of the Bank (including Executive Directors and Independent Non-executive Directors) on a named basis are set out in note 15 to the financial statements for the year ended 31 December 2015.

Indemnity Provision

Details of the Bank's permitted indemnity provision are set out in the "Corporate Governance Report" of this Annual Report.

Substantial Interests in Share Capital

The register maintained by the Bank pursuant to the SFO recorded that, as at 31 December 2015, the following corporations had interests or short positions in the shares or underlying shares (as defined in the SFO) in the Bank set opposite their respective names:

Name of Corporation	Number of Ordinary Shares in the Bank (Percentage of total)
The Hongkong and Shanghai Banking Corporation Limited	1,188,057,371 (62.14%)
HSBC Asia Holdings BV	1,188,057,371 (62.14%)
HSBC Asia Holdings (UK) Limited	1,188,057,371 (62.14%)
HSBC Holdings BV	1,188,057,371 (62.14%)
HSBC Finance (Netherlands)	1,188,057,371 (62.14%)
HSBC Holdings plc	1,188,057,371 (62.14%)

The Hongkong and Shanghai Banking Corporation Limited is a wholly-owned subsidiary of HSBC Asia Holdings BV, which is a wholly-owned subsidiary of HSBC Asia Holdings (UK) Limited, which in turn is a wholly-owned subsidiary of HSBC Holdings BV. HSBC Holdings BV is a wholly-owned subsidiary of HSBC Finance (Netherlands), which in turn is a wholly-owned subsidiary of HSBC Holdings plc. Accordingly, the interests of The Hongkong and Shanghai Banking Corporation Limited are recorded as the interests of HSBC Asia Holdings BV, HSBC Asia Holdings (UK) Limited, HSBC Holdings BV, HSBC Finance (Netherlands) and HSBC Holdings plc.

The Directors regard HSBC Holdings plc to be the beneficial owner of 1,188,057,371 ordinary shares in the Bank (62.14%).

All the interests stated above represented long positions. As at 31 December 2015, no short positions were recorded in the Register of Interests in Shares and Short Positions required to be kept under section 336 of the SFO.

Public Float

As at the date of this report, the Bank has maintained the prescribed public float under the Listing Rules, based on the information that is publicly available to the Bank and within the knowledge of the Directors of the Bank.

Code on Corporate Governance Practices

Details of the Bank's corporate governance practices are set out in the "Corporate Governance Report" in this Annual Report.

Auditor

KPMG resigned as auditor of the Bank upon signing the Auditor's Report of the 2014 financial statements on 23 February 2015. PricewaterhouseCoopers was appointed as auditor of the Bank with effect from 23 February 2015 to fill the vacancy and was appointed as auditor of the Bank to hold office at the AGM on 7 May 2015 until the conclusion of the 2016 AGM.

The financial statements for the year ended 31 December 2015 have been audited by PricewaterhouseCoopers who will retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of PricewaterhouseCoopers as auditor of the Bank will be proposed at the 2016 AGM.

On behalf of the Board

Raymond Ch'ien
Chairman

Hong Kong, 22 February 2016

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2015

(Expressed in millions of Hong Kong dollars)

		2015	2014
	note		
Interest income	4	27,063	26,270
Interest expense	4	(5,898)	(6,399)
Net interest income		21,165	19,871
Fee income		8,624	7,712
Fee expense		(1,586)	(1,463)
Net fee income	5	7,038	6,249
Net trading income	6	2,030	1,944
Net income/(loss) from financial instruments designated at fair value	7	(118)	1,201
Dividend income	8	142	1,210
Net insurance premium income	9	9,845	10,779
Other operating income	10	3,913	1,695
Total operating income		44,015	42,949
Net insurance claims and benefits paid and movement in liabilities to policyholders	11	(12,968)	(12,742)
Net operating income before loan impairment charges		31,047	30,207
Loan impairment charges	12	(1,108)	(1,144)
Net operating income		29,939	29,063
Employee compensation and benefits		(4,893)	(4,616)
General and administrative expenses		(4,522)	(4,055)
Depreciation of premises, plant and equipment		(957)	(831)
Amortisation of intangible assets		(110)	(111)
Operating expenses	13	(10,482)	(9,613)
Impairment loss on intangible assets		(24)	-
Operating profit		19,433	19,450
Net gain on partial disposal of Industrial Bank	17	10,636	-
Impairment of investment in Industrial Bank		-	(2,103)
Gains less losses from financial investments and fixed assets	18	6	(56)
Net surplus on property revaluation	19	261	521
Share of profits from associates		152	237
Profit before tax		30,488	18,049
Tax expense	20	(2,994)	(2,918)
Profit for the year		27,494	15,131
Profit attributable to shareholders		27,494	15,131
<i>(Figures in HK\$)</i>			
Earnings per share	21	14.22	7.91

The notes on pages 157 to 260 form part of these financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2015

(Expressed in millions of Hong Kong dollars)

	2015	2014
Profit for the year	27,494	15,131
Other comprehensive income		
Items that will be reclassified subsequently to the income statement when specific conditions are met:		
Available-for-sale investment reserve:		
- fair value changes taken to equity:		
-- on debt securities	(416)	319
-- on equity shares	183	16,744
- fair value changes transferred to income statement:		
-- on hedged items	91	32
-- on disposal	(14,759)	(34)
-- on impairment	-	2,188
- share of changes in equity of associates:		
-- fair value changes	(5)	-
- deferred taxes	19	(96)
- exchange difference and other	(186)	(523)
Cash flow hedging reserve:		
- fair value changes taken to equity	191	318
- fair value changes transferred to income statement	(188)	(339)
- deferred taxes	(1)	4
Exchange differences on translation of:		
- financial statements of overseas branches, subsidiaries and associates	(540)	(155)
Items that will not be reclassified subsequently to the income statement:		
Premises:		
- unrealised surplus on revaluation of premises	1,878	1,457
- deferred taxes	(314)	(244)
- exchange difference	(7)	(2)
Defined benefit plans:		
- actuarial gains on defined benefit plans	422	164
- deferred taxes	(70)	(27)
Share-based payments	2	(2)
Other comprehensive income for the year, net of tax	(13,700)	19,804
Total comprehensive income for the year	13,794	34,935
Total comprehensive income for the year attributable to shareholders	13,794	34,935

CONSOLIDATED BALANCE SHEET

at 31 December 2015

(Expressed in millions of Hong Kong dollars)

		2015	2014
	note		
ASSETS			
Cash and sight balances at central banks	26	10,118	11,311
Placings with and advances to banks	27	123,990	145,731
Trading assets	28	40,373	41,823
Financial assets designated at fair value	29	7,903	11,112
Derivative financial instruments	30	11,595	7,421
Reverse repurchase agreements – non-trading		-	1,296
Loans and advances to customers	31	688,946	658,431
Financial investments	32	372,272	318,032
Interest in associates	35	2,275	2,218
Investment properties	36	10,075	11,732
Premises, plant and equipment	37	26,186	21,898
Intangible assets	38	12,221	9,053
Other assets	39	28,475	23,932
Total assets		1,334,429	1,263,990
LIABILITIES AND EQUITY			
Liabilities			
Current, savings and other deposit accounts	40	959,228	896,521
Repurchase agreements - non-trading		2,315	-
Deposits from banks		18,780	9,095
Trading liabilities	41	62,917	72,587
Financial liabilities designated at fair value	42	3,994	3,489
Derivative financial instruments	30	9,988	6,462
Certificates of deposit and other debt securities in issue	43	5,191	12,402
Other liabilities	44	20,891	21,304
Liabilities under insurance contracts	45	101,817	92,442
Current tax liabilities	46	185	374
Deferred tax liabilities	46	4,817	4,304
Subordinated liabilities	47	2,325	5,817
Total liabilities		1,192,448	1,124,797
Equity			
Share capital	48	9,658	9,658
Retained profits		105,363	88,064
Other equity instruments	49	6,981	6,981
Other reserves		19,979	34,490
Shareholders' funds		141,981	139,193
Total equity and liabilities		1,334,429	1,263,990

Rose W M Lee *Vice-Chairman and Chief Executive*

John C C Chan *Director*

Eric K C Li *Director*

Andrew W L Leung *Chief Financial Officer*

The notes on pages 157 to 260 form part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2015

(Expressed in millions of Hong Kong dollars)

	2015	2014
Share capital		
At beginning of the year	9,658	9,559
Transfer from capital redemption reserve	-	99
	<u>9,658</u>	<u>9,658</u>
Retained profits		
At beginning of the year	88,064	82,885
Dividends to shareholders		
- dividends approved in respect of the previous year	(4,397)	(4,206)
- dividends declared in respect of the current year	(6,309)	(6,309)
Coupon paid to holder of Additional Tier 1 ('AT1') capital instrument	(310)	-
Transfer	467	428
Total comprehensive income for the year	27,848	15,266
	<u>105,363</u>	<u>88,064</u>
Other equity instruments		
At beginning of the year	6,981	-
Other equity instruments issued	-	6,981
	<u>6,981</u>	<u>6,981</u>
Other reserves		
Premises revaluation reserve		
At beginning of the year	15,687	14,904
Transfer	(467)	(428)
Total comprehensive income for the year	1,557	1,211
	<u>16,777</u>	<u>15,687</u>
Available-for-sale investment reserve		
At beginning of the year	17,012	(1,618)
Total comprehensive income for the year	(15,073)	18,630
	<u>1,939</u>	<u>17,012</u>
Cash flow hedging reserve		
At beginning of the year	(11)	6
Total comprehensive income for the year	2	(17)
	<u>(9)</u>	<u>(11)</u>
Foreign exchange reserve		
At beginning of the year	1,140	1,295
Total comprehensive income for the year	(540)	(155)
	<u>600</u>	<u>1,140</u>
Other reserves		
At beginning of the year	662	747
Cost of share-based payment arrangements	10	14
Transfer of capital redemption reserve	-	(99)
	<u>672</u>	<u>662</u>
Total equity		
At beginning of the year	139,193	107,778
Dividends to shareholders	(10,706)	(10,515)
Coupon paid to holder of AT1 capital instrument	(310)	-
Other equity instruments issued	-	6,981
Cost of share-based payment arrangements	10	14
Total comprehensive income for the year	13,794	34,935
	<u>141,981</u>	<u>139,193</u>

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December 2015

(Expressed in millions of Hong Kong dollars)

		2015	2014
	note		
Net cash inflow from operating activities	50(a)	14,209	2,219
Cash flows from investing activities			
Purchase of available-for-sale investments		(110,230)	(53,942)
Purchase of held-to-maturity debt securities		(1,737)	(1,855)
Proceeds from sale or redemption of available-for-sale investments		107,225	51,726
Proceeds from redemption of held-to-maturity debt securities		780	645
Net cash inflow from the sales of loan portfolio		5,069	610
Purchase of properties, plant and equipment and intangible assets		(1,492)	(682)
Proceeds from sale of properties, plant and equipment and assets held for sale		3	-
Interest received from available-for-sale investments		2,151	2,128
Dividends received from available-for-sale investments		141	1,209
Net cash inflow/(outflow) from investing activities		1,910	(161)
Cash flows from financing activities			
Dividends paid		(10,706)	(10,515)
Coupon paid to holder of AT1 capital instrument		(310)	-
Interest paid for subordinated liabilities		(156)	(302)
Redemption/Repayment of subordinated liabilities		(3,492)	(6,008)
Proceeds from issuance of other equity instruments		-	6,981
Net cash outflow from financing activities		(14,664)	(9,844)
Increase/(decrease) in cash and cash equivalents		1,455	(7,786)
Cash and cash equivalents at 1 January		105,350	115,779
Effect of foreign exchange rate changes		(2,408)	(2,643)
Cash and cash equivalents at 31 December	50(b)	104,397	105,350

The notes on pages 157 to 260 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2015

(Figures expressed in millions of Hong Kong dollars unless otherwise indicated)

1. Basis of preparation

(a) Compliance with Hong Kong Financial Reporting Standards

The consolidated financial statements comprise the financial statements of Hang Seng Bank Limited ("the Bank") and its subsidiaries ("the Group") made up to 31 December 2015. These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRS"), the provisions of the Hong Kong Companies Ordinance and accounting principles generally accepted in Hong Kong. HKFRS comprises Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKAS"), and interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). In addition, these financial statements comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. A summary of the principal accounting policies adopted by the Group is set out in note 3.

Standards adopted during the year ended 31 December 2015

There were no new standards applied during the year ended 31 December 2015.

During 2015, the Group adopted a number of amendments to standards which had an insignificant effect on the consolidated financial statements.

New Companies Ordinance

The requirements of Part 9 'Accounts and Audit' of the New Companies Ordinance (Cap. 622) ("NCO") came into operation during the financial year. As a result, there are changes to presentation and disclosure of certain information in the Group's consolidated financial statements.

(b) Presentation of information

The following have been included in the audited sections of the "Management Discussion and Analysis" ("MD&A"):

- Disclosure under HKFRS 4 "*Insurance Contracts*" and HKFRS 7 "*Financial Instruments: Disclosures*" concerning the nature and extent of risks relating to insurance contracts and financial instruments on pages 30 to 32.
- Capital disclosures under HKAS 1 "*Presentation of Financial Statements*" on pages 82 to 87.

In accordance with the Group's policy to provide disclosures that help stakeholders understand the Group's performance, financial position and changes thereto, the information provided in the Notes to the Financial Statements and the Risk disclosures in the MD&A goes beyond the minimum levels required by accounting standards, statutory and regulatory requirements. In particular, the Group provides additional disclosures recommended by the Enhanced Disclosure Task Force ("EDTF") report "Enhancing the Risk Disclosures of Banks" issued in October 2012. The report aims to help financial institutions identify areas in which users had highlighted a need for better and more transparent information about banks' risks, and how these risks relate to performance measurement and reporting.

(c) Consolidation

The Group controls and consequently consolidates an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Control is initially assessed based on consideration of all facts and circumstances, and is subsequently reassessed when there are significant changes to the initial setup.

Where an entity is governed by voting rights, the Group would consolidate when it holds, directly or indirectly, the necessary voting rights to pass resolutions by the governing body. In all other cases, the assessment of control is more complex and requires judgement of other factors, including having exposure to variability of returns, power over relevant activities or holding the power as agent or principal.

NOTES TO THE FINANCIAL STATEMENTS (continued)

1. Basis of preparation (continued)

(c) Consolidation (continued)

All intra-group transactions are eliminated on consolidation.

The consolidated financial statements also include the attributable share of the results and reserves of associates based on the financial statements prepared at dates not earlier than three months prior to 31 December 2015.

(d) Future Accounting Developments

The HKICPA has issued a number of amendments and new standards which are not yet effective for the year ended 31 December 2015 and which have not been adopted in the financial statements. Key changes are summarised as follows:

- In July 2014, the HKICPA issued HKFRS 15 *"Revenue from Contracts with Customers"*. The original effective date of HKFRS 15 has been delayed by one year and the standard is now effective for annual periods beginning on or after 1 January 2018 with early application permitted. HKFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognizing revenue obligations as they are satisfied. The standard should be applied retrospectively, with certain practical expedients available. The Group is currently assessing the impact of this standard but it is not practicable to quantify the effect as at the date of the publication of these financial statements.
- In September 2014, the HKICPA issued the final HKFRS 9 *"Financial Instruments"*, which is the comprehensive standard to replace HKAS 39 *"Financial Instruments: Recognition and Measurement"*, and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

The classification and measurement of financial assets will depend on the entity's business model for their management and their contractual cash flow characteristics and result in financial assets being classified and measured at amortised cost, fair value through other comprehensive income ("FVOCI") or fair value through profit or loss. The classification of financial liabilities is essentially unchanged, except that, for certain liabilities measured at fair value, gains or losses relating to changes in the entity's own credit risk are to be included in OCI.

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, lease receivables, certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of commitments and guarantees) is required for expected credit losses ("ECL") resulting from default events that are possible within the next 12 months ("12 month ECL"). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ("lifetime ECL").

The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period by considering the probability of default occurring over the remaining life of the financial instrument, rather than by considering an increase in ECL.

As a result of the final HKFRS 9, the recognition and measurement of impairment is intended to be more forward-looking than under HKAS 39.

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link between it and risk management strategy and permitting the former to be applied to a greater variety of hedging instruments and risks. The standard does not explicitly address macro hedge accounting strategies, which are being considered in a separate project. To remove the risk of any conflict between existing macro hedge accounting practice and the new general hedge accounting requirements, HKFRS 9 includes an accounting policy choice to remain with HKAS 39 hedge accounting.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

1. Basis of preparation *(continued)*

(d) Future Accounting Developments *(continued)*

The classification and measurement and impairment requirements are applied retrospectively by adjusting the statement of financial position at the date of initial application, with no requirement to restate comparative periods. Hedge accounting is generally applied prospectively from that date.

The mandatory application date for the standard as a whole is 1 January 2018, but it is possible to apply the revised presentation for certain liabilities measured at fair value at an earlier date. The Group has revised the presentation of fair value gains and losses relating to the entity's own credit risk on certain liabilities.

The Group is currently assessing the impact that the rest of HKFRS 9 will have on the financial statements through a groupwide project has been set up to prepare for the implementation of HKFRS 9 since 2012 and significant preparatory and design work has taken place, but due to the complexity of the classification and measurement, impairment, and hedge accounting requirements and their inter-relationships, it is not possible to quantify the potential effect at this stage.

2. Critical accounting estimates and judgements in applying accounting policies

The results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of the consolidated financial statements. The principal accounting policies are described in Note 3 to the financial statements.

The accounting policies that are deemed critical to our results and financial position, in terms of the materiality of the items to which the policies are applied and the high degree of judgement involved, including the use of assumptions and estimation, are discussed below.

(i) Loan Impairment charges

Application of the Group's methodology for assessing loan impairment, as set out in note 3(d), involves considerable judgement and estimation.

For individually assessed loans, judgement is required in determining whether there are indications that an impairment loss may already have been incurred and then estimating the amount and timing of expected cash flows, which form the basis of the impairment loss calculation.

For collectively assessed loans, judgement is involved in selecting and applying the criteria for grouping together loans with similar credit characteristics, as well as in selecting and applying statistical and other models used to estimate the losses incurred for each group of loans in the reporting period. The benchmarking of loss rates, the assessment of the extent to which historical losses are representative of current conditions and the ongoing refinement of modelling methodologies provide a means of identifying changes that may be required, but the process is inherently an estimation.

(ii) Valuation of financial instruments

The best evidence of fair value is a quoted price in an actively traded principal market. In the event that the market for a financial instrument is not active, and the valuation technique uses only observable market data, the reliability of the fair value measurement is high. However, when valuation techniques include one or more significant unobservable inputs, they rely to a greater extent on management judgement and the fair value derived becomes less reliable. In absence of observable valuation inputs, due to lack of or a reduced volume of similar transactions, management judgement is required to assess the price at which an arm's length transaction would occur under normal business conditions, in which case management may rely on historical prices for that particular financial instrument or on recent prices for similar instruments.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

2. Critical accounting estimates and judgements in applying accounting policies *(continued)*

(ii) Valuation of financial instruments (continued)

The main assumptions and estimates which management consider when applying a model with valuation techniques are:

- the likelihood and expected timing of future cash flows on the instrument. Judgement may be required to assess the counterparty's ability to service the instrument in accordance with its contractual terms. Future cash flows may be sensitive to changes in market rates;
- selecting appropriate discount rate for the instrument. Judgement is required to assess what a market participant would regard as the appropriate spread of the rate for an instrument over the appropriate risk-free rate; and
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivatives.

When applying a model with observable inputs, estimates are made to reflect uncertainties in fair values resulting from a lack of market data inputs, for example, as a result of illiquidity in the market. For these instruments, the fair value measurement is less reliable. Inputs into valuations based on observable data are inherently uncertain because there is little or no current market data available from which to determine the level at which an arm's length transaction would occur under normal business conditions. However, in most cases there is some market data available on which to base a determination of fair value, for example historical data, and the fair values of most financial instruments are based on some market observable inputs even when observable inputs are significant.

The Group's accounting policy for valuation of financial instruments is included in note 3(h) and is discussed further within note 58 "Fair value of financial instruments".

(iii) Liabilities under investment contracts

Estimating the liabilities for long-term investment contracts where the Group has guaranteed a minimum return involves the use of statistical techniques. The selection of these techniques and the assumptions used about future interest rates and rates of return on equities, as well as behavioural and other future events, has a significant impact on the amount recognised as a liability.

(iv) Impairment of available-for-sale financial assets

Judgement is required in determining whether or not a decline in fair value of an available-for-sale financial investment below its original cost is of such a nature as to constitute impairment, and thus whether an impairment loss needs to be recognised under HKAS 39 "*Financial Instruments: Recognition and Measurement*" ("HKAS 39").

(v) Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity investments if the Group has the intention and ability to hold them until maturity. In evaluating whether the requirements to classify a financial asset as held-to-maturity are met, management makes significant judgements. Failure in correctly assessing the Group's intention and ability to hold specific investments until maturity may result in reclassification of the whole portfolio as available-for-sale.

(vi) Insurance contracts

Classification

HKFRS 4 "*Insurance Contracts*" ("HKFRS 4") requires the Group to determine whether an insurance contract that transfers both insurance risk and financial risk is classified as an insurance contract, or as a financial instrument under HKAS 39, or whether the insurance and non-insurance elements of the contract should be accounted for separately. This process involves judgement and estimation of the amounts of different types of risks that are transferred or assumed under a contract. The estimation of such risks often involves the use of assumptions about future events and is thus subject to a degree of uncertainty.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

2. Critical accounting estimates and judgements in applying accounting policies *(continued)*

(vi) Insurance contracts (continued)

Present value of in-force long-term insurance business ("PVIF")

The value of PVIF, which is recorded as an intangible asset, depends upon assumptions regarding future events. These are described in more detail in note 38(a). The assumptions are reassessed at each reporting date and changes in the estimates which affect the value of PVIF are reflected in the income statement.

Insurance liabilities

The estimation of insurance liabilities involves selecting statistical models and making assumptions about future events which need to be frequently calibrated against experience and forecasts. The sensitivity of insurance liabilities to potential changes in key assumptions is set out in the MD&A.

(vii) Income taxes

Determining income tax provisions involves judgement on the future tax treatment of certain transactions. The Group carefully evaluates tax implications of transactions and tax provisions are set up accordingly. The tax treatment of such transactions is reconsidered periodically to take into account all changes in tax legislations.

3. Principal accounting policies

(a) Interest income and expense

Interest income and expense for all financial instruments are recognised in "Interest income" and "Interest expense" respectively in the income statement using the effective interest rates of the financial assets or financial liabilities to which they relate.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but excluding future credit losses. The calculation includes all amounts paid or received by the Group that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

For impaired financial assets, the accrual of interest income based on the original terms of the financial asset is discounted to arrive at the net present value of impaired financial assets. Subsequent increase of such net present value of impaired financial assets due to the passage of time is recognised as interest income.

(b) Non-interest income

(i) Fee income

Fee income is earned from a diverse range of services provided by the Group to its customers and accounted for as follows:

- income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as an arrangement for the acquisition of shares or other securities);
- income earned from the provision of services is recognised as revenue when the services are provided (for example, asset management, portfolio and other management advisory and service fees); and
- income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and reported in "Interest income" (see note 3(a)).

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(b) Non-interest income *(continued)*

(ii) Net trading income

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading and dividend income from equities held for trading. Gains or losses arising from changes in fair value of derivatives are recognised in "Net trading income" to the extent as described in the accounting policy set out in note 3(j). Gains and losses on foreign exchange trading and other transactions are also reported as "Net trading income" except for those gains and losses on translation of foreign currencies recognised in other comprehensive income and accumulated separately in equity in the foreign exchange reserve in accordance with the accounting policy set out in note 3(w).

(iii) Net income / (expense) from financial instruments designated at fair value

Net income / (expense) from financial instruments designated at fair value comprises all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value and dividends arising on those financial instruments and the changes in fair value of the derivatives managed in conjunction with the financial assets and liabilities designated at fair value.

(iv) Dividend income

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for listed equity securities, and usually the date when shareholders have approved the dividend for unlisted equity securities.

(v) Rental income from operating lease

Rental income received under an operating lease is recognised in "Other operating income" in equal instalments over the reporting periods covered by the lease term. Lease incentives granted are recognised in the income statement as an integral part of the aggregate net lease payments receivable. Contingent rentals receivable are recognised as income in the reporting period in which they are earned.

(c) Loans and advances to customers and placing with and advances to banks

"Loans and advances to customers" and "Placings with and advances to banks" include loans and advances originated or acquired by the Group, which are not classified as either held for trading or designated at fair value. Loans and advances are recognised when cash is advanced to borrowers and are derecognised when either the borrowers repay their obligations or the loans are sold or written off, or substantially all the risks and rewards of ownership transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest rate method, less impairment allowances.

(d) Impairment of loans and advances

Losses for impaired loans and advances are promptly recognised when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances are assessed either for significant loans individually or for loan portfolios with similar credit risk characteristics collectively.

(i) Individually assessed loans and advances

For all loans that are considered individually significant, the Group assesses on a case-by-case basis at each reporting date whether there is any objective evidence that a loan is impaired. The criteria used by the Group to determine that there is such objective evidence include:

- known cash flow difficulties experienced by the borrower;
- contractual payments of either principal or interest being past due for more than 90 days;
- the probability that the borrower will enter bankruptcy or other financial realisation;
- a concession granted to the borrower for economic or legal reasons relating to the borrower's financial difficulty that results in the forgiveness or postponement of principal, interest or fees, where the concession is not insignificant; and
- a significant downgrading in credit rating by an external rating agency.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(d) Impairment of loans and advances *(continued)*

For those loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:

- the Group’s aggregate exposure to the borrower;
- the viability of the borrower’s business model and its capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the extent of other creditors’ commitments ranking ahead of, or *pari passu* with, the Group and the likelihood of other creditors continuing to support the borrower;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of collateral (or other credit mitigants) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding;
- the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and
- where available, the secondary market price for the debt.

The realisable value of collateral is based on the most recently updated market value at the time the impairment assessment is performed. The value is not adjusted for expected future charges in market prices, though adjustments are made to reflect local conditions such as forced sale discounts.

Impairment losses are calculated by discounting the expected future cash flows of a loan, which includes expected future receipts of contractual interest, at its original effective interest rate and comparing the resultant present value with the loan’s current carrying amount. The impairment allowances on individually significant accounts are reviewed at least quarterly and more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

(ii) Collectively assessed loans and advances

Impairment allowances are calculated on a collective basis to cover losses which have been incurred but have not yet been identified:

- as loans subject to individual assessment; or
- for homogeneous groups of loans that are not considered individually significant.

Incurring but not yet identified impairment

Individually assessed loans for which no evidence of impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for a collective impairment assessment. This reflects impairment losses that the Group has incurred as a result of events occurring before the reporting date, which the Group is not able to identify on an individual loan basis, and that can be reliably estimated. These losses will only be individually identified in the future. As soon as information becomes available which identifies losses on individual loans within the Group, those loans are removed from the Group and assessed on an individual basis for impairment. The collective impairment allowance is determined after taking into account:

- historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, loan grade or product);

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(d) Impairment of loans and advances *(continued)*

- the estimated period between a loss occurring and that loss being identified and evidenced by the establishment of an appropriate allowance against the loss on an individual loan; and
- management's judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses at the reporting date is likely to be greater or less than that suggested by historical experience.

Homogeneous groups of loans and advances

Portfolios of small homogeneous groups of loans are collectively assessed using roll rate or historical loss rate methodologies.

(iii) Write-off of loans and advances

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of collateral. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write off may be earlier.

(iv) Reversals of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The write-back is recognised in the income statement.

(v) Repossessed assets

Non-financial assets acquired in exchange for loans in order to achieve an orderly realisation are reported under "Assets held for sale" if the carrying amounts of the assets are recovered principally through sale, the assets are available for sale in their present condition and the sale is highly probable. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan, net of impairment allowance amounts, at the date of exchange. No depreciation is provided in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recorded as an impairment loss and included in the income statement. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative impairment loss, is recognised in the income statement.

Financial assets acquired in exchange for loans are classified and reported in accordance with the relevant accounting policies.

(vi) Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as new loans for measurement purposes once the minimum number of payments required under the new arrangements has been received. A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument. These renegotiated loans are segregated from other parts of the loan portfolio for the purposes of collective impairment assessment, to reflect their risk profile. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired. The carrying amounts that have been classified as renegotiated loans retain this classification until maturity or derecognition.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(e) Trading assets and trading liabilities

Financial instruments and short positions thereof which have been acquired or incurred principally for the purpose of selling or repurchasing in the near term, or are 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, are classified as held-for-trading. Trading liabilities also include customer deposits and certificates of deposit with embedded options or other derivatives and the market risk of which is managed in the trading book. Trading assets and liabilities are recognised initially at fair value with transaction costs taken to the income statement, and are subsequently remeasured at fair value. All subsequent gains and losses from changes in the fair value of these assets and liabilities are recognised in the income statement within "Net trading income" as they arise. Upon disposal or repurchase, the difference between the net sale proceeds or the net payment and the carrying value is included in the income statement.

(f) Financial instruments designated at fair value

A financial instrument is classified in this category if it meets any one of the criteria set out below, and is so designated irrevocably by management on initial recognition. The Group may designate financial instruments at fair value upon inception when the designation:

- eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring financial instruments or recognising the gains and losses on them on different bases.
- applies to a group of financial instruments that is managed and its performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and where information about that group of financial instruments is provided internally on that basis to key management personnel. Under this criterion, certain liabilities under investment contracts and financial assets held to meet liabilities under insurance and investment contracts are the main classes of financial instruments so designated.
- relates to financial instruments containing one or more embedded derivatives, and which would otherwise be required to be accounted for separately.

Designated financial instruments are recognised at fair value when the Group enters into contracts with counterparties, which is generally on trade date, and are normally derecognised when either sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequent changes in fair values are recognised in the income statement within "Net income from financial instruments designated at fair value".

(g) Financial Investments

Financial instruments intended to be held on a continuing basis, other than those designated at fair value, are classified as available-for-sale or held-to-maturity.

(i) Available-for-sale financial assets

Available-for-sale financial assets are initially measured at fair value. They are subsequently remeasured at fair value, and changes therein are recognised in other comprehensive income and accumulated separately in equity in the "Available-for-sale investment reserve". When available-for-sale financial assets are sold, cumulative gains or losses which are previously recognised in other comprehensive income shall be reclassified from equity to the income statement as "Gains less losses from financial investments and fixed assets".

(ii) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has the positive intention and ability to hold until maturity. Held-to-maturity investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest rate method, less any impairment allowances.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(h) Valuation of financial instruments

All financial instruments are recognised initially at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial instrument on initial recognition is generally its transaction price (that is the fair value of the consideration given or received). However, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the Group recognises a trading gain or loss on day 1, being the difference between the transaction price and the fair value. When significant unobservable parameters are used, the entire day 1 gain or loss is deferred and is recognised in the income statement over the life of the transaction until the transaction matures, is closed out, the valuation inputs become observable, or when the Group enters into an offsetting transaction.

The fair value of financial instruments is generally measured on an individual basis. However, in cases where the Group manages a group of financial assets and liabilities according to its net market or credit risk exposure, the Group measures the fair value of the group of financial instruments on a net basis but presents the underlying financial assets and liabilities separately in the financial statements, unless they satisfy the HKFRS offsetting criteria.

(i) Sale and repurchase agreements

Where securities are sold subject to commitment to repurchase them at a pre-determined price ("repos"), they remain on the statement of financial position and a liability is recorded in respect of the consideration received in "Repurchase agreements-non-trading". Conversely, securities purchased under analogous commitments to resell ("reverse repos") are not recognised on the statement of financial position and the consideration paid is recorded in "Reverse repurchase agreements-non-trading". The difference between the sale and repurchase price is treated as interest income and recognised over the life of the agreement.

Securities lending and borrowing transactions are generally secured, with collateral taking the form of securities or cash advanced or received. The transfer of securities to counterparties under these agreements is not normally reflected on the statement of financial position. Cash collateral advanced or received is recorded as an asset or a liability respectively.

(j) Derivative financial instruments and hedge accounting

Derivatives are recognised initially, and are subsequently remeasured, at fair value. Fair values of derivatives are obtained either from quoted market prices or by using valuation techniques.

Embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract; their contractual terms would otherwise meet the definition of a stand-alone derivative; and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with changes therein recognised in the income statement.

Derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset for accounting purposes if the offsetting criteria are met, i.e. the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.

The method of recognising fair value gains or losses depends on whether the derivative is held for trading, or is designated as a hedging instrument, and if the latter, the nature of the risk being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

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

The Group designates certain derivatives as either (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ("fair value hedge"); (ii) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ("cash flow hedge").

Hedge accounting

At the inception of a hedging relationship, the Group documents the relationship between the hedging instruments and the hedged items, its risk management objective and its strategy for undertaking the hedge. The Group requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the hedging instruments, are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items.

(i) Fair value hedge

Changes in the fair value of derivatives that are designated and qualified as fair value hedging instruments are recorded in the income statement within "Net trading income", along with changes in the fair value of the hedged assets, liabilities or group thereof that are attributable to the hedged risk.

If the hedging relationship no longer meets the criteria for hedge accounting, the hedge accounting is discontinued. The cumulative adjustment to the carrying amount of a hedged item is amortised to the income statement based on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised.

(ii) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualified as cash flow hedges is recognised in other comprehensive income and accumulated separately in equity. Any gain or loss in fair value relating to an ineffective portion is recognised immediately in the income statement within "Net trading income".

The accumulated gains and losses recognised in other comprehensive income are recycled to the income statement in the periods in which the hedged item will affect 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 at that time remains in equity until 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 recognised in other comprehensive income is immediately reclassified to the income statement.

(iii) Hedge effectiveness testing

To qualify for hedge accounting, the Group requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness), and demonstrate actual effectiveness (retrospective effectiveness) on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed and the method adopted by the Group to assess hedge effectiveness depends on its risk management strategy.

For fair value hedge relationships, the Group utilises the cumulative dollar offset method or regression as effectiveness testing methodology. For cash flow hedge relationships, the Group utilises the change in variable cash flow method, capacity test or the cumulative dollar offset method using the hypothetical derivative approach.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

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

For prospective effectiveness, the hedging instrument is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For retrospective effectiveness, the change in fair value or cash flows must offset each other in the range of 80% to 125%. Hedge ineffectiveness is recognised in the income statement in "Net trading income".

(iv) Derivatives that do not qualify for hedge accounting

Non-qualifying hedges are economic hedges entered into as part of documented interest rate management strategies for which hedge accounting is not applied. Changes in fair value of non-qualifying hedges do not alter the cash flows expected as part of the documented management strategies for both the non-qualifying hedge instruments and the related assets and liabilities. All gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in the income statement.

(k) Derecognition of financial assets and liabilities

Financial assets are derecognised when the rights to receive cash flows from the assets have expired; or where the Group has transferred its contractual rights to receive the cash flows of the financial assets and has transferred substantially all the risks and rewards of ownership; or where both control and substantially all the risks and rewards are not retained. Financial liabilities are derecognised when they are extinguished, i.e. when the obligation is discharged or cancelled or expires.

(l) Offsetting financial assets and financial liabilities

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

(m) Application of trade date accounting

Except for loans and advances and deposits, all financial assets, liabilities and instruments are accounted for on trade date basis.

(n) Subsidiaries and associates

The Group classifies investments in entities which it controls as subsidiaries. The Group classifies investments in entities over which it has significant influence, and that are not subsidiaries, as associates.

For the purpose of determining this classification, control is considered when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns by exercising its power over the entity.

Investment in associates is recognised using the equity method. Under this method, such investments are initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in the Group's share of net assets less any impairment losses.

Profits on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the respective associates. Losses are also eliminated to the extent of the Group's interest in the associates unless the transaction provides evidence of an impairment of the asset transferred.

The Group's investments in subsidiaries and associates are stated at cost less any impairment losses. An impairment loss recognised in prior periods shall be reversed through the income statement if, and only if, there has been a change in the estimates used to determine the recoverable amount of the investment since the last impairment loss was recognised.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(n) Subsidiaries and associates *(continued)*

In order to determine whether an impairment test under HKAS 36 "*Impairment of Assets*" is required in respect of an interest in an associate, it is necessary to consider the indicators in HKAS 39 "*Financial Instruments: Recognition and Measurement*". Where the review of the indicators suggests that the interest in an associate may be impaired, the impairment testing requirements of HKAS 36 are applied.

The Group's policy for impairment testing on goodwill arising on acquisition of subsidiaries is included under note 3(o). In the case of an interest in an associate, the entire carrying amount in the consolidated statement of financial position is compared to its recoverable amount. If the recoverable amount is less than its carrying amount, an impairment loss is recognised in the Group's consolidated financial statements.

(o) Goodwill and intangible assets

(i) Goodwill

Goodwill arises on business combinations, including the acquisition of subsidiaries or associates when the cost of acquisition exceeds the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities acquired and is reported in the consolidated statement of financial position. If the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of an acquired business is greater than the cost of acquisition, the excess is recognised immediately in the income statement. Goodwill on acquisitions of associates is included in "Interest in associates" and is not tested separately for impairment.

Goodwill is allocated to cash-generating units ("CGUs") for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. Impairment testing is performed at least annually, and whenever there is an indication that the CGU may be impaired, by comparing the recoverable amount of a CGU with the carrying value of its net assets, including attributable goodwill. The recoverable amount of an asset is the higher of, its fair value less cost to sell, and its value in use. Value in use is the present value of the expected future cash flows from a CGU. If the recoverable amount of the CGU is less than the carrying value, an impairment loss is charged to the income statement. Any write-off in excess of the carrying value of goodwill is limited to the fair value of the individual assets and liabilities of the CGU. Goodwill is stated at cost less any accumulated impairment losses, if any.

At the date of disposal of a business, attributable goodwill is included in the Group's share of net assets in the calculation of the gain or loss on disposal.

(ii) Intangible assets

Intangible assets include PVIF, acquired software licences and capitalised development costs of computer software programmes.

- The PVIF is stated at a valuation determined annually by using the methodology as described in note 3(z).
- Computer software acquired is stated at cost less amortisation and impairment allowances. Amortisation of computer software is charged to the income statement over its estimated useful life. Costs incurred in the development phase of a project to produce application software for internal use are capitalised and amortised over the software's estimated useful life, usually five years.

Intangible assets that have an indefinite estimated useful life or are not yet ready for use are tested for impairment annually. Intangible assets that have a finite estimated useful life, except for the PVIF, are stated at cost less amortisation and accumulated impairment losses and are amortised over their estimated useful lives. Estimated useful life is the lower of legal duration and expected economic life. Intangible assets are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(p) Investment properties

Investment properties are land and/or buildings which are owned or held under a leasehold interest to earn rental income and/or for capital appreciation. Investment properties are stated at fair value with changes in fair value being recognised in the income statement. Fair values are determined by independent professional valuers, primarily on the basis of capitalisation of net incomes with due allowance for outgoings and reversionary income potential. Property interests which are held under operating leases to earn rentals, or for capital appreciation, or both, are classified and accounted for as investment property on a property-by-property basis. Such property interests are accounted for as if they were held under finance leases (see note 3(r)) and measured at fair value.

(q) Premises, plant and equipment

(i) Land and buildings

The following land and buildings held for own use are stated in the statement of financial position at their revalued amount, being their fair value at the date of the revaluation less any subsequent accumulated depreciation and impairment losses:

- leasehold land and buildings where the fair value of the land cannot be reliably separated from the value of the building at inception of the lease and the premises are not clearly held under an operating lease; and
- leasehold land and buildings where the value of the land can be reliably separated from the value of the building at inception of the lease and the term of the lease is not less than 50 years.

Revaluations are performed by professionally qualified valuers, on a market basis, with sufficient regularity to ensure that the net carrying amount does not differ materially from the fair value at the reporting date. Surpluses arising on revaluation are credited firstly to the income statement to the extent of any deficits arising on revaluation previously charged to the income statement in respect of the same land and buildings, and are thereafter taken to other comprehensive income and are accumulated separately in the "Premises revaluation reserve". Deficits arising on revaluation, are firstly set off against any previous revaluation surpluses included in the "Premises revaluation reserve" in respect of the same land and buildings, and are thereafter recognised in the income statement.

Depreciation is calculated to write off the valuation of the land and buildings over their estimated useful lives as follows:

- freehold land is not depreciated;
- leasehold land is depreciated over the unexpired terms of the leases; and
- buildings and improvements thereto are depreciated at the greater of 2% per annum on the straight-line basis or over the unexpired terms of the leases or over the remaining estimated useful lives of the buildings.

On revaluation of the land and buildings, depreciation accumulated during the year will be eliminated. Depreciation charged on revaluation surplus of the land and buildings is transferred from "Premises revaluation reserve" to "Retained profits".

On disposal of the land and buildings, the profit and loss is calculated as the difference between the net sales proceeds and the net carrying amount and recognised in the income statement. Surpluses relating to the land and buildings disposed of included in the "Premises revaluation reserve" are transferred as movements in reserves to "Retained profits".

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(q) Premises, plant and equipment *(continued)*

(ii) Other plant and equipment

Furniture, plant and equipment, are stated at cost less depreciation calculated on the straight-line basis to write off the assets over their estimated useful lives, which are generally between 3 and 20 years. On disposal, the profit and loss is calculated as the difference between the net sales proceeds and the net carrying amount.

Plant and equipment are subject to review for impairment if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

(iii) Interest in leasehold land held for own use under operating lease

The Government of Hong Kong owns all the land in Hong Kong and permits its use under leasehold arrangements. Similar arrangements exist in mainland China. At inception of the lease, where the cost of land is known or can be reliably determined and the term of the lease is less than 50 years, the Group records its interest in leasehold land and land use rights separately as operating leases.

Where the cost of land is known or can be reliably determined and the term of the lease is not less than 50 years, the Group records its interest in leasehold land and land use rights as land and buildings held for own use.

Where the cost of the land is unknown or cannot be reliably determined, and the leasehold land and land use rights are not clearly held under an operating lease, they are accounted for as land and buildings held for own use.

(r) Finance and operating leases

Leases which transfer substantially all the risks and rewards of ownership to the lessees, other than legal title, are classified as finance leases. Leases which do not transfer substantially all the risks and rewards of ownership to the lessees are classified as operating leases, with the exceptions of land and building held under a leasehold interest as set out in notes 3(p) & 3(q).

(i) Finance leases

Where the Group is a lessor under finance leases, an amount representing the net investment in the lease is included in the statement of financial position as loans and advances to customers. Hire purchase contracts having the characteristics of a finance lease are accounted for in the same manner as finance leases. Impairment allowances are accounted for in accordance with the accounting policies set out in note 3(d).

Where the Group acquires the use of assets under finance leases, the amount representing the fair value of the leased asset, or, if lower, the present value of the minimum payments of such assets is included in fixed assets and the corresponding liabilities, net of finance charges, are recorded as obligations under finance leases. Depreciation is provided at rates which write off the cost or valuation of the assets over the term of the relevant lease or, where it is likely the Group will obtain ownership of the asset, the life of the asset, as set out in note 3(q). Impairment allowances are accounted for in accordance with the accounting policy as set out in note 3(s). Finance charges implicit in the lease payments are charged to the income statement over the period of the leases so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each reporting period. Contingent rentals are written off as an expense of the reporting period in which they are incurred.

(ii) Operating leases

Where the Group leases out assets as lessors under operating leases, the assets are included in the statement of financial position according to their nature and, where applicable. Where the Group is the lessee, the leased assets are not recognised on the statement of financial position. Rental revenue arising from operating lease is recognised on a straight-line basis in accordance with the Group's revenue recognition policies as set out in note 3(b)(v).

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(s) Impairment of assets

The carrying amount of the Group's assets are reviewed at each reporting date to determine whether there is objective evidence of impairment. If any such evidence exists, the carrying amount is reduced to the estimated recoverable amount by means of a charge to the income statement.

The accounting policies on impairment losses on loans and receivables and goodwill are set out in notes 3(d) and 3(o) respectively.

(i) Held-to-maturity investments

For held-to-maturity investments, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets) on an individual basis.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement. The reversal of impairment is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

(ii) Available-for-sale financial assets

At each reporting date, an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset or group of assets. Impairment losses are recognised 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 financial asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the income statement, is reclassified from other comprehensive income to the income statement.

The impairment methodologies for available-for-sale financial assets are set out in more detail below.

Impairment losses on available-for-sale debt securities are recognised within "Loan impairment charges" in the income statement and impairment losses on available-for-sale equity securities are recognised within "Gains less losses from financial investments and fixed assets" in the income statement.

Available-for-sale debt securities

When assessing available-for-sale debt securities for objective evidence of impairment at the reporting date, the Group considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. These events may include a significant financial difficulty of the issuer, a breach of contract such as a default, bankruptcy or other financial reorganisation, or the disappearance of an active market for the debt security because of financial difficulties relating to the issuer. These types of specific event and other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment of a debt security.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(s) Impairment of assets *(continued)*

For an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognised in the income statement if, and only if there is objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income and accumulated separately in equity. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement to the extent of the increase in fair value.

Available-for-sale equity securities

Objective evidence of impairment for available-for sale equity securities may include specific information about the issuer as detailed above, but may also include information about significant changes in technology, markets, economics or the law that provides evidence that the cost of the equity securities may not be recovered. A significant or prolonged decline in the fair value of the asset below its cost is also objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the period in which the fair value of the asset has been below its original cost at initial recognition.

For an available-for-sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and recognised in other comprehensive income and accumulated separately in equity. Impairment losses recognised on the equity security are not reversed through the income statement. Subsequent recovery in the fair value of the available-for-sale equity security is recognised in the other comprehensive income and the past impairment loss recognised in the income statement is not reversed.

(iii) Non-financial assets

Internal and external sources of information are reviewed at each reporting date to identify indications that the following types of assets may be impaired or an impairment loss previously recognised no longer exists or may have decreased:

- premises and equipment (other than properties carried at revalued amounts);
- pre-paid interests in leasehold land classified as "Interest in leasehold land held for own use under operating lease";
- investments in subsidiaries and associates; and
- intangible assets.

If any such indication exists, the asset's recoverable amount is estimated and impairment losses recognised.

Calculation of recoverable amount

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the assets. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a CGU).

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(s) Impairment of assets *(continued)*

Recognition of impairment losses

An impairment loss is recognised in the income statement whenever the carrying amount of an asset, or the CGUs to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGUs (or group of units) and then, to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

Reversals of impairment losses

In respect of assets other than goodwill, an impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. An impairment loss in respect of goodwill is not reversed.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the income statement in the year in which the reversals are recognised.

(t) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the income statement except to the extent that they relate to items recognised in other comprehensive income or directly in equity, in which case the relevant amounts of tax are recognised in other comprehensive income or directly in equity, respectively.

Current tax is the expected tax payable on the taxable profits for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Current tax assets and liabilities are settled on an individual taxable entity basis.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purpose and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available, against which deductible temporary differences can be utilised.

Deferred tax is calculated using the tax rates that are expected to apply in the periods in which the assets will be realised or the liabilities settled. Deferred tax assets and liabilities are not discounted. Deferred tax assets and liabilities are offset when they arise in the same tax reporting group and relate to income taxes levied by the same taxation authority, and when a legal right to offset exists in the entity.

The carrying amount of deferred tax assets/liabilities is reviewed at each reporting date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised.

(u) Employee benefits

(i) Salaries, annual bonuses, paid annual leave, leave passage and the cost to the Group of non-monetary benefits are accrued in the year in which the associated services are rendered by the employees. Provision is made in respect of paid leave entitlement accumulated during the year, which can be carried forward into future periods for compensated absence or payment in lieu if the employee leaves employment.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(u) Employee benefits *(continued)*

(ii) The Group provides retirement benefits for staff members and operates defined benefit and defined contribution schemes and participates in mandatory provident fund schemes in accordance with the relevant laws and regulations.

Payments to defined contribution plans and state-managed retirement benefit plans, where the Group's obligations under the plans are equivalent to a defined contribution plan, are charged as an expense as they incur.

The costs recognised for funding defined benefit plans are determined using the projected unit credit method, with annual actuarial valuations performed on each plan. The net charge to the income statement mainly comprises the service cost and the net interest on the net defined benefit liability and is presented in operating expenses. Service cost comprises current service cost, past service cost, and gain or loss on settlement.

The net defined benefit asset or liability recognised in the statement of financial position represents the difference between the fair value of plan assets and the present value of the defined benefit obligations adjusted for unrecognised past service costs. In the case of a defined benefit asset, it is limited to unrecognised past service costs plus the present value of available refunds and reductions in future contributions to the plan.

(v) Share-based payments

The Group enters into equity-settled share-based payment arrangements with its employees as compensation for services provided by employees. The cost of equity-settled share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted, and recognised as an expense on a straight-line basis over the vesting period. The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, is expensed immediately.

Fair value is determined by using market prices or appropriate valuation models, taking into account the terms and conditions upon which the equity instruments were granted. Market performance conditions are taken into account when estimating the fair value of equity instruments at the date of grant, so that an award is treated as vesting irrespective of whether the market performance condition is satisfied, provided all other conditions are satisfied.

Vesting conditions, other than market performance conditions, are not taken into account in the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction, so that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. On a cumulative basis, no expense is recognised for equity instruments that do not vest because of a failure to satisfy non-market performance or service conditions.

Where an award has been modified, as a minimum, the expense of the original award continues to be recognised as if it had not been modified. Where the effect of a modification is to increase the fair value of an award or increase the number of equity instruments, the incremental fair value of the award or incremental fair value of the extra equity instruments is recognised in addition to the expense of the original grant, measured at the date of modification, over the modified vesting period.

A cancellation that occurs during the vesting period is treated as an acceleration of vesting, and recognised immediately for the amount that would otherwise have been recognised for services over the remaining vesting period.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(w) Translation of foreign currencies

Foreign currency transactions during the year are translated at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rates ruling at the reporting date. Any resulting exchange differences are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the foreign exchange rates ruling at the dates the fair value was determined.

The results of branches, subsidiaries and associates not reporting in Hong Kong dollars are translated into Hong Kong dollars at the average rates of exchange for the reporting period. Exchange differences arising from the re-translation of opening foreign currency net investments and the related cost of hedging, if any, and exchange differences arising from re-translation of the result for the reporting period from the average rate to the exchange rate ruling at the period-end, are recognised in other comprehensive income and accumulated separately in equity in the foreign exchange reserve.

Exchange differences on a monetary item that is part of a net investment in a foreign operation are recognised in the income statement of separate subsidiary's financial statements. In the consolidated financial statements, these exchange differences are recognised in other comprehensive income and accumulated separately in equity in the foreign exchange reserve. On disposal of a foreign operation, exchange differences relating thereto previously recognised in reserves are recognised in the income statement.

(x) Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation arising from past events and a reliable estimate can be made as to the amount of the obligation. Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or nonoccurrence, of one or more uncertain future events not wholly within the control of the Group; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

(y) Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of the loans or debt instruments.

Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). Financial guarantees are included within other liabilities.

(z) Insurance contracts

Through its insurance subsidiaries, the Group issues contracts to customers that contain insurance risk, financial risk or a combination thereof. A contract under which the Group accepts significant insurance risk from another party, by agreeing to compensate that party on the occurrence of a specified uncertain future event, is classified as an insurance contract. An insurance contract may also transfer financial risk, but is accounted for as an insurance contract if the insurance risk is significant.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(z) Insurance contracts *(continued)*

A contract issued by the Group that transfers financial risk, without significant insurance risk, is classified as an investment contract, and is accounted for as a financial instrument. The financial assets held by the Group for the purpose of meeting liabilities under insurance and investment contracts are classified and accounted for based on their classifications as set out in notes 3(c) to 3(j).

Insurance contracts are accounted for as follows:

Net earned insurance premiums

Premiums for life insurance contracts are accounted for when receivable, except in unit-linked insurance contracts where premiums are accounted for when liabilities are recognised.

Reinsurance premiums, netted by the reinsurers' share of provision for unearned premiums, are accounted for in the same reporting period as the premiums for the direct insurance contracts to which they relate.

Claims and reinsurance recoveries

Gross insurance claims for life insurance contracts reflect the total cost of all claims arising during the reporting period, including policyholder cash dividend payment upon policy anniversary and payments of maturities, surrenders and death claims. The technical reserves for non-linked liabilities (long-term business provision) are calculated based on actuarial principles. The technical reserves for linked liabilities are at least the element of any surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices. Reinsurance recoveries are accounted for in the same period as the related claims.

Deferred acquisition costs

The deferred acquisition costs related to insurance contract, such as initial commission, are amortised over the period in which the related revenues are earned.

Present value of in-force long-term insurance business

A value is placed on insurance contracts that are classified as long-term insurance business or long-term investment contracts with discretionary participating features ("DPF") and are in force at the reporting date is recognised as an asset. This asset represents the present value of the shareholders' interest in the profits expected to emerge from those insurance contracts written at the reporting date.

The PVIF is determined by discounting future earnings expected to emerge from business currently in force, using appropriate assumptions in assessing factors such as future mortality and morbidity, lapse rates, levels of expenses and a risk discount rate that reflects the risk premium attributable to the respective long-term insurance business. The valuation has also included explicit risk margins for non-economic risks in the projection assumptions, and explicit allowances for financial options and guarantees using stochastic methods. Risk discount rates are set on an active basis with reference to market risk free yields and incorporate the explicit margins and allowances for certain risks and uncertainties in place of implicit adjustments. Movements in the PVIF are included in other operating income on a pre-tax basis. The PVIF is reported under "Intangible assets" in the statement of financial position.

Liabilities under insurance contracts

Liabilities under non-linked life insurance contracts are calculated by each life insurance operation based on local actuarial principles. Some insurance contracts may contain discretionary participation features whereby the policyholder is entitled to additional payments whose amount and/or timing is at the discretion of the issuer. The discretionary element of these contracts is included in "Liabilities under insurance contracts".

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(z) Insurance contracts *(continued)*

Liabilities under unit-linked life insurance contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

A liability adequacy test is carried out on insurance liabilities to ensure that the carrying amount of the liabilities is sufficient in the light of current estimates of future cash flows. When performing the liability adequacy test, all expected cash flows are discounted and compared with the carrying value of the liability. When a shortfall is identified it is charged immediately to the income statement.

(aa) Investment contracts

Customer liabilities under linked investment contracts are measured at fair value and reported under "Financial liabilities designated at fair value". The linked financial assets are measured at fair value and the movements in fair value are recognised in the income statement in "Net income from financial instruments designated at fair value". Deposits receivable and amounts withdrawn are accounted for as increases or decreases in the liability recorded in respect of investment contracts.

Investment management fee receivables are recognised in the income statement over the period of the provision of the investment management services, in "Net fee income".

(ab) Subordinated liabilities

Financial liabilities are recognised when the Group enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and initially measured at fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or liability.

Subordinated liabilities are measured at amortised cost using the effective interest rate method, and are reported under "Subordinated liabilities", except for those issued for trading or designated at fair value, which are carried at fair value and reported under the "Trading liabilities" and "Financial liabilities designated at fair value" in the statement of financial position.

Financial instruments issued are classified as equity when there is no contractual obligation to transfer cash or other financial assets or issue a variable number of own equity instruments.

(ac) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of change in value. Such investments comprise cash and sight balances at central banks maturing within one month, treasury bills and certificates of deposit with less than three months' maturity from the date of acquisition and items in the course of collection from or in transmission to other banks.

(ad) Operating segments

The Group's operating segments are determined to be customer group segment because the chief operating decision maker uses customer group information in order to make decisions about allocating resources and assessing performance.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

3. Principal accounting policies *(continued)*

(ad) Operating segments *(continued)*

Hong Kong Financial Reporting Standard ("HKFRS 8") requires segmental disclosure to be based on the way that the Group's chief operating decision maker regards and manages the Group, with the amounts reported for each reportable segment being the measures reported to the Group's chief operating decision maker for the purpose of assessing segmental performance and making decision about operating matters. In 2015, there was a change in the reportable segment information reported internally to the Group's most senior executive management for the purpose of resources allocation and performance assessment. The change has taken into account of the increasingly integrated nature of our Hong Kong and mainland business. Previously, mainland China was presented as a separate segment. From 1 January 2015, mainland China was integrated within the three global businesses. To align with the internal reporting information, the Group has presented four reportable segments. Corresponding amounts have been restated to ensure information is provided on a basis consistent with the revised segment information.

(ae) Assets held for sale

Non-current assets held for sale and disposal groups (including both assets and liabilities of the disposal groups) are classified as held for sale when their carrying amounts will be recovered principally through sale, they are available for sale in their present condition and their sale is highly probable. Non-current assets held for sale and disposal groups are measured at the lower of their carrying amount and fair value less costs to sell, except for deferred tax assets, financial assets, investment properties, insurance contracts and assets arising from employee benefits, which are measured in accordance with the accounting policies described above.

Immediately before the initial classification as held for sale, the carrying amounts of the asset (or assets and liabilities in the disposal group) are measured in accordance with applicable HKFRSs. On subsequent remeasurement of a disposal group, the carrying amounts of the assets and liabilities that are not within the scope of the measurement requirements of HKFRS 5 "*Non-current Assets Held for Sale and Discontinued Operations*" are measured in accordance with applicable HKFRSs before the fair value less costs to sell of the disposal group is determined.

Income earned and expenses incurred on assets and liabilities of disposal groups held for sale continue to be recognised in the appropriate line items in the income statement until the transaction is complete.

(af) Related parties

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are members of the same group. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities which are under the significant influence of related parties of the Group and post employment benefit scheme. Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group and its holding companies, directly or indirectly, including any directors (whether executive or otherwise) and Executive Committee members of the Group and its holding companies.

NOTES TO THE FINANCIAL STATEMENTS (continued)

4 Interest income/interest expense

(a) Interest income

	2015	2014
Interest income arising from:		
- financial assets that are not at fair value through profit and loss	26,743	26,037
- trading assets	313	230
- financial assets designated at fair value	7	3
	<u>27,063</u>	<u>26,270</u>
of which:		
- interest income from listed investments	2,446	2,207
- interest income from unlisted investments	2,891	3,104
- interest income from impaired financial assets	41	12

(b) Interest expense

	2015	2014
Interest expense arising from:		
- financial liabilities that are not at fair value through profit and loss	4,101	4,149
- trading liabilities	1,763	2,244
- financial liabilities designated at fair value	34	6
	<u>5,898</u>	<u>6,399</u>
of which:		
- interest expense from debt securities in issue maturing after five years	-	-
- interest expense from customer accounts maturing after five years	-	-
- interest expense from subordinated liabilities	156	302

5 Net fee income

	2015	2014
- securities broking and related services	1,872	1,355
- retail investment funds	1,763	1,681
- insurance	472	466
- account services	439	392
- remittances	444	404
- cards	2,386	2,196
- credit facilities	420	403
- trade services	491	521
- other	337	294
Fee income	8,624	7,712
Fee expense	(1,586)	(1,463)
	<u>7,038</u>	<u>6,249</u>
of which:		
Net fee income, other than amounts included in determining the effective interest rate, arising from financial assets or financial liabilities that are not held for trading nor designated at fair value	2,501	2,368
- fee income	3,779	3,549
- fee expense	(1,278)	(1,181)
Net fee income on trust and other fiduciary activities where the Group holds or invests on behalf of its customers	988	708
- fee income	1,149	857
- fee expense	(161)	(149)

NOTES TO THE FINANCIAL STATEMENTS (continued)

6 Net trading income

	2015	2014
Dealing profits	2,033	1,953
- foreign exchange	2,100	1,824
- interest rate derivatives	(32)	1
- debt securities	75	65
- equities and other trading	(110)	63
Net loss from hedging activities	(3)	(9)
- fair value hedges	(91)	(32)
-- net loss on hedged items attributable to the hedged risk	88	22
-- net gain on hedging instruments	-	1
- cash flow hedges		
-- net hedging gain		
	<u>2,030</u>	<u>1,944</u>

7 Net income/(loss) from financial instruments designated at fair value

	2015	2014
Net (loss)/income on assets designated at fair value which back insurance and investment contracts	(139)	1,204
Net change in fair value of other financial instruments designated at fair value	21	(3)
	<u>(118)</u>	<u>1,201</u>
of which dividend income from:		
- listed investments	130	210
- unlisted investments	1	2
	<u>131</u>	<u>212</u>

8 Dividend income

	2015	2014
Dividend income:		
- listed investments	123	1,194
- unlisted investments	19	16
	<u>142</u>	<u>1,210</u>

9 Net insurance premium income

	Non-linked insurance	Linked insurance	Total
2015			
Gross insurance premium income	13,120	5	13,125
Reinsurers' share of gross insurance premium income	(3,280)	-	(3,280)
Net insurance premium income	<u>9,840</u>	<u>5</u>	<u>9,845</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

9 Net insurance premium income (continued)

	Non-linked insurance	Linked insurance	Total
2014			
Gross insurance premium income	12,202	5	12,207
Reinsurers' share of gross insurance premium income	(1,428)	-	(1,428)
Net insurance premium income	<u>10,774</u>	<u>5</u>	<u>10,779</u>

10 Other operating income

	2015	2014
Rental income from investment properties	382	395
Movement in present value of in-force long-term insurance business	3,168	1,065
Others	363	235
	<u>3,913</u>	<u>1,695</u>

11 Net insurance claims and benefits paid and movement in liabilities to policyholders

	Non-linked insurance	Linked insurance	Total
2015			
Claims, benefits and surrenders paid	7,067	12	7,079
Movement in provisions	8,976	(15)	8,961
Gross claims and benefits paid and movement in liabilities to policyholders	16,043	(3)	16,040
Reinsurers' share of claims, benefits and surrenders paid	(75)	-	(75)
Reinsurers' share of movement in provisions	(2,997)	-	(2,997)
Reinsurers' share of claims and benefits paid and movement in liabilities to policyholders	<u>(3,072)</u>	<u>-</u>	<u>(3,072)</u>
Net insurance claims and benefits paid and movement in liabilities to policyholders	<u>12,971</u>	<u>(3)</u>	<u>12,968</u>
2014			
Claims, benefits and surrenders paid	7,721	10	7,731
Movement in provisions	6,435	(3)	6,432
Gross claims and benefits paid and movement in liabilities to policyholders	14,156	7	14,163
Reinsurers' share of claims, benefits and surrenders paid	(31)	-	(31)
Reinsurers' share of movement in provisions	(1,390)	-	(1,390)
Reinsurers' share of claims and benefits paid and movement in liabilities to policyholders	<u>(1,421)</u>	<u>-</u>	<u>(1,421)</u>
Net insurance claims and benefits paid and movement in liabilities to policyholders	<u>12,735</u>	<u>7</u>	<u>12,742</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

12 Loan impairment charges

	2015	2014
Net charge for impairment of loans and advances to customers (note 31(b)):		
Individually assessed impairment allowances:		
- new allowances	594	699
- releases	(50)	(131)
- recoveries	(16)	(36)
	<u>528</u>	<u>532</u>
Net charge for collectively assessed impairment allowances	<u>580</u>	<u>612</u>
Loan impairment charges	<u><u>1,108</u></u>	<u><u>1,144</u></u>

There was no impairment charge (2014: Nil) provided for available-for-sale debt securities, held-to-maturity debt securities and placings with and advances to banks by the Group.

13 Operating expenses

	2015	2014
Employee compensation and benefits:		
- salaries and other costs*	4,448	4,155
- retirement benefit costs		
-- defined benefit scheme (note 55(a))	259	297
-- defined contribution scheme (note 55(b))	186	164
	<u>4,893</u>	<u>4,616</u>
General and administrative expenses:		
- rental expenses	696	682
- other premises and equipment	1,201	1,112
- marketing and advertising expenses	902	829
- other operating expenses	1,723	1,432
	<u>4,522</u>	<u>4,055</u>
Depreciation of premises, plant and equipment (note 37(a))	957	831
Amortisation of intangible assets (note 38(c))	110	111
	<u><u>10,482</u></u>	<u><u>9,613</u></u>
* of which:		
share-based payments (note 56(e))	38	43
Cost efficiency ratio	33.8%	31.8%

Included in operating expenses are minimum lease payments under operating leases of HK\$716m (2014: HK\$705m).

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

14 The emoluments of the five highest paid individuals

(a) The aggregate emoluments

	2015	2014
Salaries, allowances and benefits in kind	24	24
Retirement scheme contributions	1	2
Variable bonuses	27	23
	<u>52</u>	<u>49</u>

(b) The numbers of the five highest paid individuals whose emoluments fell within the following bands were:

HK\$	2015	2014
	Number of	Number of
	Individuals	Individuals
5,500,001 - 6,000,000	-	1
6,000,001 - 6,500,000	1	1
7,000,001 - 7,500,000	1	-
8,000,001 - 8,500,000	2	2
20,500,001 - 21,000,000	-	1
21,500,001 - 22,000,000	1	-
	<u>5</u>	<u>5</u>

The emoluments of the five highest paid individuals set out above include the emoluments of three (2014: three) Executive Directors which are included in note 15. There is no Non-executive Director included in the table above (2014: Nil).

NOTES TO THE FINANCIAL STATEMENTS (continued)

15 Directors' emoluments

The emoluments of the Directors of the Bank disclosed pursuant to section 383 of the Hong Kong Companies Ordinance (Cap.622) and the Companies (Disclosure of Information about Benefits of Directors) Regulation were set out below:

	Fees '000	Salaries, allowances and benefits in kind '000	contribution to retirement benefit schemes ⁽⁴⁾ '000	Variable bonus ⁽⁵⁾				Total 2015 '000	Total 2014 '000
				Cash		Shares			
				Deferred '000	Non-deferred '000	Deferred '000	Non-deferred '000		
Executive Directors									
Ms Rose Lee, Chief Executive ⁽¹⁾	-	9,992	364	3,065	2,043	4,200	2,043	21,707	20,633
Mr Nixon Chan ⁽¹⁾	-	3,972	18	900	1,350	900	1,350	8,490	7,706
Mr Andrew H C Fung ⁽¹⁾	-	3,779	278	868	1,302	868	1,302	8,397	8,208
Non-Executive Directors									
Dr Raymond K F Ch'ien ⁽³⁾	740	-	-	-	-	-	-	740	740
Dr John C C Chan ⁽³⁾	600	-	-	-	-	-	-	600	600
Dr Marvin K T Cheung ⁽³⁾ (Resigned on 1 Aug 2014)	-	-	-	-	-	-	-	-	507
Ms L Y Chiang ⁽³⁾	510	-	-	-	-	-	-	510	510
Ms Anita Y M Fung ⁽²⁾ (Resigned on 31 Jan 2014)	-	-	-	-	-	-	-	-	37
Mr Kenneth S Y Ng ⁽²⁾	450	-	-	-	-	-	-	450	366
Dr Fred Zulu Hu ⁽³⁾	610	-	-	-	-	-	-	610	610
Dr Henry K S Cheng ⁽³⁾	450	-	-	-	-	-	-	450	300
Ms Irene Y L Lee ⁽³⁾	870	-	-	-	-	-	-	870	515
Ms Sarah C Legg ⁽²⁾	450	-	-	-	-	-	-	450	450
Dr Eric K C Li ⁽³⁾	870	-	-	-	-	-	-	870	870
Dr Vincent H S Lo	450	-	-	-	-	-	-	450	450
Mr Richard Y S Tang ⁽³⁾	825	-	-	-	-	-	-	825	835
Mr Peter T S Wong ⁽²⁾	510	-	-	-	-	-	-	510	510
Mr Michael W K Wu ⁽³⁾	670	-	-	-	-	-	-	670	577
Past Directors	-	-	2,252	-	-	-	-	2,252	2,308
	8,005	17,743	2,912	4,833	4,695	5,968	4,695	48,851	46,732
2014	7,877	17,498	2,965	4,404	4,273	5,442	4,273		

During the year ended 31 December 2015, there was no termination on the appointment of directors of the Bank and its subsidiaries and thus no payments was made as compensation for the early termination of the appointment and no consideration was provided to third parties for making available directors' services (2014: Nil).

Notes :

- (1) In line with the HSBC Group's remuneration policy, no Director's fees were paid to those Directors who were full time employees of the Bank or its subsidiaries.
- (2) Fees receivable as a Director of Hang Seng Bank Limited were surrendered to The Hongkong and Shanghai Banking Corporation Limited in accordance with the HSBC Group's internal policy.
- (3) Independent Non-Executive Director.
- (4) The aggregate amount of pensions received by the past Directors of the Bank under the relevant pension schemes amounted to HK\$2.3m in 2015. The Bank made contributions during 2015 into the retirement benefit schemes of which the Bank's Directors are among their members.
- (5) The amount of variable bonus comprises the cash and the estimated purchase cost of the award of HSBC Holdings Restricted Share which is measured according to the Group's accounting policies for share-based payment as set out in note 3(v). The bonus comprises the deferred and non-deferred variable pay, details of which are also set out in the section of "remuneration of director, senior management and key personnel" under "Corporate Governance Report". The details are also set out in note 57.

NOTES TO THE FINANCIAL STATEMENTS (continued)

16 Auditors' remuneration

	2015	2014
Statutory audit services	13	12
Non-statutory audit services and others	7	9
	<u>20</u>	<u>21</u>

17 Net gain on partial disposal of Industrial Bank

	2015	2014
Net gain on partial disposal of Industrial Bank		
- realisation of amounts previously recognised in reserve at 1 January	14,707	-
- net loss arising in the year	(4,071)	-
	<u>10,636</u>	<u>-</u>

18 Gains less losses from financial investments and fixed assets

	2015	2014
Net gains from disposal of available-for-sale equity securities		
- realisation of amounts previously recognised in reserve at 1 January	-	32
- net gains arising in the year	-	1
	-	33
Net gains from disposal of available-for-sale debt securities		
- realisation of amounts previously recognised in reserve at 1 January	111	2
- net losses arising in the year	(95)	(1)
	16	1
Gains less losses on disposal of loans and advances	-	3
Gains less losses on disposal of fixed assets	(10)	(8)
Impairment of investment in Yantai Bank	-	(85)
	<u>6</u>	<u>(56)</u>

There were no impairment losses or gains less losses on disposal of held-to-maturity debt securities and financial liabilities measured at amortised cost for 2015 and 2014.

19 Net surplus on property revaluation

	2015	2014
Surplus of revaluation on investment properties	<u>261</u>	<u>521</u>

20 Tax expense

(a) Taxation in the consolidated income statement represents:

	2015	2014
Current tax - provision for Hong Kong profits tax		
Tax for the year	2,892	2,808
Adjustment in respect of prior years	(56)	(100)
	<u>2,836</u>	<u>2,708</u>
Current tax - taxation outside Hong Kong		
Tax for the year	50	151
Adjustment in respect of prior years	-	13
	<u>50</u>	<u>164</u>
Deferred tax (note 46(b))		
Origination and reversal of temporary differences	108	46
	<u>108</u>	<u>46</u>
Total tax expense	<u>2,994</u>	<u>2,918</u>

The current tax provision is based on the estimated assessable profit for 2015, and is determined for the Bank and its subsidiaries operating in the Hong Kong SAR by using the Hong Kong profits tax rate of 16.5 per cent (2014: 16.5 per cent). For subsidiaries and branches operating in other jurisdictions, the appropriate tax rates prevailing in the relevant countries are used. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised.

NOTES TO THE FINANCIAL STATEMENTS (continued)

20 Tax expense (continued)

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

	2015	2014
Profit before tax	<u>30,488</u>	<u>18,049</u>
Notional tax on profit before tax, calculated at Hong Kong tax rate of 16.5% (2014: 16.5%)	5,031	2,978
Tax effect of:		
- different tax rates in other countries/areas	2	4
- non-taxable income and non-deductible expenses *	(2,004)	(62)
- share of results of associates	(25)	(39)
- others	(10)	37
Actual charge for taxation	<u>2,994</u>	<u>2,918</u>

* Included a gain on partial disposal of the ordinary shares of Industrial Bank.

21 Earnings per share

The calculation of earnings per share in 2015 is based on earnings of HK\$27,494m (HK\$15,131m in 2014) after deducting the coupon paid on AT1 capital instrument of HK\$310m and on the weighted average number of ordinary shares in issue of 1,911,842,736 shares (unchanged from 2014).

22 Dividends per share

(a) Dividends attributable to the year:

	2015		2014	
	per share HK\$	HK\$m	per share HK\$	HK\$m
First interim	1.10	2,103	1.10	2,103
Second interim	1.10	2,103	1.10	2,103
Third interim	1.10	2,103	1.10	2,103
Fourth interim	2.40	4,588	2.30	4,397
Special interim dividend	3.00	5,736	-	-
	<u>8.70</u>	<u>16,633</u>	<u>5.60</u>	<u>10,706</u>

The fourth interim dividend and the special interim dividend are proposed after the balance sheet date, and have not been recognised as a liability at the balance sheet date.

(b) Dividends attributable to the previous year, approved and paid during the year:

	2015	2014
Fourth interim dividend in respect of the previous year, approved and paid during the year, of HK\$2.30 per share (2014: HK\$2.20 per share)	<u>4,397</u>	<u>4,206</u>

(c) Distribution to holder of AT1 capital instrument classified as equity

	2015	2014
	Total HK\$m	Total HK\$m
Coupon paid on AT1 capital instrument	<u>310</u>	<u>-</u>

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

23 Segmental analysis

Hong Kong Financial Reporting Standard 8 ('HKFRS 8') requires segmental disclosure to be based on the way that the Group's chief operating decision maker regards and manages the Group, with the amounts reported for each reportable segment being the measures reported to the Group's chief operating decision maker for the purpose of assessing segmental performance and making decisions about operating matters. In 2015, there was a change in the reportable segment information reported internally to the Group's most senior executive management for the purposes of resources allocation and performance assessment. The change has taken into account of the increasingly integrated nature of our Hong Kong and mainland business. Previously, mainland China was presented as a separate segment. From 1 January 2015, mainland China was integrated within the three global businesses. To align with the internal reporting information, the Group has presented the following four reportable segments. Corresponding amounts have been restated to ensure information is provided on a basis consistent with the revised segment information.

- **Retail Banking and Wealth Management** activities offer a broad range of products and services to meet the personal banking, consumer lending and wealth management needs of individual customers. Personal banking products typically include current and savings accounts, mortgages and personal loans, credit cards, insurance and wealth management;
- **Commercial Banking** activities offer a comprehensive suite of products and services to corporate, commercial and SME customers – including corporate lending, trade and receivable finance, payments and cash management, treasury and foreign exchange, general insurance, key-person insurance, investment services and corporate wealth management;
- **Global Banking and Markets** provides tailored financial solutions to major corporate and institutional clients. Undertaking a long-term relationships management approach, its services include general banking, corporate lending, interest rates, foreign exchange, money markets, structured products and derivatives, etc. Global Banking and Markets also manages the funding and liquidity positions of the Bank and other market risk positions arising from banking activities;
- **Other** mainly represents management of shareholders' funds and investments in premises, investment properties, equity shares and subordinated debt funding.

(a) Segmental result

For the purpose of segmental analysis, the allocation of revenue reflects the benefits of capital and other funding resources allocated to the business segments by way of internal capital allocation and fund transfer-pricing mechanisms. Cost allocation is based on the direct costs incurred by the respective business segments and apportionment of management overheads. Bank-owned premises are reported under the 'Other' segment. When these premises are utilised by Global Businesses, notional rent will be charged to the relevant business segments based on market rates.

NOTES TO THE FINANCIAL STATEMENTS (continued)

23 Segmental analysis (continued)

(a) Segmental result (continued)

	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Other	Total
2015					
Net interest income	11,281	5,929	3,498	457	21,165
Net fee income	4,864	1,672	320	182	7,038
Net trading income/(loss)	72	410	1,576	(28)	2,030
Net income/(loss) from financial instruments designated at fair value	(132)	(8)	-	22	(118)
Dividend income	1	-	-	141	142
Net insurance premium income	9,366	479	-	-	9,845
Other operating income	3,460	128	18	307	3,913
Total operating income	28,912	8,610	5,412	1,081	44,015
Net insurance claims and benefits paid and movement in liabilities to policyholders	(12,575)	(393)	-	-	(12,968)
Net operating income before loan impairment charges	16,337	8,217	5,412	1,081	31,047
Loan impairment (charges)/releases	(620)	(524)	36	-	(1,108)
Net operating income	15,717	7,693	5,448	1,081	29,939
Operating expenses*	(6,623)	(2,481)	(946)	(432)	(10,482)
Impairment loss on intangible assets	(5)	-	-	(19)	(24)
Operating profit	9,089	5,212	4,502	630	19,433
Net gain on partial disposal of Industrial Bank	-	-	-	10,636	10,636
Gains less losses from financial investments and fixed assets	10	(1)	4	(7)	6
Net surplus on property revaluation	-	-	-	261	261
Share of profits from associates	151	1	-	-	152
Profit before tax	9,250	5,212	4,506	11,520	30,488
Share of profit before tax	30.3%	17.1%	14.8%	37.8%	100.0%
Share of profit before tax (excluding Industrial Bank-related items)	46.9%	26.4%	22.8%	3.9%	100.0%
Operating profit excluding loan impairment charges	9,709	5,736	4,466	630	20,541
<i>* Depreciation/amortisation included in operating expenses</i>	(57)	(27)	(6)	(977)	(1,067)
At 31 December 2015					
Total assets	392,667	302,086	571,178	68,498	1,334,429
Total liabilities	753,208	253,626	167,178	18,436	1,192,448
Interest in associates	2,261	14	-	-	2,275
Non-current assets acquired during the year	1,090	43	4	355	1,492

NOTES TO THE FINANCIAL STATEMENTS (continued)

23 Segmental analysis (continued)

(a) Segmental result (continued)

	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Other	Total
2014 (restated)					
Net interest income	10,315	5,507	4,001	48	19,871
Net fee income	4,169	1,714	217	149	6,249
Net trading income	183	432	1,310	19	1,944
Net income/(loss) from financial instruments designated at fair value	1,206	(1)	-	(4)	1,201
Dividend income	1	-	-	1,209	1,210
Net insurance premium income	10,671	108	-	-	10,779
Other operating income	1,273	67	-	355	1,695
Total operating income	27,818	7,827	5,528	1,776	42,949
Net insurance claims and benefits paid and movement in liabilities to policyholders	(12,655)	(87)	-	-	(12,742)
Net operating income before loan impairment charges	15,163	7,740	5,528	1,776	30,207
Loan impairment charges	(543)	(592)	(9)	-	(1,144)
Net operating income	14,620	7,148	5,519	1,776	29,063
Operating expenses*	(6,230)	(2,321)	(831)	(231)	(9,613)
Operating profit	8,390	4,827	4,688	1,545	19,450
Impairment of investment in Industrial Bank	-	-	-	(2,103)	(2,103)
Gains less losses from financial investments and fixed assets	(1)	(1)	4	(58)	(56)
Net surplus on property revaluation	-	-	-	521	521
Share of profits from associates	236	1	-	-	237
Profit/(loss) before tax	8,625	4,827	4,692	(95)	18,049
Share of profit/(loss) before tax	<u>47.8%</u>	<u>26.7%</u>	<u>26.0%</u>	<u>(0.5%)</u>	<u>100.0%</u>
Share of profit before tax (excluding Industrial Bank-related items)	<u>45.5%</u>	<u>25.5%</u>	<u>24.7%</u>	<u>4.3%</u>	<u>100.0%</u>
Operating profit excluding loan impairment charges	8,933	5,419	4,697	1,545	20,594
<i>* Depreciation/amortisation included in operating expenses</i>	(52)	(31)	(6)	(853)	(942)
At 31 December 2014					
Total assets	<u>358,323</u>	<u>294,332</u>	<u>501,290</u>	<u>110,045</u>	<u>1,263,990</u>
Total liabilities	<u>717,572</u>	<u>231,673</u>	<u>155,465</u>	<u>20,087</u>	<u>1,124,797</u>
Interest in associates	<u>2,206</u>	<u>12</u>	<u>-</u>	<u>-</u>	<u>2,218</u>
Non-current assets acquired during the year	<u>253</u>	<u>18</u>	<u>9</u>	<u>402</u>	<u>682</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

23 Segmental analysis (continued)

(b) Geographic Information

The geographical regions in this analysis are classified by the location of the principal operations of the subsidiary companies or, in the case of the Bank itself, by the location of the branches responsible for reporting the results or advancing the funds. Consolidation adjustments made in preparing the Group's financial statements upon consolidation are included in the "Inter-segment elimination".

	Hong Kong	Mainland China	Others	Inter- segment elimination	Total
Year ended 31 December 2015					
Income and expense					
Total operating income	41,801	2,057	249	(92)	44,015
Profit before tax	30,224	101	163	-	30,488
At 31 December 2015					
Total assets	1,244,606	113,718	19,260	(43,155)	1,334,429
Total liabilities	1,105,668	101,806	18,655	(33,681)	1,192,448
Equity	138,938	11,912	605	(9,474)	141,981
Share capital	9,658	10,093	-	(10,093)	9,658
Interest in associates	2,272	3	-	-	2,275
Non-current assets*	47,414	1,046	22	-	48,482
Contingent liabilities and commitments	334,682	38,545	5,645	-	378,872
Year ended 31 December 2014					
Income and expense					
Total operating income	40,698	2,109	213	(71)	42,949
Profit before tax	17,814	104	131	-	18,049
At 31 December 2014					
Total assets	1,165,918	127,948	14,636	(44,512)	1,263,990
Total liabilities	1,029,796	117,726	14,170	(36,895)	1,124,797
Equity	136,122	10,222	466	(7,617)	139,193
Share capital	9,658	8,700	12	(8,712)	9,658
Interest in associates	2,198	20	-	-	2,218
Non-current assets*	41,571	1,108	4	-	42,683
Contingent liabilities and commitments	292,781	41,691	4,491	-	338,963

* Non-current assets consist of properties, plant and equipment, goodwill and other intangible assets.

NOTES TO THE FINANCIAL STATEMENTS (continued)

24 Analysis of assets and liabilities by remaining maturity

The maturity analysis is based on the remaining contractual maturity at the balance sheet date, with the exception of the trading portfolio that may be sold before maturity and is accordingly recorded as "Trading".

	Repayable on demand	One month or less but not on demand	Over one month but within three months	Over three months but within one year	Over one year but within five years	Over five years	Trading	No contractual maturity	Total
2015									
Assets									
Cash and sight balances									
at central banks	10,118	-	-	-	-	-	-	-	10,118
Placings with and									
advances to banks	15,443	54,166	49,749	2,433	-	2,199	-	-	123,990
Trading assets	-	-	-	-	-	-	40,373	-	40,373
Financial assets									
designated at									
fair value	-	1,074	2	-	9	51	-	6,767	7,903
Derivative financial									
instruments	-	-	133	122	228	9	11,103	-	11,595
Reverse repurchase									
agreements - non-trading	-	-	-	-	-	-	-	-	-
Loans and advances									
to customers	12,676	53,121	56,340	132,745	238,447	195,617	-	-	688,946
Financial investments:									
- available-for-sale									
investments	-	35,639	84,573	103,763	56,219	5,591	-	4,665	290,450
- held-to-maturity									
debt securities	-	78	1,631	4,424	31,006	44,683	-	-	81,822
Interest in									
associates	-	-	-	-	-	-	-	2,275	2,275
Investment properties	-	-	-	-	-	-	-	10,075	10,075
Premises, plant and									
equipment	-	-	-	-	-	-	-	26,186	26,186
Intangible assets	-	-	-	-	-	-	-	12,221	12,221
Other assets	9,850	5,714	4,032	2,200	5,762	199	-	718	28,475
	<u>48,087</u>	<u>149,792</u>	<u>196,460</u>	<u>245,687</u>	<u>331,671</u>	<u>248,349</u>	<u>51,476</u>	<u>62,907</u>	<u>1,334,429</u>
Liabilities									
Current, savings and									
other deposit accounts	704,866	130,724	85,748	36,786	1,104	-	-	-	959,228
Repurchase agreements - non trading	-	2,315	-	-	-	-	-	-	2,315
Deposits from banks	6,654	12,103	23	-	-	-	-	-	18,780
Trading liabilities	-	-	-	-	-	-	62,917	-	62,917
Financial liabilities									
designated at									
fair value	2	-	-	-	3,491	501	-	-	3,994
Derivative financial									
instruments	-	5	21	64	469	33	9,396	-	9,988
Certificates of deposit									
and other debt									
securities in issue:									
- certificates of									
deposit in issue	-	-	-	-	4,000	-	-	-	4,000
- other debt securities									
in issue	-	-	-	-	1,191	-	-	-	1,191
Other liabilities	6,569	5,866	4,790	1,618	92	3	-	1,953	20,891
Liabilities under									
insurance contracts	-	-	-	-	-	-	-	101,817	101,817
Current tax liabilities	-	-	-	185	-	-	-	-	185
Deferred tax liabilities	-	-	-	-	-	-	-	4,817	4,817
Subordinated liabilities	-	-	-	-	-	2,325	-	-	2,325
	<u>718,091</u>	<u>151,013</u>	<u>90,582</u>	<u>38,653</u>	<u>10,347</u>	<u>2,862</u>	<u>72,313</u>	<u>108,587</u>	<u>1,192,448</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

24 Analysis of assets and liabilities by remaining maturity (continued)

	Repayable on demand	One month or less but not on demand	Over one month but within three months	Over three months but within one year	Over one year but within five years	Over five years	Trading	No contractual maturity	Total
of which:									
Certificates of deposit included in:									
- trading assets	-	-	-	-	-	-	-	-	-
- financial assets designated at fair value	-	-	-	-	-	-	-	-	-
- available-for-sale investments	-	282	1,511	4,045	681	-	-	-	6,519
- held-to-maturity debt securities	-	-	814	832	2,309	1,579	-	-	5,534
	<u>-</u>	<u>282</u>	<u>2,325</u>	<u>4,877</u>	<u>2,990</u>	<u>1,579</u>	<u>-</u>	<u>-</u>	<u>12,053</u>
Debt securities included in:									
- trading assets	-	-	-	-	-	-	38,080	-	38,080
- financial assets designated at fair value	-	1,074	2	-	9	51	-	-	1,136
- available-for-sale investments	-	35,357	83,062	99,718	55,538	5,591	-	23	279,289
- held-to-maturity debt securities	-	78	817	3,592	28,697	43,104	-	-	76,288
	<u>-</u>	<u>36,509</u>	<u>83,881</u>	<u>103,310</u>	<u>84,244</u>	<u>48,746</u>	<u>38,080</u>	<u>23</u>	<u>394,793</u>
Certificates of deposit in issue included in:									
- trading liabilities	-	-	-	-	-	-	-	-	-
- financial liabilities designated at fair value	-	-	-	-	3,491	-	-	-	3,491
- issue at amortised cost	-	-	-	-	4,000	-	-	-	4,000
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,491</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,491</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

24 Analysis of assets and liabilities by remaining maturity (continued)

	Repayable on demand	One month or less but not on demand	Over one month but within three months	Over three months but within one year	Over one year but within five years	Over five years	Trading	No contractual maturity	Total
2014									
Assets									
Cash and sight balances at central banks	11,311	-	-	-	-	-	-	-	11,311
Placings with and advances to banks	21,413	67,164	50,532	4,510	-	2,112	-	-	145,731
Trading assets	-	-	-	-	-	-	41,823	-	41,823
Financial assets designated at fair value	-	-	-	-	15	60	-	11,037	11,112
Derivative financial instruments	-	-	-	353	179	1	6,888	-	7,421
Reverse repurchase agreements – non-trading	-	1,296	-	-	-	-	-	-	1,296
Loans and advances to customers	13,250	49,544	53,498	139,508	218,166	184,465	-	-	658,431
Financial investments:									
- available-for-sale investments	-	23,144	65,865	70,648	39,999	5,856	-	44,284	249,796
- held-to-maturity debt securities	-	87	382	3,433	27,440	36,894	-	-	68,236
Interest in associates	-	-	-	-	-	-	-	2,218	2,218
Investment properties	-	-	-	-	-	-	-	11,732	11,732
Premises, plant and equipment	-	-	-	-	-	-	-	21,898	21,898
Intangible assets	-	-	-	-	-	-	-	9,053	9,053
Other assets	8,414	5,825	3,921	2,287	2,774	138	-	573	23,932
	<u>54,388</u>	<u>147,060</u>	<u>174,198</u>	<u>220,739</u>	<u>288,573</u>	<u>229,526</u>	<u>48,711</u>	<u>100,795</u>	<u>1,263,990</u>
Liabilities									
Current, savings and other deposit accounts	630,301	124,457	94,150	44,590	3,023	-	-	-	896,521
Repurchase agreements - non trading	-	-	-	-	-	-	-	-	-
Deposits from banks	3,797	3,171	-	2,127	-	-	-	-	9,095
Trading liabilities	-	-	-	-	-	-	72,587	-	72,587
Financial liabilities designated at fair value	2	-	-	-	2,994	493	-	-	3,489
Derivative financial instruments	-	2	20	67	351	108	5,914	-	6,462
Certificates of deposit and other debt securities in issue:									
- certificates of deposit in issue	-	-	-	7,156	4,000	-	-	-	11,156
- other debt securities in issue	-	-	-	-	1,246	-	-	-	1,246
Other liabilities	6,707	5,606	4,090	2,237	127	46	-	2,491	21,304
Liabilities under insurance contracts	-	-	-	-	-	-	-	92,442	92,442
Current tax liabilities	-	-	-	374	-	-	-	-	374
Deferred tax liabilities	-	-	-	-	-	-	-	4,304	4,304
Subordinated liabilities	-	-	-	-	-	5,817	-	-	5,817
	<u>640,807</u>	<u>133,236</u>	<u>98,260</u>	<u>56,551</u>	<u>11,741</u>	<u>6,464</u>	<u>78,501</u>	<u>99,237</u>	<u>1,124,797</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

24 Analysis of assets and liabilities by remaining maturity (continued)

	Repayable on demand	One month or less but not on demand	Over one month but within three months	Over three months but within one year	Over one year but within five years	Over five years	Trading	No contractual maturity	Total
of which:									
Certificates of deposit included in:									
- trading assets	-	-	-	-	-	-	-	-	-
- financial assets designated at fair value	-	-	-	-	-	-	-	-	-
- available-for-sale investments	-	113	1,644	4,762	-	-	-	-	6,519
- held-to-maturity debt securities	-	-	-	537	2,831	2,202	-	-	5,570
	<u>-</u>	<u>113</u>	<u>1,644</u>	<u>5,299</u>	<u>2,831</u>	<u>2,202</u>	<u>-</u>	<u>-</u>	<u>12,089</u>
Debt securities included in:									
- trading assets	-	-	-	-	-	-	37,727	-	37,727
- financial assets designated at fair value	-	-	-	-	15	60	-	-	75
- available-for-sale investments	-	23,031	64,221	65,886	39,999	5,856	-	235	199,228
- held-to-maturity debt securities	-	87	382	2,896	24,609	34,692	-	-	62,666
	<u>-</u>	<u>23,118</u>	<u>64,603</u>	<u>68,782</u>	<u>64,623</u>	<u>40,608</u>	<u>37,727</u>	<u>235</u>	<u>299,696</u>
Certificates of deposit in issue included in:									
- trading liabilities	-	-	-	-	-	-	-	-	-
- financial liabilities designated at fair value	-	-	-	-	2,994	-	-	-	2,994
- issue at amortised cost	-	-	-	7,156	4,000	-	-	-	11,156
	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,156</u>	<u>6,994</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>14,150</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

25 Accounting classifications

The tables below set out the Group's classification of financial assets and liabilities:

	Trading	Designated at fair value	Available- for-sale/ hedging	Held-to- maturity	Loans and receivables	Other amortised cost	Total
2015							
Cash and sight balances at central banks	-	-	-	-	4,859	5,259	10,118
Placings with and advances to banks	-	-	-	-	123,990	-	123,990
Derivative financial instruments	11,103	20	472	-	-	-	11,595
Reverse repurchase agreements – non-trading	-	-	-	-	-	-	-
Loans and advances to customers	-	-	-	-	688,946	-	688,946
Investment securities	38,101	7,903	290,450	81,822	-	-	418,276
Acceptances and endorsements	-	-	-	-	5,724	-	5,724
Other financial assets	2,272	-	-	-	13,152	-	15,424
Total financial assets	<u>51,476</u>	<u>7,923</u>	<u>290,922</u>	<u>81,822</u>	<u>836,671</u>	<u>5,259</u>	<u>1,274,073</u>
Non-financial assets	-	-	-	-	-	-	60,356
Total assets							<u><u>1,334,429</u></u>
Current, savings and other deposit accounts	27,440	-	-	-	-	959,228	986,668
Repurchase agreements – non-trading	-	-	-	-	-	2,315	2,315
Deposits from banks	-	-	-	-	-	18,780	18,780
Derivative financial instruments	9,396	-	592	-	-	-	9,988
Certificates of deposit and other debt securities in issue	2,351	3,491	-	-	-	5,191	11,033
Other financial liabilities	33,126	-	-	-	-	13,086	46,212
Subordinated liabilities	-	-	-	-	-	2,325	2,325
Liabilities to customers under investment contracts	-	503	-	-	-	-	503
Acceptances and endorsements	-	-	-	-	-	5,724	5,724
Total financial liabilities	<u>72,313</u>	<u>3,994</u>	<u>592</u>	<u>-</u>	<u>-</u>	<u>1,006,649</u>	<u>1,083,548</u>
Non-financial liabilities	-	-	-	-	-	-	108,900
Total liabilities							<u><u>1,192,448</u></u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

25 Accounting classifications (continued)

	Trading	Designated at fair value	Available- for-sale/ hedging	Held-to- maturity	Loans and receivables (restated)	Other amortised cost (restated)	Total
2014							
Cash and sight balances at central banks	-	-	-	-	6,295	5,016	11,311
Placings with and advances to banks	-	-	-	-	145,731	-	145,731
Derivative financial instruments	6,888	-	533	-	-	-	7,421
Reverse repurchase agreements – non-trading	-	-	-	-	1,296	-	1,296
Loans and advances to customers	-	-	-	-	658,431	-	658,431
Investment securities	37,767	11,112	249,796	68,236	-	-	366,911
Acceptances and endorsements	-	-	-	-	5,715	-	5,715
Other financial assets	4,056	-	-	-	11,504	-	15,560
Total financial assets	<u>48,711</u>	<u>11,112</u>	<u>250,329</u>	<u>68,236</u>	<u>828,972</u>	<u>5,016</u>	<u>1,212,376</u>
Non-financial assets							<u>51,614</u>
Total assets							<u><u>1,263,990</u></u>
Current, savings and other deposit accounts	40,380	-	-	-	-	896,521	936,901
Repurchase agreements – non-trading	-	-	-	-	-	-	-
Deposits from banks	-	-	-	-	-	9,095	9,095
Derivative financial instruments	5,913	1	548	-	-	-	6,462
Certificates of deposit and other debt securities in issue	4,223	2,994	-	-	-	12,402	19,619
Other financial liabilities	27,984	-	-	-	-	12,991	40,975
Subordinated liabilities	-	-	-	-	-	5,817	5,817
Liabilities to customers under investment contracts	-	495	-	-	-	-	495
Acceptances and endorsements	-	-	-	-	-	5,715	5,715
Total financial liabilities	<u>78,500</u>	<u>3,490</u>	<u>548</u>	<u>-</u>	<u>-</u>	<u>942,541</u>	<u>1,025,079</u>
Non-financial liabilities							<u>99,718</u>
Total liabilities							<u><u>1,124,797</u></u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

26 Cash and sight balances at central banks

	2015	2014
Cash in hand	5,259	5,016
Sight balances at central banks	4,859	6,295
	<u>10,118</u>	<u>11,311</u>

27 Placings with and advances to banks

	2015	2014
Balances with banks	13,446	15,972
Placings with and advances to banks maturing within one month	56,163	72,605
Placings with and advances to banks maturing after one month but less than one year	52,182	55,042
Placings with and advances to banks maturing after one year	2,199	2,112
	<u>123,990</u>	<u>145,731</u>

of which:

Placings with and advances to central banks	10,305	13,566
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There were no overdue advances, impaired advances and rescheduled advances to banks at 31 December 2015 by the Group (2014: Nil).

NOTES TO THE FINANCIAL STATEMENTS (continued)

28 Trading assets

	2015	2014
Treasury bills	21,405	24,228
Other debt securities	16,675	13,499
Debt securities	<u>38,080</u>	<u>37,727</u>
Investment funds	21	40
Total trading securities	<u>38,101</u>	<u>37,767</u>
Other*	2,272	4,056
Total trading assets	<u><u>40,373</u></u>	<u><u>41,823</u></u>
Debt securities:		
- listed in Hong Kong	13,134	9,829
- listed outside Hong Kong	893	424
	<u>14,027</u>	<u>10,253</u>
- unlisted	24,053	27,474
	<u>38,080</u>	<u>37,727</u>
Investment funds:		
- listed in Hong Kong	21	40
Total trading securities	<u><u>38,101</u></u>	<u><u>37,767</u></u>
Debt securities:		
Issued by public bodies:		
- central governments and central banks	35,386	34,481
- other public sector entities	-	-
	<u>35,386</u>	<u>34,481</u>
Issued by other bodies:		
- banks	768	598
- corporate entities	1,926	2,648
	<u>2,694</u>	<u>3,246</u>
	<u>38,080</u>	<u>37,727</u>
Investment funds:		
Issued by corporate entities	21	40
Total trading securities	<u><u>38,101</u></u>	<u><u>37,767</u></u>

* This represents amount receivable from counterparties on trading transactions not yet settled.

NOTES TO THE FINANCIAL STATEMENTS (continued)

29 Financial assets designated at fair value

	2015	2014
Treasury bills	1,070	-
Other debt securities	66	75
Debt securities	<u>1,136</u>	<u>75</u>
Equity shares	1,838	6,799
Investment funds	<u>4,929</u>	<u>4,238</u>
	<u><u>7,903</u></u>	<u><u>11,112</u></u>
Debt securities:		
- listed in Hong Kong	17	20
- listed outside Hong Kong	49	55
	<u>66</u>	<u>75</u>
- unlisted	1,070	-
	<u>1,136</u>	<u>75</u>
Equity shares:		
- listed in Hong Kong	1,407	1,958
- listed outside Hong Kong	388	4,735
	<u>1,795</u>	<u>6,693</u>
- unlisted	43	106
	<u>1,838</u>	<u>6,799</u>
Investment funds:		
- listed in Hong Kong	239	1,504
- listed outside Hong Kong	43	332
	<u>282</u>	<u>1,836</u>
- unlisted	4,647	2,402
	<u>4,929</u>	<u>4,238</u>
	<u><u>7,903</u></u>	<u><u>11,112</u></u>
Debt securities:		
Issued by public bodies:		
- central governments and central banks	1,070	-
- other public sector entities	1	1
	<u>1,071</u>	<u>1</u>
Issued by other bodies:		
- banks	6	14
- corporate entities	59	60
	<u>65</u>	<u>74</u>
	<u>1,136</u>	<u>75</u>
Equity shares:		
Issued by banks	423	1,069
Issued by public sector entities	6	9
Issued by corporate entities	1,409	5,721
	<u>1,838</u>	<u>6,799</u>
Investment funds:		
Issued by corporate entities	4,929	4,238
	<u>4,929</u>	<u>4,238</u>
	<u><u>7,903</u></u>	<u><u>11,112</u></u>

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

30 Derivative financial instruments

Derivatives are financial contracts whose values and characteristics are derived from underlying assets, currency rates and interest rates, and indices. Derivative instruments are subject to both credit risk and market risk. The credit risk relating to a derivative contract is principally the replacement cost of the contract when it has a positive mark-to-market value and the estimated potential future change in value over the residual maturity of the contract. The nominal value of the contracts does not represent the amount of the Group's exposure to credit risk. All activities relating to derivatives are subject to the same credit approval and monitoring standards used to control credit risk for other transactions. Market risk from derivative positions is controlled individually and in combination with on-balance sheet market risk positions within the Group's market risk limits regime as described in the Management Discussion and Analysis.

The Group transacts derivatives for three primary purposes: to create risk management solutions for clients, for proprietary trading purposes, and to manage and hedge its own risks. For accounting purposes, derivative financial instruments are held for trading, or financial instruments designated at fair value, or designated as either fair value hedge or cash flow hedge. The Group primarily traded over-the-counter derivatives and also participated in exchange traded derivatives.

Majority of the Group's derivative transactions with counterparties are subject to enforceable bilateral netting arrangements and a small portion of these transactions are covered with cash collateral. Offsets under these bilateral netting arrangements may not necessarily meet the offsetting criteria under HKFRS in order for the Group to present the related derivative financial instruments on a net basis in the consolidated financial statements.

As at 31 December 2015, the Group presented its derivative financial instruments on a gross basis in the consolidated financial statements. The derivative assets and liabilities contracts subject to enforceable bilateral netting arrangements amounted to HK\$10,960m (2014: HK\$6,819m) and HK\$9,592m (2014: HK\$5,982m) respectively, within which HK\$6,076m (2014: HK\$2,681m) were eligible for net settlement at default under the bilateral netting arrangements but did not satisfy the requirements under HKFRS for offsetting in the consolidated financial statements.

Trading derivatives

Most of the Group's trading derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities in derivatives are entered into principally for the purpose of generating profits from short-term fluctuations in price or margin. Positions may be traded actively or be held over a period of time to benefit from expected changes in currency rates, interest rates, equity prices or other market parameters.

Derivatives classified as held for trading include non-qualifying hedging derivatives and ineffective hedging derivatives. Non-qualifying hedging derivatives are entered into for risk management purposes but do not meet the criteria for hedge accounting. These include derivatives managed in conjunction with financial instruments designated at fair value. Ineffective hedging derivatives were previously designated as hedges, but no longer meet the criteria for hedge accounting.

Hedging instruments

The Group uses derivatives (principally interest rate swaps) for hedging purposes in the management of its own asset and liability portfolios and structural positions. This enables the Group to optimise the cost of managing the balance sheet, and to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities.

(a) Fair value hedge

The Group's fair value hedge principally consists of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates.

NOTES TO THE FINANCIAL STATEMENTS (continued)

30 Derivative financial instruments (continued)

(b) Cash flow hedge

The Group is exposed to variability in future interest cash flows on non-trading assets and liabilities which bear interest at variable rates or which are expected to be re-funded or reinvested in the future. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio of financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate principal balances and interest cash flows across all portfolios over time form the basis for identifying gains and losses on the effective portions of derivatives designated as cash flow hedge of forecast transactions.

Gains and losses are initially recognised in equity, in the cash flow hedging reserve, and are transferred to the income statement when the forecast cash flows affect the income statement. During the year ended 31 December 2015, the amount of cash flow hedging reserve transferred to the income statement consist of HK\$101m (2014: HK\$42m) in net interest income and HK\$87m (2014: HK\$297m) in net trading income.

There was insignificant ineffectiveness recognised in the Group's income statement arising from cash flow hedge during the years of 2015 and 2014. During the years of 2015 and 2014, there were no termination made for forecast transactions for which hedge accounting had previously been used but which were no longer expected to occur.

The schedules of forecast principal balances on which the expected interest cash flows associated with derivatives that are cash flow hedge were as follows:

	Three months or less	Over three months but within one year	Over one year but within five years
At 31 December 2015			
Cash inflows from assets	32,583	33,947	17,825
Cash outflows from liabilities	-	-	-
Net cash inflows	<u>32,583</u>	<u>33,947</u>	<u>17,825</u>
At 31 December 2014			
Cash inflows from assets	18,691	21,109	10,345
Cash outflows from liabilities	-	-	-
Net cash inflows	<u>18,691</u>	<u>21,109</u>	<u>10,345</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

30 Derivative financial instruments (continued)

(c) The following table shows the nominal contract amounts and marked-to-market value of assets and liabilities by each class of derivatives.

	2015			2014		
	Contract amounts	Derivative assets	Derivative liabilities	Contract amounts	Derivative assets	Derivative liabilities
Derivatives held for trading						
Exchange rate contracts:						
- spot and forward foreign exchange	623,963	5,572	4,066	638,980	3,588	2,727
- currency swaps	62,549	1,516	1,399	30,014	192	238
- currency options purchased	68,008	2,787	-	99,703	2,098	-
- currency options written	64,812	-	2,808	98,597	-	2,079
	<u>819,332</u>	<u>9,875</u>	<u>8,273</u>	<u>867,294</u>	<u>5,878</u>	<u>5,044</u>
Interest rate contracts:						
- interest rate swaps	207,984	873	867	184,283	758	639
- interest rate options written	4,482	-	-	5,084	-	-
- other interest rate contracts	948	2	-	2,130	2	1
	<u>213,414</u>	<u>875</u>	<u>867</u>	<u>191,497</u>	<u>760</u>	<u>640</u>
Equity and other contracts:						
- equity swaps	2,687	2	92	2,223	5	74
- equity options purchased	11,599	351	-	8,011	227	-
- equity options written	9,204	-	162	5,370	-	154
- spot and forward contracts and others	411	-	2	824	18	1
	<u>23,901</u>	<u>353</u>	<u>256</u>	<u>16,428</u>	<u>250</u>	<u>229</u>
Total derivatives held for trading	<u>1,056,647</u>	<u>11,103</u>	<u>9,396</u>	<u>1,075,219</u>	<u>6,888</u>	<u>5,913</u>
Derivatives managed in conjunction with financial assets designated at fair value						
Interest rate contracts:						
- interest rate swaps	<u>3,500</u>	<u>20</u>	<u>-</u>	<u>3,000</u>	<u>-</u>	<u>1</u>
Cash flow hedge derivatives						
Exchange rate contracts:						
- currency swaps	15,359	388	163	4,332	491	10
Interest rate contracts:						
- interest rate swaps	28,259	44	10	17,078	12	8
	<u>43,618</u>	<u>432</u>	<u>173</u>	<u>21,410</u>	<u>503</u>	<u>18</u>
Fair value hedge derivatives						
Interest rate contracts:						
- interest rate swaps	<u>29,381</u>	<u>40</u>	<u>419</u>	<u>24,075</u>	<u>30</u>	<u>530</u>
Total derivatives	<u>1,133,146</u>	<u>11,595</u>	<u>9,988</u>	<u>1,123,704</u>	<u>7,421</u>	<u>6,462</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

30 Derivative financial instruments (continued)

(d) Contract amounts, risk-weighted amounts and fair value

The table below gives the contract amounts, risk-weighted amounts and fair value of derivatives. The information is consistent with that in the "Capital Adequacy Ratio" return submitted to the Hong Kong Monetary Authority by the Group. The return is prepared on a consolidated basis as specified by the Hong Kong Monetary Authority under the requirement of section 3C(1) of the Banking (Capital) Rules ("the Capital Rules").

Derivatives arise from futures, forward, swap and option transactions undertaken by the Group in the foreign exchange, interest rate, equity, credit and commodity markets. The contract amounts of these instruments indicate the volume of transactions outstanding at the end of the balance sheet date, they do not represent amounts at risk.

Where a legally enforceable bilateral netting is arranged with counterparty, the Group has the right to offset the gross amount of positive marked-to-market assets with any negative marked-to-market liabilities with the same customer. These offsets are recognised by the Hong Kong Monetary Authority in the calculation of risk assets for the capital adequacy ratio.

	Contract amounts	Risk- weighted amounts	Fair value
2015			
Exchange rate contracts:			
- spot and forward foreign exchange	556,913	1,365	1,858
- currency swaps	78,350	416	372
- currency options purchased	67,947	5,080	2,712
	<u>703,210</u>	<u>6,861</u>	<u>4,942</u>
Interest rate contracts:			
- interest rate swaps	268,924	263	32
- other interest rate contracts	948	-	-
	<u>269,872</u>	<u>263</u>	<u>32</u>
Equity and other contracts:			
- equity swaps	2,687	22	2
- equity options purchased	12,894	396	246
	<u>15,581</u>	<u>418</u>	<u>248</u>

The fair values at 31 December 2015 are calculated after taking into account the effect of valid bilateral netting agreements amounting to HK\$5,840m (31 December 2014: HK\$2,390m).

	Contract amounts	Risk- weighted amounts	Fair value
2014			
Exchange rate contracts:			
- spot and forward foreign exchange	556,036	1,525	1,530
- currency swaps	32,426	242	527
- currency options purchased	99,709	5,231	2,072
	<u>688,171</u>	<u>6,998</u>	<u>4,129</u>
Interest rate contracts:			
- interest rate swaps	228,436	405	204
- other interest rate contracts	2,130	-	1
	<u>230,566</u>	<u>405</u>	<u>205</u>
Equity and other contracts:			
- equity swaps	2,223	23	5
- equity options purchased	5,438	371	152
	<u>7,661</u>	<u>394</u>	<u>157</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

31 Loans and advances to customers

(a) Loans and advances to customers

	2015	2014
Gross loans and advances to customers	690,561	660,269
Less:		
Loan impairment allowances		
- individually assessed	(807)	(999)
- collectively assessed	(808)	(839)
	<u>688,946</u>	<u>658,431</u>

Total loan impairment allowances as a percentage of gross loans and advances to customers are as follows:

	2015	2014
	%	%
Loan impairment allowances:		
- individually assessed	0.12	0.15
- collectively assessed	0.12	0.13
Total loan impairment allowances	<u>0.24</u>	<u>0.28</u>

(b) Loan impairment allowances against loans and advances to customers

	Individually assessed	Collectively assessed	Total
2015			
At 1 January	999	839	1,838
Amounts written off	(676)	(674)	(1,350)
Recoveries of loans and advances written off in previous years	16	76	92
New impairment allowances charged			
to income statement (note 12)	594	712	1,306
Impairment allowances released to income statement (note 12)	(66)	(132)	(198)
Unwinding of discount of loan impairment allowances recognised as "interest income"	(36)	(5)	(41)
Exchange difference	(24)	(8)	(32)
At 31 December	<u>807</u>	<u>808</u>	<u>1,615</u>
2014			
At 1 January	709	739	1,448
Amounts written off	(266)	(563)	(829)
Recoveries of loans and advances written off in previous years	36	56	92
New impairment allowances charged			
to income statement (note 12)	699	668	1,367
Impairment allowances released to income statement (note 12)	(167)	(56)	(223)
Unwinding of discount of loan impairment allowances recognised as "interest income"	(8)	(4)	(12)
Exchange difference	(4)	(1)	(5)
At 31 December	<u>999</u>	<u>839</u>	<u>1,838</u>

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

31 Loans and advances to customers *(continued)*

(c) Impaired loans and advances to customers and allowances

	2015	2014
Gross impaired loans and advances	2,737	2,115
Individually assessed allowances	(807)	(999)
Net impaired loans and advances	<u>1,930</u>	<u>1,116</u>
Individually assessed allowances as a percentage of gross impaired loans and advances	<u>29.5%</u>	<u>47.2%</u>
Gross impaired loans and advances as a percentage of gross loans and advances to customers	<u>0.40%</u>	<u>0.32%</u>

Impaired loans and advances to customers are those loans and advances where objective evidence exists that full repayment of principal or interest is considered unlikely.

	2015	2014
Gross individually assessed impaired loans and advances	2,505	1,963
Individually assessed allowances	(807)	(999)
	<u>1,698</u>	<u>964</u>
Gross individually assessed impaired loans and advances as a percentage of gross loans and advances to customers	<u>0.36%</u>	<u>0.30%</u>
Amount of collateral which has been taken into account in respect of individually assessed impaired loans and advances to customers	<u>1,651</u>	<u>637</u>

Collateral includes any tangible security that carries a fair market value and is readily marketable. This includes (but is not limited to) cash and deposits, stocks and bonds, mortgages over properties and charges over other fixed assets such as plant and equipment. Where collateral values are greater than gross loans and advances to customers, only the amount of collateral up to the gross loans and advances is included.

NOTES TO THE FINANCIAL STATEMENTS (continued)

31 Loans and advances to customers (continued)

(d) Overdue loans and advances to customers

Loans and advances to customers that are more than three months overdue and their expression as a percentage of gross loans and advances to customers are as follows:

2015	%
Gross loans and advances	
which have been overdue with respect to	
either principal or interest for periods of:	
- more than three months	
but not more than six months	696
	0.1
- more than six months	
but not more than one year	543
	0.1
- more than one year	912
	0.1
	<u>2,151</u>
	<u>0.3</u>

of which:

- individually impaired allowances	(759)
- covered portion of overdue loans	
and advances	1,141
- uncovered portion of overdue loans	
and advances	1,010
- current market value of collateral held	
against the covered portion of	
overdue loans and advances	2,527

2014

Gross loans and advances	
which have been overdue with respect to	
either principal or interest for periods of:	
- more than three months	
but not more than six months	449
	0.1
- more than six months	
but not more than one year	98
	-
- more than one year	558
	0.1
	<u>1,105</u>
	<u>0.2</u>

of which:

- individually impaired allowances	(622)
- covered portion of overdue loans	
and advances	377
- uncovered portion of overdue loans	
and advances	728
- current market value of collateral held	
against the covered portion of	
overdue loans and advances	1,043

Collateral held with respect to overdue loans and advances is mainly residential properties and commercial properties. The current market value of residential properties and commercial properties were HK\$1,307m and HK\$122m respectively (2014: HK\$558m and HK\$66m respectively).

Loans and advances with a specific repayment date are classified as overdue when the principal or interest is overdue and remains unpaid at period-end. Loans and advances repayable by regular instalments are treated as overdue when an instalment payment is overdue and remains unpaid at period-end. Loans and advances repayable on demand are classified as overdue either when a demand for repayment has been served on the borrower but repayment has not been made in accordance with the demand notice, or when the loans and advances have remained continuously outside the approved limit advised to the borrower for more than the overdue period in question.

NOTES TO THE FINANCIAL STATEMENTS (continued)

31 Loans and advances to customers (continued)

(e) Rescheduled loans and advances to customers

Rescheduled loans and advances to customers and their expression as a percentage of gross loans and advances to customers are as follows:

		%
2015	140	-
2014	90	-

Rescheduled loans and advances to customers are those loans and advances that have been rescheduled or renegotiated for reasons related to the borrower's financial difficulties. This will normally involve the granting of concessionary terms and resetting the overdue account to non-overdue status.

Rescheduled loans and advances to customers are stated net of any advances which have subsequently become overdue for more than three months and which are included in "Overdue loans and advances to customers" (note 31(d)).

(f) Segmental analysis of loans and advances to customers by geographical area

Loans and advances to customers by geographical area are classified according to the location of the counterparties after taking into account the transfer of risk. In general, risk transfer applies when a loan is guaranteed by a party located in an area that is different from that of the counterparty. From 1 January 2015, 'Mainland China' is presented as a separate line as the balances under mainland China have exceeded 10% of the total loans and advances. Previously, 'Mainland China' and 'Others' were grouped under 'Rest of Asia Pacific'. Comparative figures for 2014 have been restated to conform with current year's presentation.

	Gross loans and advances	Individually impaired loans and advances	Overdue loans and advances	Individually assessed allowances	Collectively assessed allowances
At 31 December 2015					
Hong Kong	567,668	1,667	1,539	414	605
Mainland China	97,131	829	611	392	171
Others	25,762	9	1	1	32
	<u>690,561</u>	<u>2,505</u>	<u>2,151</u>	<u>807</u>	<u>808</u>
At 31 December 2014 (restated)					
Hong Kong	543,757	1,124	842	506	692
Mainland China	92,510	830	257	490	123
Others	24,002	9	6	3	24
	<u>660,269</u>	<u>1,963</u>	<u>1,105</u>	<u>999</u>	<u>839</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

31 Loans and advances to customers (continued)

(g) Gross loans and advances to customers by industry sector

The analysis of gross loans and advances to customers by industry sector based on categories and definitions used by the Hong Kong Monetary Authority is as follows:

	2015	% of gross advances covered by collateral	2014	% of gross advances covered by collateral
Gross loans and advances to customers for use in Hong Kong				
Industrial, commercial and financial sectors				
- property development	43,951	46.7	41,676	38.6
- property investment	108,840	90.5	112,589	94.6
- financial concerns	5,556	28.7	5,499	45.8
- stockbrokers	32	96.9	531	24.7
- wholesale and retail trade	27,272	43.0	27,550	47.0
- manufacturing	21,478	43.2	21,501	52.5
- transport and transport equipment	9,608	68.5	7,530	72.9
- recreational activities	114	11.5	125	7.6
- information technology	3,821	18.1	2,935	34.2
- other	42,307	62.8	34,279	64.1
	<u>262,979</u>	<u>66.7</u>	<u>254,215</u>	<u>70.0</u>
Individuals				
- loans and advances for the purchase of flats under the Government Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	16,446	100.0	15,710	100.0
- loans and advances for the purchase of other residential properties	158,275	100.0	143,541	100.0
- credit card loans and advances	25,982	-	24,175	-
- other	19,737	40.6	17,039	39.7
	<u>220,440</u>	<u>82.9</u>	<u>200,465</u>	<u>82.8</u>
Total gross loans and advances for use in Hong Kong	483,419	74.1	454,680	75.7
Trade finance	46,885	22.0	41,537	26.5
Gross loans and advances for use outside Hong Kong	160,257	31.0	164,052	21.4
Gross loans and advances to customers	690,561	60.6	660,269	59.1

NOTES TO THE FINANCIAL STATEMENTS (continued)

31 Loans and advances to customers (continued)

(h) Net investments in finance leases

Loans and advances to customers include net investments in equipment leased to customers under finance leases and hire purchase contracts having the characteristics of finance leases. The contracts usually run for an initial period of 5 to 25 years, with an option for acquiring by the lessee the leased asset at nominal value at the end of the lease period. The total minimum lease payments receivable and their present value at the year-end are as follows:

	2015	2014	
Finance leases	-	-	
Hire purchase contracts	<u>5,903</u>	<u>5,315</u>	
	<u>5,903</u>	<u>5,315</u>	
	Present value of minimum lease payments receivable	Interest income relating to future periods	Total minimum lease payments receivable
2015			
Amounts receivable:			
- within one year	315	105	420
- after one year but within five years	1,179	365	1,544
- after five years	<u>4,409</u>	<u>717</u>	<u>5,126</u>
	<u>5,903</u>	<u>1,187</u>	<u>7,090</u>
Loans impairment allowances	-		
Net investments in finance leases and hire purchase contracts	<u>5,903</u>		
2014			
Amounts receivable:			
- within one year	300	71	371
- after one year but within five years	1,107	239	1,346
- after five years	<u>3,908</u>	<u>428</u>	<u>4,336</u>
	<u>5,315</u>	<u>738</u>	<u>6,053</u>
Loans impairment allowances	-		
Net investments in finance leases and hire purchase contracts	<u>5,315</u>		

NOTES TO THE FINANCIAL STATEMENTS (continued)

32 Financial investments

	2015	2014
Financial investments:		
- which may be repledged or resold by counterparties	923	506
- which may not be repledged or resold or are not subject to repledge or resale by counterparties	<u>371,349</u>	<u>317,526</u>
	<u>372,272</u>	<u>318,032</u>
Held-to-maturity debt securities at amortised cost	81,822	68,236
Available-for-sale at fair value:		
- debt securities	285,808	205,747
- equity shares	4,633	44,039
- investment funds	9	10
	<u>372,272</u>	<u>318,032</u>
Treasury bills	152,014	107,503
Certificates of deposit	12,053	12,089
Other debt securities	<u>203,563</u>	<u>154,391</u>
Debt securities	367,630	273,983
Equity shares	4,633	44,039
Investment funds	9	10
	<u>372,272</u>	<u>318,032</u>

There were no overdue debt securities at 31 December 2015 (31 December 2014: Nil) for the Group. The Group did not hold any asset-backed securities, mortgage-backed securities and collateralised debt obligations.

(a) Held-to-maturity debt securities

	2015	2014
Listed in Hong Kong	3,466	1,704
Listed outside Hong Kong	<u>17,688</u>	<u>12,303</u>
	21,154	14,007
Unlisted	<u>60,668</u>	<u>54,229</u>
	<u>81,822</u>	<u>68,236</u>
Issued by public bodies:		
- central governments and central banks	612	543
- other public sector entities	<u>10,993</u>	<u>10,143</u>
	11,605	10,686
Issued by other bodies:		
- banks	33,175	29,321
- corporate entities	<u>37,042</u>	<u>28,229</u>
	70,217	57,550
	<u>81,822</u>	<u>68,236</u>
Fair value of held-to-maturity debt securities:		
- listed	21,606	14,805
- unlisted	<u>62,965</u>	<u>56,024</u>
	<u>84,571</u>	<u>70,829</u>

There were no held-to-maturity debt securities determined to be impaired at 31 December 2015 for the Group (31 December 2014: Nil).

NOTES TO THE FINANCIAL STATEMENTS (continued)

32 Financial investments (continued)

(b) Available-for-sale debt securities

	2015	2014
Listed in Hong Kong	15,672	10,870
Listed outside Hong Kong	<u>110,301</u>	<u>54,483</u>
	125,973	65,353
Unlisted	<u>159,835</u>	<u>140,394</u>
	<u>285,808</u>	<u>205,747</u>
Issued by public bodies:		
- central governments and central banks	<u>222,977</u>	<u>156,336</u>
- other public sector entities	<u>14,966</u>	<u>9,493</u>
	237,943	165,829
Issued by other bodies:		
- banks	<u>42,665</u>	<u>34,361</u>
- corporate entities	<u>5,200</u>	<u>5,557</u>
	47,865	39,918
	<u>285,808</u>	<u>205,747</u>

At 31 December 2015 and 2014, there were no available-for-sale debt securities determined to be impaired on the basis that there was objective evidence of impairment in the value of the debt securities for the Group.

(c) Available-for-sale equity shares

	2015	2014
Listed in Hong Kong	66	69
Listed outside Hong Kong	<u>3,406</u>	<u>42,736</u>
	3,472	42,805
Unlisted	<u>1,161</u>	<u>1,234</u>
	<u>4,633</u>	<u>44,039</u>
Issued by banks	4,096	43,556
Issued by corporate entities	<u>537</u>	<u>483</u>
	<u>4,633</u>	<u>44,039</u>

During the year of 2015, there were no available-for-sale equity shares determined to be impaired. During 2014, certain available-for-sale equity shares were individually determined to be impaired on the basis that there was a "significant" or "prolonged" decline in the fair value of an equity investment. Impairment losses on these investments were recognised in the income statement in accordance with the accounting policy set out in note 3(s).

(d) Available-for-sale investment funds

	2015	2014
Unlisted	<u>9</u>	<u>10</u>
Issued by corporate entities	<u>9</u>	<u>10</u>

There were no available-for-sale investment funds determined to be impaired during the years of 2015 and 2014 for the Group.

NOTES TO THE FINANCIAL STATEMENTS (continued)

33 Transfers of financial assets not qualifying for derecognition

The Group enters into transactions in the normal course of business by which it transfers recognised financial assets directly to third parties or to special purpose entities. These transfers may give rise to full or partial derecognition of the financial assets concerned.

- Full derecognition occurs when the Group transfers its contractual right to receive cash flows from the financial assets, or retains the right but assumes an obligation to pass on the cash flows from the asset, and transfers substantially all the risks and rewards of ownership. The risks include credit, interest rate, currency, prepayment and other price risks.
- Partial derecognition occurs when the Group sells or otherwise transfers financial assets in such a way that some but not substantially all of the risks and rewards of ownership are transferred but control is retained. These financial assets are recognised in the balance sheet to the extent of the Group's continuing involvement.

The majority of transferred financial assets that do not qualify for derecognition are securities lent under securities lending agreements. The following table analyses the carrying amount of financial assets transferred to third parties that did not qualify for derecognition during 2015 and 2014.

Financial assets and associated financial liabilities not qualifying for full derecognition

	2015			
	Carrying amount of transferred assets	Carrying amount of associated liabilities	Fair value of associated liabilities	Net position
Transaction not qualifying for full derecognition: Securities lending agreements	<u><u>923</u></u>	<u><u>-</u></u>	<u><u>-</u></u>	<u><u>923</u></u>
	2014			
	Carrying amount of transferred assets	Carrying amount of associated liabilities	Fair value of associated liabilities	Net position
Transaction not qualifying for full derecognition: Securities lending agreements	<u><u>506</u></u>	<u><u>-</u></u>	<u><u>-</u></u>	<u><u>506</u></u>

There were no outstanding transferred financial assets in which the Group has a continuing involvement, that were derecognised in their entirety at 31 December 2015 (31 December 2014: Nil).

NOTES TO THE FINANCIAL STATEMENTS (continued)

34 Subsidiaries

The following is a list of the principal subsidiaries at 31 December 2015:

<u>Name of company</u>	<u>Place of incorporation</u>	<u>Principal activities</u>	<u>Issued equity capital</u>
Hang Seng Bank (China) Limited	People's Republic of China	Banking	RMB8,317,500,000
Hang Seng Finance Limited	Hong Kong SAR	Lending	HK\$1,000,000,000
Hang Seng Credit Limited	Hong Kong SAR	Lending	HK\$200,000,000
Hang Seng Bank (Trustee) Limited	Hong Kong SAR	Trustee service	HK\$3,000,000
Hang Seng (Nominee) Limited	Hong Kong SAR	Nominee service	HK\$100,000
Hang Seng Life Limited	Hong Kong SAR	Retirement benefits and life assurance	HK\$970,000,000
Hang Seng Insurance Company Limited	Hong Kong SAR	Retirement benefits and life assurance	HK\$6,426,184,570
Hang Seng Investment Management Limited	Hong Kong SAR	Fund management	HK\$10,000,000
Haseba Investment Company Limited	Hong Kong SAR	Investment holding	HK\$6,000
Hang Seng Securities Limited	Hong Kong SAR	Stockbroking	HK\$26,000,000
Yan Nin Development Company Limited	Hong Kong SAR	Investment holding	HK\$100,000
Hang Seng Indexes Company Limited	Hong Kong SAR	Compilation and dissemination of the Hang Seng share index	HK\$10,000
Hang Seng Real Estate Management Limited	Hong Kong SAR	Property management	HK\$10,000
High Time Investments Limited	Hong Kong SAR	Investment holding	HK\$2,250,010,000

All the above companies are wholly-owned subsidiaries and unlisted. All subsidiaries are held directly by the Bank except for Hang Seng Life Limited and Hang Seng Indexes Company Limited. The principal places of operation are the same as the places of incorporation.

Some principal subsidiaries are regulated banking and insurance entities and as such, are required to maintain certain minimum levels of capital and liquid assets to support their operations. The effect of these regulatory requirements is to limit the extent to which the subsidiaries may transfer funds to the Bank in the form of repayment of certain shareholder loans or cash dividends.

NOTES TO THE FINANCIAL STATEMENTS (continued)

35 Interest in associates

	2015	2014
Share of net assets	<u>2,275</u>	<u>2,218</u>

The associates are:

<u>Name of company</u>	<u>Place of incorporation and operation</u>	<u>Principal activity</u>	<u>Group's interest in equity capital</u>	<u>Issued equity capital</u>
Unlisted				
Barrowgate Limited	Hong Kong SAR	Property investment	24.64%	HK\$10,000
GZHS Research Co., Ltd.	People's Republic of China	Conduct market/securities analysis and publish research reports	33.00%	RMB44,680,000

The interest in Barrowgate Limited and GZHS Research Co., Ltd. ("GZHS") are owned by the subsidiaries of the Bank.

The above two associates are accounted for using the equity method in the consolidated financial statements as at 31 December 2015 and 2014.

For the year ended 31 December 2015, the financial results of GZHS was included in the financial statements based on financial statements drawn up to 30 September 2015, but taking into account any changes in the subsequent period from 1 October 2015 to 31 December 2015 that would materially affect the results. The Group has taken advantage of the provision contained in HKAS 28 (2011) "Investments in Associates and Joint Ventures" whereby it is permitted to include the attributable share of associates' results based on accounts drawn up to a non-coterminous period end where the difference must be no greater than three months.

	Assets	Liabilities	Equity	Revenue	Expenses	Revenue Less Expenses
2015						
100 per cent	10,502	1,271	9,231	826	163	663
The Group's effective interest	2,590	315	2,275	219	67	152
2014						
100 per cent	10,243	1,291	8,952	1,212	238	974
The Group's effective interest	2,538	320	2,218	302	65	237

At 31 December 2015, the investment in GZHS was tested for impairment by estimating the recoverable amount of the investment based on "value in use". An impairment loss of HK\$13m was recognised since the carrying amount exceeded the recoverable amount (2014: HK\$11m).

NOTES TO THE FINANCIAL STATEMENTS (continued)

36 Investment properties

The Group's investment properties were revalued by DTZ Debenham Tie Leung Limited, an independent professional valuer, at 30 November 2015, and were updated for any material changes in the valuation as at 31 December 2015. The valuations were carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of valuations of investment properties were market value which is consistent with the definition of fair value under HKFRS 13 "Fair Value Measurement" and take into account the highest and best use of the property from the perspective of market participants.

(a) Movement of investment properties

	2015	2014
At 1 January	11,732	10,918
Additions	699	-
Surplus on revaluation credited to income statement	417	556
Transfer (to)/from premises (note 37(a))	(2,773)	258
At 31 December	<u>10,075</u>	<u>11,732</u>
Representing:		
- measure at valuation	<u>10,075</u>	<u>11,732</u>

(b) Terms of lease

	2015	2014
Leaseholds		
Held in Hong Kong:		
- long leases (over 50 years unexpired)	1,732	1,670
- medium leases (10 to 50 years unexpired)	8,343	10,062
	<u>10,075</u>	<u>11,732</u>

(c) The Group leases out investment properties under operating leases. The leases typically run for an initial period of 2 to 3 years, and may contain an option to renew the lease after that date at which time all terms are renegotiated. None of the leases includes contingent rentals.

	2015	2014
Direct operating expenses arising from investment properties	<u>23</u>	<u>26</u>
Direct operating expenses arising from investment properties that generated rental income	<u>20</u>	<u>22</u>

The Group's total future minimum lease payments receivable under non-cancellable operating leases are as follows:

	2015	2014
Less than one year	287	379
Over one year but within five years	192	132
Over five years	-	-
	<u>479</u>	<u>511</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

37 Premises, plant and equipment

The Group's premises were revalued by DTZ Debenham Tie Leung Limited, an independent professional valuer, at 30 November 2015, and were updated for any material changes in the valuation as at 31 December 2015. The valuations were carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of valuations of premises were market value which is consistent with the definition of fair value under HKFRS 13 "Fair Value Measurement" and take into account the highest and best use of the property from the perspective of market participants.

(a) Movement of premises, plant and equipment

2015	Premises	Plant and equipment	Total
Cost or valuation:			
At 1 January	21,073	4,163	25,236
Additions	84	571	655
Disposals	-	(201)	(201)
Elimination of accumulated depreciation on revalued premises	(660)	-	(660)
Surplus on revaluation:			
- credited to premises revaluation reserve	1,878	-	1,878
Transfer from investment properties (note 36(a))	2,773	-	2,773
Exchange adjustments and other	(40)	(28)	(68)
At 31 December	<u>25,108</u>	<u>4,505</u>	<u>29,613</u>
Accumulated depreciation:			
At 1 January	-	(3,338)	(3,338)
Exchange adjustments	-	20	20
Charge for the year (note 13)	(660)	(297)	(957)
Written off on disposal	-	188	188
Elimination of accumulated depreciation on revalued premises	660	-	660
At 31 December	<u>-</u>	<u>(3,427)</u>	<u>(3,427)</u>
Net book value at 31 December	<u>25,108</u>	<u>1,078</u>	<u>26,186</u>
Representing:			
- measure at cost	-	1,078	1,078
- measure at valuation	25,108	-	25,108
	<u>25,108</u>	<u>1,078</u>	<u>26,186</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

37 Premises, plant and equipment (continued)

(a) Movement of premises, plant and equipment (continued)

	Premises	Plant and equipment	Total
2014			
Cost or valuation:			
At 1 January	20,496	3,856	24,352
Additions	-	556	556
Disposals	-	(238)	(238)
Elimination of accumulated depreciation on revalued premises	(607)	-	(607)
Surplus on revaluation:			
- credited to premises revaluation reserve	1,457	-	1,457
Transfer to investment properties (note 36(a))	(258)	-	(258)
Exchange adjustments and other	(15)	(11)	(26)
At 31 December	<u>21,073</u>	<u>4,163</u>	<u>25,236</u>
Accumulated depreciation:			
At 1 January	-	(3,352)	(3,352)
Exchange adjustments	-	8	8
Charge for the year (note 13)	(607)	(224)	(831)
Written off on disposal	-	230	230
Elimination of accumulated depreciation on revalued premises	607	-	607
At 31 December	<u>-</u>	<u>(3,338)</u>	<u>(3,338)</u>
Net book value at 31 December	<u>21,073</u>	<u>825</u>	<u>21,898</u>
Representing:			
- measure at cost	-	825	825
- measure at valuation	21,073	-	21,073
	<u>21,073</u>	<u>825</u>	<u>21,898</u>

(b) Terms of lease

The net book value of premises comprises:

	2015	2014
Leaseholds		
Held in Hong Kong:		
- long leases (over 50 years unexpired)	2,561	2,451
- medium leases (10 to 50 years unexpired)	21,697	17,749
Held outside Hong Kong:		
- long leases (over 50 years unexpired)	-	-
- medium leases (10 to 50 years unexpired)	850	873
	<u>25,108</u>	<u>21,073</u>

(c) The carrying amount of all premises which have been stated in the balance sheet would have been as follows had they been stated at cost less accumulated depreciation:

	2015	2014
Cost less accumulated depreciation at 31 December	<u>5,854</u>	<u>3,127</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

37 Premises, plant and equipment (continued)

(d) Fair value measurement of properties

(i) Fair value hierarchy

The following table presents the fair value of the Group's properties measured at the end of the reporting period on a recurring basis, categorised into the three-level fair value hierarchy as defined in HKFRS 13 "Fair value measurement". The level into which a fair value measurement is classified is determined with reference to the observability and significance of the inputs used in the valuation technique as follows:

Level 1: Fair value measured using unadjusted quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2: Fair value measured using observable inputs and not using significant unobservable inputs. Unobservable inputs are inputs for which market data are not available.

Level 3: Fair value measured using significant unobservable inputs.

	Fair value	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3
Recurring fair value measurement				
2015				
Investment properties	10,075	-	-	10,075
Properties held for own use				
- held in Hong Kong	24,258	-	-	24,258
- held outside Hong Kong	850	-	-	850
2014				
Investment properties	11,732	-	-	11,732
Properties held for own use				
- held in Hong Kong	20,200	-	-	20,200
- held outside Hong Kong	873	-	-	873

During the year ended 31 December 2015, there were no transfers between Level 1 and Level 2, or transfers into or out of Level 3. Transfers between levels of the fair value hierarchy are deemed to occur at the end of the reporting period.

The Group's investment properties were revalued by DTZ Debenham Tie Leung Limited, an independent professional valuer, at 30 November 2015, and were updated for any material changes in the valuation as at 31 December 2015. The valuations were carried out by qualified persons who are members of the Hong Kong Institute of Surveyors in accordance with the HKIS Valuation Standards published by the Hong Kong Institute of Surveyors.

The fair value of investment properties is determined using Investment Approach on the basis of capitalisation of net incomes with due allowance for outgoings and reversionary income potential.

The fair values of the majorities of properties owned and occupied by the Group in Hong Kong and the PRC are determined using Direct Comparison Approach assuming sale with immediate vacant possession and by making reference to comparable sales evidence.

For properties with development potentials, their values are on redevelopment basis and reported upon the assessment on the basis that each of these properties will be developed to its full potential and completed to a good standard. The fair values are determined using Direct Comparison Approach by making reference to comparable sales transactions as available in the relevant market and have also taken into account the development costs that will be expended to complete the development.

NOTES TO THE FINANCIAL STATEMENTS (continued)

37 Premises, plant and equipment (continued)

(d) Fair value measurement of properties (continued)

(i) Fair value hierarchy (continued)

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy

The following table provides a reconciliation of the movement between opening and closing balances of Level 3 properties, measured at fair value using a valuation technique with significant unobservable inputs:

	Investment properties	Properties held for own use in Hong Kong	Properties held for own use outside Hong Kong
At 1 January 2015	11,732	20,200	873
Additions	699	84	-
Depreciation for the year	-	(628)	(32)
Surplus on revaluation:			
- credited to premises revaluation reserve	-	1,829	49
- credited to income statement	417	-	-
Transfer	(2,773)	2,773	-
Exchange adjustments and other	-	-	(40)
At 31 December 2015	<u>10,075</u>	<u>24,258</u>	<u>850</u>

Unrealised gains or losses recognised in profit or loss relating to those assets held at the end of the reporting period

- other operating income	156	-	-
- net surplus on property revaluation	261	-	-
- depreciation of premises, plant and equipment	-	(628)	(32)

	Investment properties	Properties held for own use in Hong Kong	Properties held for own use outside Hong Kong
At 1 January 2014	10,918	19,619	877
Depreciation for the year	-	(576)	(31)
Surplus on revaluation:			
- credited to premises revaluation reserve	-	1,415	42
- credited to income statement	556	-	-
Transfer	258	(258)	-
Exchange adjustments and other	-	-	(15)
At 31 December 2014	<u>11,732</u>	<u>20,200</u>	<u>873</u>

Unrealised gains or losses recognised in profit or loss relating to those assets held at the end of the reporting period

- other operating income	35	-	-
- net surplus on property revaluation	521	-	-
- depreciation of premises, plant and equipment	-	(576)	(31)

NOTES TO THE FINANCIAL STATEMENTS (continued)

37 Premises, plant and equipment (continued)

(d) Fair value measurement of properties (continued)

(ii) Information about significant unobservable inputs in Level 3 valuations

At 31 December 2015

	Valuation technique(s)	Unobservable input(s)	Range
Investment properties	Investment approach	Market yields (reversionary yield)	2.8% to 5.5%
		Market rental	HK\$18 to HK\$890 per square foot
Premises held for own use	Direct comparison approach	Premium (discount) on characteristic of the properties	-20% to 20%

At 31 December 2014

	Valuation technique(s)	Unobservable input(s)	Range
Investment properties	Investment approach	Market yields (reversionary yield)	2.9 % to 5.2 %
		Market rental	HK\$17 to HK\$1,020 per square foot
Premises held for own use	Direct comparison approach	Premium (discount) on characteristic of the properties	-20% to 20%

The fair value of investment properties is determined using investment approach on the basis of capitalisation of net incomes with due allowance of outgoings and reversionary income potential. The fair value measurement is positively correlated to the market rental but inversely correlated to the market yields.

The fair value of premises held for own use are determined using direct comparison approach to value these properties in their respective existing states and uses on the market basis assuming sale with immediate vacant possession and by making reference to comparable sales evidence. The valuations take into account the characteristic of the properties which included the location, size, shape, view, floor level, year of completion and other factors collectively. Higher premium for properties with better characteristic will result in a higher fair value measurement.

NOTES TO THE FINANCIAL STATEMENTS (continued)

38 Intangible assets

	2015	2014
Present value of in-force long-term insurance business	11,431	8,263
Internally developed software	379	372
Acquired software	82	89
Goodwill	329	329
	<u>12,221</u>	<u>9,053</u>

(a) Movement of present value of in-force long-term insurance business ("PVIF")

	2015	2014
At 1 January	8,263	7,198
Addition from current year new business	1,568	1,410
Movement from in-force business	1,600	(345)
At 31 December	<u>11,431</u>	<u>8,263</u>

The key assumptions used in the computation of "PVIF" are as follows:

	2015	2014
Risk discount rate	5.4%	5.9%
Expenses inflation	3.0%	3.0%
Average lapse rate:		
- 1st year	3.1%	2.8%
- 2nd year onwards	3.0% *	0.5%

The sensitivity of PVIF valuation to changes in individual assumptions at the balance sheet dates is shown in the Management Discussion and Analysis.

* Includes shock lapse assumption of 25% after accumulation period for some deferred annuity products, as introduced in 2015 assumption change.

(b) Goodwill

	2015	2014
At 1 January and at 31 December	<u>329</u>	<u>329</u>

Goodwill arising from acquisition of the remaining 50 per cent of Hang Seng Life Limited from HSBC Insurance (Asia-Pacific) Holdings Limited amounted to HK\$329m is allocated to cash-generating units of Life Insurance - Hang Seng Insurance Company Limited ("HSIC") for the purpose of impairment testing.

During 2015, there was no impairment of goodwill (2014: Nil). Impairment testing in respect of goodwill is performed annually by comparing the recoverable amount of cash generating unit based on appraisal value with the carrying amount of its net assets, including attributable goodwill.

The appraisal value comprises HSIC's net assets (other than value of business acquired and goodwill), the PVIF and the expected value of future business as at 31 December 2015. The PVIF is determined by discounting future earnings expected from the current business, taking into account factors such as future mortality, lapse rates, levels of expenses and risk discount rate. The above details are shown in note 38(a) and the Management Discussion and Analysis.

NOTES TO THE FINANCIAL STATEMENTS (continued)

38 Intangible assets (continued)

(c) Movement of internally developed application software and acquired software

	2015	2014
Cost:		
At 1 January	1,298	1,178
Additions	138	126
Disposals	(11)	(5)
Exchange and others	(7)	(1)
At 31 December	<u>1,418</u>	<u>1,298</u>
Accumulated amortisation:		
At 1 January	(837)	(731)
Charge for the year (note 13)	(110)	(111)
Impairment	(24)	-
Written off on disposal	11	5
Exchange and others	3	-
At 31 December	<u>(957)</u>	<u>(837)</u>
Net book value at 31 December	<u>461</u>	<u>461</u>

During 2015, an impairment of HK\$24m (2014: Nil) was made on internally developed application software.

39 Other assets

	2015	2014
Items in the course of collection from other banks	6,922	5,182
Bullion	3,536	3,681
Prepayments and accrued income	3,717	3,820
Acceptances and endorsements	5,724	5,715
Reinsurers' share of liabilities under insurance contracts (note 45)	5,782	2,776
Other accounts	2,794	2,758
	<u>28,475</u>	<u>23,932</u>

Other accounts include "Assets held for sale" of HK\$33m (2014: HK\$6m). It also includes "Retirement benefit assets" of HK\$42m (2014: HK\$42m).

There was no accumulated loss recognised directly in equity relating to assets held for sale for 2015 and 2014.

There was no significant impaired, overdue or rescheduled other assets at the year-end of 2015 and 2014.

NOTES TO THE FINANCIAL STATEMENTS (continued)

40 Current, savings and other deposit accounts

	2015	2014
Current, savings and other deposit accounts:		
- as stated in consolidated balance sheet	959,228	896,521
- structured deposits reported as trading liabilities (note 41)	<u>27,440</u>	<u>40,380</u>
	<u>986,668</u>	<u>936,901</u>
By type:		
- demand and current accounts	86,644	76,807
- savings accounts	615,135	550,765
- time and other deposits	<u>284,889</u>	<u>309,329</u>
	<u>986,668</u>	<u>936,901</u>

41 Trading liabilities

	2015	2014
Other structured debt securities in issue (note 43)	2,351	4,223
Structured deposits (note 40)	27,440	40,380
Short positions in securities and others	<u>33,126</u>	<u>27,984</u>
	<u>62,917</u>	<u>72,587</u>

42 Financial liabilities designated at fair value

	2015	2014
Certificates of deposit in issue (note 43)	3,491	2,994
Liabilities to customers under investment contracts	<u>503</u>	<u>495</u>
	<u>3,994</u>	<u>3,489</u>

43 Certificates of deposit and other debt securities in issue

	2015	2014
Certificates of deposit and other debt securities in issue:		
- as stated in consolidated balance sheet	5,191	12,402
- certificates of deposit in issue designated at fair value (note 42)	3,491	2,994
- other structured debt securities in issue reported as trading liabilities (note 41)	<u>2,351</u>	<u>4,223</u>
	<u>11,033</u>	<u>19,619</u>
By type:		
- certificates of deposit in issue	7,491	14,150
- other debt securities in issue	<u>3,542</u>	<u>5,469</u>
	<u>11,033</u>	<u>19,619</u>

44 Other liabilities

	2015	2014
Items in the course of transmission to other banks	7,586	7,508
Accruals	3,531	3,859
Acceptances and endorsements	5,724	5,715
Retirement benefit liabilities	1,013	1,615
Other	<u>3,037</u>	<u>2,607</u>
	<u>20,891</u>	<u>21,304</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

45 Liabilities under insurance contracts

	Gross	Reinsurers' share ¹	Net
2015			
Non-linked insurance contracts			
At 1 January	92,356	(2,776)	89,580
Benefits paid	(7,067)	75	(6,992)
Increase in liabilities to policyholders	16,043	(3,072)	12,971
Exchange and other movements	414	(9)	405
At 31 December	<u>101,746</u>	<u>(5,782)</u>	<u>95,964</u>
Linked insurance contracts			
At 1 January	86	-	86
Benefits paid	(12)	-	(12)
Decrease in liabilities to policyholders	(3)	-	(3)
Exchange and other movements	-	-	-
At 31 December	<u>71</u>	<u>-</u>	<u>71</u>
	<u>101,817</u>	<u>(5,782)</u>	<u>96,035</u>
2014			
Non-linked insurance contracts			
At 1 January	85,756	(1,446)	84,310
Benefits paid	(7,721)	31	(7,690)
Increase in liabilities to policyholders	14,156	(1,421)	12,735
Exchange and other movements	165	60	225
At 31 December	<u>92,356</u>	<u>(2,776)</u>	<u>89,580</u>
Linked insurance contracts			
At 1 January	88	-	88
Benefits paid	(10)	-	(10)
Increase in liabilities to policyholders	7	-	7
Exchange and other movements	1	-	1
At 31 December	<u>86</u>	<u>-</u>	<u>86</u>
	<u>92,442</u>	<u>(2,776)</u>	<u>89,666</u>

¹ Amounts recoverable from reinsurance of liabilities under insurance contracts are included in the consolidated balance sheet in "Other assets".

46 Current tax and deferred tax

(a) Current tax and deferred tax are represented in the balance sheet:

	2015	2014
Included in "Other assets":		
Current taxation recoverable	3	5
Deferred tax assets	<u>115</u>	<u>80</u>
	<u>118</u>	<u>85</u>
Current tax liabilities:		
Provision for Hong Kong profits tax	167	358
Provision for taxation outside Hong Kong	<u>18</u>	<u>16</u>
	<u>185</u>	<u>374</u>
Deferred tax liabilities	<u>4,817</u>	<u>4,304</u>
	<u>5,002</u>	<u>4,678</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

46 Current tax and deferred tax (continued)

(b) Deferred tax assets and liabilities recognised

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

	Depreciation allowances in excess of related depreciation	Revaluation of properties	Loan impairment allowances	Fair value adjustments for available- for-sale financial assets	Cash flow hedge	Other	Total
2015							
At 1 January	179	3,171	(120)	54	(2)	942	4,224
Exchange adjustment Charged/(credited) to	-	(2)	5	(3)	-	5	5
income statement (note 20(a))	9	(73)	(78)	-	-	250	108
Charged/(credited) to reserves	-	314	-	(20)	1	70	365
At 31 December	<u>188</u>	<u>3,410</u>	<u>(193)</u>	<u>31</u>	<u>(1)</u>	<u>1,267</u>	<u>4,702</u>
2014							
At 1 January	103	3,007	(82)	(48)	1	826	3,807
Exchange adjustment Charged/(credited) to	-	-	1	-	-	1	2
income statement (note 20(a))	76	(79)	(39)	-	-	88	46
Charged/(credited) to reserves	-	243	-	102	(3)	27	369
At 31 December	<u>179</u>	<u>3,171</u>	<u>(120)</u>	<u>54</u>	<u>(2)</u>	<u>942</u>	<u>4,224</u>

(c) Deferred tax assets not recognised

At the balance sheet date, the Group has not recognised deferred tax assets in respect of tax losses amounting to HK\$30m (2014: HK\$30m) which are considered unlikely to be utilised. The unrecognised deferred tax assets of HK\$30m (2014: HK\$30m) have no expiry date.

(d) Deferred tax liabilities not recognised

There were no deferred tax liabilities not recognised as at 31 December 2015 (31 December 2014: Nil).

NOTES TO THE FINANCIAL STATEMENTS (continued)

47 Subordinated liabilities

Nominal value	Description	2015	2014
Amounts owed to HSBC Group undertakings			
US\$450 million	Floating rate subordinated loan due July 2021 ¹	-	3,490
US\$300 million	Floating rate subordinated loan due July 2022 ²	<u>2,325</u>	<u>2,327</u>
		<u>2,325</u>	<u>5,817</u>
Representing:			
- measured at amortised cost		<u>2,325</u>	<u>5,817</u>

¹ The Bank exercised its option to redeem the subordinated loan at par of US\$450 million.

² Interest rate at three-month US dollar LIBOR plus 4.06 per cent per annum, payable quarterly, to the maturity date.

The outstanding subordinated loans serve to help the Bank maintain a balanced capital structure and support business growth.

The Group has not had any defaults of principal, interest or other breaches with respect to its debt securities during the years of 2015 and 2014.

48 Share capital

	2015		2014	
	No. of shares	HK\$	No. of shares	HK\$
Ordinary shares, issued and fully paid				
At 1 January	1,911,842,736	9,658	1,911,842,736	9,559
Transfer from capital redemption reserve ¹	-	-	-	99
At 31 December	<u>1,911,842,736</u>	<u>9,658</u>	<u>1,911,842,736</u>	<u>9,658</u>

¹ During 2014, as part of the transition to the no-par value regime, the amount of HK\$99m standing to the credit of the capital redemption reserve on 3 March 2014 had become part of the Bank's share capital.

49 Other equity instruments

Nominal value	Description	2015	2014
US\$900 million	Floating rate perpetual capital instrument callable from December 2019 ¹	<u>6,981</u>	<u>6,981</u>

¹ Coupon rate at one-year US dollar LIBOR plus 3.84 per cent.

The additional tier 1 capital instruments are perpetual and subordinated, and the coupon payments may be cancelled at the sole discretion of the Bank. The capital instruments will be written down at the point of non-viability on the occurrence of a trigger event as defined in the Banking (Capital) Rules. They rank higher than ordinary shares in the event of a winding-up.

NOTES TO THE FINANCIAL STATEMENTS (continued)

50 Reconciliation of cash flow statement

(a) Reconciliation of operating profit to net cash flow from operating activities

	2015	2014
Operating profit	19,433	19,450
Net interest income	(21,165)	(19,871)
Dividend income	(142)	(1,210)
Loan impairment charges	1,108	1,144
Impairment loss of intangible assets	24	-
Depreciation	957	831
Amortisation of intangible assets	110	111
Amortisation of available-for-sale investments	215	9
Amortisation of held-to-maturity debt securities	(2)	-
Loans and advances written off net of recoveries	(1,258)	(737)
Movement in present value of in-force long-term insurance business	(3,168)	(1,065)
Interest received	24,851	24,432
Interest paid	(5,196)	(6,548)
Operating profit before changes in working capital	15,767	16,546
Change in treasury bills and certificates of deposit with original maturity more than three months	(29,328)	(26,402)
Change in placings with and advances to banks maturing after one month	2,860	9,544
Change in trading assets	(930)	(11,000)
Change in derivative financial instruments	(507)	441
Change in reverse repurchase agreements – non-trading	1,296	(1,296)
Change in loans and advances to customers	(34,813)	(72,569)
Change in other assets	(1,485)	(5,079)
Change in financial liabilities designated at fair value	497	2,975
Change in current, savings and other deposit accounts	62,707	71,542
Change in repurchase agreements - non trading	2,315	-
Change in deposits from banks	9,211	(2,815)
Change in trading liabilities	(9,670)	10,470
Change in certificates of deposit and other debt securities in issue	(7,211)	3,801
Change in other liabilities	5,400	5,393
Elimination of exchange differences and other non-cash items	1,173	3,779
Cash generated from operating activities	17,282	5,330
Taxation paid	(3,073)	(3,111)
Net cash inflow from operating activities	14,209	2,219

(b) Analysis of the balances of cash and cash equivalents

	2015	2014
Cash and sight balances at central banks	10,118	11,311
Balances with banks	13,446	15,972
Items in the course of collection from other banks	6,922	5,182
Placings with and advances to banks maturing within one month	55,792	67,553
Treasury bills	25,705	12,840
Less: items in the course of transmission to other banks	(7,586)	(7,508)
	104,397	105,350

The balances of cash and cash equivalents included cash and sight balances at central banks, balances with banks and placings with and advances to banks maturing within one month that are subject to exchange control and regulatory restrictions, amounting to HK\$15,098m at 31 December 2015 (31 December 2014: HK\$20,277m).

NOTES TO THE FINANCIAL STATEMENTS (continued)

51 Contingent liabilities and commitments

(a) Off-balance sheet contingent liabilities and commitments

The table below gives the nominal contract amounts and risk-weighted amounts of contingent liabilities, commitments and derivative transactions. The information is consistent with that in the "Capital Adequacy Ratio" return submitted to the Hong Kong Monetary Authority ("HKMA") by the Group. The return is prepared on a consolidated basis as specified by the HKMA under the requirement of section 3C(1) of the Capital Rules.

For accounting purposes, acceptances and endorsements are recognised on the balance sheet in "Other assets" and "Other Liabilities" in accordance with HKAS 39 "Financial Instruments: Recognition and Measurement". For the purpose of the Capital Rules, acceptances and endorsements are included in the capital adequacy calculation as if they were contingencies. The contract amount of acceptances and endorsements included in the below tables for the Group was HK\$5,724m (2014: HK\$5,715m).

Contingent liabilities and commitments are credit-related instruments. Contractual amounts represent the amounts at risk should contracts be fully drawn upon and clients default. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contractual amounts is not representative of expected future liquidity requirements.

The risk-weighted assets at balance sheet dates were calculated based on the advanced internal ratings-based approach.

	2015	2014
Direct credit substitutes	7,558	4,541
Transaction-related contingencies	3,336	2,474
Trade-related contingencies	11,217	13,355
Forward asset purchases	-	85
Commitments that are unconditionally cancellable without prior notice	323,270	280,000
Commitments which have an original maturity of not more than one year	2,642	4,286
Commitments which have an original maturity of more than one year	22,126	26,029
Contract amounts	370,149	330,770
Risk-weighted amounts	36,227	31,464

(b) Contingencies

There is no material litigation expected to result in a significant adverse effect on the financial position of the Group, either collectively or individually. Management believes that adequate provisions have been made in respect of such litigation.

NOTES TO THE FINANCIAL STATEMENTS (continued)

52 Assets pledged as security for liabilities and collateral accepted as security for assets

	2015	2014
Assets pledged to secure liabilities		
Financial assets ¹ pledged to secure liabilities	39,232	30,084
Liabilities secured by financial assets	35,549	29,789
Collateral accepted as security for assets		
Fair value of the collateral permitted to sell or repledge in the absence of default ²	-	1,296
Fair value of collateral actually sold or repledged	-	-

¹ Financial assets comprise trading assets and financial investments.

² These transactions are conducted under terms that are usual and customary to standard securities borrowing and reverse repurchase agreements. The Group is obliged to return equivalent securities.

53 Capital commitments

	2015	2014
Expenditure authorised and contracted for	<u>825</u>	<u>1,176</u>
Expenditure authorised but not contracted for	<u>-</u>	<u>-</u>

54 Lease commitments

The Group leases certain properties and equipment under operating leases. The leases typically run for an initial period of one to five years and may include an option to renew the lease when all terms are renegotiated. None of these leases includes contingent rentals.

The total future minimum lease payments payable under non-cancellable operating leases are as follows:

	2015	2014
Within one year	623	632
Between one and five years	1,128	545
Over five years	29	59
	<u>1,780</u>	<u>1,236</u>

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

55 Employee retirement benefits

(a) Defined benefit schemes

(i) Total defined benefit recognised in the income statement

Included within "Employee compensation and benefits" are components of expense related to the Group's defined benefit schemes, as follows:

	2015	2014
Defined benefit schemes		
- Current service cost	232	261
- Net interest expense on the net defined benefit liability/asset	25	34
- Administrative costs and taxes paid by scheme	2	2
Total expense (note 13)	<u>259</u>	<u>297</u>

(ii) Cumulative actuarial gains/(losses) recognised in other comprehensive income in respect of defined benefit schemes

	2015	2014
At 1 January	(1,861)	(2,025)
Actuarial gains recognised in other comprehensive income	422	164
At 31 December	<u>(1,439)</u>	<u>(1,861)</u>

The Group operates three defined benefit schemes, the Hang Seng Bank Limited Defined Benefit Scheme ("HSBDBS"), which is the principal scheme which covers about 27 per cent of the Group's employees, and two other schemes, the Hang Seng Bank Limited Pension Scheme ("HSBPS") and the Hang Seng Bank Limited Non-contributory Terminal Benefits Scheme ("HSBNTBS"). HSBDBS was closed to new entrants with effect from 1 April 1999, and HSBPS and HSBNTBS were closed to new entrants with effect from 31 December 1986. Since the defined benefit section of the HSBDBS is a final salary lump sum scheme, its exposure to longevity risk and interest rate risk is limited.

These schemes are registered under Occupational Retirement Schemes Ordinance (Cap. 426 of the law of Hong Kong) ("the Ordinance"). These schemes are administered by trustees, with their assets held separately from those of the Group. The trustees are required by the Trust Deed to act in the best interest of the scheme participants and are responsible for setting investment policies of the schemes.

HSBDBS is predominantly a funded scheme with assets which is held under insurance policy separate from the Group. HSBDBS is reviewed at least on a triennial basis in accordance with local regulations. The actuarial assumptions used to calculate the defined benefit obligations of HSBDBS vary according to the economic conditions.

HSBDBS mainly invests in bonds and equities and each investment manager has been assigned an investment mandate with the targeted asset allocation. The ranges of target asset allocations for the portfolio are as follows: Bonds (0 – 50%), Equity (0 – 50%) and cash (0 – 100%).

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

55 Employee retirement benefits *(continued)*

(a) Defined benefit schemes *(continued)*

(iii) Movements in the scheme assets and present value of the defined benefit obligations

Net asset/(liability) under defined benefit schemes

	Fair value of scheme assets	Present value of defined benefit obligations	Net defined benefit (liability)/ asset
At 1 January 2015	4,582	(6,155)	(1,573)
Current service cost	-	(232)	(232)
Net interest income/(cost) on the net defined benefit liability	79	(104)	(25)
Remeasurement effects recognised in other comprehensive income	167	255	422
- Actuarial gains from changes in financial assumptions	-	233	233
- Actuarial gains from experience	167	22	189
Contributions by the Group	439	-	439
Benefits paid	(671)	671	-
Administrative costs and taxes paid by scheme	(2)	-	(2)
At 31 December 2015	<u>4,594</u>	<u>(5,565)</u>	<u>(971)</u>
Retirement benefit liabilities recognised in balance sheet (included in "Other liabilities")	4,384	(5,397)	(1,013)
Retirement benefit assets recognised in balance sheet (included in "Other accounts" of "Other assets")	210	(168)	42
Present value of defined benefit obligation relating to:			
- Actives		(5,400)	
- Pensioners		(165)	

NOTES TO THE FINANCIAL STATEMENTS (continued)

55 Employee retirement benefits (continued)

(a) Defined benefit schemes (continued)

(iii) Movements in the scheme assets and present value of the defined benefit obligations (continued)

Net asset/(liability) under defined benefit schemes (continued)

	Fair value of scheme assets	Present value of defined benefit obligations	Net defined benefit (liability)/ asset
At 1 January 2014	4,660	(6,392)	(1,732)
Current service cost	-	(261)	(261)
Net interest income/(cost) on the net defined benefit liability	99	(133)	(34)
Remeasurement effects recognised in other comprehensive income	1	163	164
- Actuarial gains from changes in financial assumptions	-	36	36
- Actuarial gains from experience	1	127	128
Contributions by the Group	292	-	292
Benefits paid	(468)	468	-
Administrative costs and taxes paid by scheme	(2)	-	(2)
At 31 December 2014	<u>4,582</u>	<u>(6,155)</u>	<u>(1,573)</u>
Retirement benefit liabilities recognised in balance sheet (included in "Other liabilities")	4,360	(5,975)	(1,615)
Retirement benefit assets recognised in balance sheet (included in "Other accounts" of "Other assets")	222	(180)	42
Present value of defined benefit obligation relating to:			
- Actives		(5,978)	
- Pensioners		(177)	

The Group expect to make HK\$257m of contributions to defined benefit schemes during 2016.

(iv) Benefits expected to be paid

Benefits expected to be paid from the HSBDBS, HSBPS and HSBNTBS to retirees over each of the next five years, and in aggregate for the five years thereafter, are as follows:

	2016	2017	2018	2019	2020	2021-2025
HSBDBS	263	368	420	427	478	2,353
HSBPS / HSBNTBS	14	13	13	12	11	48

The duration of the principal scheme HSBDBS is 8.0 years (2014: 8.4 years) under the disclosure assumptions adopted.

NOTES TO THE FINANCIAL STATEMENTS (continued)

55 Employee retirement benefits (continued)

(a) Defined benefit schemes (continued)

(v) Fair value of scheme assets by asset classes

	Value	Quoted market price in active market	Of which held by the Group
2015			
Fair value of scheme assets			
- Equities	2,195	2,195	-
- Bonds	1,710	1,710	-
- Other*	689	689	396
	<u>4,594</u>	<u>4,594</u>	<u>396</u>
2014			
Fair value of scheme assets			
- Equities	2,324	2,324	-
- Bonds	2,165	2,165	-
- Other*	93	93	56
	<u>4,582</u>	<u>4,582</u>	<u>56</u>

* Other mainly consists of cash and deposits.

(vi) The Principal Scheme's actuarial financial assumptions

These schemes are funded defined benefit schemes and are administered by trustees with assets held separately from those of the Group. The latest annual actuarial valuations at 31 December 2015 were performed by Simon Ferry, Fellow of the Institute of Actuaries of United Kingdom, of Mercer (Hong Kong) Limited, using the Attained Age Method.

The Ordinance requires that registered retirement benefit schemes shall at all time be fully funded to meet its aggregate vested liability (i.e. on a wind-up basis) in accordance with the recommendations contained in an actuarial certificate supplied under the Ordinance. Any shortfall must be made up within the specified time under the Ordinance. Any deficits to meet the aggregate past service liability (i.e. on an on-going basis) can however be eliminated over a period of time in accordance with the funding recommendations of an actuary.

On an on-going basis, the value of the principal scheme assets of HSBDBS represented 99 per cent (2014: 97 per cent) of the benefits accrued to scheme members, after allowing for expected future increases in salaries, and the resulting deficit amounted to HK\$66m (deficit in 2014: HK\$158m). On a wind-up basis, the actuarial value of the HSBDBS assets represented 101 per cent (2014: 103 per cent) of the members' vested benefits, based on salaries at that date, and the resulting surplus amounted to HK\$39m (surplus in 2014: HK\$130m).

The determinations for actuarial funding valuation purposes are based on different methods and assumptions from those used for financial reporting purposes, and as a result should neither be compared nor related to other determinations included in these financial statements.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

55 Employee retirement benefits *(continued)*

(a) Defined benefit schemes *(continued)*

(vi) The Principal Scheme's actuarial financial assumptions *(continued)*

The present value of the principal scheme's obligation was a final lump sum salary of HK\$5,397m (2014: HK\$5,975m). The principal actuarial assumptions used to calculate the Group's obligations for the HSBDBS for each year, and used as the basis for measuring the expenses in relation to the scheme, were as follows:

Principal actuarial assumptions for the principal scheme

	HSBDBS %
2015	
Discount rate	1.70
Expected rate of salary increases	3.80
<i>of which:</i>	
- 2016	3.80
- thereafter	3.80
 2014	
Discount rate	1.75
Expected rate of salary increases	4.50
<i>of which:</i>	
- 2015	4.50
- thereafter	4.50

The Group determines the discount rates to be applied to its obligations in consultation with the schemes' actuaries, on the basis of current average yields of high quality (AA rated or equivalent) debt instruments, with maturities consistent with those of the defined benefit obligations. Where there is not a deep market in corporate bonds, government bond yields have been used, and this is the case for HSBDBS. The yield curve has been extrapolated where the term of the liabilities is longer than the duration of available bonds and the discount rate used then takes into account the term of the liabilities and the shape of the yield curve.

NOTES TO THE FINANCIAL STATEMENTS (continued)

55 Employee retirement benefits (continued)

(a) Defined benefit schemes (continued)

(vii) Actuarial assumption sensitivities

The discount rate and rate of pay increase are sensitive to changes in market conditions arising during the reporting year. The following table shows the effect of changes in these on the HSBDBS:

The effect of changes in key assumptions:

	HSBDBS	
	2015	2014
Discount rate		
- change in retirement benefit obligation at year end from a 25bps increase	(104)	(122)
- change in retirement benefit obligation at year end from a 25bps decrease	108	126
- change in 2016/2015 retirement benefit cost from a 25bps increase	(4)	(4)
- change in 2016/2015 retirement benefit cost from a 25bps decrease	3	3
Rate of pay increase		
- change in retirement benefit obligation at year end from a 25bps increase	105	123
- change in retirement benefit obligation at year end from a 25bps decrease	(103)	(119)
- change in 2016/2015 retirement benefit cost from a 25bps increase	6	8
- change in 2016/2015 retirement benefit cost from a 25bps decrease	(6)	(7)

(b) Defined contribution schemes

The principal defined contribution scheme for Group employees joining on or after 1 April 1999 is the HSBC Group Hong Kong Local Staff Defined Contribution Scheme. The Group also operates two other defined contribution schemes, the Hang Seng Bank Provident Fund Scheme which was closed to new entrants since 31 December 1986 and the Hang Seng Insurance Company Limited Employees' Provident Fund. The Bank and relevant Group entities also participated in mandatory provident fund schemes ("MPF schemes") registered under the Hong Kong Mandatory Provident Fund Ordinance, which are also defined contribution schemes.

Contributions made in accordance with the relevant scheme rules to these defined contribution schemes (including MPF schemes) are charged to the income statement as below:

	2015	2014
Amounts charged to the income statement (note 13)	186	164

Under the schemes, the Group's contributions are reduced by contributions forfeited by those employees who leave the schemes prior to the contributions vesting fully. The forfeited contributions utilised during the year or available at the year-end to reduce future contributions is HK\$2m (2014: HK\$2m).

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

56 Share-based payments

The Group participated in various share compensation plans as listed in the following tables that are operated by the HSBC Group for acquiring of HSBC Holdings plc shares. These are to be settled by the delivery of shares of HSBC Holdings plc.

Share awards and option plans

<u>Award</u>	<u>Policy</u>	<u>Purpose</u>
Restricted Share Awards (including Group Performance Share Plan)	<ul style="list-style-type: none"> - Vesting of awards generally subject to continued employment with the Group - Vesting often staggered over three years - Certain shares subject to a retention requirement post-vesting - Awards generally not subject to performance conditions - Awards granted from 2010 onwards are subject to clawback provision prior to vesting 	<ul style="list-style-type: none"> - Rewards employee performance, potential and retention of key employees - To defer variable pay and deferral provides an incentive for a longer-term commitment.
International Employee Share Purchase Plan	<ul style="list-style-type: none"> - A new broad-based employee plan which was first offered to eligible employees in Hong Kong in September 2013 - Eligible employees make contributions up to the local equivalent of £250 per month which are applied in the purchase of shares on a quarterly basis. For every three shares purchased, the employee is granted a matching award by the HSBC Group of one share - The matching award vests subject to continued employment with the Group and retention of the purchased shares in the plan until the third anniversary of the start of the relevant plan year 	<ul style="list-style-type: none"> - To align the interests of all employees with the creation of shareholder value
Savings-related share option plan	<ul style="list-style-type: none"> - Eligible employees save up to £250 per month (or its equivalent in Hong Kong dollars), with the option to use the savings to acquire shares. The last grant of options under this plan was in 2012. - Exercisable within six months following either the third or fifth anniversaries of the commencement of three-year or five-year contracts, respectively - The exercise price is set at a 20% (2014: 20%) discount to the market value immediately preceding the date of invitation 	<ul style="list-style-type: none"> - To align the interests of all employees with the creation of shareholder value
Group Share Option Plan	<ul style="list-style-type: none"> - Vesting of awards based on achievement of certain corporate performance condition targets - Exercisable between third and tenth anniversaries of the date of grant - Plan ceased in 2004 	<ul style="list-style-type: none"> - Long-term incentive plan between 2000 and 2004 during which certain employees were awarded share options

NOTES TO THE FINANCIAL STATEMENTS (continued)

56 Share-based payments (continued)

(a) Savings-related share option plan

The number of options, weighted average exercise price, and the weighted average remaining contractual life for options outstanding at the balance sheet date, are as follows:

Option scheme with exercise price set in Hong Kong dollars

	2015		2014	
	Weighted average exercise price HK\$	Number ('000)	Weighted average exercise price HK\$	Number ('000)
Outstanding at 1 January	55.49	1,363	42.82	5,548
Exercised in the year	55.64	(1,155)	38.36	(4,084)
Less: Cancellation/ Lapsed in the year	55.49	(14)	42.82	(101)
Outstanding at 31 December	56.60	<u>194</u>	55.49	<u>1,363</u>
Exercisable at 31 December	-	<u>-</u>	-	<u>-</u>

The weighted average share price at the date of exercise for share options exercised during the year was HK\$66.65 (2014: HK\$82.95).

The options outstanding at the year end of 2015 had an exercise price in the range of HK\$55.47 to HK\$63.99 (2014: HK\$37.88 to HK\$63.99), and a weighted average remaining contractual life of 1.20 years (2014: 1.23 years).

No share option was granted during 2015 and 2014.

(b) Group Share Option Plan

The number of options, weighted average exercise price, and the weighted average remaining contractual life for options outstanding at the balance sheet date, are as follows:

	2015		2014	
	Weighted average exercise price £	Number ('000)	Weighted average exercise price £	Number ('000)
Outstanding at 1 January	-	-	7.22	794
Exercised in the year	-	-	7.22	(1)
Lapsed in the year	-	-	7.22	(793)
Outstanding at 31 December	-	<u>-</u>	-	<u>-</u>
Exercisable at 31 December	-	<u>-</u>	-	<u>-</u>

There were no options outstanding at the year end of 2015 and 2014.

The weighted average share price at the date of exercise for share options exercised was £7.22 in 2014.

No share option was granted during 2015 and 2014.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

56 Share-based payments *(continued)*

(c) HSBC share awards

	2015 Number (‘000)	2014 Number (‘000)
Outstanding at 1 January	357	323
Additions during the year	881	288
Less: Released/ lapsed in the year	(352)	(254)
Outstanding at 31 December	<u>886</u>	<u>357</u>

The closing price of the HSBC Holdings plc share at 31 December 2015 was £5.36 (2014: £6.09).

The weighted average remaining vesting period as at 31 December 2015 was 0.65 years (2014: 0.94 years).

(d) Calculation of fair value

The fair values of share options at the date of grant of the options are calculated using a Black-Scholes model. The fair value of a share award is based on the share price at the date of the grant.

(e) Income statement charge

	2015	2014
Restricted share awards	24	25
Savings-related share awards and option plans	14	18
Income statement charge (note 13)	<u>38</u>	<u>43</u>
Equity-settled share-based payments	38	43
Cash-settled share-based payments	-	-
	<u>38</u>	<u>43</u>

The above charge was computed from the fair values of the share-based payment transaction when contracted, that arose under employee share awards made in accordance with HSBC's reward structures.

NOTES TO THE FINANCIAL STATEMENTS (continued)

57 Material related-party transactions

(a) Immediate holding company and its subsidiaries, fellow subsidiary companies, subsidiaries and associates

In 2015, the Group entered into transactions with its immediate holding company, its subsidiaries and fellow subsidiary companies in the ordinary course of its interbank activities mainly including lending activities, acceptance and placement of interbank deposits, correspondent banking transactions, off-balance sheet transactions and the provision of other banking and financial services. The activities were on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

The Group used the IT service of, and shared an automated teller machine network with, its immediate holding company. The Group also shared certain IT projects with and used certain processing services of fellow subsidiaries on a cost recovery basis. The Group maintained a staff retirement benefit scheme for which a fellow subsidiary company acts as insurer and administrator. A fellow subsidiary company was appointed as fund manager to manage the Group's life insurance investment portfolios. The Bank acted as agent for the marketing of Mandatory Provident Fund products and the distribution of retail investment funds for two fellow subsidiary companies.

There was an arrangement whereby a fellow subsidiary provided certain management services to Hang Seng Insurance Company Limited. The fees on these transactions are determined on an arm's length basis.

During 2014, the Bank has issued perpetual capital instrument of HK\$6,981m that was included in the Group's capital base as Basel III compliant additional tier 1 capital ('AT1') under the Banking (Capital) Rules to its immediate holding company reported under 'other equity instruments'. The balance of the AT1 at 31 December 2015 remained unchanged at HK\$6,981m. During 2015, the Bank has paid coupon on AT1 capital instrument of HK\$310m to its immediate holding company (2014: Nil).

The aggregate amount of income and expenses arising from these transactions during the year, the balances of amounts due to and from the relevant related parties, and the total contract sum of off-balance sheet transactions at the year-end are as follows:

	Immediate holding company and its subsidiaries		Fellow subsidiaries		Associates [#]	
	2015	2014	2015	2014	2015	2014
Interest income	66	69	11	2	106	190
Interest expense	(268)	(350)	-	-	(4)	(3)
Other operating income	57	125	(9)	(16)	-	-
Operating expenses*	(726)	(689)	(824)	(636)	(36)	(37)
Amounts due from:						
Placements with and advances to banks	15,913	24,353	7,840	5,218	2,567	4,398
Financial assets designated at fair value	-	-	-	-	-	-
Derivative financial instruments	1,204	408	88	35	-	-
Reverse repurchase agreements – non-trading	-	1,296	-	-	-	-
Loans and advances to customers	-	300	-	-	233	233
Financial investments	-	-	-	-	-	-
Other assets	28	27	9	-	6	7
	<u>17,145</u>	<u>26,384</u>	<u>7,937</u>	<u>5,253</u>	<u>2,806</u>	<u>4,638</u>
Amounts due to:						
Current, savings and other deposit accounts	1,468	1,440	-	-	229	166
Deposits from banks	10,190	3,789	41	22	71	250
Derivative financial instruments	1,150	617	2,021	1,607	-	-
Certificates of deposit and other debt securities in issue	4,000	6,493	-	-	-	-
Subordinated liabilities	2,325	5,817	-	-	-	-
Other liabilities	333	296	163	83	-	-
	<u>19,466</u>	<u>18,452</u>	<u>2,225</u>	<u>1,712</u>	<u>300</u>	<u>416</u>
Derivative contracts:						
Contract amount	141,308	96,322	56,936	75,982	-	-

* 2015 operating expenses included payment of HK\$107m (2014: HK\$81m) of software costs which were capitalised as intangible assets in the balance sheet of the Group.

Representing associates in HSBC Group.

NOTES TO THE FINANCIAL STATEMENTS (continued)

57 Material related-party transactions (continued)

(b) Key management personnel remuneration

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group and Bank. It includes members of the Board of Directors and Executive Committee of the Bank. During the year, the members of the Bank's Executive Committee has increased from 8 to 13. The amount of remuneration paid to key management personnel was pro-rata from the date of being appointed as Directors of the Bank or members of Executive Committee, if any. The aggregate amount of remuneration of the key management personnel during the year are as follows:-

	2015	2014 (restated)
Salaries, allowances and benefits in kind	43	40
Retirement scheme contributions	2	2
Variable bonuses	35	30
	<u>80</u>	<u>72</u>

(c) Material transactions with key management personnel

During the year, the Group provided credit facilities to and accepted deposits from key management personnel of the Bank and its holding companies, their close family members and companies controlled or significantly influenced by them. The credit facilities extended and deposit taken 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.

Material transactions conducted with key management personnel of the Bank and its holding companies and parties related to them are as follows:

	2015	2014
<i>For the year</i>		
Interest income	387	399
Interest expense	53	16
Fees and commission income	37	17
Maximum aggregate amount of loans and advances	18,293	16,098
<i>At the year-end</i>		
Loans and advances	14,901	13,136
Deposits	10,797	5,895
Guarantees issued	44	65
Undrawn commitments	2,664	1,443

The Group adheres to section 83 of the Hong Kong Banking Ordinance regarding lending to related parties; this includes unsecured lending to key management personnel, their relatives and companies that may be directly or indirectly influenced or controlled by such individuals.

No impairment losses have been recorded against balances outstanding during the year with key management personnel, and there are no specific impairment allowances on balances with key management personnel at the year-end.

(d) Loans to Directors

Particulars of loans to directors disclosed pursuant to section 17 of the Hong Kong Companies Ordinance (Cap.622G) (Disclosure of Information about Benefits of Directors) for the year ended 31 December 2015 are shown as below. They are not directly comparable with the Loans to officers, which include directors, managers and secretary, reported for the year ended 31 December 2014, which were pursuant to section 161B of the predecessor Hong Kong Companies Ordinance (Cap. 32).

	2015	2014
Aggregate amount of relevant transactions outstanding at 31 December		
- Loans and advances	14,017	245
- Guarantees issued	44	-
	<u>14,061</u>	<u>245</u>
Maximum aggregate amount of relevant transactions during the year		
- Loans and advances	16,602	272
- Guarantees issued	67	-
	<u>16,669</u>	<u>272</u>

The above relevant transactions in 2015 were all transacted by the Bank and nil by the Bank's subsidiaries.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

57 Material related-party transactions *(continued)*

(e) Directors' material interests in transactions, arrangements or contracts

No transaction, arrangement or contract (that is significant in relation to the Bank's business), to which the Bank or any of its holding companies or any of its subsidiaries or fellow subsidiaries was a party and in which a Director of the Bank had, directly or indirectly, a material interest, subsisted as at the end of the year or at any time during the year.

(f) Associates

Information relating to associates and transactions with associates can be found in notes 35 and 57(a).

The Group maintains a shareholders' loan to an associate. The shareholders' loan is unsecured, interest free and with no fixed term of repayment. The balance at 31 December 2015 was HK\$233m (2014: HK\$233m).

(g) Ultimate holding company

The Group participates in various share option and share plans operated by HSBC Holdings plc whereby share options or shares of HSBC Holdings plc are granted to employees of the Group. As disclosed in note 56, the Group recognises an expense in respect of these share options and share awards. The cost borne by the ultimate holding company in respect of these share options and share awards is treated as a capital contribution and is recorded under "Other reserves". The balance of this reserve as at 31 December 2015 amounted to HK\$672m comprising HK\$668m relating to share option schemes and HK\$4m relating to share award schemes (2014: HK\$662m comprising HK\$664m relating to share option schemes and negative reserve amounted to HK\$2m relating to share award schemes).

(h) Employee retirement benefits

At 31 December 2015, defined benefit scheme assets amounted to HK\$3,471m (2014: HK\$1,855m) was under management by the Bank's subsidiary company and the related fee paid was HK\$7m (2014: HK\$6m).

NOTES TO THE FINANCIAL STATEMENTS (continued)

58 Fair value of financial instruments

(a) Fair value of financial instruments carried at fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following tables set out the financial instruments carried at fair value.

	Valuation techniques			Third party total	Amounts with HSBC entities *	Total
	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3			
Recurring fair value measurements						
2015						
Assets						
Trading assets	34,513	5,860	-	40,373	-	40,373
Financial assets designated at fair value	3,330	4,026	547	7,903	-	7,903
Derivative financial instruments	494	9,796	13	10,303	1,292	11,595
Available-for-sale financial investments	197,686	91,603	1,161	290,450	-	290,450
Liabilities						
Trading liabilities	33,062	29,828	27	62,917	-	62,917
Financial liabilities designated at fair value	-	3,994	-	3,994	-	3,994
Derivative financial instruments	44	6,770	3	6,817	3,171	9,988
2014						
Assets						
Trading assets	34,094	7,729	-	41,823	-	41,823
Financial assets designated at fair value	8,817	1,594	701	11,112	-	11,112
Derivative financial instruments	492	6,455	32	6,979	442	7,421
Available-for-sale financial investments	161,459	87,103	1,234	249,796	-	249,796
Liabilities						
Trading liabilities	27,791	44,707	89	72,587	-	72,587
Financial liabilities designated at fair value	-	3,489	-	3,489	-	3,489
Derivative financial instruments	117	4,121	1	4,239	2,223	6,462

* Included structured instruments and derivative contracts transacted with HSBC entities which were mainly classified within Level 2 of the valuation hierarchy.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

58 Fair value of financial instruments *(continued)*

(a) Fair value of financial instruments carried at fair value *(continued)*

Transfers between levels of the fair value hierarchy are deemed to occur at the end of the reporting period.

There were no material transfers between Level 1 and Level 2 during the year.

Control framework

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk-taker.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is utilised. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the Group will source alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors that are considered in this regard are, inter alia:

- the extent to which prices may be expected to represent genuine traded or tradable prices;
- the degree of similarity between financial instruments;
- the degree of consistency between different sources;
- the process followed by the pricing provider to derive the data;
- the elapsed time between the date to which the market data relates and the balance sheet date; and
- the manner in which the data was sourced.

For fair values determined using a valuation model, the control framework may include, as applicable, development or validation by independent support functions of (i) the logic within valuation models; (ii) the inputs to those models; (iii) any adjustments required outside the valuation models; and (iv) where possible, model outputs. Valuation models are subject to a process of due diligence and calibration before becoming operational and are calibrated against external market data on an ongoing basis.

To this end, ultimate responsibility for the determination of fair values lies with Finance. Finance establishes the accounting policies and procedures governing valuation, and is responsible for ensuring compliance with all relevant accounting standards.

Determination of fair value

Fair values are determined according to the following hierarchy:

(i) Level 1: Quoted market price

Financial instruments with quoted prices for identical instruments in active markets that the Group can assess at the measurement date.

(ii) Level 2: Valuation technique using observable inputs

Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

(iii) Level 3: Valuation technique with significant unobservable inputs

Financial instruments valued using models where one or more significant inputs are unobservable.

The best evidence of fair value is a quoted price in an actively traded market. The fair values of financial instruments that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities issued. Where a financial instrument has a quoted price in an active market and it is part of a portfolio, the fair value of the portfolio is calculated as the product of the number of units and quoted price. In the event that the market for a financial instrument is not active, a valuation technique is used.

The judgement as to whether a market is active may include, but is not restricted to, the consideration of factors such as the magnitude and frequency of trading activity, the availability of prices and the size of bid/offer spreads. The bid/offer spread represents the difference in prices at which a market participant would be willing to buy compared with the price at which they would be willing to sell. In inactive markets, obtaining assurance that the transaction price provides evidence of fair value or determining the adjustments to transaction prices that are necessary to measure the fair value of the instrument requires additional work during the valuation process.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

58 Fair value of financial instruments *(continued)*

(a) Fair value of financial instruments carried at fair value *(continued)*

Valuation techniques incorporate assumptions about factors that other market participants would use in their valuations. A range of valuation techniques is employed, dependent upon the instrument type and available market data. Most valuation techniques are based upon discounted cash flow analysis, in which expected future cash flows are calculated and discounted to present value using a discounting curve. Prior to consideration of credit risk, the expected future cash flows may be known, as would be the case for the fixed leg of an interest rate swap, or may be uncertain and require projection, as would be the case for the floating leg of an interest rate swap. Projection utilises market forward curves, if available. In option models, the probability of different potential future outcomes must be considered. In addition, the value of some products are dependent upon more than one market factor, and in these cases it will typically be necessary to consider how movements in one market factor may impact the other market factors. The model inputs necessary to perform such calculations include interest rate yield curves, exchange rates, volatilities, correlations, prepayment and default rates.

The majority of valuation techniques employ only observable market data. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable, and for them the measurement of fair value is more judgemental. An instrument in its entirety is classified as valued using significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument's inception profit ("day 1 gain or loss") or greater than 5% of the instrument's carrying value is driven by unobservable inputs. "Unobservable" in this context means that there is little or no current market data available from which to determine the price at which an arm's length transaction would be likely to occur. It generally does not mean that there is no market data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used). All fair value adjustments are included within the levelling determination.

The types of financial instruments carried at fair values are as follows:

- Debt securities, Treasury and eligible bills, and Equities

These instruments are valued based on quoted market prices from an exchange, dealer, broker, industry group or pricing service, where available. Where unavailable, fair value is determined by reference to quoted market prices for similar instruments, or in the case of certain unquoted equities, valuation techniques using inputs derived from observable and unobservable market data.

- Structured notes

The fair value of structured notes valued using a valuation technique is derived from the fair value of the underlying debt security, and the fair value of the embedded derivative is determined as described in the paragraph below on derivatives.

Trading liabilities valued using a valuation technique with significant unobservable inputs principally comprised equity-linked structured notes, which are issued by the Group and provide the counterparty with a return that is linked to the performance of certain equity securities, and other portfolios. The notes are classified as level 3 due to the unobservability of parameters such as long-dated equity volatilities and correlations between equity prices, between equity prices and interest rates and between interest rates and foreign exchange rates.

- Derivatives

OTC (i.e. non-exchange traded) derivatives are valued using valuation models. Valuation models calculate the present value of expected future cash flows, based upon "no-arbitrage" principles. For many vanilla derivative products, such as interest rate swaps and European options, the modelling approaches used are standard across the industry. For more complex derivative products, there may be some discrepancies in practice. Inputs to valuation models are determined from observable market data wherever possible, including prices available from exchanges, dealers, brokers or providers of consensus pricing. Certain inputs may not be observable in the market directly, but can be determined from observable prices via model calibration procedures. Finally, some inputs are not observable, but can generally be estimated from historical data or other sources.

Examples of inputs that are generally observable include foreign exchange spot and forward rates, benchmark interest rate curves and volatility surfaces for commonly traded option products. Examples of inputs that may be unobservable include volatility surfaces, in whole or in part, for less commonly traded option products, and correlations between market factors, such as foreign exchange rates, interest rates and equity prices.

NOTES TO THE FINANCIAL STATEMENTS (continued)

58 Fair value of financial instruments (continued)

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

Fair value adjustments

Fair value adjustments are adopted when the Group considers that there are additional factors that would be considered by a market participant that are not incorporated within the valuation model. The Group classifies fair value adjustments as either 'risk-related' or 'model-related'. The majority of these adjustments relate to Global Markets.

Movements in the level of fair value adjustments do not necessarily result in the recognition of profits or losses within the income statement. For example, as models are enhanced, fair value adjustments may no longer be required. Similarly, fair value adjustments will decrease when the related positions are unwound, but this may not result in profit or loss.

The major fair value adjustment categories being regularly reviewed by the Group are as follows:

Risk-related adjustments

- Bid-offer

HKFRS 13 requires use of the price within the bid-offer spread that is most representative of fair value. Valuation models will typically generate mid-market values. The bid-offer adjustment reflects the extent to which bid-offer cost would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding the position.

- Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective. In these circumstances, there exists a range of possible values that the financial instrument or market parameter may assume and an adjustment may be necessary to reflect the likelihood that in estimating the fair value of the financial instrument, market participants would adopt more conservative values for uncertain parameters and/or model assumptions than those used in the valuation model.

- Credit valuation adjustment

The credit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the counterparty may default and that the Group may not receive the full market value of the transactions.

- Debit valuation adjustment

The debit valuation adjustment is an adjustment to the valuation of OTC derivative contracts to reflect within fair value the possibility that the Group may default, and that the Group may not pay full market value of the transactions.

- Funding fair value adjustment

The funding fair value adjustment is calculated by applying future market funding spreads to the expected future funding exposure of any uncollateralised component of the OTC derivative portfolio. This includes the uncollateralised component of collateralised derivatives in addition to derivatives that are fully uncollateralised. The expected future funding exposure is calculated by a simulation methodology, where available. The expected future funding exposure is adjusted for events that may terminate the exposure such as the default of the Group or the counterparty. The funding fair value adjustment and debit valuation adjustment are calculated independently.

Model-related adjustments

- Model limitation

Models used for portfolio valuation purposes may be based upon a simplifying set of assumptions that do not capture all material market characteristics. Additionally, markets evolve, and models that were adequate in the past may require development to capture all material market characteristics in current market conditions. In these circumstances, model limitation adjustments are adopted. As model development progresses, model limitations are addressed within the valuation models and a model limitation adjustment is no longer needed.

- Inception profit (Day 1 P&L reserves)

Inception profit adjustments are adopted where the fair value estimated by a valuation model is based on one or more significant unobservable inputs.

NOTES TO THE FINANCIAL STATEMENTS (continued)

58 Fair value of financial instruments (continued)

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

Financial instruments measured at fair value using a valuation technique with significant unobservable inputs - Level 3

	Assets				Liabilities		
	Available-for-sale	Held for trading	Designated at fair value through profit or loss	Derivatives	Held for trading	Designated at fair value through profit or loss	Derivatives
2015							
Private equity	1,161	-	547	-	-	-	-
Structured notes	-	-	-	-	27	-	-
Derivatives	-	-	-	13	-	-	3
	<u>1,161</u>	<u>-</u>	<u>547</u>	<u>13</u>	<u>27</u>	<u>-</u>	<u>3</u>
2014							
Private equity	1,234	-	701	-	-	-	-
Structured notes	-	-	-	-	89	-	-
Derivatives	-	-	-	32	-	-	1
	<u>1,234</u>	<u>-</u>	<u>701</u>	<u>32</u>	<u>89</u>	<u>-</u>	<u>1</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

58 Fair value of financial instruments (continued)

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

Movement in Level 3 financial instruments

	Assets				Liabilities		
	Available-for-sale	Held for trading	Designated at fair value through profit or loss	Derivatives	Held for trading	Designated at fair value through profit or loss	Derivatives
At 1 January 2015	1,234	-	701	32	89	-	1
Total gains or losses recognised in profit or loss							
- trading income	-	-	-	11	-	-	2
- net income from other financial instruments designated at fair value	-	-	53	-	-	-	-
- gains less losses from financial investments	-	-	-	-	-	-	-
Total gains or losses recognised in other comprehensive income							
- fair value gains	(73)	-	-	-	-	-	-
- exchange differences	-	-	-	-	-	-	-
Purchases	-	-	198	-	-	-	-
Issues/ deposit taking	-	-	-	-	78	-	-
Sales	-	-	(31)	-	-	-	-
Settlements	-	-	(188)	-	(122)	-	-
Transfers out	-	-	(186)	(30)	(18)	-	-
Transfers in	-	-	-	-	-	-	-
At 31 December 2015	<u>1,161</u>	<u>-</u>	<u>547</u>	<u>13</u>	<u>27</u>	<u>-</u>	<u>3</u>
Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of the reporting period							
- trading income	-	-	-	3	-	-	(3)
- net income from other financial instruments designated at fair value	-	-	51	-	-	-	-

NOTES TO THE FINANCIAL STATEMENTS (continued)

58 Fair value of financial instruments (continued)

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

Movement in Level 3 financial instruments (continued)

	Assets				Liabilities			
	Available-for-sale	Held for trading	Designated at fair value through profit or loss	Derivatives	Held for trading	Designated at fair value through profit or loss	Derivatives	
At 1 January 2014	984	-	500	3	108	-	-	
Total gains or losses recognised in profit or loss								
- trading income	-	-	-	37	-	-	2	
- net income from other financial instruments designated at fair value	-	-	110	-	-	-	-	
- gains less losses from financial investments	-	-	-	-	-	-	-	
Total gains or losses recognised in other comprehensive income								
- fair value gains	250	-	-	-	-	-	-	
- exchange differences	-	-	-	-	-	-	-	
Purchases	-	-	264	-	-	-	-	
Issues/ deposit taking	-	-	-	-	89	-	-	
Sales	-	-	(2)	-	-	-	-	
Settlements	-	-	(257)	-	(87)	-	-	
Transfers out	-	-	-	(9)	(21)	-	(1)	
Transfers in	-	-	86	1	-	-	-	
At 31 December 2014	<u>1,234</u>	<u>-</u>	<u>701</u>	<u>32</u>	<u>89</u>	<u>-</u>	<u>1</u>	
Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of the reporting period								
- trading income	-	-	-	38	-	-	(5)	
- net income from other financial instruments designated at fair value	-	-	115	-	-	-	-	

NOTES TO THE FINANCIAL STATEMENTS (continued)

58 Fair value of financial instruments (continued)

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

Movement in Level 3 financial instruments (continued)

The transfer out of Level 3 designated at fair value assets was due to the change in observability of valuations of collective investment schemes in the year. For derivative assets, the transfer out predominantly resulted from increase in observability in equity volatilities. In respect of the held for trading liabilities, the transfer out of level 3 reflected the change in observability of correlations between equity and equity index used for pricing the instrument.

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

As discussed above, the fair value of financial instruments are, in certain circumstances, measured using valuation techniques that incorporate assumptions which are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data. The following table shows the sensitivity of these fair values to reasonably possible alternative assumptions:

Sensitivity of fair values to reasonably possible alternative assumptions

	Reflected in profit or loss		Reflected in other comprehensive income	
	Favourable changes	Unfavourable changes	Favourable changes	Unfavourable changes
2015				
Private equity	27	(27)	74	(74)
Structured notes	-	-	-	-
Derivatives	1	(1)	-	-
	<u>28</u>	<u>(28)</u>	<u>74</u>	<u>(74)</u>
2014				
Private equity	70	(70)	127	(127)
Structured notes	-	-	-	-
Derivatives	-	-	-	-
	<u>70</u>	<u>(70)</u>	<u>127</u>	<u>(127)</u>

When the fair value of a financial instrument is affected by more than one unobservable assumption, the above table reflects the most favourable or the most unfavourable change from varying the assumptions individually.

NOTES TO THE FINANCIAL STATEMENTS (continued)

58 Fair value of financial instruments (continued)

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

Quantitative information about significant unobservable inputs in Level 3 valuations

	Fair value at 31 December 2015	Valuation technique(s)	Unobservable input(s)	Range
Assets				
Private equity	1,708	Net asset value Market-comparable approach	N/A Earnings Multiple P/B ratios Liquidity Discount	N/A 27 - 37 0.89-1.58 10% - 30%
Derivatives	10	Option model	Equity Volatility	33.11% - 52.46%
	3	Discounted cash flow model	FX Volatility IR Curve	6.44% - 13.80% 1.76% - 5.46%
Liabilities				
Structured notes	27	Option model	FX Volatility Equity and Equity Index Correlation	7.10% - 13.80% 0.256 - 0.256
Derivatives	1	Option model	FX Volatility	6.44% - 13.80%
	2	Discounted cash flow model	IR Curve	1.76% - 5.46%
	Fair value at 31 December 2014	Valuation technique(s)	Unobservable input(s)	Range
Assets				
Private equity	1,935	Net asset value Market-comparable approach	N/A Earnings Multiple P/B ratios Liquidity Discount	N/A 22 - 37 1.11-1.59 10% - 30%
Derivatives	30	Option model	Equity Volatility	17.77% - 36.97%
	2	Discounted cash flow model	FX Volatility IR Curve	3.61% - 10.49% 1.33% - 5.37%
Liabilities				
Structured notes	89	Option model	FX Volatility Equity and Equity Index Correlation	8.95% - 15.56% 0.585 - 0.710
Derivatives	1	Option model	FX Volatility	6.25% - 10.49%

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

58 Fair value of financial instruments *(continued)*

(a) Fair value of financial instruments carried at fair value *(continued)*

Key unobservable inputs to Level 3 financial instruments

The table above lists the key unobservable inputs to Level 3 financial instruments, and provides the range of those inputs as at 31 December 2015. A further description of the categories of key unobservable inputs is given below.

Private equity

The Group's private equity includes investment funds and unlisted equity shares, which are classified as designated at fair value through profit or loss or available-for-sale and are not traded in active markets. In the absence of an active market, the investment's fair value is estimated on the basis of an analysis of the investee's financial position and results, risk profile, prospects and other factors, as well as by reference to market valuations for similar entities quoted in an active market, or the price at which similar companies have changed ownership.

Investment funds are valued using their net asset value. Higher net asset value results in higher fair value, and vice versa. Given the bespoke nature of the analysis, it is not practical to quote a range of key observable inputs.

For unlisted available-for-sale equity shares, the fair values are determined with reference to multiples of comparable listed companies, such as price/earning or price/book ratios of comparables, adjusted for a liquidity discount to reflect the fact that the shares are not actively traded. An increase in the ratio in isolation will result in favourable movement in the fair values, while an increase in liquidity discount in isolation will result in unfavourable movement.

Volatility

Volatility is a measure of the anticipated future variability of a market price. Volatility tends to increase in stressed market conditions, and decrease in calmer market conditions. Volatility is an important input in the pricing of options. In general, the higher the volatility, the more expensive the option will be. This reflects both the higher probability of an increased return from the option, and the potentially higher costs that the Group may incur in hedging the risks associated with the option. If option prices become more expensive, this will increase the value of the Group's long option positions (i.e. the positions in which the Group has purchased options), while the Group's short option positions (i.e. the positions in which the Group has sold options) will suffer losses.

Volatility varies by underlying reference market price, and by strike and maturity of the option. Volatility also varies over time. As a result, it is difficult to make general statements regarding volatility levels.

Certain volatilities, typically those of a longer-dated nature, are unobservable. The unobservable volatility is then estimated from observable data.

The range of unobservable volatilities quoted in the table reflects the wide variation in volatility inputs by reference to market price. For any single unobservable volatility, the uncertainty in the volatility determination is significantly less than the range quoted above.

Correlation

Correlation is a measure of the inter-relationship between two market prices. Correlation is a number between minus one and one. A positive correlation implies that the two market prices tend to move in the same direction, with a correlation of one implying that they always move in the same direction. A negative correlation implies that the two market prices tend to move in opposite directions, with a correlation of minus one implying that the two market prices always move in opposite directions.

Correlation is used to value more complex instruments where the payout is dependent upon more than one market price. Correlation may be unobservable. Unobservable correlations may be estimated based upon a range of evidence, including consensus pricing services, the Group's trade prices, proxy correlations and examination of historical price relationships.

The range of unobservable correlations quoted in the table reflects the wide variation in correlation inputs by market price pair. For any single unobservable correlation, the uncertainty in the correlation determination is likely to be less than the range quoted above.

NOTES TO THE FINANCIAL STATEMENTS (continued)

58 Fair value of financial instruments (continued)

(b) Fair value of financial instruments not carried at fair value

The following table provides an analysis of the fair value of financial instruments not measured at fair value on the balance sheet. For all other instruments, the fair value is equal to the carrying value.

	Carrying amount	Quoted market price Level 1	Using observable inputs Level 2	With significant unobservable inputs Level 3	Fair value
2015					
Financial Assets					
Placings with and advances to banks	123,990	-	124,316	-	124,316
Loans and advances to customers	688,946	-	1,830	688,418	690,248
Held-to-maturity debt securities	81,822	491	84,080	-	84,571
Financial Liabilities					
Current, savings and other deposit accounts	959,228	-	959,216	-	959,216
Deposits from banks	18,780	-	18,780	-	18,780
Certificates of deposit and other debt securities in issue	5,191	-	5,223	-	5,223
Subordinated liabilities	2,325	-	2,915	-	2,915
2014					
Financial Assets					
Placings with and advances to banks	145,731	-	145,798	-	145,798
Loans and advances to customers	658,431	-	2,854	652,786	655,640
Held-to-maturity debt securities	68,236	495	70,334	-	70,829
Financial Liabilities					
Current, savings and other deposit accounts	896,521	-	896,578	-	896,578
Deposits from banks	9,095	-	9,095	-	9,095
Certificates of deposit and other debt securities in issue	12,402	-	12,484	-	12,484
Subordinated liabilities	5,817	-	6,939	-	6,939

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

58 Fair value of financial instruments *(continued)*

(b) Fair value of financial instruments not carried at fair value *(continued)*

The calculation of fair values of financial instruments that are not carried at fair value is described below.

The calculation of fair value incorporates the Group's estimate of the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It does not reflect the economic benefits and costs that the Group expects to flow from the instruments' cash flows over their expected future lives.

(i) Loans and advances to banks and customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using valuation models that incorporate a range of input assumptions. These assumptions may include value estimates from third party brokers which reflect over-the-counter trading activity; forward looking discounted cash flow models using assumptions which the Group believes are consistent with those which would be used by market participants in valuing such loans; and trading inputs from other market participants which includes observed primary and secondary trades.

Loans are grouped, as far as possible, into homogeneous groups and stratified by loans with similar characteristics to improve the accuracy of estimated valuation outputs. The stratification of a loan book considers all material factors, including vintage, origination period, estimates of future interest rates, prepayment speeds, delinquency rates, loan-to-value ratios, the quality of collateral, default probability, and internal credit risk ratings.

Valuation techniques are calibrated on a regular basis and tested for validity using prices from observable current market transactions in the same instrument, without modification or repackaging, or are based on any available observable market data.

The fair value of a loan reflects both loan impairments at the balance sheet date and estimates of market participants' expectations of credit losses over the life of the loans, and the fair value impact of repricing between origination and the balance sheet date. For impaired loans, fair value is estimated by discounting the future cash flows over the time period they are expected to be recovered.

(ii) Financial investments

The fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that take into consideration the prices and future earnings streams of equivalent quoted securities.

(iii) Deposits by banks and customer accounts

For the purpose of estimating fair value, deposits by banks and customer accounts are grouped by remaining contractual maturity. Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is assumed to be the amount payable on demand at the balance sheet date.

(iv) Debt securities in issue and subordinated liabilities

Fair values are determined using quoted market prices at the balance sheet date where available, or by reference to quoted market prices for similar instruments.

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. In many cases, it would not be possible to realise immediately the estimated fair values given the size of the portfolios measured. Accordingly, these fair values do not represent the value of these financial instruments to the Group as a going concern.

The following table lists financial instruments for which their carrying amounts are reasonable approximations of their fair values because, for example, they are short-term in nature or reprice to current market rates frequently:

Assets

Cash and sight balances at central banks
Items in the course of collection from other banks
Reverse repurchase agreements – non-trading
Acceptances and Endorsements
Short-term receivables within "Other assets"
Accrued income

Liabilities

Items in the course of transmission to other banks
Acceptances and Endorsements
Short-term payables within "Other liabilities"
Accruals

NOTES TO THE FINANCIAL STATEMENTS (continued)

59 The New Hong Kong Companies Ordinance (Cap. 622)

In accordance with the requirements of Part 9 "Accounts and Audit" of the new Hong Kong Companies Ordinance (Cap. 622) which came into operation during the financial year. As a result, there are changes to presentation and disclosure of certain information in the Group's consolidated financial statements.

60 Comparative figures

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

61 Immediate and ultimate holding companies

The immediate and ultimate holding companies of the Bank are The Hongkong and Shanghai Banking Corporation Limited (incorporated in Hong Kong) and HSBC Holdings plc (incorporated in England) respectively.

62 Major transaction – Partial disposal of the Bank's shareholding in Industrial Bank

On 10 February 2015, the Bank entered into a placing agreement with Goldman Sachs Gao Hua Securities Company Limited to sell 5% (representing 952,616,838 ordinary shares) of its shareholding of the ordinary shares of Industrial Bank Co., Ltd. ('Industrial Bank'), at a price of RMB13.36 per share (approximately HK\$16.58 per share). The disposal price represented a discount of approximately 7% to the closing price of Industrial Bank's ordinary shares listed on the Shanghai Stock Exchange on the date of entry into the placing agreement. The transaction was completed on 13 February 2015.

On 12 May 2015, the Bank entered into another placing agreement with Goldman Sachs Gao Hua Securities Company Limited and UBS Securities Co. Limited to sell 4.99% (representing 950,700,000 ordinary shares) of the ordinary shares of Industrial Bank, at a price of RMB17.68 per share (approximately HK\$22.08 per share). The price per share represented a discount of approximately 5.96% to the closing price of Industrial Bank's shares on the Shanghai Stock Exchange on the date of entry into the placing agreement. This transaction, together with the previous transaction in February 2015 mentioned above, raised approximately RMB30bn (approximately HK\$37bn) for the Bank, before expenses.

The net gain on the sale of the shares on the two transactions mentioned above was HK\$10.6bn, representing the difference between the consideration and the carrying value of such shares at 31 December 2014 in the Bank's and the Group's financial statements, together with the reclassification of the related cumulative foreign exchange and revaluation reserve less the tax effect and expenses of the transactions. Following completion of the two transactions, the Bank's remaining shareholding in Industrial Bank represents approximately 0.88% of the ordinary shares of Industrial Bank.

Since there are significant financial implications as a result of the recognition of the gain on partial disposal in the income statement of 2015, the key financial results and performance metrics are not directly comparable with 2014. For comparison, we have prepared the following key financial results and performance metrics by excluding the financial impact of Industrial Bank-related items in both years.

	Year ended 31 December 2015			Year ended 31 December 2014			Change	
	As reported	IB adjustment *	Adjusted	As reported	IB adjustment *	Adjusted	As reported	Adjusted
	Net interest income	21,165	-	21,165	19,871	-	19,871	6.5%
Non-interest income	9,882	(119) **	9,763	10,336	(1,190) **	9,146	(4.4%)	6.7%
Net operating income before loan impairment charge	31,047	(119)	30,928	30,207	(1,190)	29,017	2.8%	6.6%
Operating profit	19,433	(119)	19,314	19,450	(1,190)	18,260	(0.1%)	5.8%
Net gain on partial disposal of IB	10,636	(10,636)	-	-	-	-	n.a.	n.a.
Impairment of investment in IB	-	-	-	(2,103)	2,103	-	n.a.	n.a.
Profit before tax	30,488	(10,755)	19,733	18,049	913	18,962	68.9%	4.1%
Tax expense	(2,994)	12 **	(2,982)	(2,918)	119 **	(2,799)	2.6%	6.5%
Attributable profit	27,494	(10,743)	16,751	15,131	1,032	16,163	81.7%	3.6%

* IB adjustment refers to the net gain on partial disposal of the investment in IB in 2015, the impairment of investment in IB in 2014 and dividends from investment in IB in both years.

** Represented the gross dividend of HK\$119m (2014: HK\$1,190m) received from IB reported under 'non-interest income' and related tax charges of HK\$12m (2014: HK\$119m) reported under tax expense.

NOTES TO THE FINANCIAL STATEMENTS (continued)

62 Major transaction – Partial disposal of the Bank’s shareholding in Industrial Bank (continued)

	Year ended 31 December 2015			Year ended 31 December 2014			Change #	
	As	IB	Adjusted	As	IB	Adjusted	As	
	reported	adjustment *		reported	adjustment *		reported	Adjusted
Earnings per share (HK\$)	14.22	(5.62)	8.60	7.91	0.54	8.45	79.8%	1.8%
Return on average ordinary shareholders’ equity (%)	20.7	(6.9)	13.8	13.4	0.9	14.3	7.3pp	(0.5pp)
Return on average total assets (%)	2.1	(0.8)	1.3	1.3	0.0	1.3	0.8pp	0.0pp

* IB adjustment refers to the net gain on partial disposal of the investment in IB in 2015, the impairment of investment in IB in 2014 and dividends from investment in IB in both years.

Change in "pp" represents change in percentage points.

NOTES TO THE FINANCIAL STATEMENTS (continued)

63 Balance sheet and reserve movement of the Bank

Balance Sheet at 31 December 2015

	2015	2014
	note	
ASSETS		
Cash and sight balances at central banks	8,294	9,246
Placings with and advances to banks	102,035	111,656
Trading assets	37,625	38,160
Derivative financial instruments	11,044	7,039
Reverse repurchase agreements – non-trading	-	1,296
Loans and advances to customers	618,304	588,131
Amounts due from subsidiaries	21,332	28,195
Financial investments	267,382	222,878
Investments in subsidiaries	19,762	17,902
Investment properties	4,374	6,973
Premises, plant and equipment	20,774	16,578
Intangible assets	383	376
Other assets	16,246	14,695
Total assets	<u><u>1,127,555</u></u>	<u><u>1,063,125</u></u>
LIABILITIES AND EQUITY		
Liabilities		
Current, savings and other deposit accounts	911,135	850,324
Deposits from banks	15,566	4,140
Trading liabilities	37,757	34,373
Financial liabilities designated at fair value	3,491	2,994
Derivative financial instruments	9,848	6,224
Certificates of deposit and other debt securities in issue	4,000	11,156
Amounts due to subsidiaries	10,702	15,490
Other liabilities	16,816	17,021
Current tax liabilities	135	283
Deferred tax liabilities	2,394	2,143
Subordinated liabilities	2,325	5,817
Total liabilities	<u><u>1,014,169</u></u>	<u><u>949,965</u></u>
Equity		
Share capital	9,658	9,658
Retained profits	(Note 63a) 81,503	67,159
Other equity instruments	6,981	6,981
Other reserves	(Note 63a) 15,244	29,362
Shareholders' funds	113,386	113,160
Total equity and liabilities	<u><u>1,127,555</u></u>	<u><u>1,063,125</u></u>

Rose W M Lee *Vice-Chairman and Chief Executive*

John C C Chan *Director*

Eric K C Li *Director*

Andrew W L Leung *Chief Financial Officer*

NOTES TO THE FINANCIAL STATEMENTS (continued)

63 Balance sheet and reserve movement of the Bank (continued)

(a) Reserves movement of the Bank

The Bank and its banking subsidiaries operate under regulatory jurisdictions which require the maintenance of minimum capital adequacy ratios and which could therefore potentially restrict the amount of realised profits which can be distributed to shareholders.

Regulatory reserve

To satisfy the provisions of the Hong Kong Banking Ordinance and local regulatory requirements for prudential supervision purposes, the Group has earmarked a "regulatory reserve" from retained profits. Movements in the reserve are made directly through retained earnings. As at 31 December 2015, the effect of this requirement is to restrict the amount of reserves which can be distributed by the Group and the Bank to shareholders by HK\$6,610m (2014: HK\$6,229m) and HK\$6,060m (2014: HK\$5,642m) respectively.

Retained profits

Retained profits are the cumulative net earnings of the Bank that have not been paid out as dividends, but retained to be reinvested in the business.

Premises revaluation reserve

The premises revaluation reserve represents the difference between the fair value of the premises and its original depreciated cost.

There is no premises revaluation reserve related to premises classified as assets held for sale, included in "Other assets" in the balance sheet at 31 December 2015 (31 December 2014: Nil).

Cash flow hedging reserve

The cash flow hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions.

Available-for-sale investment reserve

The available-for-sale investment reserve includes the cumulative net change in the fair value of available-for-sale investments other than impairments which have been recognised in the income statement.

Capital redemption reserve

Capital redemption reserve has been included in share capital under the Hong Kong New Companies Ordinance (Cap. 622) which became effective on 3 March 2014.

Other reserves

Other reserves comprise foreign exchange reserve and share-based payment reserve. The foreign exchange reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations. The share-based payment reserve is used to record the corresponding amount of share options granted by ultimate holding company to the Group's employees and other cost of share-based payment arrangement.

NOTES TO THE FINANCIAL STATEMENTS (continued)

63 Balance sheet and reserve movement of the Bank (continued)

(a) Reserves movement of the Bank (continued)

Details of the changes in the Bank's individual components of equity between the beginning and the end of the year are set out below:

	2015	2014
Retained profits	81,503	67,159
Other equity instruments	6,981	6,981
Premises revaluation reserve	13,092	12,168
Cash flow hedging reserve	(9)	(11)
Available-for-sale investment reserve:		
- on debt securities	(152)	33
- on equity securities	1,617	16,490
Other reserves	696	682
Total reserves	<u>103,728</u>	<u>103,502</u>
<i>Retained profits</i>		
At beginning of the year	67,159	64,473
Dividends to shareholders:		
- dividends approved in respect of the previous year	(4,397)	(4,206)
- dividends declared in respect of the current year	(6,309)	(6,309)
Coupon paid to holder of AT1 capital instrument	(310)	-
Transfer	385	351
Total comprehensive income for the year	<u>24,975</u>	<u>12,850</u>
	<u>81,503</u>	<u>67,159</u>
<i>Other equity instruments</i>		
At beginning of the year	6,981	-
Other equity instrument issued	-	6,981
	<u>6,981</u>	<u>6,981</u>
<i>Premises revaluation reserve</i>		
At beginning of the year	12,168	11,654
Transfer	(385)	(351)
Total comprehensive income for the year	<u>1,309</u>	<u>865</u>
	<u>13,092</u>	<u>12,168</u>
<i>Cash flow hedging reserve</i>		
At beginning of the year	(11)	6
Total comprehensive income for the year	<u>2</u>	<u>(17)</u>
	<u>(9)</u>	<u>(11)</u>
<i>Available-for-sale investment reserve</i>		
At beginning of the year	16,523	(1,806)
Total comprehensive income for the year	<u>(15,058)</u>	<u>18,329</u>
	<u>1,465</u>	<u>16,523</u>
<i>Capital redemption reserve</i>		
At beginning of the year	-	99
Transfer to share capital	-	(99)
	<u>-</u>	<u>-</u>
<i>Other reserve</i>		
At beginning of the year	682	662
Costs of share-based payment arrangements	10	14
Total comprehensive income for the year	<u>4</u>	<u>6</u>
	<u>696</u>	<u>682</u>
Total reserves	<u>103,728</u>	<u>103,502</u>

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

63 Balance sheet and reserve movement of the Bank *(continued)*

(a) Reserves movement of the Bank *(continued)*

At 31 December 2015, the aggregate amount of reserves available for distribution to equity shareholders of the Bank as calculated under the provision of Part 6 of the new Hong Kong Companies Ordinance (Cap. 622), with reference to section 79B of the predecessor Hong Kong Companies Ordinance (Cap. 32) amounted to HK\$69,780m (2014: HK\$35,544m). After considering regulatory capital requirement and business development needs, amounts of HK\$4,588m (2014: HK\$4,397m) and HK\$5,736m (2014: Nil) were declared as the proposed fourth interim dividend and special interim dividend respectively in respect of the financial year ended 31 December 2015. The difference between the aggregate distributable reserves of HK\$69,780m and the Bank's retained profit of HK\$81,503m as reported above mainly represents the exclusion of unrealised revaluation gain on investment properties and the regulatory reserve of the Bank.

64 Approval of financial statements

The financial statements were approved and authorised for issue by the Board of Directors on 22 February 2016.

Independent Auditor's Report
To the Members of Hang Seng Bank Limited
(incorporated in Hong Kong with limited liability)

We have audited the consolidated financial statements of Hang Seng Bank Limited (the "Bank") and its subsidiaries set out on pages 152 to 260, which comprise the consolidated balance sheet as at 31 December 2015, and the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Consolidated Financial Statements

The directors of the Bank are responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with 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 misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to report our opinion solely to you, as a body, in accordance with section 405 of the Hong Kong Companies Ordinance and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, 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 consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

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

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 22 February 2016

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS *(unaudited)*

(Figures expressed in millions of Hong Kong dollars unless otherwise indicated)

These notes set out on pages 262 to 283 are supplementary to and should be read in conjunction with the consolidated financial statements set out on pages 152 to 260. The consolidated financial statements and these supplementary notes taken together comply with the Banking (Disclosure) Rules (the "Disclosure Rules") made under section 60A of the Banking Ordinance.

1 Basis of preparation

- (a) Except where indicated otherwise, the financial information contained in these supplementary notes has been prepared on a consolidated basis in accordance with Hong Kong Financial Reporting Standards. Some parts of these supplementary notes, however, are required by the Disclosure Rules to be prepared on a different basis. In such cases, the Disclosure Rules require that certain information is prepared on a basis which excludes some of the subsidiaries of the Bank.

Further information regarding subsidiaries that are not included in the consolidation for regulatory purpose is set out in Management Discussion and Analysis.

- (b) The accounting policies applied in preparing these supplementary notes are the same as those applied in preparing the consolidated financial statements for the year ended 31 December 2015 as set out in note 3 to the financial statements.
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SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (*unaudited*) (*continued*)

2 Credit risk capital requirements

The table below shows the capital requirements for credit risk for each class and subclass of exposures as specified in the Capital Rules.

	2015	2014
Subject to internal ratings-based approach		
Sovereign exposures	901	1,097
Bank exposures	2,044	2,680
Corporate exposures	19,788	19,498
Residential mortgages to individuals and property-holding shell companies	2,059	1,135
Qualifying revolving retail exposures	1,853	1,660
Small business retail exposures	11	13
Other retail exposures to individuals	451	417
Other exposures	2,093	1,894
Securitisation exposures	-	-
Equity exposures subject to internal models method under the market-based approach	2,923	1,892
Total capital requirements for credit risk under internal ratings-based approach	32,123	30,286
Subject to standardised (credit risk) approach		
<i>On-balance sheet</i>		
Sovereign exposures	-	-
Public sector entity exposures	131	71
Bank exposures	1	9
Securities firm exposures	-	-
Corporate exposures	1,691	1,530
Collective investment scheme exposures	-	-
Regulatory retail exposures	347	268
Residential mortgage loans	769	701
Other exposures which are not past due exposures	171	150
Past due exposures	37	14
Total capital requirements for on-balance sheet exposures	3,147	2,743
<i>Off-balance sheet</i>		
Direct credit substitutes	128	147
Transaction-related contingencies	1	1
Trade-related contingencies	1	2
Forward asset purchases	-	7
Partly paid-up shares and securities	-	-
Forward deposits placed	-	-
Unconditionally cancellable commitments	-	-
Other commitments	30	55
Exchange rate contracts	11	7
Interest rate contracts	-	1
Equity contracts	26	28
OTC derivative transactions and credit derivative contracts subject to valid bilateral netting agreements	2	1
Other off-balance exposures which are not elsewhere specified	-	-
Total capital requirements for off-balance sheet exposures	199	249
Total capital requirements for credit risk under standardised (credit risk) approach	3,346	2,992
Capital required for Central Counterparties	-	-
Capital required for Credit Valuation Adjustment	270	232
Total capital requirements for credit risk	35,739	33,510

The capital requirement is made by multiplying the Group's risk-weighted amount derived from the relevant calculation approach by 8 per cent. It does not reflect the Group's actual regulatory capital.

3 Credit risk under the internal ratings-based approach

(a) The internal rating system

(i) Nature of exposures within each internal ratings-based ("IRB") class

The Group adopted advanced IRB approach for the majority of its business under the approval granted by the HKMA. The following exposures are subject to IRB approach:

- Corporate exposures include exposures to global large corporates, local large corporates, middle market corporates and small and medium-sized enterprises, non-bank financial institutions and specialised lending.
- Sovereign exposures include exposures to central governments, government agencies, central monetary institutions, multilateral development banks and relevant international organisations.
- Bank exposures include exposures to banks and regulated securities firms.
- Retail exposures include residential mortgages, qualifying revolving retail exposures, small business retail exposures and other retail exposures to individuals.
- Equity Exposures
- Other exposures mainly include notes and coins, premises, plant and equipment and other assets.

(ii) Risk rating systems and control mechanisms

The Group's exposure to credit risk arises from a wide range of customers and product types. To measure and manage the risk in these exposures, both to distinct customer types or product categories, the Group employs diverse risk rating systems and methodologies: judgmental, analytical, and hybrids of the two.

A fundamental principle of the Group's policy and approach is that analytical risk rating systems and scorecards are decision tools facilitating management, serving ultimately judgemental decisions for which individual approvers are accountable. In case of automated decision making process, accountability rests with those responsible for the parameters built into those processes/systems and the controls surrounding their use. For individually assessed customers, the credit process provides for at least annual review of the facility granted. Review may be more frequent, as required by circumstances.

The Group adopts a set of standards that govern the process through which risk rating systems are initially developed, judged fit for purpose, approved and implemented, the conditions under which analytical risk model outcomes can be overridden by approvers; and the process of model performance monitoring and reporting. The framework emphasises on an effective dialogue between business line and risk management, suitable independence of decision takers and a good understanding and robust reflection on the part of senior management.

Analytical risk rating systems are not static and are subject to review and modification in light of the changing environment and the greater availability and quality of data. Processes are established to capture the relevant data for continuous model improvement.

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS *(unaudited) (continued)*

3 Credit risk under the internal ratings-based approach *(continued)*

(a) The internal rating system *(continued)*

(iii) Application of IRB parameters

The Group-wide credit risk rating framework incorporates probability of default ("PD", representing the likelihood of a default event in a one-year horizon) of an obligor and loss severity expressed in terms of exposures at default ("EAD", an estimate of exposures at time of default) and loss given default ("LGD", the estimates of loss that the Group may incur in the event of default expressed as a percentage of EAD). These measures are used to calculate expected loss and capital requirements. They are also used in conjunction with other inputs to form rating assessments for the purpose of credit approval and for risk management decisions.

For sovereign, bank and corporate exposures, PD models are developed based on historical loss data, combining both quantitative and qualitative data on financial and various aspects such as industry environment, economic and political conditions. PD for wholesale customers segments is estimated using a Customer Risk Rating ("CRR") of 23 grades, of which 21 are non-default ratings representing varying degrees of strength of financial condition, and two are default ratings. Credit score generated by a model and/or a scorecard for individual obligor, mapped to the corresponding Customer Risk Rating, is recommended to and reviewed by credit approver taking into account all relevant information (including external rating and market data where available) for risk rating determination. The approved CRR is mapped to a PD value range of which the "mid-point" is used in regulatory capital calculation. PD models are developed where the risk profile of corporate borrower is specific to a country or a region.

LGD and EAD estimation for wholesale business is subject to Group framework of basic principles. EAD is estimated to a 12-month horizon and broadly represents the current exposure plus an estimate for future drawdown on undrawn facilities and the crystallization of contingent exposures after default. LGD focuses on the facility and collateral structure which takes into account the priority/seniority of the facility, the type and value of the collateral and past experience on the type of counterparty, which is expressed as a percentage of EAD.

The Group uses supervisory slotting criteria approach in rating its regulatory specialised lending exposure. Under this approach, rating will be assigned based on the borrower and transaction characteristics.

For retail business including residential mortgage exposures, qualifying revolving retail exposures, small business retail exposures and other retail exposures to individuals, the PD models typically incorporate the characteristics of the products and the borrower's account behaviour.

EAD models are developed for retail revolving exposures to predict additional drawdown at the time of default, plus current outstanding balance. For non-revolving retail exposures such as residential mortgage, EAD is mainly estimated based on current outstanding balance and related interest.

LGD models for retail exposures are developed based on the Group's internal loss and default experience including recovery values for different types of collaterals for secured retail exposures such as residential mortgage; for unsecured retail exposures such as qualifying revolving retail exposures, LGD models are developed based on past recovery experiences, account behaviours and repayment ability.

For management information and reporting purposes, retail portfolios are segmented into 10 Expected Loss ("EL") bands facilitating comparability across retail customer segment and product types. EL band is derived through a combination of PD and LGD.

(iv) Model Governance

Model governance is under the oversight of HSBC Group or Regional Model Oversight Committee ("Group MOC" or "HBAP MOC"). Local Model Oversight Committee ("Local MOC") is established for Wholesale Credit and Market Risk ("WCMR") and Retail Banking and Wealth Management ("RBWM") respectively in the Bank with comparable terms of reference as Regional MOC. Local MOCs meet bi-monthly and report to Risk Management Committee. They are chaired by the Risk function, and its membership is drawn from Risk, Finance and Global Businesses.

Compliance with the Group and local standards for development, validation and implementation of credit risk models are subject to review by Independent Model Review Team and Internal Audit annually. Internal Audit also conducts regular reviews of the risk rating model application by credit and business groups.

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (unaudited) (continued)

3 Credit risk under the internal ratings-based approach (continued)

(a) The internal rating system (continued)

(v) Use of internal ratings

While internal estimates derived from applying the IRB approach are employed in the calculation of risk-weighted exposure amounts for the purpose of determining regulatory capital requirements, they are also used in a multitude of contexts within risk management and business processes. Such uses continue to develop and become embedded as experience grows and the repository of quality data improves. They include:

- credit approval: authorities, including those for specific counterparty types and transactions, are delegated to officers and executives in the Group's credit risk function and business division involving lending activities using a risk-based approach, tiered relative to obligor customer risk rating;
- credit risk analytical tools: IRB measures are valuable tools deployed in the assessment of customer and portfolio risk; migration of customer risk rating is one of the important indicators in credit monitoring process;
- pricing: pricing products commensurately with the level of risk and cost, e.g. customer relationship managers apply a risk adjusted return on capital methodology in risk-weighted assets and profitability calculators;
- portfolio management: regular reports to respective Portfolio Oversight Committees of wholesale credit risk and retail credit risk, and Risk Management Committee containing analyses of risk exposures employing IRB risk metrics, e.g. portfolio distribution by internal-credit grade, return on risk weighted asset; the monitoring on the distribution and planning on risk weighted asset are undertaken and reviewed by Capital Management Committee regularly.
- economic capital: IRB risk measures are essential components of the credit risk economic capital model, which are evaluated in the capital adequacy assessment process of the Group;
- stress testing: IRB risk measures are stressed to understand the sensitivities of the Group's capital management plan under adverse economic environment; and
- risk appetite: IRB risk capital and risk estimates are elements of the risk appetite and internal risk control measures of the Group.

(vi) Credit risk mitigation

The Group's approach when granting credit facilities is on the basis of capacity to repay, rather than primarily rely on credit risk mitigation. Depending on a customer's standing and the type of product, facilities may be provided on unsecured basis. Nevertheless, mitigation of credit risk is an important aspect of effective management and takes in many forms.

The Group's general policy is to promote the use of credit risk mitigation, justified by commercial prudence and good practice as well as capital efficiency. Policies covering the acceptability, structuring, control and valuation with regard to different types of collateral security are established to ensure that they are supported by evidence and continue to fulfil their intended purpose.

The main types of recognised collateral taken by the Group are those as stated in section 80 of the Capital Rules, including (but not limited to) cash on deposit, gold bullion, equities listed in a main index and/or a recognised exchange, collective investment schemes, various recognised debt securities, residential, industrial and commercial property, etc.

The Group's policy provides that netting is only to be applied where it has the legal right to do so. Consistent with the Capital Rules, only bilateral netting arrangements are included for capital adequacy credit risk mitigation calculation.

In terms of the application within IRB approach, credit risk mitigants are considered in two broad categories: first, those which reduce the intrinsic probability of default of an obligor and therefore operate as adjustments to PD estimation, and second, those which affect estimated recoverability of obligations and require adjustment of LGD. The first includes, for example, full parental or group company guarantees; the second, collateral security of various kinds such as cash, equity, properties, fixed assets such as motor vehicles, plant and machinery, stock and debtors, bank and sovereign guarantees, etc.

(b) Exposures subject to supervisory estimates

The following table indicates the exposure classes and the respective exposure amounts that are subject to supervisory estimates as at 31 December:

	2015	2014
IRB Exposure Class		
Sovereign exposures	-	-
Bank exposures	-	-
Corporate exposures	13,601	17,684
Total EAD	13,601	17,684

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (unaudited) (continued)

3 Credit risk under the internal ratings-based approach (continued)

(c) **Exposures by IRB calculation approach**

The table below shows the Group's exposures:

	Advanced IRB approach	Supervisory slotting criteria approach	Retail IRB approach	Specific risk-weight approach	Total exposures
2015					
Sovereign exposures	250,012	-	-	-	250,012
Bank exposures	156,992	-	-	-	156,992
Corporate exposures	437,633	13,601	-	-	451,234
Retail exposures:					
- Residential mortgages to individuals and property-holding shell companies	-	-	181,064	-	181,064
- Qualifying revolving retail exposures	-	-	93,385	-	93,385
- Small business retail exposures	-	-	5,080	-	5,080
- Other retail exposures to individuals	-	-	11,917	-	11,917
Equity exposures	-	-	-	11,482	11,482
Other exposures	-	-	-	50,299	50,299
	<u>844,637</u>	<u>13,601</u>	<u>291,446</u>	<u>61,781</u>	<u>1,211,465</u>
2014					
Sovereign exposures	190,619	-	-	-	190,619
Bank exposures	167,420	-	-	-	167,420
Corporate exposures	418,052	17,684	-	-	435,736
Retail exposures:					
- Residential mortgages to individuals and property-holding shell companies	-	-	167,240	-	167,240
- Qualifying revolving retail exposures	-	-	82,079	-	82,079
- Small business retail exposures	-	-	5,200	-	5,200
- Other retail exposures to individuals	-	-	10,993	-	10,993
Equity exposures	-	-	-	8,672	8,672
Other exposures	-	-	-	48,738	48,738
	<u>776,091</u>	<u>17,684</u>	<u>265,512</u>	<u>57,410</u>	<u>1,116,697</u>

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (unaudited) (continued)

3 Credit risk under the internal ratings-based approach (continued)

(d) Exposures by credit risk mitigation used

The table below shows the Group's exposures (after the effect of any on-balance sheet or off-balance sheet recognised netting) which are covered by recognised guarantees after the application of haircuts required under the Capital Rules. These exposures exclude derivative contracts and securities financing transactions.

	2015	2014
Portfolio		
Sovereign exposures	-	-
Bank exposures	5,635	4,601
Corporate exposures	159,481	153,295
Retail exposures	17,942	17,185
	<u>183,058</u>	<u>175,081</u>

For the class of sovereign exposures, there were no exposures covered by recognised guarantees.

(e) Risk assessment for exposures under IRB approach

The tables below detail the total EAD of sovereign, bank and corporate exposures by exposure-weighted average risk-weight, exposure-weighted average PD and exposure-weighted average LGD for each obligor grade as at 31 December.

(i) Sovereign, bank and corporate (other than specialised lending) exposures - analysis by obligor grade

The exposures at default disclosed below in respect of sovereign, bank and corporate exposures have taken into account the effect of recognised collateral, recognized netting, recognised guarantees and recognized credit derivative contracts.

	2015			
	Exposure-weighted average PD %	Exposure-weighted average LGD %	Exposure-weighted average risk-weight %	Exposure at default
Sovereign exposure				
Minimal default risk	0.02	30.19	4.38	248,091
Low default risk	0.11	44.98	20.46	1,921
				<u>250,012</u>
Bank exposure				
Minimal default risk	0.04	42.39	12.54	114,325
Low default risk	0.08	32.85	20.42	36,390
Satisfactory default risk	0.37	45.06	54.93	5,478
Fair default risk	0.92	45.02	94.03	759
Moderate default risk	2.94	29.97	97.92	17
Significant default risk	7.85	45.00	165.77	23
				<u>156,992</u>
Corporate exposure (other than specialised lending)				
Minimal default risk	0.04	38.14	15.58	19,241
Low default risk	0.11	43.21	29.02	83,517
Satisfactory default risk	0.42	37.70	51.60	197,300
Fair default risk	1.20	35.79	75.45	98,060
Moderate default risk	2.60	33.93	92.09	33,326
Significant default risk	5.98	36.92	122.45	3,394
High default risk	10.00	10.73	58.83	119
Special management	18.93	52.51	279.61	104
Default	100.00	40.85	-	2,572
				<u>437,633</u>

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (unaudited) (continued)

3 Credit risk under the internal ratings-based approach (continued)

(e) **Risk assessment for exposures under IRB approach** (continued)

(i) Sovereign, bank and corporate (other than specialised lending) exposures - analysis by obligor grade (continued)

	2014			
	Exposure-weighted average PD %	Exposure-weighted average LGD %	Exposure-weighted average risk-weight %	Exposure at default
Sovereign exposure				
Minimal default risk	0.02	21.43	3.50	138,721
Low default risk	0.07	45.00	17.08	51,898
				<u>190,619</u>
Bank exposure				
Minimal default risk	0.04	33.69	10.30	67,617
Low default risk	0.08	45.97	22.85	89,356
Satisfactory default risk	0.36	45.34	56.24	10,127
Fair default risk	1.20	45.28	86.42	136
Moderate default risk	4.15	45.00	157.37	125
Significant default risk	7.57	51.68	183.54	59
				<u>167,420</u>
Corporate exposure (other than specialised lending)				
Minimal default risk	0.04	42.00	14.75	12,868
Low default risk	0.10	42.36	28.80	97,323
Satisfactory default risk	0.41	39.86	53.63	187,023
Fair default risk	1.25	39.05	80.25	88,963
Moderate default risk	2.95	37.23	101.25	28,711
Significant default risk	6.24	23.35	84.72	814
High default risk	11.10	24.42	112.03	246
Special management	19.00	40.29	214.38	82
Default	100.00	45.61	-	2,022
				<u>418,052</u>

(ii) Corporate exposures (specialised lending) - analysis by supervisory rating grade

	2015		2014	
	Exposure-weighted average risk-weight %	Exposure at default	Exposure-weighted average risk-weight %	Exposure at default
Obligor Grade				
Strong	63.92	11,766	63.48	15,196
Good	85.52	1,738	87.73	2,311
Satisfactory	121.90	97	121.90	177
Weak	-	-	-	-
		<u>13,601</u>		<u>17,684</u>

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (unaudited) (continued)

3 Credit risk under the internal ratings-based approach (continued)

(e) **Risk assessment for exposures under IRB approach** (continued)

(iii) Retail exposures - analysis by credit quality

The table below shows a breakdown of exposures (the EAD of on-balance sheet exposures and off-balance sheet exposures) on a pool basis by credit quality classification:

	Residential mortgages	Qualifying revolving retail exposures	Small business retail exposures	Other retail exposures	Total exposures
2015					
Strong	180,408	78,210	5,080	8,774	272,472
Medium	541	14,595	-	2,977	18,113
Sub-standard	-	519	-	113	632
Impaired	115	61	-	53	229
	<u>181,064</u>	<u>93,385</u>	<u>5,080</u>	<u>11,917</u>	<u>291,446</u>
2014					
Strong	166,608	68,617	5,200	7,959	248,384
Medium	513	13,004	-	2,900	16,417
Sub-standard	-	407	-	111	518
Impaired	119	51	-	23	193
	<u>167,240</u>	<u>82,079</u>	<u>5,200</u>	<u>10,993</u>	<u>265,512</u>

(iv) Undrawn commitments

The table below shows the amount of undrawn commitments and exposure-weighted average EAD for sovereign, bank and corporate exposures as at 31 December:

	2015		2014	
	Undrawn commitments	Exposure-weighted average EAD	Undrawn commitments	Exposure-weighted average EAD
Sovereign exposures	-	-	-	-
Bank exposures	448	218	348	108
Corporate exposures	159,361	45,222	133,554	38,867
	<u>159,809</u>	<u>45,440</u>	<u>133,902</u>	<u>38,975</u>

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS *(unaudited) (continued)*

3 Credit risk under the internal ratings-based approach *(continued)*

(f) Analysis of actual loss and estimates

The table below set out, for each IRB exposure class, the actual loss experience reflected in impairment charge. Impairment charges are the net charge for actual losses for each IRB class made during the year.

	2015	2014
Exposure Class		
Sovereign	-	-
Bank	-	-
Corporate	867	585
Residential mortgage	-	(5)
Qualifying revolving retail	561	510
Other retail	224	139
	<u>1,652</u>	<u>1,229</u>

Actual impairment charges increased in 2015 due to higher impairment charges of corporate and personal loan portfolios in Hong Kong.

The table below set out, for each IRB exposure class, the expected loss ("EL") which is the estimated loss likely to be incurred arising from the potential default of the obligor in respect of the exposure over a one-year period.

	31 December 2014	31 December 2013
Exposure Class		
Sovereign	23	29
Bank	63	64
Corporate	2,114	1,691
Residential mortgage	87	76
Qualifying revolving retail	969	525
Other retail	210	173
	<u>3,466</u>	<u>2,558</u>

It should be noted that actual loss and EL are measured and calculated using different methodologies which may not be directly comparable. In general, EL is greater than impairment charges. The limitation arises mainly from the fundamental differences in the definition of "loss" under the accounting standards which determine impairment charges by reflecting the current circumstances and specific cashflow expectations of a customer, and the Basel III framework which determines the regulatory EL calculation on a forward looking basis using modelled estimates.

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (unaudited) (continued)

3 Credit risk under the internal ratings-based approach (continued)

(f) Analysis of actual loss and estimates (continued)

The tables below set out the comparison of the predicted risk estimates of the Group's credit risk models against actual outcomes of the wholesale and retail exposures.

(i) Wholesale exposures

Risk estimates as at 31 December 2014 against actual outcome for the year 2015

	PD		LGD		EAD	
	Actual %	Estimated %	Actual %	Estimated %	Actual %	Estimated %
Sovereign exposure	-	0.05	-	27.84	-	100.00
Bank exposure	-	0.25	-	37.07	-	99.86
Corporate exposure	0.81	1.11	46.50	39.94	73.12	81.37

Risk estimates as at 31 December 2013 against actual outcome for the year 2014

	PD		LGD		EAD	
	Actual %	Estimated %	Actual %	Estimated %	Actual %	Estimated %
Sovereign exposure	-	0.06	-	45.00	-	100.00
Bank exposure	-	0.33	-	31.58	-	98.15
Corporate exposure	0.57	1.17	44.21	42.88	79.92	79.08

The actual PD rate is measured using the number of obligor defaulted during the reporting period whereas the estimated PD rate is the long run average default rate estimated at the beginning of the reporting period. The PD estimated by internal model is calibrated to the Group's long run default experience. Hence, actual default rate in a particular year ("point-in-time") will typically differ from the estimated PD which is the "through the cycle" estimates as economies move above or below cyclical norms.

The estimated LGD is the exposure weighted average LGD for the portfolio, adjusted by a downturn factor, as of the beginning of the reporting period whereas the actual LGD is computed using the resolved default cases accumulated in 2015 which covers cases defaulted in or before 2015. No default and loss has been observed for Bank and Sovereign exposures during the reporting period.

The estimated EAD% represents the ratio of total model estimated exposure values to total limits for the portfolio at the beginning of the reporting period. The actual EAD% compares the realised EAD of the resolved default cases accumulated in 2015 which covers cases defaulted in or before 2015 to the limits 1 year prior to default.

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (*unaudited*) (*continued*)

3 Credit risk under the internal ratings-based approach (*continued*)

(f) Analysis of actual loss and estimates (*continued*)

(ii) Retail exposures

Risk estimates as at 31 December 2014 against actual outcome for the year 2015

	PD		LGD		EAD	
	Actual %	Estimated %	Actual %	Estimated %	Actual %	Estimated %
Residential mortgages to individuals and property-holding shell companies	0.13	0.51	0.63	10.15	96.13	100.00
Qualifying revolving retail exposures	0.42	0.67	83.54	93.11	78.58	88.87
Small business retail exposures	0.22	0.63	3.88	5.52	96.62	100.00
Other retail exposures to individuals	2.49	2.72	62.95	82.49	77.67	99.49

Risk estimates as at 31 December 2013 against actual outcome for the year 2014

	PD		LGD		EAD	
	Actual %	Estimated %	Actual %	Estimated %	Actual %	Estimated %
Residential mortgages to individuals and property-holding shell companies	0.13	0.49	0.58	10.45	92.57	100.00
Qualifying revolving retail exposures	0.42	0.54	84.79	93.27	82.08	90.33
Small business retail exposures	0.05	0.58	0.02	32.70	96.58	100.00
Other retail exposures to individuals	2.31	2.60	68.25	84.52	80.41	98.14

The actual and estimated PD rate are measured in the same ways as wholesale exposure.

The actual LGD for the retail exposures takes into account the 24-months recovery period and represents the realised LGD for cases defaulted during 2013 which were recovered within 24 months after default. The estimated LGD is the exposure weighted average LGD for the defaulted cases estimated prior to default.

The estimated EAD% represents the ratio of total model estimated EAD to total limits for cases defaulted during 2015 whereas the actual EAD% compares the exposure values of the cases defaulted in 2015 at the time of default against the maximum limit 1 year prior to default.

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS *(unaudited) (continued)*

4 Credit risk under the standardised (credit risk) approach

(a) Ratings from External Credit Assessment Institutions ("ECAIs")

The Group uses the following ECAIs to calculate its capital adequacy requirements under the standardised (credit risk) approach prescribed in the Capital Rules:

- Fitch Ratings
- Moody's Investors Service
- Standard & Poor's Ratings Services

Where exposures have been rated by the above-mentioned ECAIs, they are categorised under the following class of exposures:

- Sovereign exposures
- Public sector entity exposures
- Bank exposures
- Securities firm exposures
- Corporate exposures
- Collective investment scheme exposures

The process used to map ECAIs issuer ratings or ECAIs issue specific ratings in the Group's banking book is consistent with those prescribed in the Capital Rules.

(b) Credit risk mitigation

As stated in sections 98 and 99 of the Capital Rules, certain guarantees and credit derivative contracts are recognised for credit risk mitigation purposes. The main types of guarantees are from sovereigns, corporate and banks. With corporate guarantees, in order for it to be recognised as a credit risk mitigants, it must have a credit rating of A- or better by Standard & Poor's Ratings Services, Fitch Ratings or a credit rating of A3 or better by Moody's Investors Service.

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (unaudited) (continued)

4 Credit risk under the standardised (credit risk) approach (continued)

(c) Credit risk exposures under the standardised (credit risk) approach

Class of exposures	Total exposures*	Exposures after recognised credit risk mitigation		Risk-weighted amounts		Total risk-weighted amounts	Total exposures covered by recognised collateral	Total exposures covered by recognised guarantees or recognised credit derivative contracts
		Rated	Unrated	Rated	Unrated			
2015								
On-balance sheet								
Sovereign	-	2,542	-	-	-	-	-	-
Public sector entity	20,527	17,852	346	1,501	146	1,647	-	2,330
Bank	18	-	18	-	12	12	-	-
Securities firm	-	-	-	-	-	-	-	-
Corporate	23,793	-	21,218	-	21,218	21,218	2,364	217
Collective investment scheme	-	-	-	-	-	-	-	-
Regulatory retail Residential mortgage loan	6,541	-	5,799	-	4,349	4,349	742	-
Other exposures which are not past due exposures	5,059	-	2,144	-	2,144	2,144	2,914	-
Past due exposures	345	1	344	-	463	463	100	3
	<u>77,181</u>	<u>20,395</u>	<u>50,703</u>	<u>1,501</u>	<u>37,985</u>	<u>39,486</u>	<u>6,183</u>	<u>2,550</u>
Off-balance sheet								
Off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts	2,287	-	2,111	-	2,009	2,009	176	8
OTC derivative contracts	504	-	504	-	491	491	-	-
Credit derivative contracts	-	-	-	-	-	-	-	-
Other off-balance sheet exposures not elsewhere specified	-	-	-	-	-	-	-	-
	<u>2,791</u>	<u>-</u>	<u>2,615</u>	<u>-</u>	<u>2,500</u>	<u>2,500</u>	<u>176</u>	<u>8</u>
Total	<u>79,972</u>	<u>20,395</u>	<u>53,318</u>	<u>1,501</u>	<u>40,485</u>	<u>41,986</u>	<u>6,359</u>	<u>2,558</u>
Exposures risk-weighted at 1,250%	<u>-</u>							

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

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (unaudited) (continued)

4 Credit risk under the standardised (credit risk) approach (continued)

(c) **Credit risk exposures under the standardised (credit risk) approach** (continued)

Class of exposures	Total exposures*	Exposures after recognised credit risk mitigation		Risk-weighted amounts		Total risk-weighted amounts	Total exposures covered by recognised collateral	Total exposures covered by recognised guarantees or recognised credit derivative contracts
		Rated	Unrated	Rated	Unrated			
2014								
On-balance sheet								
Sovereign	-	935	289	-	-	-	-	-
Public sector entity	9,984	8,690	360	738	150	888	-	935
Bank	13	-	230	-	113	113	-	-
Securities firm	-	-	-	-	-	-	-	-
Corporate	21,523	-	19,214	-	19,214	19,214	1,806	503
Collective investment scheme	-	-	-	-	-	-	-	-
Regulatory retail	5,204	-	4,492	-	3,369	3,369	709	3
Residential mortgage loan	18,225	-	18,194	-	8,794	8,794	30	1
Other exposures which are not past due exposures	4,310	-	1,887	-	1,887	1,887	2,423	-
Past due exposures	130	-	130	-	178	178	23	3
	<u>59,389</u>	<u>9,625</u>	<u>44,796</u>	<u>738</u>	<u>33,705</u>	<u>34,443</u>	<u>4,991</u>	<u>1,445</u>
Off-balance sheet								
Off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts	3,029	-	2,926	-	2,653	2,653	103	3
OTC derivative contracts	476	-	476	-	461	461	-	-
Credit derivative contracts	-	-	-	-	-	-	-	-
Other off-balance sheet exposures not elsewhere specified	-	-	-	-	-	-	-	-
	<u>3,505</u>	<u>-</u>	<u>3,402</u>	<u>-</u>	<u>3,114</u>	<u>3,114</u>	<u>103</u>	<u>3</u>
Total	<u>62,894</u>	<u>9,625</u>	<u>48,198</u>	<u>738</u>	<u>36,819</u>	<u>37,557</u>	<u>5,094</u>	<u>1,448</u>
Exposures risk-weighted at 1,250%	<u>-</u>							

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

5 Counterparty credit risk-related exposures

- (a) Counterparty credit risk arises from securities financing transactions and derivative contracts (referred as "relevant transaction") hereunder. It is calculated in both the trading and non-trading books, and is the risk that counterparty to a transaction may default before completing the satisfactory settlement of the transaction.

Credit equivalent amount and risk-weighted amount of relevant transaction is determined following the regulatory capital requirements. Risk-weighted amount is calculated in accordance with the counterparty risk weighting as per internal ratings-based approach/standardised (credit risk) approach under the Capital Rules.

In respect of the counterparty credit risk exposures arising from relevant transaction, all credit limits are established in advance of transaction. Credit and settlement risk is captured, monitored and reported in accordance with the Group risk methodologies. Credit exposures are divided into two categories: (1) exposure measures in book or market value terms depending on the product involved; and (2) exposure measures on the basis of 95 percentile potential worst case loss estimates. These methods of calculating credit exposure apply to all counterparties and differences in credit quality are reflected in the size of the limits.

The Group adopts the current exposure method to determine its exposures to counterparty credit risk to over-the-counter ("OTC") derivative transactions.

Collateral arrangements

The policy for secured collateral on derivatives is guided by the Group's internal Best Practice Guidelines ensuring that the due diligence necessary to understand the effectiveness of netting and collateralisation by jurisdiction, counterparty, product and agreement type is assessed and that due-diligence standards are consistently applied.

Credit ratings downgrade

The credit ratings downgrade language in a Master Agreement or Credit Support Annexes defines the series of events that are triggered if the credit rating of the affected party falls below a specified level.

Under the terms of our current collateral obligations under derivative contracts, we estimate based on the positions as at 31 December 2015 that the Bank would not be required to post additional collateral in the event of one or two notch downgrade in the Bank's credit ratings (2014: Nil).

Wrong-way risk

Wrong-way risk occurs when a counterparty's exposures are adversely correlated with its credit quality. There are two types of wrong-way risk.

General wrong-way risk occurs when the probability of counterparty default is positively correlated with general risk factors such as where the counterparty is resident and/or incorporated in a higher-risk country and seeks to sell a non-domestic currency in exchange for its home currency.

Specific wrong-way risk occurs when the exposure to a particular counterparty is positively correlated with the probability of counterparty default such as a reverse repo on the counterparty's own bonds. Group policy sets out that specific wrong-way transactions are approved on a case by case basis.

We monitor and control wrong-way risk, including requiring the business to obtain prior approval before undertaking wrong-way risk transactions outside pre-agreed guidelines. The Traded Risk functions are responsible for the control and the monitoring process. This includes the monthly submission of wrong-way risk information to Regional Risk and Risk Management Committee.

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (unaudited) (continued)

5 Counterparty credit risk-related exposures (continued)

(b) Counterparty credit risk exposures

The following tables show the counterparty credit risk exposures under the internal-ratings based approach and standardised (credit risk) approach.

(i) Counterparty credit risk exposures under the internal-ratings based approach

	2015		2014	
	Derivative contracts*	Securities financing transactions**	Derivative contracts*	Securities financing transactions**
Gross total positive fair value	10,814	-	6,684	-
Default risk exposures, net of bilateral netting	12,402	187	12,486	9
Default risk exposures, net of cross-product netting	-	-	-	-
Recognised collateral held by type:				
Debt securities	-	2,316	-	1,298
Others	330	-	238	-
	<u>330</u>	<u>2,316</u>	<u>238</u>	<u>1,298</u>
Default risk exposures, net of recognised collateral held	<u>12,402</u>	<u>187</u>	<u>12,486</u>	<u>9</u>
Risk-weighted amounts	<u>7,053</u>	<u>12</u>	<u>7,336</u>	<u>-</u>
Notional amount of recognised credit derivative contracts which provide credit protection	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

*For OTC derivative contracts, the recognised collateral is reflected in LGD.

**For repo-style transactions, the recognised collateral is netted against EAD

(ii) Counterparty credit risk exposures under the standardised (credit risk) approach

There were no outstanding securities financing transactions at 31 December 2015 (2014: Nil).

	2015	2014
Derivative contracts:		
Gross total positive fair value	248	196
Default risk exposures, net of bilateral netting	504	476
Default risk exposures, net of cross-product netting	-	-
Recognised collateral held by type:		
Debt securities	-	-
Others	-	-
	<u>-</u>	<u>-</u>
Default risk exposures, net of recognised collateral held	<u>504</u>	<u>476</u>
Risk-weighted amount	<u>491</u>	<u>461</u>
Notional amount of recognised credit derivative contracts which provide credit protection	<u>-</u>	<u>-</u>

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS *(unaudited) (continued)*

5 Counterparty credit risk-related exposures *(continued)*

(c) Major classes of exposures by counterparty type

(i) Major classes of exposures under the internal ratings-based approach by counterparty type

	2015			2014		
	Contract amount	Credit equivalent amount	Risk-weighted amount	Contract amount	Credit equivalent amount	Risk-weighted amount
Sovereign	-	-	-	-	-	-
Public sector entities	-	-	-	-	-	-
Banks	901,321	7,564	1,722	792,252	6,179	1,540
Corporates	83,278	5,025	5,343	128,317	6,316	5,796
	<u>984,599</u>	<u>12,589</u>	<u>7,065</u>	<u>920,569</u>	<u>12,495</u>	<u>7,336</u>

(ii) Major classes of exposures under the standardised (credit risk) approach by counterparty type

	2015			2014		
	Contract amount	Credit equivalent amount	Risk-weighted amount	Contract amount	Credit equivalent amount	Risk-weighted amount
Sovereign	-	-	-	-	-	-
Public sector entities	-	-	-	-	-	-
Banks	-	-	-	-	-	-
Corporates	6,724	504	491	7,127	476	461
	<u>6,724</u>	<u>504</u>	<u>491</u>	<u>7,127</u>	<u>476</u>	<u>461</u>

The Group had no credit exposures that are risk-weighted at 1250% at 31 December 2015 (2014: Nil).

6 Asset securitisation

There was no asset securitisation for which the Group is an originating institution or an investing institution at 31 December 2015 (2014: Nil).

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (unaudited) (continued)

7 Market risk

- (a) Market risk is the risk that movements in market factors, including foreign exchange rates, interest rates, credit spreads or equity and commodity prices will result in profits or losses to the Group. The Hong Kong Monetary Authority has granted approval under sections 18(2)(a) and 18(5) of the Capital Rules for the Group to use the internal models approach to calculate its market risk for the risk categories of foreign exchange and general interest rate. Standardised approach is used for the calculation of specific interest rate risk, equity risk and commodity risk.

The Group's market risk capital requirement under the internal models approach uses value at risk ('VAR') and stressed VAR.

	2015	2014
Market risk calculated by:		
- Internal models approach:		
-- VAR	284	130
-- Stressed VAR	705	275
- Standardised approach:		
-- specific interest rate exposures	107	55
-- equity exposures	-	-
-- commodity exposures	-	-
Total capital charge for market risk	<u>1,096</u>	<u>460</u>

Capital charge means an amount of regulatory capital which the Group is required to hold for an exposure to a relevant risk which, if multiplied by 12.5, becomes the risk-weighted amount of that exposure for that risk.

- (b) Methodology for valuation of market risk position under internal model approach

VAR is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. A Historical Simulation approach is used to model foreign currency and interest rate risk. Standard 1-day VAR is generated by revaluing the portfolio for each of 500 historical scenarios from one-day market movements, and is derived from a clean two-year time series of historic market risk factor data. Apart from the standard 1-day VAR, the Group has introduced stressed VAR since the start of 2012 according to the Basel 2.5 requirement. Stressed VAR is the measure of VAR using a continuous one-year historical period of significant stress for the trading portfolio, assuming a 10-day holding period.

- (c) Characteristics and coverage of VAR model

The VAR and stressed VAR models cover all material sources of price risk relating to foreign exchange risk and general interest rate risk. Foreign exchange risk factors include, but are not limited to, foreign currency prices and foreign currency option volatilities. General interest rate risk factors include, but are not limited to, interest rate curves and interest rate option volatilities.

Historical simulation approach is used for all outright interest rate and foreign exchange in VAR calculation. Standard VAR uses a 99% confidence interval and a one day time horizon based on 500 historical scenarios. The result is then scaled up to a ten day holding period. Stressed VAR uses a 10-day holding period and a 99% confidence interval based on a continuous one-year historical significant stress period.

Historical, hypothetical and technical scenario stress testing is performed on positions on a bi-weekly basis. Back-testing of the interest rate and foreign exchange uses clean and hypothetical profits and losses from trading operations and compares these to overall and individual business level VAR on a daily basis.

Add-ons are used to capture the risks that are not adequately captured in the VAR models. The add-ons include, but are not limited to, interest rate basis risks on LIBOR tenor and bond futures. These add-ons are calibrated at least as conservatively as comparable risk factors under the internal models approach.

8 Operational risk

The Hong Kong Monetary Authority has granted approval under section 25(2) of the Capital Rules for the Group to use the standardised approach to calculate its operational risk.

	2015	2014
Capital charge for operational risk	<u>3,922</u>	<u>3,643</u>

Capital charge means an amount of regulatory capital which the Group is required to hold for an exposure to a relevant risk which, if multiplied by 12.5, becomes the risk-weighted amount of that exposure for that risk.

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (unaudited) (continued)

9 Equity exposures in banking book

Investments in equity shares which are intended to be held on a continuing basis, but which do not comprise investments in associates, jointly controlled entities or subsidiaries, are classified as available-for-sale securities and are reported in the balance sheet as "Financial investments". Available-for-sale securities are measured at fair value as described in notes 3(g)(i) and 3(h) to the financial statements. Included within this category are investments made by the Group for strategic purposes, which are subject to additional internal procedures and approvals to ensure that the investment is in accordance with the Group's strategy and to ensure compliance with all relevant regulatory and legal restrictions. In some cases, additional investments may be made later such that the investee becomes an associate, jointly controlled entity or subsidiary, at which point the investment is reclassified in accordance with the Group's accounting policies.

	2015	2014
Cumulative realised gains/ (losses)		
- on disposal	10,636	33
- due to impairment	-	(2,188)
Unrealised gains:		
- recognised in reserve but not through the income statement	1,895	16,733

10 Disclosure for selected exposure

Involvement with Special Purpose Entities ("SPEs")

From time to time, the Group enters into certain transactions with customers in the ordinary course of business which involve the establishment of SPEs. The use of SPEs is not a significant part of the Group's activities and the Group is not reliant on SPEs for any material part of its business operations or profitability.

11 Analysis of gross loans and advances to customers by categories based on internal classification used by the Group

Gross advances, overdue advances, impaired advances, individually assessed and collectively assessed loan impairment allowances, the amount of new impairment allowances charged to income statement, and the amount of impaired loans and advances written off during the year in respect of industry sectors which constitute not less than 10 per cent of gross loans and advances to customers are analysed as follows:

	Gross advances	Overdue advances	Impaired advances	Individually assessed loan impairment allowances	Collectively assessed loan impairment allowances	New impairment allowances	Advances written off during the year
2015							
Residential mortgages	181,461	112	177	(10)	(4)	4	-
Commercial, industrial and international trade	164,391	1,671	1,970	(787)	(536)	855	670
Commercial real estate	86,006	208	50	(1)	(3)	2	1
Other property-related lending	134,486	-	284	-	(14)	3	-
2014							
Residential mortgages	165,481	60	193	(11)	-	11	7
Commercial, industrial and international trade	158,231	883	1,583	(963)	(599)	848	263
Commercial real estate	87,882	27	44	-	(3)	-	-
Other property-related lending	126,112	-	19	-	(16)	5	1

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (*unaudited*) (*continued*)

12 Mainland activities exposures

The analysis of mainland activities exposures is based on the categories of non-bank counterparties and the type of direct exposures defined by the Hong Kong Monetary Authority ("HKMA") under the Banking (Disclosure) Rules with reference to the HKMA Return of Mainland activities. This includes the mainland activities exposures extended by the Bank and its mainland banking subsidiary.

	On-balance sheet exposure	Off-balance sheet exposure	Total exposures
2015			
1. Central government, central government-owned entities and their subsidiaries and joint ventures (JVs)	48,144	9,643	57,787
2. Local governments, local government-owned entities and their subsidiaries and JVs	26,278	5,002	31,280
3. PRC nationals residing in Mainland China or other entities incorporated in Mainland China and their subsidiaries and JVs	60,665	21,172	81,837
4. Other entities of central government not reported in item 1 above	3,514	1,513	5,027
5. Other entities of local governments not reported in item 2 above	4,486	168	4,654
6. PRC nationals residing outside Mainland China or entities incorporated outside Mainland China where the credit is granted for use in Mainland China	48,518	3,158	51,676
7. Other counterparties where the exposures are considered by the reporting institution to be non-bank Mainland China exposures	10,611	24	10,635
	<u>202,216</u>	<u>40,680</u>	<u>242,896</u>
Total assets after provision	<u>1,231,738</u>		
On-balance sheet exposures as percentage of total assets	<u>16.42%</u>		
2014 (restated) #			
1. Central government, central government-owned entities and their subsidiaries and joint ventures (JVs)	64,581	10,465	75,046
2. Local governments, local government-owned entities and their subsidiaries and JVs	27,493	4,751	32,244
3. PRC nationals residing in Mainland China or other entities incorporated in Mainland China and their subsidiaries and JVs	54,404	18,934	73,338
4. Other entities of central government not reported in item 1 above	4,744	1,055	5,799
5. Other entities of local governments not reported in item 2 above	3,762	949	4,711
6. PRC nationals residing outside Mainland China or entities incorporated outside Mainland China where the credit is granted for use in Mainland China	43,123	3,113	46,236
7. Other counterparties where the exposures are considered by the reporting institution to be non-bank Mainland China exposures	8,271	10	8,281
	<u>206,378</u>	<u>39,277</u>	<u>245,655</u>
Total assets after provision	<u>1,183,020</u>		
On-balance sheet exposures as percentage of total assets	<u>17.45%</u>		

The comparative figures for the year ended 31 December 2014 have been restated to align with current period's disclosure and the HKMA requirements.

SUPPLEMENTARY NOTES TO THE FINANCIAL STATEMENTS (unaudited) (continued)

13 International claims

The Group's country risk exposures in the table below are prepared in accordance with the Hong Kong Monetary Authority's (HKMA) Return of International Banking Statistics - (MA(BS)21) guidelines. International claims are on-balance sheet exposures to counterparties based on the location of the counterparties after taking into account the transfer of risk, and represent the sum of cross-border claims in all currencies and local claims in foreign currencies.

The table shows claims on individual countries and territories or areas, after recognised risk transfer, amounting to not less than 10% of the group's total international claims.

There are changes of reporting basis and the categorisation on the types of counterparties as required by the HKMA in 2015, hence the disclosures reported in the year of 2014 are not directly comparable.

	Banks	Official Sector	Non Bank Financial Institution	Non-Financial Private Sector	Others	Total
2015						
Developed countries	74,451	91,609	12,047	39,007	-	217,114
Offshore centres	16,110	2,244	12,924	112,334	-	143,612
of which : Hong Kong SAR	2,589	1,353	3,728	87,461	-	95,131
Developing Asia and Pacific	82,746	10,675	6,425	53,685	-	153,531
of which : China	54,388	10,619	5,177	46,620	-	116,804

	Banks & other financial institutions	Public sector entities	Sovereign & other	Total
2014				
Asia-Pacific excluding Hong Kong:				
- China	87,611	-	67,491	155,102
- Japan	14,765	-	20,638	35,403
- Other	42,814	2,713	24,443	69,970
	145,190	2,713	112,572	260,475
Americas	8,387	1,621	25,429	35,437
Europe	20,887	8,736	20,027	49,650

ANALYSIS OF SHAREHOLDERS

As at 31 December 2015	Shareholders		Number of Shares	
	Number	Percentage of total	Number in millions	Percentage of total
Number of shares held				
1 - 500	6,486	34.09	1.5	0.08
501 - 2,000	5,930	31.17	7.3	0.38
2,001 - 5,000	3,102	16.30	10.6	0.56
5,001 - 20,000	2,639	13.87	27.0	1.41
20,001 - 50,000	577	3.03	17.9	0.94
50,001 - 100,000	159	0.84	11.3	0.59
100,001 - 200,000	73	0.38	10.6	0.56
Over 200,000	60	0.32	1,825.6	95.48
	19,026	100.00	1,911.8	100.00

Geographical Distribution

Hong Kong	18,732	98.45	1,908.9	99.84
Malaysia	59	0.31	0.4	0.02
Canada	46	0.24	0.1	0.01
United States of America	33	0.17	0.2	0.01
Singapore	41	0.22	1.9	0.10
United Kingdom	31	0.16	0.0	0.00
Australia	28	0.15	0.1	0.00
Macau	30	0.16	0.1	0.01
Others	26	0.14	0.1	0.01
	19,026	100.00	1,911.8	100.00

SUBSIDIARIES *

Fulcher Enterprises Company Limited
Hang Seng Bank (China) Limited
Hang Seng Bank (Trustee) Limited
Hang Seng Bullion Company Limited
Hang Seng Credit Limited
Hang Seng Data Services Limited
Hang Seng Finance Limited
Hang Seng Financial Information Limited
Hang Seng Futures Limited
Hang Seng Indexes Company Limited
Hang Seng Insurance Company Limited
Hang Seng Investment Management Limited
Hang Seng Investment Services Limited
Hang Seng Life Limited
Hang Seng (Nominee) Limited
Hang Seng Real Estate Management Limited
Hang Seng Security Management Limited
Hang Seng Securities Limited
Haseba Investment Company Limited
High Time Investments Limited
HSI International Limited
Imenson Limited
Yan Nin Development Company Limited

* As defined in Section 15 of the Hong Kong Companies Ordinance (Cap 622).

DIRECTORS OF SUBSIDIARIES

The names of Directors who have served on the Boards of the Bank's subsidiaries during the year ended 31 December 2015, or during the period from the end of year 2015 to 22 February 2016, being the date of the Report of Directors of this Annual Report, are set out below:

CHAN Lik Sang Nixon
CHAN Shuk Pui Ivy
CHAN Yiu Cheong
CHEN Charng Terk Alex*
CHEUNG Ho Fai Derek
CHEUNG Yiu Kwong Ralph
CHUNG Wai Yee Betty
ERH Chung Kei Johnson
FUNG Hau Chung Andrew
GOMES TEIXEIRA Marcelo*
HARVEY-SAMUEL Guy Daniel*
HO Hing Nin Christopher
JIA Tingyu
JIN Fang
KWAN Wing Shing Vincent
LAM Louise
LAM Wai Chung Gordon
LAM Yin Shing Donald
LAU Chuen Chung*
LEE Pui Shan Rosita
LEE Wai Mun Rose
LEUNG Kit Yee Jeannie
LEUNG Wing Lok Andrew
LI Chi Chung Godwin
LI Chi Kwong Jason
LIANG Chun Fei Belle
LIN Yik Kwong Ronald
LU Yongwei
LUK Sai Lung
LUK Ting Lung Alan
NG Man Wai Ryan
NGAN Man Kit Dave
PANG Yiu Hung Victor
POON Chun Ming David
POON Sun Cheong Patrick
PUN Tze Wah Patrick
SIN Pui Pik Jasmine
TAM Chi Kok Gabriel
TAM Lai King Peggy
TANG Chee Ping Wilson
TSUI Chun Man Thomas
WONG Wai Hung Daniel
YIU Pak Chow*

* *He/She has resigned/ceased as a Director of the relevant subsidiary(ies) of the Bank.*

CORPORATE INFORMATION AND CALENDAR

CORPORATE INFORMATION

BOARD OF DIRECTORS

Chairman

Raymond K F Ch'ien GBS, CBE, JP

Vice-Chairman

Rose W M Lee JP

Directors

John C C Chan GBS, JP

Nixon L S Chan

Patrick K W Chan

Henry K S Cheng GBS

L Y Chiang JP

Andrew H C Fung JP

Fred Zulu Hu

Irene Y L Lee

Sarah C Legg

Eric K C Li GBS, OBE, JP

Vincent H S Lo GBS, JP

Kenneth S Y Ng

Richard Y S Tang BBS, JP

Peter T S Wong JP

Michael W K Wu

Secretary

C C Li

REGISTERED OFFICE

83 Des Voeux Road Central, Hong Kong

Website: www.hangseng.com

Email: hangseng@computershare.com.hk

STOCK CODE

The Stock Exchange of Hong Kong Limited: 11

REGISTRAR

Computershare Hong Kong Investor Services Limited
Shops 1712-1716, 17th Floor, Hopewell Centre
183 Queen's Road East, Wanchai, Hong Kong

DEPOSITARY *

BNY Mellon Shareowner Services
PO Box 30170
College Station, TX 77842-3170, USA
Telephone: 1-201-680-6825
Toll free (domestic): 1-888-BNY-ADRS
Website: www.mybnymdr.com
Email: shrrelations@cpushareownerservices.com

* The Bank offers investors in the United States a Sponsored Level-1 American Depositary Receipts Programme through The Bank of New York Mellon Corporation.

ANNUAL REPORT 2015

This Annual Report 2015 in both English and Chinese is now available in printed form and on the Bank's website (www.hangseng.com) and the website of Hong Kong Exchanges and Clearing Limited ("HKEx") (www.hkexnews.hk).

Shareholders who:

A) browse this Annual Report 2015 on the Bank's website and wish to receive a printed copy; or
B) receive this Annual Report 2015 in either English or Chinese and wish to receive a printed copy in the other language version,
may send a request form, which can be obtained from the Bank's Registrar or downloaded from the Bank's website (www.hangseng.com) or HKEx's website (www.hkexnews.hk), to the Bank's Registrar:

Computershare Hong Kong Investor Services Limited
17M Floor, Hopewell Centre
183 Queen's Road East
Wanchai, Hong Kong
Facsimile: (852) 2529 6087
Email: hangseng@computershare.com.hk

If shareholders who have chosen (or are deemed to have chosen) to read this Annual Report 2015 on the Bank's website have difficulty in reading or gaining access to this Annual Report 2015 via the Bank's website for any reason, the Bank will promptly send this Annual Report 2015 in printed form free of charge upon the shareholders' request.

Shareholders may change their choice of means of receipt or language of the Bank's future corporate communications at any time, free of charge, by giving the Bank c/o the Bank's Registrar reasonable notice in writing or by email to hangseng@computershare.com.hk.

CALENDAR

2015 Full Year Results

Announcement date 22 February 2016

2015 Fourth Interim Dividend and Special Interim Dividend*

Announcement date 22 February 2016

Book close and record date 9 March 2016

Payment date 29 March 2016

2015 Annual Report

to be posted to shareholders in late March 2016

Annual General Meeting

to be held on 6 May 2016

Tentative date for 2016 Half Year Results

Announcement date 5 August 2016

2016 Interim Report

tentative to be posted to shareholders in late August 2016

Tentative dates for 2016:

2016 First Interim Dividend

Announcement date 3 May 2016

Book close and record date 19 May 2016

Payment date 7 June 2016

2016 Second Interim Dividend

Announcement date 5 August 2016

Book close and record date 23 August 2016

Payment date 13 September 2016

2016 Third Interim Dividend

Announcement date 3 October 2016

Book close and record date 20 October 2016

Payment date 8 November 2016

2016 Full Year Results

Announcement date 20 February 2017

2016 Fourth Interim Dividend

Announcement date 20 February 2017

Book close and record date 8 March 2017

Payment date 28 March 2017

* The Register of Shareholders of the Bank will be closed on Wednesday, 9 March 2016, during which no transfer of shares can be registered. To qualify for the fourth interim dividend and the special interim dividend, all transfers, accompanied by the relevant share certificates, must be lodged with the Bank's Registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, for registration not later than 4:30 pm on Tuesday, 8 March 2016. The fourth interim dividend and the special interim dividend will be payable on Tuesday, 29 March 2016 to shareholders on the Register of Shareholders of the Bank on Wednesday, 9 March 2016. Shares of the Bank will be traded ex-dividend as from Monday, 7 March 2016.