Financial Review

Group Summary

The Group has continued its strong performance trajectory with another good set of results for the year ended 31 December 2005. Operating profit before tax of $2,681 million was up 19 per cent over the same period in 2004. Normalised earnings per share has increased by 23 per cent to 153.7 cents. (Refer to note 12 on page 82 for the details of basic and diluted earnings per share).

On 15 April 2005 the Group acquired 100 per cent of Korea First Bank (KFB). On 10 September 2005 KFB was renamed SC First Bank (SCFB) and on 28 November 2005 the assets and businesses of the Standard Chartered branch in Korea were transferred to SCFB. The impact of the post acquisition results of SCFB in the 2005 results, together with significant one-off items affecting the 2004 results, make the comparability of the full year results to December 2005 with the equivalent period in 2004 complex. The table below therefore sets out underlying results for the two years excluding these two components.

	2005			2004		
	SCFB $m	Underlying $m	As reported $m	*One off items $m	Underlying $m	As reported $m
Net interest income	781	3,554	4,335	–	3,182	3,182
Fees and commissions income, net	29	1,466	1,495	–	1,332	1,332
Net trading income	23	746	769	–	651	651
Other operating income	26	236	262	108	109	217
	78	2,448	2,526	108	2,092	2,200
Operating income	859	6,002	6,861	108	5,274	5,382
Operating expenses	(579)	(3,232)	(3,811)	(23)	(2,826)	(2,849)
Operating profit before provisions	280	2,770	3,050	85	2,448	2,533
Impairment losses on loans and advances	(53)	(266)	(319)	–	(214)	(214)
Other impairment	–	(50)	(50)	(67)	(1)	(68)
Operating profit before taxation	227	2,454	2,681	18	2,233	2,251

* See note 12 on page 82.

Operating Income and Profit

Operating income, including SCFB, increased by 27 per cent to $6,861 million over 2004. Of this increase, SCFB accounted for $859 million. Underlying income growth excluding SCFB and 2004 one-off items was 14 per cent to $6,002 million. Both Consumer Banking and Wholesale Banking delivered double-digit income growth and business momentum remains strong across an increasingly broad range of customer segments and markets.

Net interest income grew by 36 per cent to $4,335 million. Underlying growth was 12 per cent. Net interest margin was 2.5 per cent, down from 2.6 per cent in the prior year reflecting the impact of changes in geographic and product mix.

Fees and commissions increased by 12 per cent to $1,495 million. Underlying growth was 10 per cent driven mainly by higher volumes in wealth management, cash management and global markets products across most markets.

Net trading income grew by 18 per cent to $769 million due to higher volumes of foreign exchange dealing by both Wholesale and Consumer Banking customers. Underlying growth was 15 per cent.

Other operating income of $262 million increased by 21 per cent. Excluding one-off items in 2004 from the sale of shares in KorAm and Bank of China (Hong Kong), growth was strong on the back of structured transactions and sales of available-for-sale securities within the asset and liability management (ALM) portfolio.

Operating expenses increased from $2,849 million to $3,811 million. Of this increase, $579 million was due to the inclusion of SCFB.

Underlying expense growth was 14 per cent, in line with underlying income growth for the full year. The normalised cost income ratio was 54.5 per cent (2004: 54.0 per cent) on a headline basis including SCFB, but on an underlying normalised basis has improved to 53.0 per cent (2004: 54.0 per cent). The Group has continued to invest in both Consumer Banking and Wholesale Banking in order to sustain the double-digit client led income growth. Such investments were directed primarily at new market entry, new products, reinforced capabilities, expanded client coverage, increased distribution and improvements to technology and infrastructure to support new and rapidly growing markets.

Impairment losses on loans and advances rose by 49 per cent from $214 million to $319 million, an increase of $105 million of which SCFB accounted for $53 million.

The underlying increase in impairment losses was 24 per cent reflecting asset growth in Consumer Banking, a deterioration in the Taiwan consumer credit environment and movements in portfolio provisioning under IFRS. Wholesale Banking continued to benefit from a benign credit environment, the successful conclusion of the Loan Management Agreement in Thailand and strong recoveries. Other impairment includes provisions made in 2005 for exposures in Zimbabwe.

Consumer Banking

Including the acquisition of SCFB, Consumer Banking grew operating profit by 21 per cent to $1,278 million compared to 2004. Of the $220 million increment in profit, SCFB accounted for $137 million. Underlying growth was eight per cent.

Consumer Banking has maintained strong income momentum with income up 41 per cent to $3,807 million. SCFB accounted for $671 million or 61 per cent of Consumer Banking's total income growth of $1,107 million. Underlying income was up 16 per cent to $3,136 million. Underlying income growth was driven by volume and fee income growth across almost all product lines, strong growth in customer balances, particularly deposits and the contribution from business segments such as consumer finance and small and medium enterprises (SME) loans. Businesses acquired in 2004, including PrimeCredit and Bank Permata, contributed to income and profit growth.

Excluding SCFB, customer liabilities saw double-digit growth year on year while assets grew four per cent. Deposit growth was particularly strong in Hong Kong, Singapore and Other Asia Pacific Region (Other APR).

On an underlying basis excluding SCFB, expense growth was broadly in line with income growth at 15 per cent for the year. This expense growth included investment expenditure in new products, extended client coverage, enhanced infrastructure, increased compliance costs and investment in new businesses. Total expenses in Consumer Banking grew by $701 million with SCFB accounting for $486 million.

Overall, Consumer Banking's impairment losses on loans and advances rose to $425 million from $242 million in 2004. This reflects the impact of asset growth outside Korea, inclusion of SCFB, movements in portfolio provisions under IFRS and deterioration in the Taiwan consumer credit environment. The underlying impairment charge has risen 20 bps to one per cent of average customer assets largely as a result of changes in portfolio mix and the deteriorating credit environment in Taiwan, where the banking industry as a whole has been significantly affected by a strong increase in consumer default rates. Consumer Banking anticipated this deterioration and took action to mitigate exposure. Nonetheless, the Consumer Banking loan impairment charge in Taiwan increased to $98 million in 2005 from $26 million in 2004. Consumer Banking in Taiwan has customer assets of approximately $1.3 billion as at 31 December 2005. We expect Taiwan to remain challenging through 2006.

Hong Kong delivered an increase in operating profit of 17 per cent to $540 million. Income growth was four per cent. Operating expenses were lower than in 2004 as a result of the actions taken to reconfigure the cost base. This resulted in pre-impairment profit growth of seven per cent. Responding to the rising interest rate environment, the business has put greater focus onto wealth management and SME, by successfully launching several new products and achieving growth in customer liabilities. The acquisition of PrimeCredit in 2004 has been a great success with performance well ahead of plan. Asset portfolios continue to perform well with a 56 per cent reduction in the loan impairment charge compared to the prior period.

In Singapore, income was down two per cent in 2005 with strong growth in wealth management and SME largely offsetting the sharp decline in mortgage margins. Mortgage margins reduced by nearly half on a full year basis. The successful launch of a new on-line savings product, together with good growth in investment services resulted in strong wealth management income growth.

Operating profit before provisions was up 28 per cent in Malaysia on the back of a 19 per cent rise in income and moderate expense growth focused on building infrastructure and expanding distribution. Good balance sheet growth, new products, a developing Islamic banking presence and better fee income coupled with productivity improvements all contributed to a strong performance for Consumer Banking. Loan impairment charges rose from $14 million to $37 million primarily due to attributing portfolio provision movements under IFRS.

In the eight and a half months since acquisition, the Consumer Banking division of SCFB earned $137 million of operating profit on income of $671 million. With the expansion of the product range since acquisition there has been good volume growth, particularly in wealth management with a significant growth in deposits. The cards and loans portfolios and mortgage portfolio have also enjoyed robust asset growth although moderate mortgage margin contraction has continued during the second half of the year. Expenses were higher in the second half, as anticipated, reflecting integration costs, re-branding and investment in product capabilities.

Other APR had income growth of 55 per cent driven by strong balance sheet growth in all product segments and continued investment in expanding sales forces, new branches and new products. Bank Permata in Indonesia accounted for $69 million of income and $9 million of profit before tax. China enjoyed very strong organic growth in all major products delivering a threefold increase in income. Thailand continues to perform very well with increasingly diversified income and balance sheet growth. Impairment provisions increased by $100 million, of which $72 million was in Taiwan.

India's very strong income growth in wealth management and SME was offset in part by lower growth in mortgages and a small decline in unsecured lending due to eroding margins resulting in an overall income growth of 10 per cent. The Consumer Business has continued to diversify its income streams with double-digit balance sheet growth in all business lines except credit cards. Continued investment spending underpinned a 17 per cent overall increase in expenses directed towards opening five new branches, the launch of six consumer finance business centres, new investment and insurance products and a continued strengthening of the risk and control infrastructure. Whilst there are near term challenges in profitability, Consumer Banking remains focused on building a substantial franchise in this fast growing and highly competitive market.

Operating profit in the Middle East and Other South Asia (MESA) increased by 23 per cent to $163 million with income up by 28 per cent to $378 million. This continued strong year on year momentum was led by wealth management, credit cards and SME. Investment in sustaining this growth trajectory resulted in a 26 per cent increase in expenses, with a focus on strengthening distribution, product and people capabilities. The global Consumer Banking business model is now embedded in these rapidly growing markets.

In the United Arab Emirates (UAE), Consumer Banking grew income 27 per cent to $158 million driven by wealth management, SME and credit cards. As new products continue to be launched, volume growth on both sides of the balance sheet remains robust.

In Africa, operating profit more than doubled as a result of broad based income growth of 18 per cent and expense growth contained to just five per cent, benefiting from productivity gains and prior year investments. Asset growth of 26 per cent reflected an increasing market demand for borrowing.

The Americas, UK and Group Head Office saw a decrease in operating profit from $19 million to $9 million largely driven by lower income as a result of the reconfiguration of the Jersey business.

Financial Review continued

Consumer Banking continued

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

	2005									
	Asia Pacific									
	Hong Kong $m	Singapore $m	Malaysia $m	Korea $m	Other Asia Pacific $m	India $m	*Middle East & Other S Asia $m	Africa $m	Americas UK & Group Head Office $m	Consumer Banking Total $m
Income	989	322	209	695	611	285	378	257	61	3,807
Expenses	(415)	(126)	(95)	(505)	(342)	(179)	(182)	(205)	(52)	(2,101)
Loan impairment	(34)	(30)	(37)	(56)	(166)	(56)	(33)	(13)	–	(425)
Other impairment	–	–	–	–	–	–	–	(3)	–	(3)
Operating profit	540	166	77	134	103	50	163	36	9	1,278

	2004									
	Asia Pacific									
	Hong Kong $m	Singapore $m	Malaysia $m	Korea $m	Other Asia Pacific $m	India $m	*Middle East & Other S Asia $m	Africa $m	Americas UK & Group Head Office $m	Consumer Banking Total $m
Income	954	330	175	7	393	258	296	218	69	2,700
Expenses	(416)	(117)	(86)	(12)	(225)	(153)	(144)	(196)	(51)	(1,400)
Specific	(88)	(40)	(18)	–	(69)	(29)	(21)	(6)	–	(271)
General	11	6	4	–	3	2	2	–	1	29
Loan impairment	(77)	(34)	(14)	–	(66)	(27)	(19)	(6)	1	(242)
Operating profit	461	179	75	(5)	102	78	133	16	19	1,058

* Middle East and Other S Asia includes UAE income of $158 million (2004: $124 million), expenses of $67 million (2004: $51 million), loan impairment of $21 million (2004: $9 million) and operating profit of $70 million (2004: $64 million).

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

	2005			2004
Income by product	Total $m	SCFB $m	Underlying $m	$m
Cards and Loans	1,526	248	1,278	1,117
Wealth Management and Deposits	1,442	212	1,230	891
Mortgages and Auto Finance	764	207	557	638
Other	75	4	71	54
	3,807	671	3,136	2,700

Including SCFB, cards and loans have delivered a solid 37 per cent increase in income to $1,526 million. Underlying income and assets have increased 14 per cent and 17 per cent respectively in a highly competitive market environment with lower net interest margins broadly offset by higher fee income. Cards and loans enjoyed strong growth in Malaysia, Other APR, MESA and Africa. In Hong Kong three per cent growth year on year was achieved, reversing the previous declining trend in balances. Growth accelerated in the second half as successful new campaigns were rolled out for the Manhattan brand, cashback and balance building, leveraging the new positive file credit bureau.

In wealth management, underlying double-digit deposit growth and improved margins have been the primary drivers of a 62 per cent growth in income to $1,442 million. The primary contributors being Singapore, India, Other APR and MESA. Product innovation, expanded distribution and effective sales and marketing campaigns have boosted both core deposit volumes and fee based investment product sales.

Total mortgage and auto finance income is up 20 per cent at $764 million. Underlying income is lower by 13 per cent reflecting significant mortgage margin compression in Hong Kong, Singapore and India. Proactive re-pricing strategies have helped to offset some of this margin compression together with very good volume growth in Other APR.

Wholesale Banking

In 2005 Wholesale Banking continued to execute its highly successful client-led strategy, driving sustained income momentum in all key client segments and across multiple products and geographies. Including SCFB, operating profit was up 22 per cent to $1,439 million. Underlying profit growth increased 15 per cent to $1,349 million.

Total income growth was 19 per cent to $3,054 million. Underlying income growth of 11 per cent to $2,866 million was achieved through client revenue growth of 19 per cent, driven by balanced growth across local corporates and large local corporates, multinationals and financial institutions. Global markets products together with cash and custody were the principal contributors to the continued strong growth in Wholesale Banking client revenues. Own account ALM and trading revenues were adversely affected by a rising interest rate environment and a flat yield curve.

Expenses in Wholesale Banking increased by 20 per cent to $1,710 million. Underlying expense growth was 13 per cent. Investment spend focused on enhancing global market product capabilities and client coverage with an emphasis on corporate finance and capital markets and the high growth markets of India, China and the UAE. Higher transaction volumes plus continued upgrading of the technology and operations infrastructure and preparation for Basel II made up the balance.

The net loan impairment release in 2005 was $106 million compared to $28 million in the prior period. New provisions increased by three per cent and recoveries were up by 60 per cent.

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

	2005									
	Asia Pacific									
	Hong Kong $m	Singapore $m	Malaysia $m	Korea $m	Other Asia Pacific $m	India $m	*Middle East & Other S Asia $m	Africa $m	Americas UK & Group Head Office $m	Wholesale Banking Total $m
Income	523	188	124	259	443	305	430	294	488	3,054
Expenses	(234)	(120)	(55)	(127)	(268)	(127)	(157)	(194)	(428)	(1,710)
Loan impairment	(83)	(13)	7	(5)	117	6	42	(30)	65	106
Other impairment	(1)	–	–	–	–	1	–	(8)	(3)	(11)
Operating profit	205	55	76	127	292	185	315	62	122	1,439

	2004									
	Asia Pacific									
	Hong Kong $m	Singapore $m	Malaysia $m	Korea $m	Other Asia Pacific $m	India $m	*Middle East & Other S Asia $m	Africa $m	Americas UK & Group Head Office $m	Wholesale Banking Total $m
Income	416	183	95	63	362	231	352	366	506	2,574
Expenses	(226)	(111)	(58)	(29)	(252)	(98)	(125)	(164)	(363)	(1,426)
Specific	(54)	(2)	11	3	19	3	13	(6)	15	2
General	6	3	1	–	4	2	4	–	6	26
Loan impairment	(48)	1	12	3	23	5	17	(6)	21	28
Other impairment	–	–	–	–	–	2	–	–	(3)	(1)
Operating profit	142	73	49	37	133	140	244	196	161	1,175

* Middle East and Other S Asia includes UAE income of $173 million (2004: $147 million), expenses of $66 million (2004: $49 million), loan impairment recovery of $1 million (2004: recovery of $8 million) and operating profit of $108 million (2004: $106 million).

Financial Review continued

Wholesale Banking continued

When looking at the performance of Wholesale Banking on a geographic basis it is important to note that it is a network business, with about half of client revenues originated in a different geography than where they are booked. This means the geographic segmentation can give a somewhat imperfect view of the performance of different parts of the business.

In Hong Kong, income grew by 26 per cent to $523 million as the increased focus on the local corporates segment yielded good results. Global markets and cash products generated strong growth in volumes supported by improved margins. Expenses grew four per cent to $234 million with most of this increase directed towards building the sales force and product capabilities to deepen income generation from existing client relationships.

Income in Singapore was up three per cent to $188 million driven by transaction banking together with global markets sales. Double-digit client income growth was offset by a reduction in trading and ALM income. Singapore continues to increase its franchise value, originating significant revenues for other parts of the network. Expenses grew eight per cent to $120 million reflecting increased front office investments to sustain the strong client revenue momentum.

In Malaysia, income increased 31 per cent to $124 million with global markets products now contributing 64 per cent of the total. The business achieved strong growth in the large local corporate sector. Expenses were lower by five per cent at $55 million.

The Wholesale Banking business in SCFB earned $90 million of operating profit on income of $188 million. Income and volumes of global markets product sales, together with cash management and custody, grew in the second half as the significant investment in more sophisticated products, new skills and infrastructure began to deliver benefits.

Other APR continued to deliver strong growth in income and profits from all countries with significant contributions from China, Indonesia and Taiwan. Income increased 22 per cent to $443 million and expenses grew six per cent to $268 million.

India's income grew 32 per cent to $305 million with client income growing at an even higher rate offset by lower trading and ALM income. Growth was balanced across all target segments with transactional banking and global markets products leading the way. Expenses grew 30 per cent to $127 million, with continued investment in geographic expansion to sustain the momentum amongst local corporates.

Operating profit in the Middle East and Other South Asia grew by 29 per cent to $315 million. Income rose 22 per cent to $430 million and expenses 26 per cent to $157 million. Client revenues enjoyed very strong growth in cash, capital markets and corporate finance products. Within this total the Wholesale Banking business in the UAE grew income by 18 per cent.

In Africa, income at $294 million was 20 per cent lower than in the prior year. A marked deterioration in Zimbabwe was the primary contributor to this result. 2005 saw Zimbabwe suffer from high inflation and very rapid currency depreciation, particularly in the fourth quarter. Elsewhere in Africa, Wholesale Banking saw robust income growth in Nigeria, Ghana and Tanzania, driven by cash management, trade and corporate finance.

The Americas, UK and Group Head Office has seen income decline by four per cent to $488 million mainly as a result of lower income from asset and liability management. Expense growth of 18 per cent reflects the full year impact of the project finance business acquired at the end of 2004, which originates revenues largely booked elsewhere, together with significant investment in compliance and control infrastructure.

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

	2005			2004
Income by product	Total $m	SCFB $m	Underlying $m	$m
Trade and Lending	879	69	810	868
Global Markets	1,434	75	1,359	1,217
Cash Management and Custody	741	44	697	489
	3,054	188	2,866	2,574

Trade and lending income increased one per cent overall to $879 million and decreased by seven per cent on an underlying basis due to lower lending income. Trade finance income grew three per cent reflecting the increased competitiveness in pricing and a shift to integrated supply chain financing to support strong intra-Asian trade flows.

Global markets income grew strongly at 18 per cent overall to $1,434 million and 12 per cent on an underlying basis. The enhanced product set, including FX options, fixed income and project and export finance, has made a significant contribution to this growth. Income from ALM has fallen due to the flat yield curves and rising interest rates prevalent in most markets, particularly in the second half.

Cash management and custody income was up by 52 per cent at $741 million. Underlying growth was also very strong at 43 per cent driven by volume and margin growth.

Acquisition of SC First Bank (formerly Korea First Bank)

On 15 April 2005 the Group acquired 100 per cent of SCFB. The post-acquisition profit has been included in the Group results within the Korea geographic segment. The following tables provides an analysis of SCFB's post acquisition results by business segment:

Consumer Banking

	2005 Total $m	2005 SCFB $m	2005 Underlying $m	2004 $m
Income	3,807	671	3,136	2,700
Expenses	(2,101)	(486)	(1,615)	(1,400)
Loan impairment	(425)	(48)	(377)	(242)
Other impairment	(3)	–	(3)	–
Operating profit	1,278	137	1,141	1,058

SCFB Consumer Banking income was broadly based with margin, volume and fee income growth in wealth management and SME banking. Mortgage and unsecured lending volumes have continued to grow but margin compression impacted income growth.

Wholesale Banking

	2005 Total $m	2005 SCFB $m	2005 Underlying $m	2004 $m
Income	3,054	188	2,866	2,574
Expenses	(1,710)	(93)	(1,617)	(1,426)
Loan impairment	106	(5)	111	28
Other impairment	(11)	–	(11)	(1)
Operating profit	1,439	90	1,349	1,175

SCFB Wholesale Banking income is being generated by a broader product set and client base. New global markets products and cash management are now driving growth while balance sheet reshaping continues in lending.

Korea segment – Total

	2005 Total $m	2005 SCFB $m	2005 Underlying $m	2004 $m
Income	954	859	95	70
Expenses	(632)	(579)	(53)	(41)
Loan impairment	(61)	(53)	(8)	3
Operating profit	261	227	34	32

Operating profit from SCFB for the eight and a half months since taking control on 15 April 2005 was $227 million. Operating income for the period was $859 million, expenses were $579 million and loan impairment was $53 million.

Financial Review continued

Risk

Through its risk management structure the Group seeks to manage efficiently the core risks: credit, market, country and liquidity risk. These arise directly through the Group's commercial activities whilst compliance and regulatory risk, operational risk and reputational risks are normal consequences of any business undertaking.

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. Acting with authority delegated by the Board, the Audit and Risk Committee (ARC), whose members are all Non-Executive Directors of the Company, reviews specific risk areas and monitors the activities of the Group Risk Committee (GRC) and the Group Asset and Liability Committee (GALCO).

GRC, through authority delegated by the Board is responsible for credit risk, market risk, operational risk, compliance and regulatory risk, legal risk and reputational risk. GALCO, through authority delegated by the Board, is responsible for liquidity risk, for structural interest rate and foreign exchange exposures and for capital ratios.

All the Group Executive Directors (GEDs) of Standard Chartered PLC, members of the Standard Chartered Bank Court and the Group Head of Risk and Group Special Asset Management (Group Head of Risk) are members of the GRC. This Committee is chaired by the Group Head of Risk and Group Special Assets Management (GSAM). The GRC is responsible for agreeing Group standards for risk measurement and management, and also delegating authorities and responsibilities to risk committees and the Group and Regional Credit Committees and Risk Officers.

The committee process ensures that standards and policy are cascaded down through the organisation from the Board through the GRC and the GALCO to the functional, regional and country level committees. Key information is communicated through the country, regional and functional committees to Group so as to provide assurance that standards and policies are being followed.

The Group Finance Director and the Group Head of Risk manage a risk function that is separate from the business line 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 the credit committee and delegates credit authorities;
- validates risk models; and
- recommends risk appetite and strategy.

Individual GEDs 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 GRC across all business activity;
- managing risk in line with appetite levels agreed by the GRC; and
- developing and maintaining appropriate risk management infrastructure and systems to facilitate compliance with risk policy.

The Group's Risk Management Framework identifies 18 risk types which are managed by designated Risk Type Owners (RTOs) who are all approved persons under the FSA regulatory framework and have responsibility for setting minimum standards and governance and assurance processes. The RTOs report up through specialist risk committees to the GRC, or in the case of Liquidity Risk, to the GALCO.

The Group Finance Director and the Group Head of Risk, together with Group Internal Audit, provides assurance separate from the business lines that risk is being measured and managed in accordance with the Group's standards and policies.

Credit Risk Management

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 in the banking and trading books.

Clear responsibility for credit risk is delegated from the Board through to the GRC. Standards are approved by the GRC which also delegates credit authorities through the Group Finance Director to the Group Head of Risk, the Group and Regional Credit Committees and 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 set for different risk environment and business goals. The Risk Officers are located in the businesses to maximise the efficiency of decision making, but have a reporting line which is separate from the business lines into the Group Head of Risk.

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

Risk continued

Wholesale Banking

Within the Wholesale Banking business, a numerical grading system is used 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. These Committees receive their authority and delegated responsibilities from the GRC.

Consumer Banking

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 55 per cent during the year to $112.2 billion. Of this increase, SCFB accounts for $31.2 billion (28 per cent).

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

	2005									
	Asia Pacific									
	Hong Kong $m	Singapore $m	Malaysia $m	Korea $m	Other Asia Pacific $m	India $m	*Middle East & Other S Asia $m	Africa $m	Americas UK & Group Head Office $m	Total $m
Loans to individuals										
Mortgages	12,051	4,129	2,532	22,522	996	1,469	132	88	152	44,071
Other	2,154	1,043	663	3,954	3,145	947	2,001	525	158	14,590
Small and medium enterprises	791	1,673	794	4,727	989	332	78	107	–	9,491
Consumer Banking	14,996	6,845	3,989	31,203	5,130	2,748	2,211	720	310	68,152
Agriculture, forestry and fishing	24	–	44	9	110	17	25	183	234	646
Construction	91	48	11	90	64	139	223	41	6	713
Commerce	2,004	958	325	237	598	392	1,324	420	819	7,077
Electricity, gas and water	290	1	65	17	284	49	180	12	664	1,562
Financing, insurance and business services	1,425	925	589	1,135	1,065	502	1,235	168	1,842	8,886
Loans to governments	–	2,323	1,976	66	101	–	70	7	331	4,874
Mining and quarrying	24	11	8	19	140	10	185	75	656	1,128
Manufacturing	1,223	302	344	1,702	2,955	1,019	1,210	402	2,186	11,343
Commercial real estate	1,194	834	3	797	555	61	5	13	18	3,480
Transport, storage and communication	320	235	240	80	304	108	452	174	1,477	3,390
Other	50	85	49	750	11	5	257	46	40	1,293
Wholesale Banking	6,645	5,722	3,654	4,902	6,187	2,302	5,166	1,541	8,273	44,392
Portfolio impairment provision	(57)	(26)	(30)	(68)	(107)	(33)	(29)	(10)	(7)	(367)
Total loans and advances to customers	21,584	12,541	7,613	36,037	11,210	5,017	7,348	2,251	8,576	112,177
Total loans and advances to banks	5,688	2,431	173	3,222	2,213	238	1,255	313	7,426	22,959

* Middle East and Other S Asia includes the following amounts relating to the UAE: Consumer Banking, $915 million (2004: $832 million) Wholesale Banking, $2,448 million (2004: $2,300 million), total loans and advances to customers, $3,363 million (2004: $3,132 million), and total loans and advances to banks, $391 million (2004: $237 million).

Financial Review continued

Risk continued

	2004									
	Asia Pacific									
	Hong Kong $m	Singapore $m	Malaysia $m	Korea $m	Other Asia Pacific $m	India $m	#*Middle East & Other S Asia $m	Africa $m	Americas UK & Group Head Office $m	#Total $m
Loans to individuals										
Mortgages	12,189	5,064	2,422	–	737	1,194	87	63	262	22,018
Other	2,097	651	488	194	2,909	1,201	1,928	431	102	10,001
Small and medium enterprises	731	1,622	578	–	200	230	42	76	–	3,479
Consumer Banking	15,017	7,337	3,488	194	3,846	2,625	2,057	570	364	35,498
Agriculture, forestry and fishing	–	26	55	–	56	15	19	171	314	656
Construction	154	27	6	–	34	105	239	46	4	615
Commerce	1,560	804	136	31	864	262	1,202	353	1,113	6,325
Electricity, gas and water	387	40	71	78	193	104	119	102	300	1,394
Financing, insurance and business services	1,914	1,608	554	41	721	497	1,362	47	2,268	9,012
Loans to governments	–	306	1,551	–	–	–	16	7	225	2,105
Mining and quarrying	–	65	63	–	122	1	149	95	1,032	1,527
Manufacturing	1,343	423	269	316	2,196	814	1,267	404	2,294	9,326
Commercial real estate	984	721	2	–	388	–	–	29	2	2,126
Transport, storage and communication	366	280	128	134	187	226	299	165	1,177	2,962
Other	19	128	51	–	354	43	243	24	86	948
Wholesale Banking	6,727	4,428	2,886	600	5,115	2,067	4,915	1,443	8,815	36,996
General Provision									(335)	(335)
Total loans and advances to customers	21,744	11,765	6,374	794	8,961	4,692	6,972	2,013	8,844	72,159
Total loans and advances to banks	2,852	2,072	349	1,646	1,705	171	892	374	7,321	17,382

* Middle East and Other S Asia includes the following amounts relating to the UAE: Consumer Banking, $915 million (2004: $832 million) Wholesale Banking, $2,448 million (2004: $2,300 million), total loans and advances to customers, $3,363 million (2004: $3,132 million), and total loans and advances to banks, $391 million (2004: $237 million).

A reclassification of $997 million from Other to Small and medium enterprises that was made at 30 June 2005 (31 December 2004: $951 million) has been reversed.

Maturity analysis

Approximately 47 per cent of the Group's loans and advances are short term having a contractual maturity of one year or less. The Wholesale Banking portfolio is predominately short term, with 75 per cent of loans and advances having a contractual maturity of one year or less. In Consumer Banking, 65 per cent of the portfolio is in the mortgage book, traditionally longer term in nature. Whilst the Other and SME loans in Consumer Banking have short contractual maturities, in the normal course of business they may be renewed and repaid over longer terms.

	2005				2004			
	One year or less $m	One to five years $m	Over five years $m	Total $m	One year or less $m	One to five years $m	Over five years $m	Total $m
Consumer Banking								
Mortgages	4,756	9,598	29,717	44,071	1,877	4,156	15,985	22,018
Other	8,352	4,666	1,572	14,590	5,718	3,880	403	10,001
SME	5,883	1,687	1,921	9,491	989	440	2,050	3,479
Total	18,991	15,951	33,210	68,152	8,584	8,476	18,438	35,498
Wholesale Banking	33,450	7,246	3,696	44,392	27,670	5,227	4,099	36,996
Portfolio impairment provision				(367)				(335)
Loans and advances to customers	52,441	23,197	36,906	112,177	36,254	13,703	22,537	72,159

Risk continued

Problem Credit Management and Provisioning

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 accounts are closely monitored and subject to a special collections process. Accounts that are overdue by more than 90 days are considered non-performing.

The process used for raising provisions is dependant on the product. For mortgages, individual provisions are generally raised at 150 days past due and for other secured products at 90 days past due based on the difference between the outstanding amount of the loan and the present value of the estimated future cash flows. For unsecured products individual provisions are raised and loans are charged off at 150 days past due.

A portfolio impairment provision is held to cover the inherent risk of losses, which, although not identified, are known by experience to be present in the loan portfolio including performing loans and loans overdue. The provision is set with reference to past experience using flow rate methodology as well as taking account of judgemental factors such as the economic and business environment in our core markets, and the trends in a range of portfolio indicators.

The 2005 coverage ratio includes the Consumer Banking portfolio provisions upon adoption of IAS 39, whereas 2004 comparatives exclude the UK GAAP general provision.

	2005									
	Asia Pacific									
	Hong Kong $m	Singapore $m	Malaysia $m	Korea $m	Other Asia Pacific $m	India $m	*Middle East & Other S Asia $m	Africa $m	Americas UK & Group Head Office $m	Total $m
Loans and advances Gross non-performing	81	117	171	856	101	53	22	17	29	1,447
Individual impairment provision	(22)	(31)	(63)	(310)	(61)	(13)	(16)	(9)	(3)	(528)
Non-performing loans net of individual impairment provision	59	86	108	546	40	40	6	8	26	919
Portfolio impairment provision										(278)
Net non-performing loans and advances										641
Cover ratio										56%

	2004									
	Asia Pacific									
	Hong Kong $m	Singapore $m	Malaysia $m	Korea $m	Other Asia Pacific $m	India $m	*Middle East & Other S Asia $m	Africa $m	Americas UK & Group Head Office $m	Total $m
Loans and advances Gross non-performing	72	146	181	–	94	42	42	24	46	647
Impairment provision	(32)	(24)	(28)	–	(47)	(12)	(22)	(9)	(5)	(179)
Interest in suspense	(1)	(4)	(24)	–	(7)	(8)	(15)	(8)	(7)	(74)
Net non-performing loans and advances	39	118	129	–	40	22	5	7	34	394
Cover ratio										39%

* Middle East and Other S Asia includes net non-performing loans and advances net of individual impairment provision relating to the UAE of $nil (2004: $1 million).

Financial Review continued

Risk continued

Wholesale Banking

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 with oversight involving senior Risk Officers and GSAM. 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 GSAM, the specialist recovery unit.

Loans are designated as impaired and considered non-performing as soon as payment of interest or principal is 90 days or more overdue or where recognised weakness implies that full payment of either interest or principal becomes questionable. Impaired accounts are managed by GSAM, which is independent of the main businesses of the Group. Where the principal, or a portion thereof, is considered uncollectible, an individual impairment provision is raised being the difference between the loan carrying amount and the present value of estimated future cash flows. 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 an element of an account against which an impairment provision has been raised, then that amount will be written off.

A portfolio impairment provision is held to cover the inherent risk of losses, which, although not identified, are known by experience to be present in any loan portfolio. The provision is not held to cover losses arising from future events. In Wholesale Banking, the portfolio impairment provision is set with reference to past experience using expected loss and judgemental factors such as the economic environment and the trends in key portfolio indicators.

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

	2005									
	Asia Pacific									
	Hong Kong $m	Singapore $m	Malaysia $m	Korea $m	Other Asia Pacific $m	India $m	*Middle East & Other S Asia $m	Africa $m	Americas UK & Group Head Office $m	Total $m
Loans and advances Gross non-performing	355	125	36	156	133	83	60	89	210	1,247
Individual Impairment provision	(257)	(109)	(33)	(51)	(118)	(27)	(48)	(51)	(164)	(858)
Non-performing loans and advances net of individual impairment provision	98	16	3	105	15	56	12	38	46	389
Portfolio impairment provision										(90)
Net non-performing loans and advances										299

	2004									
	Asia Pacific									
	Hong Kong $m	Singapore $m	Malaysia $m	Korea $m	Other Asia Pacific $m	India $m	*Middle East & Other S Asia $m	Africa $m	Americas UK & Group Head Office $m	Total $m
Loans and advances Gross non-performing	409	185	117	1	557	68	175	104	674	2,290
Impairment provision	(257)	(89)	(68)	(1)	(255)	(29)	(100)	(46)	(435)	(1,280)
Interest in suspense	(92)	(56)	(35)	–	(54)	(26)	(68)	(42)	(127)	(500)
Net non-performing loans and advances										510

* Middle East and Other S Asia includes net non-performing loans and advances net of individual impairment provision relating to the UAE of $nil (2004: $5 million).

Risk continued

Wholesale Banking Cover Ratio

At 76 per cent, the Wholesale Banking non-performing portfolio is well covered. The balance uncovered by impairment provision represents the value of collateral held and/or the Group's estimate of the net value of any work-out strategy.

The cover ratio as at December 2004 shown below was calculated on a UK GAAP basis which included interest in suspense as part of the cover. The non-performing loans recorded below under Standard Chartered Nakornthon Bank (SCNB) are excluded from the cover ratio calculation as they were the subject of a Loan Management Agreement (LMA) with a Thai Government Agency. Refer to note 20 on page 90. Claims under the LMA were settled in the first half of 2005 and accordingly the balances reported under SCNB have reduced to $nil in the 2005 table below.

	2005		
	Total $m	SCNB (LMA) $m	Total excl LMA $m
Loans and advances – Gross non-performing	1,247	–	1,247
Impairment provision	(948)	–	(948)
Net non-performing loans and advances	299	–	299
Cover ratio			76%

	2004		
	Total $m	SCNB (LMA) $m	Total excl LMA $m
Loans and advances – Gross non-performing	2,290	351	1,939
Impairment provision	(1,280)	(115)	(1,165)
Interest in suspense	(500)	–	(500)
Net non-performing loans and advances	510	236	274
Cover ratio			86%

Movement in Group Individual Impairment Provision

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

	2005									
	Asia Pacific									
	Hong Kong $m	Singapore $m	Malaysia $m	Korea $m	Other Asia Pacific $m	India $m	*Middle East & Other S Asia $m	Africa $m	Americas UK & Group Head Office $m	Total $m
Provisions held at 1 January 2005	289	113	96	1	302	41	122	55	440	1,459
Adjusted for adoption of IAS 39	5	6	31	–	17	2	3	9	17	90
Restated provision held at 1 January 2005	294	119	127	1	319	43	125	64	457	1,549
Exchange translation differences	(7)	(2)	1	4	(8)	(1)	5	(4)	(13)	(25)
Amounts written off	(156)	(30)	(58)	(21)	(204)	(66)	(70)	(43)	(223)	(871)
Recoveries of amounts previously written off	49	6	11	5	36	21	14	4	7	153
Acquisitions	–	–	–	352	–	–	–	–	–	352
Discount unwind	(3)	(3)	(4)	(28)	(2)	(1)	–	(2)	(5)	(48)
Other	1	–	–	–	19	(1)	1	(2)	3	21
New provisions	165	92	62	57	153	105	48	60	12	754
Recoveries/provisions no longer required	(64)	(42)	(43)	(9)	(134)	(60)	(59)	(17)	(71)	(499)
Net charge against/(credit) to profit	101	50	19	48	19	45	(11)	43	(59)	255
Provisions held at 31 December 2005	279	140	96	361	179	40	64	60	167	1,386

* Middle East and Other S Asia provisions at 31 December 2005 includes $26 million (2004: $42 million) relating to the UAE.

Financial Review continued

Risk continued

	2004									
	Asia Pacific									
	Hong Kong $m	Singapore $m	Malaysia $m	Korea $m	Other Asia Pacific $m	India $m	*Middle East & Other S Asia $m	Africa $m	Americas UK & Group Head Office $m	Total $m
Provisions held at 1 January 2004	268	123	144	–	390	55	158	58	465	1,661
Exchange translation differences	–	3	–	–	2	2	(4)	2	8	13
Acquisitions	–	–	–	–	36	–	–	–	–	36
Amounts written off	(154)	(62)	(63)	–	(142)	(65)	(42)	(21)	(58)	(607)
Recoveries of amounts previously written off	29	7	10	–	12	24	7	4	2	95
Other	4	–	(2)	–	(42)	(1)	(5)	–	38	(8)
New provision	207	60	36	1	94	106	43	27	35	609
Recoveries/provisions no longer required	(65)	(18)	(29)	–	(48)	(80)	(35)	(15)	(50)	(340)
Net charge against/(credit) to profit	142	42	7	1	46	26	8	12	(15)	269
Provisions held at 31 December 2004	289	113	96	1	302	41	122	55	440	1,459

* Middle East and Other S Asia provisions at 31 December 2005 includes $26 million (2004: $42 million) relating to the UAE.

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.

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

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

Cross border assets 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 assets are recorded. Cross border assets also include exposures to local residents denominated in currencies other than the local currency.

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

	2005				2004			
	Public sector $m	Banks $m	Other $m	Total $m	Public sector $m	Banks $m	Other $m	Total $m
USA	1,227	555	2,505	4,287	824	745	2,660	4,229
Korea	13	1,476	2,006	3,495	47	1,258	698	2,003
Hong Kong	1	311	2,776	3,088	4	199	2,719	2,922
France	159	2,550	155	2,864	149	1,243	183	1,575
China	63	982	1,405	2,450	101	686	902	1,689
India	1	949	1,456	2,406	74	1,132	867	2,073
Singapore	–	326	1,945	2,271	–	325	1,939	2,264
Netherlands	–	–	–	–	–	2,639	406	3,045

Risk continued

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 GRC, which agrees policies and levels of risk appetite in terms of Value at Risk (VaR). The Group Market Risk Committee (GMR) provides market risk oversight and guidance on policy setting. Policies cover the trading book of the Group and also market risks within the banking book. Trading and Banking books are defined as per the Financial Services Authority (FSA) Handbook IPRU (Bank). Limits by location and portfolio are proposed by the businesses within the terms of agreed policy. GMR approves the limits within delegated authorities and monitors exposures against these limits.

GMR 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 banking books combined at 31 December 2005 was $10.8 million (31 December 2004: $15.4 million).

Interest rate related VaR was $10.3 million (31 December 2004: $15.6 million) and foreign exchange related VaR was $1.1 million (31 December 2004: $3.0 million).

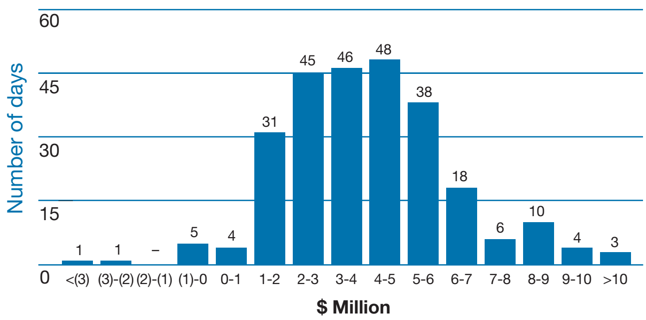
The average total VaR for trading and banking books during the year to 31 December 2005 was $12.4 million (31 December 2004: $15.8 million) with a maximum exposure of $20.6 million.

VaR for interest rate risk in the banking books of the Group totalled $9.2 million at 31 December 2005 (31 December 2004: $16.7 million).

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

The average daily income earned from market risk related activities was $4.1 million, compared with $3.8 million during 2004.

Revenue Distribution



Foreign Exchange Exposure

The Group's foreign exchange exposures comprise trading and banking foreign currency translation exposures and structural currency exposures in net investments in non US dollar units.

Foreign exchange trading exposures are principally derived from customer driven transactions. The average daily income from foreign exchange trading businesses during 2005 was $2.0 million (2004: $1.6 million).

Interest Rate Exposure

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

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

The average daily income from interest rate trading businesses during 2005 was $2.1million (2004: $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, credit 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, credit and exchange rates.

Derivatives are carried at fair value and shown in the balance sheet as separate totals of assets and liabilities. Recognition of fair value gains and losses depends on whether the derivatives are classified as trading or for hedging purposes.

The Group applies a future exposure methodology to manage counterparty credit exposure associated with derivative transactions. Please refer to note 50 on page 125 for further information on Market Risk.

Hedging

In accounting terms, hedges are classified into three typical types: fair value hedges, where fixed rates of interest or foreign exchange are exchanged for floating rates; cash flow hedges, where variable rates of interest or foreign exchange are exchanged for fixed rates; and hedges of net investments in overseas operations translated to the parent company's functional currency, US dollars.

The Group uses futures, forwards, swaps and options transactions in the foreign exchange and interest rate markets to hedge risk.

The Group occasionally hedges 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, management believes that the Group's reserves are sufficient to absorb any foreseeable adverse currency depreciation.

Financial Review continued

Risk continued

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

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 aims to be 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 GALCO, which is chaired by the Group Finance Director and with authority derived from the Board. GALCO 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 and 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 also oversees the structural foreign exchange and interest rate exposures that arise within the Group. These responsibilities are managed through the provision of authorities, policies and procedures that are co-ordinated by the Capital Management Committee. Policies and guidelines for the maintenance of capital ratio levels are approved by GALCO. Compliance with Group ratios are monitored centrally by Group Corporate Treasury while local requirements are monitored by the local ALCO.

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.

A Group operational risk function separate from the business lines 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.

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 the risk of failing to meet the standards of performance or behaviour required or expected by stakeholders in commercial activities or the way in which business is conducted. Reputational Risks arise as a result of poor management of problems occurring in one or more of the primary banking risk areas (Credit, Market, Operational risk areas) and/or from Social, Ethical or Environmental Risk issues. All members of staff have a responsibility for maintaining the Group's reputation.

The Group manages reputational risk through the Group Reputational Risk Committee, which reports to the GRC, and through Country Management Committees. Wholesale Banking has a specialised Reputational Risk Committee which reviews individual transactions. In Consumer Banking, potential reputational risks resulting from transactions or products are reviewed by the Product and Reputational Risk Committee.

Independent Monitoring

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

Capital

The Group Asset and Liability Committee targets Tier 1 and Total capital ratios of 7-9 per cent and 12-14 per cent respectively.

	2005 $m	*2004 $m
Tier 1 capital:		
Called up ordinary share capital and preference shares	5,982	3,818
Eligible reserves	6,151	4,617
Minority interests	115	111
Innovative Tier 1 securities	1,542	1,246
Less: Restriction on innovative Tier 1 securities	(83)	(68)
Goodwill and other intangible assets	(4,321)	(1,900)
Unconsolidated associated companies	186	30
Other regulatory adjustments	153	110
Total Tier 1 capital	9,725	7,964
Tier 2 capital:		
Eligible revaluation reserves	195	–
Portfolio impairment provision (2004: general provision)	368	335
Qualifying subordinated liabilities:		
Perpetual subordinated debt	3,128	1,961
Other eligible subordinated debt	4,169	3,525
Less: Amortisation of qualifying subordinated liabilities	(229)	–
Restricted innovative Tier 1 securities	83	68
Total Tier 2 capital	7,714	5,889
Investments in other banks	(148)	(33)
Other deductions	(173)	(34)
Total capital base	17,118	13,786
Banking book:		
Risk weighted assets	99,378	69,438
Risk weighted contingents	16,274	14,847
	115,652	84,285
Trading book:		
Market risks	6,701	4,608
Counterparty/settlement risk	3,571	3,231
Total risk weighted assets and contingents	125,924	92,124
Capital ratios:		
Tier 1 capital	7.7%	8.6%
Total capital	13.6%	15.0%

* As previously reported under UK GAAP.