Financial Review

Group Summary

The Group delivered another strong performance in the year ended 31 December 2004 with a record profit before tax of $2,158 million, up 39 per cent on the previous year. Normalised earnings per share has grown by 40 per cent to 125.9 cents. (Refer to note 12 on page 85 for the details of basic and diluted earnings per share).

This performance is the result of broadly based organic growth across both businesses and a significantly improved debt performance. The results have also benefited from several one-off items, described below, which together generated profit of $85 million before tax. Operating profit before tax adjusted to exclude these one-off items increased by 34 per cent compared to 2003.

Prior period figures have been restated, principally to reflect the full adoption of the provisions of Financial Reporting Standard 17 – Retirement Benefits (FRS17). See note 6 on page 78.

The Group has made several acquisitions in 2004. In August, it acquired 100 per cent of Advantage Limited (‘PrimeCredit’), a consumer finance business in Hong Kong, and increased its share in Standard Chartered Bank Nepal Limited from 50 per cent to 75 per cent. In November, the Group entered into a consortium agreement with PT Astra International Tbk to acquire a controlling interest in PT Bank Permata Tbk (‘Permata’), an Indonesian commercial bank. The Group’s effective interest in Permata at 31 December 2004 was 31.55 per cent. It has been accounted for as a joint venture. In December 2004 the Group acquired from ANZ part of its project finance business, a team of specialists and a portfolio of loan commitments amounting to $1.26 billion. Together these acquisitions contributed $8 million to profit before tax in 2004.

Net revenue has grown by 13 per cent in total to $5,367 million compared to 2003. The increase is 11 per cent when adjusted for the one-off items above. Business momentum is strong and revenue has grown at twice the pace of revenue growth a year ago. Revenue from outside Hong Kong and Singapore, our two most mature and competitive markets, now comprise 64 per cent of the Group’s total revenue and grew at 19 per cent over 2003.

Net interest income grew by seven per cent to $3,168 million. A fall in interest margins from 2.8 per cent to 2.7 per cent has been offset by ten per cent growth in average earning assets. Interest spread fell from 2.5 per cent to 2.4 per cent.

Other finance income at $10 million compares with a finance charge of $13 million in 2003, principally as a result of contributions made to the UK and Hong Kong funds.

Net fees and commissions increased by 15 per cent from $1,156 million to $1,334 million. Growth was seen in most markets, driven by wealth management, mortgages and corporate advisory services.

Dealing profits grew by 23 per cent from $525 million to $648 million, largely driven by customer led foreign exchange dealing. In particular, retail foreign exchange performed well.

Other operating income at $207 million compares to $104 million in 2003. The increase reflects the one-off items partly offset by a fall in profits on investment securities as a result of a programme to reduce the risk in the book in 2003.

Total operating expenses increased from $2,643 million to $2,996 million. Of this increase $44 million arose from accelerated goodwill amortisation. The adjusted cost increase, excluding goodwill, and one-off items was 11 per cent, in line with adjusted revenue growth. The normalised cost income ratio has fallen from 53.6 per cent in 2003 to 53.5 per cent in 2004. The Group’s investment programmes over recent years in market expansion, new products, distribution outlets and sales capabilities have been paying back in good revenue growth. This investment continued in 2004 together with increased spend on the Group’s regulatory and control infrastructure.

Provisions for bad and doubtful debts fell from $536 million to $214 million, a reduction of 60 per cent. This includes a $55 million release from the Group’s general provision. This performance is a direct result of significantly strengthened risk management discipline, as well as a favourable credit environment.

One-off items from Corporate Activity

In January 2004 the Group sold its investment in BOC Hong Kong (Holdings) Limited realising a net profit of $36 million and in May 2004, it disposed of its investment in KorAm Bank realising a net profit of $95 million. These gains were partially offset by a $23 million premium paid on the repurchase of surplus subordinated debt in India and are reported in other operating income.

One-off costs of $18 million were incurred on incorporating the Group's business in Hong Kong and, at the end of December, the Group agreed to donate $5 million to the Tsunami relief effort.

The effect of these gains and charges, all of which arose from corporate decisions taken at the centre and which are non-recurring in nature, have not been attributed to either Consumer Banking or Wholesale Banking in the business segmental results.

Consumer Banking

Consumer Banking has built up strong momentum with operating profit up 42 per cent in 2004 to $1,064 million. The accelerated investment in growth opportunities in 2003 is delivering results. Revenue increased by eight per cent, which is twice the rate that was achieved in 2003, to $2,693 million. This was driven by loan growth of 18 per cent outside Hong Kong and an increased contribution across all product segments, in particular the SME business. Investing for growth has led to a 10 per cent increase in costs when compared to 2003. The specific bad debt charge fell by 43 per cent. The debt charge in Hong Kong fell significantly and charges elsewhere also improved. In addition, $29 million of general provision held against the Consumer portfolio has been released in 2004.

Hong Kong delivered an increase in operating profit of 77 per cent to $462 million. This resulted from a lower debt charge, cost efficiencies and improved mortgage margins, although these showed some decline in the second half. Revenue was flat at $954 million. Improved margins in mortgages and a good performance in wealth management was offset by subdued loan demand across the market. Costs were tightly controlled and, in the fourth quarter, an operational efficiency programme was initiated to reduce back office costs and improve productivity.

In Singapore, operating profit was broadly flat at $180 million in an intensely competitive environment. Although asset growth was strong at 16 per cent and there was good performance in wealth management and the SME business, revenue was offset by contracting margins, particularly in the mortgage business. Cost growth was five per cent, largely supporting product investment.

Operating profit in Malaysia was up 17 per cent to $75 million with strong performance across all products and a lower debt charge. Revenue grew by eight per cent. Continued margin pressure in the mortgage portfolio was more than offset by higher volume. Revenue from wealth management increased significantly, driven by unit trust sales. Costs increased by nine per cent as a result of significant infrastructure investment.

In Other Asia Pacific, operating profit at $97 million was 11 per cent higher than in 2003 with revenue up 18 per cent. Thailand, Taiwan, Indonesia and Korea performed well across a broad range of products. Costs increased by 23 per cent as the Group continued to invest in China and Korea.

In India, strong asset growth and a lower debt charge drove operating profit up by 100 per cent to $78 million, despite contracting margins in both mortgages and deposit accounts. Costs increased by 22 per cent to $153 million as a result of continued investment in enhanced risk management, new products and delivery channels to support rapid business growth.

Operating profit in the United Arab Emirates (UAE) increased by 42 per cent to $64 million with revenue up by 22 per cent, driven by credit cards, personal loans and wealth management. Costs were 11 per cent higher than in 2003, reflecting further investment in infrastructure and product capability. Elsewhere in the Other Middle East and Other South Asia (MESA) region operating profit grew by 38 per cent to $69 million with strong performances in wealth management, cards and personal loans, particularly in Bangladesh, Pakistan and Bahrain.

In Africa, operating profit increased from $7 million to $17 million with revenue up by 28 per cent to $218 million. This was largely a result of strong asset growth as new products were launched in a number of countries, including Nigeria, South Africa and Kenya, together with improved margins in Zimbabwe. Costs have grown by 23 per cent. This was driven by continued investment in South Africa and inflationary pressures.

The Americas, UK and Group Head Office have seen an increase in operating profit of 10 per cent to $22 million, mostly through firm cost control. The re-focused international banking offering has delivered good profit growth, with revenues largely booked in Hong Kong, Singapore and Dubai.

The following tables provide an analysis of operating profit by geographic segment for Consumer Banking:

2004

	Asia Pacific					MESA				
	Hong Kong $million	Singapore $million	Malaysia $million	Other Asia Pacific $million	India $million	UAE $million	Other Middle East & Other South Asia $million	Africa $million	Americas, UK & Group Head Office $million	Consumer Banking Total $million
Net revenue	954	330	175	393	258	124	172	218	69	2,693
Costs	(415)	(116)	(86)	(231)	(153)	(51)	(93)	(195)	(48)	(1,388)
Specific	(88)	(40)	(18)	(69)	(29)	(10)	(11)	(6)	–	(271)
General	11	6	4	3	2	1	1	–	1	29
(Charge) for/release of debts	(77)	(34)	(14)	(66)	(27)	(9)	(10)	(6)	1	(242)
Income from joint venture	–	–	–	1	–	–	–	–	–	1
Operating profit	462	180	75	97	78	64	69	17	22	1,064

2003*

	Asia Pacific					MESA				
	Hong Kong $million	Singapore $million	Malaysia $million	Other Asia Pacific $million	India $million	UAE $million	Other Middle East & Other South Asia $million	Africa $million	Americas, UK & Group Head Office $million	Consumer Banking Total $million
Net revenue	954	328	162	333	223	102	138	170	78	2,488
Costs	(411)	(110)	(79)	(188)	(125)	(46)	(83)	(159)	(58)	(1,259)
Specific charge for debts	(282)	(40)	(19)	(58)	(59)	(11)	(5)	(4)	–	(478)
Operating profit	261	178	64	87	39	45	50	7	20	751

*Comparative restated (see note 54 on page 118).

An analysis of Consumer Banking revenue by product is set out below:

Revenue by product	2004 $million	2003* $million
Cards and Personal Loans	1,117	1,043
Wealth Management/Deposits	891	805
Mortgages and Auto Finance	638	603
Other	47	37
	2,693	2,488

*Comparative restated (see note 54 on page 118).

Cards and personal loans have delivered increased revenue of seven per cent in a very competitive price environment. Assets have grown by 25 per cent outside of Hong Kong. Hong Kong has returned to profitability despite a seven per cent decline in cards outstandings.

Wealth management revenue has increased by 11 per cent to $891 million with strong demand for investment products, partially offset by compression in deposit margins.

Mortgages and auto finance revenue has grown by six per cent to $638 million driven by new products, increased fee income and, in Hong Kong, improved mortgage margins.

Costs in Consumer Banking have increased by 10 per cent to $1,388 million. This was a direct result of the investment which began in 2003 to expand distribution outlets and launch new products and services in key growth markets.

The specific net charge for debts in Consumer Banking has fallen by 43 per cent to $271 million. The specific net debt charge in Hong Kong fell significantly as bankruptcy losses continued to fall sharply due to the improving economic environment. Other areas showed a stable or improving performance while sustaining strong business growth.

Wholesale Banking.

Wholesale Banking delivered a strong broadly based performance across all geographies, products and customer segments. Operating profit was up 28 per cent at $1,190 million. This was achieved on controlled economic capital, through expanding product capabilities and deepening customer relationships. Revenue increased by 14 per cent to $2,566 million. Customer revenues were up by 19 per cent. Costs increased by 12 per cent due to increased investment in product capabilities such as debt capital markets and derivatives, increased spend on infrastructure and controls, and an increase in performance driven compensation. There was a net specific debt release in 2004 of $2 million compared to a charge of $68 million in 2003. This reflected success in changing the risk profile of the business and also a benign credit environment. In addition, a $26 million release was made from the general provision held against the Wholesale portfolio (2003: $10 million).

The following tables provide an analysis of operating profit by geographic segment for Wholesale Banking:

2004

	Asia Pacific					MESA				
	Hong Kong $million	Singapore $million	Malaysia $million	Other Asia Pacific $million	India $million	UAE $million	Other Middle East & Other South Asia $million	Africa $million	Americas, UK & Group Head Office $million	Wholesale Banking Total $million
Net revenue	**418**	**183**	**95**	**422**	**231**	**147**	**205**	**366**	**499**	**2,566**
Costs	**(221)**	**(110)**	**(57)**	**(277)**	**(97)**	**(48)**	**(75)**	**(162)**	**(357)**	**(1,404)**
Specific	**(54)**	**(2)**	**11**	**22**	**3**	**6**	**7**	**(6)**	**15**	**2**
General	**6**	**3**	**1**	**4**	**2**	**2**	**2**	**–**	**6**	**26**
(Charge) for/release of debts	**(48)**	**1**	**12**	**26**	**5**	**8**	**9**	**(6)**	**21**	**28**
Amounts written off fixed asset investments	**–**	**–**	**–**	**–**	**2**	**–**	**–**	**–**	**(3)**	**(1)**
Income from joint venture	**–**	**–**	**–**	**1**	**–**	**–**	**–**	**–**	**–**	**1**
Operating profit	**149**	**74**	**50**	**172**	**141**	**107**	**139**	**198**	**160**	**1,190**

2003*

	Asia Pacific					MESA				
	Hong Kong $million	Singapore $million	Malaysia $million	Other Asia Pacific $million	India $million	UAE $million	Other Middle East & Other South Asia $million	Africa $million	Americas, UK & Group Head Office $million	Wholesale Banking Total $million
Net revenue	401	158	73	348	243	132	177	273	447	2,252
Costs	(207)	(100)	(57)	(241)	(87)	(45)	(62)	(123)	(328)	(1,250)
Specific	(23)	7	21	(41)	(1)	9	9	(5)	(44)	(68)
General	–	–	–	–	–	–	–	–	10	10
(Charge) for/release of debts	(23)	7	21	(41)	(1)	9	9	(5)	(34)	(58)
Amounts written off fixed asset investments	–	–	–	–	(4)	–	–	–	(7)	(11)
Operating profit	171	65	37	66	151	96	124	145	78	933

*Comparative restated (see note 54 on page 118).

In Hong Kong, net revenue grew by four per cent from $401 million to $418 million. The growth was largely from foreign exchange and derivatives on the back of strong trade flows. Costs were $14 million higher at $221 million with continued investment in the front office partially offset by a reduction in technology costs.

Revenue in Singapore grew by 16 per cent. Strong customer revenue, particularly from global markets products, more than offset a decline in revenue from asset and liability management. Costs increased by 10 per cent to $110 million mainly due to investment in risk and governance infrastructure.

In Malaysia, revenue increased from $73 million to $95 million with good growth in global markets products facilitated by a wider product mix and advisory services. Costs were held flat at $57 million through tight control.

The Other Asia Pacific region delivered strong results with excellent contributions in all countries and in particular from Korea and Taiwan. Revenue grew by 21 per cent to $422 million. This increase was broadly spread across the commercial banking and global markets product range. Costs increased by 15 per cent to $277 million reflecting investment in product capability in the region.

In India, profit on the sale of investment securities arising as a result of a programme to reduce the risk in the book was significantly lower in 2004. Excluding the effect of this, revenue grew by around 12 per cent. This reflected broad based product growth and a positive contribution from all customer segments. The increase in costs of 11 per cent to $97 million is the result of investment in new businesses, people and infrastructure to capture further growth opportunities.

In the UAE revenue increased by 11 per cent to $147 million, driven largely by foreign exchange, cash management and structured global markets products. Elsewhere in the MESA region revenue grew by $28 million to $205 million, led by significant cross-selling of global markets products. The increase in costs in the region was due to expansion into new markets, investment in new products, infrastructure and continued strengthening of risk and governance functions.

In Africa, revenue at $366 million was 34 per cent higher than in 2003. High commodity prices and relative economic stability in a number of key markets have contributed to this result. The contribution from Botswana and Zimbabwe was particularly strong. Costs grew by 32 per cent, mainly due to inflationary pressure and expansion in Nigeria and South Africa.

The Americas, UK and Group Head Office have seen revenue increase by 12 per cent to $499 million. Strong fees and commissions were partially offset by reduced yield on asset and liability management.

An analysis of Wholesale Banking revenue by product is set out below:

Revenue by product	2004 $million	2003* $million
Trade and Lending	**868**	815
Global Markets	**1,209**	1,054
Cash Management and Custody	**489**	383
	2,566	2,252

*Comparative restated (see note 54 on page 118).

Trade and lending revenue has increased by seven per cent to $868 million. Trade finance, underpinned by strong intra-Asian trade flows, has outstripped lending growth.

Global markets revenue has grown strongly at 15 per cent. Investment in new product capability in debt capital markets, asset backed securities, structured trade and derivatives have started to deliver good returns. Revenue from asset and liability management was lower than in 2003 due to the shape of the yield curves, but the decline has stabilised.

Cash management and custody revenue were up by 28 per cent. Cash management grew on the back of higher transaction volumes and an increase of more than 30 per cent in average balances. Custody increased by more than 40 per cent with assets under administration up by more than 50 per cent.

Costs in Wholesale Banking increased by 12 per cent. This was due to further investment for growth, increased spending on infrastructure and controls and higher performance driven costs, largely due to variable compensation.

Wholesale Banking had a net specific debt release of $2 million compared to a $68 million charge in the previous period. Gross provisions were down by 37 per cent and recoveries down by 13 per cent. This has been achieved through continued enhancement of risk management processes and improvement in the risk profile, together with a favourable credit environment. $26 million of general provision was released against the Wholesale portfolio in 2004 (2003: $10 million).

Risk

Through its risk management structure the Group seeks to manage efficiently the core risks: credit, market, country and liquidity risk arise directly through the Group's commercial activities whilst business, regulatory, operational and reputational risk are normal consequences of any business undertaking. The key element of risk management philosophy is for the risk functions to operate as an independent control working in partnership with the business units to provide a competitive advantage to the Group.

The basic principles of risk management followed by the Group include:

- ensuring that business activities are controlled on the basis of risk adjusted return;
- managing risk within agreed parameters with risk quantified wherever possible;
- assessing risk at the outset and throughout the time that we continue to be exposed to it;
- abiding by all applicable laws, regulations, and governance standards in every country in which we do business;
- applying high and consistent ethical standards to our relationships with all customers, employees, and other stakeholders; and
- undertaking activities in accordance with fundamental control standards. These controls include the disciplines of planning, monitoring, segregation, authorisation and approval, recording, safeguarding, reconciliation and valuation.

Risk Management Framework

Ultimate responsibility for the effective management of risk rests with the Company's Board of Directors. The Audit and Risk Committee reviews specific risk areas and guides and monitors the activities of the Group Risk Committee and Group Asset and Liability Committee.

All the Executive Directors of Standard Chartered PLC and members of the Standard Chartered Bank Court are members of the Group Risk Committee which is chaired by the Group Executive Director responsible for Risk ('GED Risk'). This Committee has responsibility for determining the Group standards and policies for risk measurement and management, and also delegating authorities and responsibilities to various sub-committees.

The committee process ensures that standards and policy are cascaded down through the organisation from the Board through the Group Asset and Liability Committee and the Group Risk Committee to the functional, regional and country level committees. Key information is communicated through the country, regional and functional committees to Group, to provide assurance that standards and polices are being followed.

The GED Risk manages an independent risk function which:

- recommends Group standards and policies for risk measurement and management;
- monitors and reports Group risk exposures for country, credit, market and operational risk;
- approves market risk limits and monitors exposure;
- sets country risk limits and monitors exposure;
- chairs credit committee and delegates credit authorities subject to oversight;
- validates risk models; and
- recommends risk appetite and strategy.

Individual Group Executive Directors are accountable for risk management in their businesses and support functions and for countries where they have governance responsibilities. This includes:

- implementing the policies and standards as agreed by the Group Risk Committee across all business activity;
- managing risk in line with appetite levels agreed by the Group Risk Committee; and
- developing and maintaining appropriate risk management infrastructure and systems to facilitate compliance with risk policy.

The GED Risk, together with Group Internal Audit, provides independent assurance that risk is being measured and managed in accordance with the Group's standards and policies.

Credit Risk

Credit risk is the risk that a counterparty will not settle its obligations in accordance with agreed terms.

Credit exposures include individual borrowers and connected groups of counterparties and portfolios, on the banking and trading books.

Clear responsibility for credit risk is delegated from the Board to the Group Risk Committee. Standards and policies for managing credit risk are determined by the Group Risk Committee which also delegates credit authorities through the GED Risk to independent Risk Officers at Group and at the Wholesale Banking and Consumer Banking business levels. Procedures for managing credit risk are determined at the business levels with specific policies and procedures being adapted to different risk environment and business goals. The Risk Officers are located in the businesses to maximise the efficiency of decision-making, but have an independent reporting line into the GED Risk.

Within the Wholesale Banking business, credit analysis includes a review of facility detail, credit grade determination and financial spreading/ratio analysis. The Bank uses a numerical grading system for quantifying the risk associated with a counterparty. The grading is based on a probability of default measure with customers analysed against a range of quantitative and qualitative measures. There is a clear segregation of duties with loan applications being prepared separately from the approval chain. Significant exposures are reviewed and approved centrally through a Group or Regional level Credit Committee. This Committee receives its authority and delegated responsibilities from the Group Risk Committee.

The businesses, working with the Risk Officers, take responsibility for managing pricing for risk, portfolio diversification and overall asset quality within the requirements of Group standards, policies, and the business strategy.

For Consumer Banking, standard credit application forms are generally used which are processed in central units using manual or automated approval processes as appropriate to the customer, the product or the market. As with Wholesale Banking, origination and approval roles are segregated.

Loan Portfolio

Loans and advances to customers have increased by 20 per cent during the year to $71.6 billion. In Consumer Banking growth has resulted from increases in the mortgage book, mainly in Singapore, Malaysia and India. In Wholesale Banking growth was across all regions. This was particularly in trade, syndications and project finance, including the acquisition of the $1.2 billion ANZ project finance portfolio.

Approximately 49 per cent (2003: 53 per cent) of the portfolio relates to Consumer Banking, predominantly retail mortgages. Other Consumer Banking covers credit cards, personal loans and other secured lending.

Approximately half of the Group's loans and advances are short term in nature and have a maturity of one year or less. The Wholesale Banking portfolio is predominantly short term, with 75 per cent of loans and advances having a maturity of one year or less. In Consumer Banking, 63 per cent of the portfolio is in the mortgage book, traditionally longer term in nature.

The following tables set out by maturity the amount of customer loans net of provisions:

	2004				2003*			
	One year or less $million	**One to five years $million**	**Over five years $million**	**Total $million**	One year or less $million	One to five years $million	Over five years $million	Total $million
Consumer Banking								
Mortgages	**1,877**	**4,156**	**15,985**	**22,018**	1,917	4,143	14,229	20,289
Other	**5,241**	**3,876**	**403**	**9,520**	4,874	3,534	553	8,961
Small and medium enterprises	**989**	**440**	**2,050**	**3,479**	558	217	1,631	2,406
Total	**8,107**	**8,472**	**18,438**	**35,017**	7,349	7,894	16,413	31,656
Wholesale Banking	**27,670**	**5,145**	**4,099**	**36,914**	22,209	4,526	1,778	28,513
General Provisions	**–**	**–**	**–**	**(335)**	–	–	–	(425)
Net loans and advances to customers	**35,777**	**13,617**	**22,537**	**71,596**	29,558	12,420	18,191	59,744

*The analysis of net loans and advances to customers for Consumer and Wholesale Banking at 31 December 2003 has been restated to separately disclose small and medium enterprises within Consumer Banking. This has resulted in a transfer of $514 million from the Wholesale Banking portfolio to Consumer Banking. There was no impact on total net loans and advances to customers.

The following tables set out an analysis of the Group's net loans and advances as at 31 December 2004 and 31 December 2003 by the principal category of borrowers, business or industry and/or geographical distribution:

	Asia Pacific					MESA				2004
	Hong Kong $million	Singapore $million	Malaysia $million	Other Asia Pacific $million	India $million	UAE $million	Other Middle East & Other South Asia $million	Africa $million	Americas, UK & Group Head Office $million	Total $million
Loans to individuals										
Mortgages	12,189	5,064	2,422	737	1,194	–	87	63	262	22,018
Other	2,097	651	488	2,622	1,201	819	1,109	431	102	9,520
Small and medium enterprises	731	1,622	578	200	230	13	29	76	–	3,479
Consumer Banking	15,017	7,337	3,488	3,559	2,625	832	1,225	570	364	35,017
Agriculture, forestry and fishing	–	26	55	56	15	–	19	171	314	656
Construction	154	27	6	34	105	103	136	46	4	615
Commerce	1,560	804	136	895	262	824	378	353	1,113	6,325
Electricity, gas and water	387	40	71	271	104	–	119	102	300	1,394
Financing, insurance and business services	1,914	1,608	554	762	415	951	411	47	2,268	8,930
Loans to governments	–	306	1,551	–	–	–	16	7	225	2,105
Mining and quarrying	–	65	63	122	1	92	57	95	1,032	1,527
Manufacturing	1,343	423	269	2,512	814	236	1,031	404	2,294	9,326
Commercial real estate	984	721	2	388	–	–	–	29	2	2,126
Transport, storage and communication	366	280	128	321	226	56	243	165	1,177	2,962
Other	19	128	51	354	43	38	205	24	86	948
Wholesale Banking	6,727	4,428	2,886	5,715	1,985	2,300	2,615	1,443	8,815	36,914
General provision									(335)	(335)
Total loans and advances to customers	21,744	11,765	6,374	9,274	4,610	3,132	3,840	2,013	8,844	71,596
Total loans and advances to banks	2,852	2,399	480	3,554	325	535	932	510	7,335	18,922

Under 'Loans to individuals – Other', $1,270 million (2003: $1,371 million) relates to the cards portfolio in Hong Kong. The total cards portfolio is $3,586 million (2003: $3,329 million).

The Wholesale Banking portfolio is well diversified across both geography and industry, with no concentration in exposure to sub-industry classification levels in manufacturing, financing, insurance and business services, commerce and transport, storage and communication.

	Asia Pacific					MESA				2003*
	Hong Kong $million	Singapore $million	Malaysia $million	Other Asia Pacific $million	India $million	UAE $million	Other Middle East & Other South Asia $million	Africa $million	Americas, UK & Group Head Office $million	Total $million
Loans to individuals										
Mortgages	11,974	4,450	1,951	831	640	–	67	30	346	20,289
Other	2,219	703	660	1,990	999	677	1,127	430	156	8,961
Small and medium enterprises	577	1,162	541	–	126	–	–	–	–	2,406
Consumer Banking	14,770	6,315	3,152	2,821	1,765	677	1,194	460	502	31,656
Agriculture, forestry and fishing	6	2	76	49	12	–	24	144	387	700
Construction	104	9	13	43	34	83	91	19	13	409
Commerce	1,350	848	187	717	30	619	394	398	725	5,268
Electricity, gas and water	327	36	25	240	56	3	69	127	84	967
Financing, insurance and business services	1,575	883	428	657	194	434	320	116	1,184	5,791
Loans to governments	–	61	747	8	–	–	13	–	281	1,110
Mining and quarrying	–	14	78	35	–	59	59	16	470	731
Manufacturing	1,326	745	214	2,016	943	179	916	283	1,738	8,360
Commercial real estate	873	663	7	250	–	–	1	18	3	1,815
Transport, storage and communication	491	143	38	118	71	30	237	114	1,513	2,755
Other	23	62	44	170	1	26	166	44	71	607
Wholesale Banking	6,075	3,466	1,857	4,303	1,341	1,433	2,290	1,279	6,469	28,513
General provision									(425)	(425)
Total loans and advances to customers	20,845	9,781	5,009	7,124	3,106	2,110	3,484	1,739	6,546	59,744
Total loans and advances to banks	2,113	1,045	204	2,784	239	605	889	308	5,167	13,354

*The analysis of net loans and advances to customers for Consumer and Wholesale Banking at 31 December 2003 has been restated to separately disclose small and medium enterprises within Consumer Banking. This has resulted in a transfer of $514 million from the Wholesale Banking portfolio to Consumer Banking. There was no impact on total net loans and advances to customers.

Problem Credits

The Group employs a variety of tools to monitor the loan portfolio and to ensure the timely recognition of problem credits.

In Wholesale Banking, accounts or portfolios are placed on Early Alert when they display signs of weakness. Such accounts and portfolios are subject to a dedicated process involving senior risk officers and representatives from the specialist recovery unit, which is independent of the business units. Account plans are re-evaluated and remedial actions are agreed and monitored until complete. Remedial actions include, but are not limited to, exposure reduction, security enhancement, exit of the account or immediate movement of the account into the control of the specialist recovery unit.

In Consumer Banking, an account is considered to be in default when payment is not received on the due date. Accounts that are overdue by more than 30 days (60 days for mortgages) are considered delinquent. These are closely monitored and subject to a special collections process.

In general, loans are treated as non-performing when interest or principal is 90 days or more past due.

Consumer Banking

Provisions are derived on a formulaic basis depending on the product:

Mortgages: a provision is raised where accounts are 150 days past due based on the difference between the outstanding value of the loan and the forced sale value of the underlying asset.

Credit cards: a charge-off is made for all balances which are 150 days past due or earlier as circumstances dictate. In Hong Kong charge-off is currently at 120 days.

Other unsecured Consumer Banking products are charged off at 150 days past due.

For other secured Consumer Banking products a provision is raised at 90 days past due for the difference between the outstanding value and the forced sale value of the underlying asset. The underlying asset is then re-valued periodically until disposal.

It is current practice to provision and write-off exposure in respect of Hong Kong bankruptcies at the time the customer petitions for bankruptcy.

The Small and Medium Enterprises (SME) portfolio is provisioned on a case by case basis.

The following tables set out the non-performing portfolio in Consumer Banking:

2004

	Asia Pacific					MESA				
	Hong Kong $million	**Singapore $million**	**Malaysia $million**	**Other Asia Pacific $million**	**India $million**	**UAE $million**	**Other Middle East & Other South Asia $million**	**Africa $million**	**Americas, UK & Group Head Office $million**	**Total $million**
Loans and advances – Gross non-performing	**72**	**146**	**181**	**60**	**42**	**14**	**28**	**24**	**46**	**613**
Specific provisions for bad and doubtful debts	**(32)**	**(24)**	**(28)**	**(13)**	**(12)**	**(11)**	**(11)**	**(9)**	**(5)**	**(145)**
Interest in suspense	**(1)**	**(4)**	**(24)**	**(7)**	**(8)**	**(2)**	**(13)**	**(8)**	**(7)**	**(74)**
Net non-performing loans and advances	**39**	**118**	**129**	**40**	**22**	**1**	**4**	**7**	**34**	**394**
Cover ratio										**36%**

2003

	Asia Pacific					MESA				
	Hong Kong $million	Singapore $million	Malaysia $million	Other Asia Pacific $million	India $million	UAE $million	Other Middle East & Other South Asia $million	Africa $million	Americas, UK & Group Head Office $million	Total $million
Loans and advances – Gross non-performing	138	115	192	63	43	16	23	18	10	618
Specific provisions for bad and doubtful debts	(48)	(17)	(26)	(15)	(11)	(11)	(8)	(7)	(5)	(148)
Interest in suspense	(1)	(3)	(23)	(9)	(9)	(5)	(8)	(7)	(2)	(67)
Net non-performing loans and advances	89	95	143	39	23	–	7	4	3	403
Cover ratio										35%

The relatively low Consumer Banking cover ratio reflects the fact that the Group classifies all exposure which is more than 90 days past due as non-performing, whilst specific provisions on unsecured lending are only raised at the time of charge-off.

For secured products, provisions reflect the difference between the value of the underlying assets and the outstanding loan (see details relating to the raising of provisions above).

Wholesale Banking

Loans are designated as non-performing as soon as payment of interest or principal is 90 days or more overdue or where sufficient weakness is recognised so that full payment of either interest or principal becomes questionable. Where customer accounts are recognised as non-performing or display weakness that may result in non-performing status being assigned, they are passed to the management of a specialist unit which is independent of the main businesses of the Group.

For loans and advances designated as non-performing, interest continues to accrue on the customer's account but is not included in income.

Where the principal, or a portion thereof, is considered uncollectible and of such little realisable value that it can no longer be included at its full nominal amount on the balance sheet, a specific provision is raised. In any decision relating to the raising of provisions, the Group attempts to balance economic conditions, local knowledge and experience and the results of independent asset reviews.

Where it is considered that there is no realistic prospect of recovering the principal of an account against which a specific provision has been raised, then that amount will be written off.

The following tables set out the total non-performing portfolio in Wholesale Banking including the portfolio covered by a Loan Management Agreement (LMA) with a Thai Government Agency (see note 19 on page 89). This portfolio amounted to $236 million net of provisions at 31 December 2004 (2003: $660 million). The net non-performing loan portfolio has decreased by $607 million (54 per cent) over 2003.

2004

	Asia Pacific					MESA				
	Hong Kong $million	Singapore $million	Malaysia $million	Other Asia Pacific $million	India $million	UAE $million	Other Middle East & Other South Asia $million	Africa $million	Americas, UK & Group Head Office $million	Total $million
Loans and advances – Gross non-performing	409	185	117	558	68	49	126	104	674	2,290
Specific provisions for bad and doubtful debts	(257)	(89)	(68)	(256)	(29)	(31)	(69)	(46)	(435)	(1,280)
Interest in suspense	(92)	(56)	(35)	(54)	(26)	(13)	(55)	(42)	(127)	(500)
Net non-performing loans and advances	60	40	14	248	13	5	2	16	112	510

2003

	Asia Pacific					MESA				
	Hong Kong $million	Singapore $million	Malaysia $million	Other Asia Pacific $million	India $million	UAE $million	Other Middle East & Other South Asia $million	Africa $million	Americas, UK & Group Head Office $million	Total $million
Loans and advances – Gross non-performing	357	236	194	1,077	86	52	180	116	887	3,185
Specific provisions for bad and doubtful debts	(220)	(106)	(118)	(375)	(44)	(40)	(99)	(51)	(460)	(1,513)
Interest in suspense	(91)	(64)	(55)	(68)	(30)	(12)	(66)	(43)	(126)	(555)
Net non-performing loans and advances	46	66	21	634	12	–	15	22	301	1,117

Wholesale Banking Cover Ratio

The following tables show the Wholesale Banking cover ratio. The non-performing loans recorded below under Standard Chartered Nakornthon Bank (SCNB) are excluded from the cover ratio calculation as they are the subject of a Loan Management Agreement (LMA) with a Thai Government Agency. Refer to note 19 on page 89.

At 86 per cent, the Wholesale Banking non-performing portfolio is well covered. The balance uncovered by specific provision and interest in suspense represents the value of collateral held and/or the Group's estimate of the net value of any work-out strategy.

			2004
	Total $million	**SCNB (LMA) $million**	**Total excl LMA $million**
Loans and advances – Gross non-performing	**2,290**	**351**	**1,939**
Specific provisions for bad and doubtful debts	**(1,280)**	**(115)**	**(1,165)**
Interest in suspense	**(500)**	**–**	**(500)**
Net non–performing loans and advances	**510**	**236**	**274**
Cover ratio			**86%**

			2003
	Total $million	SCNB (LMA) $million	Total excl LMA $million
Loans and advances – Gross non-performing	3,185	772	2,413
Specific provisions for bad and doubtful debts	(1,513)	(112)	(1,401)
Interest in suspense	(555)	–	(555)
Net non-performing loans and advances	1,117	660	457
Cover ratio			81%

Group

The following tables set out the movements in the Group's total specific provisions against loans and advances:

										2004
	Asia Pacific					**MESA**				
	Hong Kong $million	**Singapore $million**	**Malaysia $million**	**Other Asia Pacific $million**	**India $million**	**UAE $million**	**Other Middle East & Other South Asia $million**	**Africa $million**	**Americas, UK & Group Head Office $million**	**Total $million**
Provisions held at 1 January 2004	**268**	**123**	**144**	**390**	**55**	**51**	**107**	**58**	**465**	**1,661**
Exchange translation differences	**–**	**3**	**–**	**4**	**2**	**(3)**	**(1)**	**2**	**8**	**15**
Amounts written off	**(154)**	**(62)**	**(63)**	**(142)**	**(65)**	**(13)**	**(29)**	**(21)**	**(58)**	**(607)**
Recoveries of amounts previously written off	**29**	**7**	**10**	**12**	**24**	**3**	**4**	**4**	**2**	**95**
Other	**4**	**–**	**(2)**	**(42)**	**(1)**	**–**	**(5)**	**–**	**38**	**(8)**
New provisions	**207**	**60**	**36**	**95**	**106**	**15**	**28**	**27**	**35**	**609**
Recoveries/provisions no longer required	**(65)**	**(18)**	**(29)**	**(48)**	**(80)**	**(11)**	**(24)**	**(15)**	**(50)**	**(340)**
Net charge against/ (credit to) profit	**142**	**42**	**7**	**47**	**26**	**4**	**4**	**12**	**(15)**	**269**
Provisions held at 31 December 2004	**289**	**113**	**96**	**269**	**41**	**42**	**80**	**55**	**440**	**1,425**

2003

	Asia Pacific					MESA				
	Hong Kong $million	Singapore $million	Malaysia $million	Other Asia Pacific $million	India $million	UAE $million	Other Middle East & Other South Asia $million	Africa $million	Americas, UK & Group Head Office $million	Total $million
Provisions held at 1 January 2003	255	159	235	358	60	108	144	53	452	1,824
Exchange translation differences	2	2	–	13	3	–	2	1	10	33
Amounts written off	(353)	(85)	(99)	(120)	(87)	(64)	(32)	(6)	(64)	(910)
Recoveries of amounts previously written off	23	14	10	13	18	1	1	1	3	84
Other	36	–	–	27	1	4	(4)	–	20	84
New provisions	364	72	34	142	142	14	22	24	90	904
Recoveries/provisions no longer required	(59)	(39)	(36)	(43)	(82)	(12)	(26)	(15)	(46)	(358)
Net charge against/ (credit to) profit	305	33	(2)	99	60	2	(4)	9	44	546
Provisions held at 31 December 2003	268	123	144	390	55	51	107	58	465	1,661

General Provision

The general provision is held to cover the inherent risk of losses, which, although not identified, are known by experience to be present in a loan portfolio and to other material uncertainties where specific provisioning is not appropriate. It is not held to cover losses arising from future events.

The Group sets the general provision with reference to past experience by using both Flow Rate and Expected Loss methodology, as well as taking judgemental factors into account. These factors include, but are not confined to, the economic environment in our core markets, the shape of the portfolio with reference to a range of indicators, and management actions taken to proactively manage the portfolio.

During the year, $39 million of the general provision was applied to cover litigation in India dating back to 1992 and $4 million was added from acquisitions. $55 million has been released from the general provision reflecting the benign economic environment, the significant improvement in the Hong Kong bankruptcy situation and other portfolio indicators. At 31 December 2004, the balance of general provision stood at $335 million, 0.5 per cent of loans and advances to customers (2003: $425 million, 0.7 per cent).

Country Risk

Country Risk is the risk that a counterparty is unable to meet its contractual obligations as a result of adverse economic conditions or actions taken by governments in the relevant country.

This covers the risk that:

- the sovereign borrower of a country may be unable or unwilling to fulfil its foreign currency or cross-border contractual obligations; and/or
- a non-sovereign counterparty may be unable to fulfil its contractual obligations as a result of currency shortage due to adverse economic conditions or actions taken by the government of the country.

The Group Risk Committee approves country risk policy and procedures and delegates the setting and management of country limits to the Group Head, Credit and Country Risk.

The businesses and country Chief Executive Officers manage exposures within these set limits and policies. Countries designated as higher risk are subject to increased central monitoring.

The following table, based on the Bank of England Cross Border Reporting Country Exposure (CE) guidelines, shows the Group's cross border assets including acceptances, where they exceed one per cent of the Group's total assets.

Cross border assets exclude facilities provided within the Group. They comprise loans and advances, interest bearing deposits with other banks, trade and other bills, acceptances, amounts receivable under finance leases, certificates of deposit and other negotiable paper and investment securities where the counterparty is resident in a country other than that where the cross border asset is recorded. Cross border assets also include exposures to local residents denominated in currencies other than the local currency.

				2004				2003
	Public sector $million	Banks $million	Other $million	Total $million	Public sector $million	Banks $million	Other $million	Total $million
USA	**824**	**745**	**2,660**	**4,229**	1,436	902	2,149	4,487
Netherlands	**–**	**2,639**	**406**	**3,045**	–	1,729	275	2,004
Hong Kong	**4**	**199**	**2,719**	**2,922**	14	112	2,301	2,427
Singapore	**–**	**325**	**1,939**	**2,264**	–	160	1,509	1,669
India	**74**	**1,132**	**867**	**2,073**	60	641	1,052	1,753
Korea	**47**	**1,258**	**698**	**2,003**	3	1,393	475	1,871
China*	**101**	**686**	**902**	**1,689**	–	–	–	–
France	**149**	**1,243**	**183**	**1,575**	4	1,529	253	1,786
Germany**	**–**	**–**	**–**	**–**	–	1,292	315	1,607

* Less than one per cent of total assets at 31 December 2003.

** Less than one per cent of total assets at 31 December 2004.

Market Risk

The Group recognises market risk as the exposure created by potential changes in market prices and rates. The Group is exposed to market risk arising principally from customer driven transactions.

Market Risk is governed by the Group Risk Committee, which agrees policies and levels of risk appetite in terms of Value at Risk (VaR). The Group Market Risk Committee provides market risk oversight and guidance on policy settings. Policies cover the trading book of the Group and also market risks within the non-trading books. Limits by location and portfolio are proposed by the businesses within the terms of agreed policy. Group Market Risk approves the limits within delegated authorities and monitors exposures against these limits.

Group Market Risk complements the VaR measurement by regularly stress testing market risk exposures to highlight potential risk that may arise from extreme market events that are rare but plausible. In addition, VaR models are back tested against actual results to ensure pre-determined levels of accuracy are maintained.

Additional limits are placed on specific instruments and currency concentrations where appropriate. Sensitivity measures are used in addition to VaR as risk management tools. Option risks are controlled through revaluation limits on currency and volatility shifts, limits on volatility risk by currency pair and other underlying variables that determine the options' value.

Value at Risk

The Group uses historic simulation to measure VaR on all market risk related activities.

The total VaR for trading and non-trading books combined at 31 December 2004 was $15.4 million (2003: $12.2 million). Interest rate related VaR was $15.6 million (2003: $12.2 million) and foreign exchange related VaR was $3.0 million (2003: $1.3 million). The total VaR of $15.4 million recognises offsets between interest rate and foreign exchange risks. Additional information is given in note 52 on page 116.

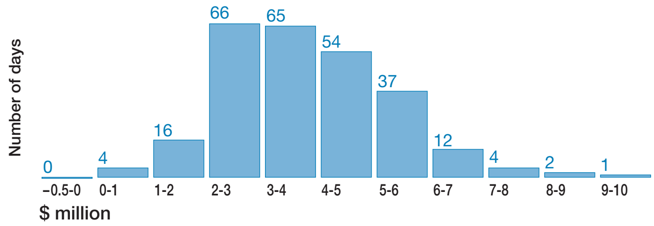
The average total VaR for trading and non-trading books during the year was $15.8 million (2003: $13.6 million) with a maximum exposure of $19.4 million (2003: $16.0 million).

VaR for interest rate risk in the non-trading books of the Group total $16.7 million at 31 December 2004 (2003: $9.5 million). The increase in VaR reflects the rise in interest rates and positional changes.

The Group has no significant trading exposure to equity or commodity price risk.

The average daily revenue earned from market risk related activities was $3.8 million, compared with $3.5 million during 2003.

Revenue Distribution



Foreign Exchange Exposure

The Group's foreign exchange exposures comprise trading, non-trading and structural foreign currency translation exposures.

Foreign exchange trading exposures are principally derived from customer driven transactions. The average daily revenue from foreign exchange trading businesses during 2004 was $1.6 million (2003: $1.3 million).

Interest Rate Exposure

The Group's interest rate exposures comprise trading exposures and non-trading structural interest rate exposures.

Structural interest rate risk arises from the differing re-pricing characteristics of commercial banking assets and liabilities.

The average daily revenue from interest rate trading businesses during 2004 was $2.2 million (2003: $2.2 million).

Derivatives

Derivatives are contracts whose characteristics and value derive from underlying financial instruments, interest and exchange rates or indices. They include futures, forwards, swaps and options transactions in the foreign exchange and interest rate markets. Derivatives are an important risk management tool for banks and their customers because they can be used to manage the risk of price, interest rate and exchange rate movements.

The Group's derivative transactions are principally in instruments where the mark-to-market values are readily determinable by reference to independent prices and valuation quotes or by using standard industry pricing models.

The Group enters into derivative contracts in the normal course of business to meet customer requirements and to manage its own exposure to fluctuations in interest and exchange rates.

The Group applies a potential future exposure methodology to manage counterparty credit exposure associated with derivative transactions. This is calculated by taking the cost of replacing the contract, where its mark-to-market value is positive together with an estimate for the potential future change in the market value of the contract, reflecting the volatilities that affect it. The credit risk on contracts with a negative mark-to-market value is restricted to the potential future change in their market value. The credit risk on derivatives is therefore usually small relative to their notional principal values. For an analysis of derivative contracts see notes 47 and 48 on pages 112 to 113.

Liquidity Risk

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

It is the policy of the Group to maintain adequate liquidity at all times, in all geographical locations and for all currencies. Hence the Group is in a position to meet all obligations, to repay depositors, to fulfil commitments to lend and to meet any other commitments made.

Liquidity risk management is governed by the Group Asset and Liability Committee (GALCO). This Committee, chaired by the GED Finance and with authority derived from the Board, is responsible for both statutory and prudential liquidity. These responsibilities are managed through the provision of authorities, policies and procedures that are co-ordinated by the Liquidity Management Committee (LMC) with regional and country Asset and Liability Committees (ALCO).

Due to the diversified nature of the Group's business, the Group's policy is that liquidity is more effectively managed locally, in-country. Each Country ALCO is responsible for ensuring that the country is self-sufficient and is able to meet all its obligations to make payments as they fall due. The Country ALCO has primary responsibility for compliance with regulations/Group policy and maintaining a Country Liquidity Crisis Contingency Plan. A substantial portion of the Group's assets are funded by customer deposits made up of current and savings accounts and other deposits. These customer deposits, which are widely diversified by type and maturity, represent a stable source of funds. Lending is normally funded by liabilities in the same currency.

The Group also maintains significant levels of marketable securities either for compliance with local statutory requirements or as prudential investments of surplus funds.

The GALCO oversees the structural foreign exchange and interest rate exposures that arise within the Group. Policies and terms of reference are set within which Group Corporate Treasury manage these exposures on a day-to-day basis.

Policies and guidelines for the setting and maintenance of capital ratio levels are also delegated by GALCO. Group ratios are monitored centrally by Group Corporate Treasury, while local requirements are monitored by the local ALCO.

Operational Risk

Operational risk is the risk of direct or indirect loss due to an event or action resulting from the failure of technology, processes, infrastructure, personnel and other risks having an operational impact. The Group seeks to ensure that key operational risks are managed in a timely and effective manner through a framework of policies, procedures and tools to identify, assess, monitor, control and report such risks.

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

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

Compliance with operational risk policies and procedures is the responsibility of all managers. Every country operates a Country Operational Risk Group (CORG). The CORG has in-country governance responsibility for ensuring that an appropriate and robust risk management framework is in place to monitor and manage operational risk.

Business Risk

Business risk is the risk of failing to achieve business targets due to inappropriate strategies, inadequate resources or changes in the economic or competitive environment and is managed through the Group's management processes. Regular reviews of the performance of Group businesses by the Group Management Committee, comprising Group Executive Directors and other senior management are used to assess business risks and agree management action. The reviews include corporate financial performance measures, capital usage, resource utilisation and risk statistics to provide a broad understanding of the current business position.

Compliance and Regulatory Risk

Compliance and Regulatory risk includes the risk of non-compliance with regulatory requirements in a country in which the Group operates. The Group Compliance and Regulatory Risk function is responsible for establishing and maintaining an appropriate framework of Group compliance policies and procedures. Compliance with such policies and procedures is the responsibility of all managers.

Legal Risk

Legal risk is the risk of unexpected loss, including reputational loss, arising from defective transactions or contracts, claims being made or some other event resulting in a liability or other loss for the Group, failure to protect the title to and ability to control the rights to assets of the Group (including intellectual property rights), changes in the law, or jurisdictional risk.

The Group manages legal risk through the Group Legal Risk Committee, Legal risk policies and procedures, and effective use of its internal and external lawyers.

Reputational Risk

Reputational risk is defined as the risk that any action taken by the Group or its employees creates a negative perception in the external market place. This includes the Group's and/or its customers' impact on the environment. The Group Risk Committee examines issues that are considered to have reputational repercussions for the Group and issues guidelines or policies as appropriate. It also delegates responsibilities for the management of legal/regulatory and reputational risk to the business through business risk committees. In Wholesale Banking, potential reputational risks resulting from transactions or policies and procedures are reviewed and actioned through the Wholesale Banking Reputational Risk Committee. Consumer Banking's Product and Reputational Risk Committee provides similar assurance.

Independent Monitoring

Group Internal Audit is an independent Group function that reports directly to the Group Chief Executive and the Audit and Risk Committee. Group Internal Audit provides independent confirmation that Group and business standards, policies and procedures are being complied with. Where necessary, corrective action is recommended.

Hedging Policies

The Group does not generally hedge the value of its foreign currency denominated investments in subsidiaries and branches. Hedges may be taken where there is a risk of a significant exchange rate movement but, in general, the management believes that the Group's reserves are sufficient to absorb any foreseeable adverse currency depreciation. The Group also seeks to match its assets denominated in foreign currencies with corresponding liabilities in the same currencies.

The effect of exchange rate movements on the capital risk asset ratio is mitigated by the fact that both the value of these investments and the risk weighted value of assets and contingent liabilities follow substantially the same exchange rate movements.

Capital

The Group believes that being well capitalised is important. The Group Asset and Liability Committee targets Tier 1 and Total capital ratios of 7-9 per cent and 12-14 per cent respectively.

Basel II

The Group has a centrally managed Basel programme with work streams operating in businesses covering both credit and operational risk. Work is well advanced and the Group expects to be in line to gain compliance with the Basel Accord by 1 January 2007.

There is close alignment between the objectives of Basel II and the Group's own best practice goals. As a leading international bank, we are concerned by the potential impact of inconsistent implementation of the Basel Accord cross border and regard this as a key industry issue for Regulators to address.

International Financial Reporting Standards (IFRS)

From 1 January 2005, the Group will be required by European Directives to report its consolidated financial statements under IFRS, as endorsed by the European Union. Our first published results under IFRS will be the 2005 Interim Report. In May 2005 we intend to present to investors and analysts the impact of IFRS on the Group following the restatement of our 2004 financial statements.

The transition to IFRS represents a significant change in our accounting policies. The principal changes are:

- recording all derivatives and certain debt security assets at fair value on the balance sheet;
- recording additional bad debt charges for time-value discount provisions;
- recording interest on a 'level yield' basis;
- recording the cost of share options awarded to employees on a fair value basis;

- ceasing goodwill amortisation;
- dividends proposed but not declared are no longer accrued as a liability;
- grossing up of the balance sheet for items no longer permitted to be netted;
- consolidating certain assets and liabilities previously permitted to be off balance sheet;
- reclassification between liabilities and shareholders' funds of certain preferred securities and shares; and
- deferred tax effect on IFRS adjustments.

IFRS does not change net cash flows or the underlying economics of our business. However, excluding the potential impact of recording all derivatives on balance sheet at fair value, we expect an increase in shareholders' funds, particularly from not accruing dividends until declared. The cost of awarding share options to employees is expected to increase.

The accounting rules for fair valuing all derivatives is expected to cause some degree of earnings volatility in the future. Although the Group will aim to minimise this volatility, our priority will be to ensure risk is managed effectively.

Our expectation is that the impact of IFRS on the Group's regulatory capital will be minimal.

	2004 $million	2003* $million
Tier 1 capital:		
Shareholders' funds	**8,435**	7,529
Minority interests – equity	**111**	83
Innovative Tier 1 securities	**1,246**	1,155
Less: restriction on innovative Tier 1 securities	**(68)**	(160)
Unconsolidated associated companies	**30**	13
Less: goodwill capitalised	**(1,900)**	(1,986)
Add: provision for retirement benefits after tax	**110**	124
Total Tier 1 capital	**7,964**	6,758
Tier 2 capital:		
Qualifying general provision	**335**	387
Perpetual subordinated debt	**1,961**	1,914
Other eligible subordinated debt	**3,525**	2,898
Restricted innovative Tier 1 securities	**68**	160
Total Tier 2 capital	**5,889**	5,359
Investments in other banks	**(33)**	(742)
Other deductions	**(34)**	(4)
Total capital	**13,786**	11,371
Risk weighted assets	**71,096**	58,371
Risk weighted contingents	**21,028**	19,791
Total risk weighted assets and contingents	**92,124**	78,162
Capital ratios:		
Tier 1 capital	**8.6%**	8.6%
Total capital	**15.0%**	14.5%

	2004 $million	2003* $million
Shareholders' funds		
Equity	**7,759**	6,880
Non-equity	**676**	649
	8,435	7,529
Post-tax return on equity (normalised)	**20.1%**	15.7%

*Comparative restated (see note 54 on page 118).