

NOTES TO THE FINANCIAL STATEMENTS

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

1 Interest income

	<i>Half-year ended</i> 30 June <i>2006</i>	<i>Half-year ended</i> <i>30 June</i> <i>2005</i>	<i>Half-year ended</i> <i>31 December</i> <i>2005</i>
Interest income on listed investments	128	123	123
Interest income on unlisted investments	4,445	3,032	3,740
Interest income on impaired financial assets	14	9	11
Other interest income	9,067	5,042	7,633
	13,654	8,206	11,507
Less: interest income classified as "Net trading income" (note 4)	(275)	(277)	(346)
Less: interest income classified as "Net income from financial instruments designated at fair value" (note 5)	(45)	(29)	(32)
Interest income (per Consolidated Income Statement)	13,334	7,900	11,129

2 Interest expense

	<i>Half-year ended</i> 30 June <i>2006</i>	<i>Half-year ended</i> <i>30 June</i> <i>2005</i>	<i>Half-year ended</i> <i>31 December</i> <i>2005</i>
Interest expense on debt securities in issue maturing after five years	30	17	109
Interest expense on customer accounts maturing after five years	15	9	8
Interest expense on subordinated liabilities	108	–	58
Other interest expense	7,973	2,848	5,868
	8,126	2,874	6,043
Less: interest expense classified as "Net trading income" (note 4)	(1,154)	(233)	(696)
Less: interest expense classified as "Net income from financial instruments designated at fair value" (note 5)	(13)	(5)	(22)
Interest expense (per Consolidated Income Statement)	6,959	2,636	5,325

3 Net fee income

	<i>Half-year ended</i> 30 June 2006	<i>Half-year ended</i> 30 June 2005	<i>Half-year ended</i> 31 December 2005
• stockbroking and related services	439	233	260
• retail investment products and funds under management	521	575	341
• insurance	59	77	39
• account services	121	110	115
• private banking	160	95	79
• remittances	75	67	74
• cards	403	334	371
• credit facilities	52	51	66
• trade services	176	180	195
• other	72	70	62
Fee income	2,078	1,792	1,602
Fee expense	(296)	(215)	(305)
	1,782	1,577	1,297

4 Net trading income

	<i>Half-year ended</i> 30 June 2006	<i>Half-year ended</i> 30 June 2005	<i>Half-year ended</i> 31 December 2005
Trading profits:			
• foreign exchange	610	277	508
• securities, derivatives and other trading activities	49	112	(12)
	659	389	496
Interest on trading assets and liabilities:			
• interest income (note 1)	275	277	346
• interest expense (note 2)	(1,154)	(233)	(696)
	(879)	44	(350)
	(220)	433	146

5 Net income from financial instruments designated at fair value

	<i>Half-year ended</i> 30 June 2006	<i>Half-year ended</i> 30 June 2005	<i>Half-year ended</i> 31 December 2005
Net income/(expense) on assets designated at fair value which back insurance and investment contracts	57	31	(56)
Net change in fair value of other financial assets and liabilities designated at fair value	(7)	(5)	(2)
Interest on financial assets and liabilities designated at fair value:			
• interest income (note 1)	45	29	32
• interest expense (note 2)	(13)	(5)	(22)
	32	24	10
	82	50	(48)

6 Other operating income

	<i>Half-year ended</i> 30 June 2006	<i>Half-year ended</i> 30 June 2005	<i>Half-year ended</i> 31 December 2005
Rental income from investment properties	104	100	107
Value of in-force long-term assurance business	185	160	156
Other	103	150	125
	392	410	388

7 Loan impairment charges and other credit risk provisions

	<i>Half-year ended</i> 30 June 2006	<i>Half-year ended</i> 30 June 2005	<i>Half-year ended</i> 31 December 2005
Loan impairment (charges)/releases:			
• individually assessed	29	(95)	(214)
• collectively assessed	(63)	(207)	(102)
	(34)	(302)	(316)
Of which:			
• new and additional	(165)	(666)	(404)
• releases	97	314	37
• recoveries	34	50	51
	(34)	(302)	(316)

8 Operating expenses

	<i>Half-year ended</i> 30 June 2006	<i>Half-year ended</i> 30 June 2005	<i>Half-year ended</i> 31 December 2005
Employee compensation and benefits:			
• salaries and other costs	1,218	1,059	1,085
• retirement benefit costs	59	66	71
	1,277	1,125	1,156
General and administrative expenses:			
• rental expenses	117	98	109
• other premises and equipment	350	343	408
• other operating expenses	440	451	567
	907	892	1,084
Depreciation of business premises and equipment	150	135	145
Amortisation of intangible assets	4	4	5
	2,338	2,156	2,390
Cost efficiency ratio	26.8%	26.7%	29.4%
Staff numbers by region *			
Hong Kong	7,524	7,148	7,425
Mainland and others	521	377	420
Total	8,045	7,525	7,845

* Full-time equivalent

9 Profit on disposal of fixed assets and financial investments

	<i>Half-year ended</i> 30 June 2006	<i>Half-year ended</i> 30 June 2005	<i>Half-year ended</i> 31 December 2005
Profit on disposal of available-for-sale securities	126	328	130
Profit less loss on disposal of fixed assets	448	20	(1)
	574	348	129

10 Tax expenses

Taxation in the consolidated income statement represents:

	<i>Half-year ended</i> 30 June 2006	<i>Half-year ended</i> 30 June 2005	<i>Half-year ended</i> 31 December 2005
Current tax			
Tax for the period	1,378	789	724
Deferred tax			
Origination and reversal of temporary differences	(176)	135	147
Total tax expenses	1,202	924	871

The current tax provision is based on the estimated assessable profit for the first half of 2006, and is determined for the Bank and its subsidiaries operating in the Hong Kong SAR by using the Hong Kong profits tax rate of 17.5 per cent (the same rate as in 2005). For subsidiaries and branches operating in other jurisdictions, the appropriate tax rates prevailing in the relevant countries are used.

Deferred tax is calculated at the tax rates that are expected to apply in the year when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement except when it relates to items charged or credited directly to reserves, in which case the deferred tax is also recorded within reserves. The carrying amount of deferred tax assets/liabilities is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised.

11 Earnings per share

The calculation of earnings per share for the first half of 2006 is based on earnings of HK\$6,190 million (HK\$6,045 million for the first half of 2005) and on the weighted average number of ordinary shares in issue of 1,911,842,736 shares (unchanged from the first half of 2005).

12 Dividends per share

	<i>Half-year ended</i>		<i>Half-year ended</i>		<i>Half-year ended</i>	
	<i>30 June</i>		<i>30 June</i>		<i>31 December</i>	
	<i>2006</i>		<i>2005</i>		<i>2005</i>	
	<i>per share</i>	<i>HK\$ million</i>	<i>per share</i>	<i>HK\$ million</i>	<i>per share</i>	<i>HK\$ million</i>
	<i>HK\$</i>		<i>HK\$</i>		<i>HK\$</i>	
First interim	1.10	2,103	1.10	2,103	–	–
Second interim	1.10	2,103	1.10	2,103	–	–
Third interim	–	–	–	–	1.10	2,103
Fourth interim	–	–	–	–	1.90	3,633
	2.20	4,206	2.20	4,206	3.00	5,736

13 Segmental analysis

Segmental information is presented in respect of business and geographical segments. Business by customer group information, which is more relevant to the Group in making operating and financial decisions, is chosen as the primary reporting format.

For the purpose of segmental analysis, the allocation of revenue reflects the benefits of capital and other funding resources allocated to the customer groups or geographical segments by way of internal capital allocation and funds transfer pricing mechanisms. Cost allocation is based on the direct cost incurred by the respective customer groups and apportionment of management overheads. Rental charges at market rate for usage of premises are reflected as inter-segment income for the "Other" customer group and inter-segment expenses for the respective customer groups.

(a) By customer group

The Group's business comprises five customer groups. Personal Financial Services provides banking (including deposits, credit cards, mortgages and other retail lending) and wealth management services (including private banking, investment and insurance) to personal customers. Commercial Banking manages middle market and smaller corporate relationships and specialises in trade-related financial services. Corporate Banking handles relationships with large corporate and institutional customers. Treasury engages in interbank and capital market activities and proprietary trading. Treasury also manages the funding and liquidity positions of the Group and other market risk positions arising from banking activities. "Other" mainly represents management of shareholders' funds and investments in premises, investment properties and equity shares.

13 Segmental analysis (continued)

(a) By customer group (continued)

	Personal Financial Services	Commercial Banking	Corporate Banking	Treasury	Other	Inter- segment elimination	Total
Half-year ended 30 June 2006							
Net interest income	3,543	920	293	175	563	881	6,375
Net fee income	1,334	394	40	(13)	27	–	1,782
Net trading income	252	70	4	368	–	(914)	(220)
Net income from financial instruments designated at fair value	50	–	–	(1)	–	33	82
Dividend income	3	–	–	–	28	–	31
Net earned insurance premiums	3,872	81	1	–	–	–	3,954
Other operating income	273	15	–	–	104	–	392
Inter-segment income	–	–	–	–	191	(191)	–
Total operating income	9,327	1,480	338	529	913	(191)	12,396
Net insurance claims incurred and movement in policyholder liabilities	(3,641)	(30)	–	–	–	–	(3,671)
Net operating income before loan impairment (charges)/releases and other credit risk provisions	5,686	1,450	338	529	913	(191)	8,725
Loan impairment (charges)/releases and other credit risk provisions	(74)	26	14	–	–	–	(34)
Net operating income	5,612	1,476	352	529	913	(191)	8,691
Total operating expenses *	(1,561)	(498)	(78)	(81)	(120)	–	(2,338)
Inter-segment expenses	(165)	(19)	(3)	(4)	–	191	–
Operating profit	3,886	959	271	444	793	–	6,353
Profit on disposal of fixed assets and financial investments	–	–	–	–	574	–	574
Net surplus on property revaluation	–	–	–	–	318	–	318
Share of profits from associates	11	137	–	62	58	–	268
Profit before tax	3,897	1,096	271	506	1,743	–	7,513
Share of pre-tax profit	51.9%	14.6%	3.6%	6.7%	23.2%	–	100.0%
Operating profit excluding inter-segment transactions	4,051	978	274	448	602	–	6,353
Operating profit excluding loan impairment (charges)/releases and other credit risk provisions	3,960	933	257	444	793	–	6,387
* Depreciation/amortisation included in total operating expenses	(51)	(4)	(2)	(1)	(96)	–	(154)
At 30 June 2006							
Total assets	160,551	59,758	72,230	305,126	30,624	–	628,289
Total liabilities	399,620	71,670	39,398	48,950	23,653	–	583,291
Investments in associates	131	1,649	–	745	742	–	3,267
Capital expenditure incurred during the period	69	10	3	3	57	–	142

13 Segmental analysis (continued)

(a) By customer group (continued)

	Personal Financial Services	Commercial Banking	Corporate Banking	Treasury	Other	Inter- segment elimination	Total
Half-year ended 30 June 2005							
Net interest income	3,363	734	302	686	257	(78)	5,264
Net fee income	1,196	325	39	(11)	28	–	1,577
Net trading income	173	60	3	122	–	75	433
Net income from financial instruments designated at fair value	31	–	–	14	2	3	50
Dividend income	3	1	–	–	33	–	37
Net earned insurance premiums	2,619	109	–	–	–	–	2,728
Other operating income	293	13	2	–	102	–	410
Inter-segment income	–	–	–	–	154	(154)	–
Total operating income	7,678	1,242	346	811	576	(154)	10,499
Net insurance claims incurred and movement in policyholder liabilities	(2,387)	(22)	–	–	–	–	(2,409)
Net operating income before loan impairment (charges)/releases and other credit risk provisions	5,291	1,220	346	811	576	(154)	8,090
Loan impairment (charges)/releases and other credit risk provisions	260	(453)	(109)	–	–	–	(302)
Net operating income	5,551	767	237	811	576	(154)	7,788
Total operating expenses *	(1,468)	(429)	(63)	(80)	(116)	–	(2,156)
Inter-segment expenses	(123)	(25)	(3)	(3)	–	154	–
Operating profit	3,960	313	171	728	460	–	5,632
Profit on disposal of fixed assets and financial investments	–	–	–	–	348	–	348
Net surplus on property revaluation	–	–	–	–	877	–	877
Share of profits from associates	10	124	–	56	15	–	205
Profit before tax	3,970	437	171	784	1,700	–	7,062
Share of pre-tax profit	56.2%	6.2%	2.4%	11.1%	24.1%	–	100.0%
Operating profit excluding inter-segment transactions	4,083	338	174	731	306	–	5,632
Operating profit excluding loan impairment (charges)/releases and other credit risk provisions	3,700	766	280	728	460	–	5,934
* Depreciation/amortisation included in total operating expenses	(50)	(9)	(1)	(1)	(78)	–	(139)
At 30 June 2005							
Total assets	146,398	54,865	80,182	267,687	23,101	–	572,233
Total liabilities	353,402	75,517	29,628	61,214	10,041	–	529,802
Investments in associates	96	1,210	–	546	597	–	2,449
Capital expenditure incurred during the period	63	13	5	1	15	–	97

13 Segmental analysis (continued)

(a) By customer group (continued)

	Personal Financial Services	Commercial Banking	Corporate Banking	Treasury	Other	Inter- segment elimination	Total
Half-year ended 31 December 2005							
Net interest income	3,737	853	310	172	257	475	5,804
Net fee income	905	341	40	(10)	21	–	1,297
Net trading income	194	74	3	381	–	(506)	146
Net income from financial instruments designated at fair value	(64)	–	–	(9)	(6)	31	(48)
Dividend income	2	4	–	–	17	–	23
Net earned insurance premiums	5,023	114	–	–	–	–	5,137
Other operating income	269	12	2	–	105	–	388
Inter-segment income	–	–	–	–	154	(154)	–
Total operating income	10,066	1,398	355	534	548	(154)	12,747
Net insurance claims incurred and movement in policyholder liabilities	(4,577)	(28)	–	–	–	–	(4,605)
Net operating income before loan impairment (charges)/releases and other credit risk provisions	5,489	1,370	355	534	548	(154)	8,142
Loan impairment (charges)/releases and other credit risk provisions	(28)	(350)	62	–	–	–	(316)
Net operating income	5,461	1,020	417	534	548	(154)	7,826
Total operating expenses *	(1,618)	(474)	(79)	(77)	(142)	–	(2,390)
Inter-segment expenses	(135)	(15)	(2)	(2)	–	154	–
Operating profit	3,708	531	336	455	406	–	5,436
Profit on disposal of fixed assets and financial investments	–	–	–	(217)	346	–	129
Net surplus on property revaluation	–	–	–	–	436	–	436
Share of profits from associates	8	110	–	50	127	–	295
Profit before tax	3,716	641	336	288	1,315	–	6,296
Share of pre-tax profit	59.0%	10.2%	5.3%	4.6%	20.9%	–	100.0%
Operating profit excluding inter-segment transactions	3,843	546	338	457	252	–	5,436
Operating profit excluding loan impairment (charges)/releases and other credit risk provisions	3,736	881	274	455	406	–	5,752
* Depreciation/amortisation included in total operating expenses	(53)	(4)	(2)	(1)	(90)	–	(150)
At 31 December 2005							
Total assets	152,086	54,319	77,514	266,645	30,256	–	580,820
Total liabilities	372,941	77,249	31,672	33,541	21,687	–	537,090
Investments in associates	116	1,454	–	657	702	–	2,929
Capital expenditure incurred during the period	44	7	2	1	80	–	134

13 Segmental analysis (continued)**(b) By geographical region**

The geographical regions in this analysis are classified by the location of the principal operations of the subsidiary companies or, in the case of the Bank itself, by the location of the branches responsible for reporting the results or advancing the funds.

	<i>Half-year ended</i>		<i>Half-year ended</i>		<i>Half-year ended</i>	
	<i>30 June</i>		<i>30 June</i>		<i>31 December</i>	
	<i>2006</i>		<i>2005</i>		<i>2005</i>	
		<i>%</i>		<i>%</i>		<i>%</i>
Total operating income						
Hong Kong	11,666	94	9,441	90	11,936	94
Americas	573	5	962	9	682	5
Mainland and other	157	1	96	1	129	1
	12,396	100	10,499	100	12,747	100
Profit before tax						
Hong Kong	6,668	89	5,877	83	5,376	85
Americas	558	7	947	13	667	11
Mainland and other	287	4	238	4	253	4
	7,513	100	7,062	100	6,296	100
Capital expenditure incurred during the period						
Hong Kong	130	92	81	84	125	93
Americas	–	–	–	–	–	–
Mainland and other	12	8	16	16	9	7
	142	100	97	100	134	100
		<i>At 30 June</i>		<i>At 30 June</i>		<i>At 31 December</i>
		<i>2006</i>		<i>2005</i>		<i>2005</i>
		<i>%</i>		<i>%</i>		<i>%</i>
Total assets						
Hong Kong	539,776	86	487,581	85	497,406	86
Americas	63,216	10	64,811	11	60,845	10
Mainland and other	25,297	4	19,841	4	22,569	4
	628,289	100	572,233	100	580,820	100
Total liabilities						
Hong Kong	567,193	97	512,998	97	520,260	97
Americas	6,782	1	10,095	2	9,395	2
Mainland and other	9,316	2	6,709	1	7,435	1
	583,291	100	529,802	100	537,090	100
Contingent liabilities and commitments						
Hong Kong	146,988	94	138,219	98	137,536	97
Americas	–	–	–	–	–	–
Mainland and other	9,197	6	3,429	2	3,973	3
	156,185	100	141,648	100	141,509	100

14 Analysis of assets and liabilities by remaining maturity

The maturity analysis is based on the remaining period at the balance sheet date to the contractual maturity date, with the exception of the trading portfolio that may be sold before maturity and is accordingly recorded as "Repayable on demand".

	<i>Repayable on demand</i>	<i>Three months or less but not on demand</i>	<i>Three months to one year</i>	<i>One year to five years</i>	<i>Over five years</i>	<i>Undated</i>	<i>Total</i>
Assets							
Cash and balances with banks and other financial institutions	13,763	-	-	-	-	-	13,763
Placings with and advances to banks and other financial institutions	9,146	69,689	3,628	100	-	-	82,563
Trading assets	14,543	-	-	-	-	-	14,543
Financial assets designated at fair value	-	41	298	1,460	2,679	1,951	6,429
Derivative financial instruments	1,631	30	71	277	152	-	2,161
Advances to customers	14,922	29,248	38,550	88,183	95,602	-	266,505
Financial investments	58	22,001	36,506	138,026	14,013	1,351	211,955
Investments in associates	-	-	-	-	-	3,267	3,267
Investment properties	-	-	-	-	-	3,161	3,161
Premises, plant and equipment	-	-	-	-	-	6,553	6,553
Interest in leasehold land held for own use under operating lease	-	-	-	-	-	587	587
Intangible assets	-	-	-	-	-	1,857	1,857
Other assets	5,180	7,398	1,001	418	4	944	14,945
At 30 June 2006	59,243	128,407	80,054	228,464	112,450	19,671	628,289
At 30 June 2005	40,599	111,720	76,324	222,444	102,633	18,513	572,233
At 31 December 2005	57,790	97,970	74,642	220,176	110,087	20,155	580,820

14 Analysis of assets and liabilities by remaining maturity (continued)

	<i>Repayable on demand</i>	<i>Three months or less but not on demand</i>	<i>Three months to one year</i>	<i>One year to five years</i>	<i>Over five years</i>	<i>Undated</i>	<i>Total</i>
Liabilities							
Current, savings and other deposit accounts	250,973	188,149	8,042	933	–	–	448,097
Deposits from banks	9,999	11,764	368	–	–	–	22,131
Trading liabilities	61,630	–	–	–	–	–	61,630
Financial liabilities designated at fair value	–	–	–	–	995	(45)	950
Derivative financial instruments	1,733	21	197	303	2	–	2,256
Certificates of deposit and other debt securities in issue	–	79	755	7,478	–	–	8,312
Other liabilities	5,231	4,554	571	42	106	317	10,821
Liabilities to customers under investment contracts	–	–	–	–	–	544	544
Liabilities to customers under insurance contracts	–	–	–	–	–	18,877	18,877
Deferred tax and current tax liabilities	1	8	1,411	–	–	1,248	2,668
Subordinated liabilities	–	–	–	–	7,005	–	7,005
At 30 June 2006	329,567	204,575	11,344	8,756	8,108	20,941	583,291
At 30 June 2005	273,285	213,445	13,321	12,571	3,518	13,662	529,802
At 31 December 2005	289,758	207,494	8,478	9,148	4,690	17,522	537,090

15 Cash and balances with banks and other financial institutions

	<i>At 30 June 2006</i>	<i>At 30 June 2005</i>	<i>At 31 December 2005</i>
Cash in hand	5,229	4,172	4,772
Balances with central banks	323	405	303
Balances with banks and other financial institutions	8,211	3,239	4,126
	13,763	7,816	9,201

16 Placings with and advances to banks and other financial institutions

	<i>At 30 June</i> 2006	<i>At 30 June</i> 2005	<i>At 31 December</i> 2005
Placings with and advances to banks and other financial institutions maturing within one month	61,425	43,150	54,338
Placings with and advances to banks and other financial institutions maturing after one month	21,138	22,832	14,948
	82,563	65,982	69,286

17 Trading assets

	<i>At 30 June</i> 2006	<i>At 30 June</i> 2005	<i>At 31 December</i> 2005
Treasury bills	7,966	1,843	2,594
Certificates of deposit	294	1,017	538
Other debt securities	6,269	10,920	9,440
	14,529	13,780	12,572
Debt securities	14	32	28
Equity shares	14,543	13,812	12,600
Debt securities:			
• listed in Hong Kong	874	908	767
• listed outside Hong Kong	164	–	–
	1,038	908	767
• unlisted	13,491	12,872	11,805
	14,529	13,780	12,572
Equity shares:			
• listed in Hong Kong	14	14	17
• unlisted	–	18	11
	14	32	28
	14,543	13,812	12,600
Debt securities:			
Issued by public bodies:			
• central governments and central banks	10,188	4,679	5,625
• other public sector entities	1,163	1,491	1,489
	11,351	6,170	7,114
Issued by other bodies:			
• banks and other financial institutions	1,945	4,281	2,836
• corporate entities	1,233	3,329	2,622
	3,178	7,610	5,458
	14,529	13,780	12,572
Equity shares:			
Issued by corporate entities	14	32	28
	14,543	13,812	12,600

18 Financial assets designated at fair value

	<i>At 30 June 2006</i>	<i>At 30 June 2005</i>	<i>At 31 December 2005</i>
Certificates of deposit	234	190	194
Other debt securities	3,906	2,392	4,075
Debt securities	4,140	2,582	4,269
Equity shares	2,289	1,161	1,758
	6,429	3,743	6,027
Debt securities:			
• listed in Hong Kong	101	106	100
• listed outside Hong Kong	30	20	22
	131	126	122
• unlisted	4,009	2,456	4,147
	4,140	2,582	4,269
Equity shares:			
• listed in Hong Kong	918	576	732
• listed outside Hong Kong	1,069	538	979
	1,987	1,114	1,711
• unlisted	302	47	47
	2,289	1,161	1,758
	6,429	3,743	6,027
Debt securities:			
Issued by public bodies:			
• central governments and central banks	846	875	865
• other public sector entities	287	420	295
	1,133	1,295	1,160
Issued by other bodies:			
• banks and other financial institutions	2,888	1,140	2,937
• corporate entities	119	147	172
	3,007	1,287	3,109
	4,140	2,582	4,269
Equity shares:			
Issued by corporate entities	2,289	1,161	1,758
	6,429	3,743	6,027

Financial assets are designated at fair value, usually together with the related liabilities or derivative financial instruments, primarily for the purpose of eliminating or significantly reducing the accounting mismatch. The figures also include those financial assets of the life insurance funds designated at fair value for backing policyholder liabilities.

19 Advances to customers

(a) Advances to customers

	<i>At 30 June 2006</i>	<i>At 30 June 2005</i>	<i>At 31 December 2005</i>
Gross advances to customers	267,393	261,713	261,714
Loan impairment allowances:			
• individually assessed	(377)	(733)	(524)
• collectively assessed	(511)	(468)	(510)
	266,505	260,512	260,680
Included in advances to customers are:			
• trade bills	3,577	3,015	3,024
• loan impairment allowances	(15)	(12)	(14)
	3,562	3,003	3,010

(b) Loan impairment allowances against advances to customers

	<i>Individually assessed</i>	<i>Collectively assessed</i>	<i>Total</i>
At 1 January 2006	524	510	1,034
Amounts written off	(119)	(81)	(200)
Recoveries of advances written off in previous years	15	19	34
New impairment allowances charged to income statement (note 7)	83	82	165
Impairment allowances released to income statement (note 7)	(112)	(19)	(131)
Unwind of discount of loan impairment allowances	(14)	–	(14)
At 30 June 2006	377	511	888

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

	<i>At 30 June 2006</i>	<i>At 30 June 2005</i>	<i>At 31 December 2005</i>
	%	%	%
Loan impairment allowances:			
• individually assessed	0.14	0.28	0.20
• collectively assessed	0.19	0.18	0.19
Total loan impairment allowances	0.33	0.46	0.39

19 Advances to customers (continued)**(c) Impaired advances and allowances**

	At 30 June 2006	At 30 June 2005	At 31 December 2005
Gross impaired advances	1,209	1,946	1,433
Individually assessed allowances	(377)	(760)	(558)
Net impaired advances	832	1,186	875
Individually assessed allowances as a percentage of gross impaired advances	31.2%	39.1%	38.9%
Gross impaired advances as a percentage of gross advances to customers	0.4%	0.7%	0.5%

Impaired advances are those advances where objective evidence exists that full repayment of principal or interest is considered unlikely. Impairment allowances are made to write down the carrying value of the advances to the discounted value of future recoverable amounts, including the realisation of collateral.

(d) Overdue advances

Advances to customers that are more than three months overdue and their expression as a percentage of gross advances to customers are as follows:

	At 30 June 2006		At 30 June 2005		At 31 December 2005	
	%		%		%	
Gross advances to customers that have been overdue with respect to either principal or interest for periods of:						
• six months or less but over three months	538	0.2	500	0.2	482	0.2
• one year or less but over six months	337	0.1	224	0.1	211	0.1
• over one year	149	0.1	423	0.1	169	–
	1,024	0.4	1,147	0.4	862	0.3

Advances with a specific repayment date are classified as overdue when the principal or interest is overdue and remains unpaid at period-end. Advances repayable by regular instalments are treated as overdue when an instalment payment is overdue and remains unpaid at period-end. Advances repayable on demand are classified as overdue either when a demand for repayment has been served on the borrower but repayment has not been made in accordance with the demand notice, or when the advances have remained continuously outside the approved limit advised to the borrower for more than the overdue period in question.

(e) Rescheduled advances

Rescheduled advances and their expression as a percentage of gross advances to customers are as follows:

	At 30 June 2006		At 30 June 2005		At 31 December 2005	
	%		%		%	
Rescheduled advances to customers	349	0.1	357	0.1	361	0.1

Rescheduled advances are those that have been rescheduled or renegotiated for reasons related to the borrower's financial difficulties. This will normally involve the granting of concessionary terms and resetting the overdue account to non-overdue status. A rescheduled advance will continue to be disclosed as such unless the debt has been performing in accordance with the rescheduled terms for a period of six to twelve months. Rescheduled advances that have been overdue for more than three months under the rescheduled terms are reported as overdue advances to customers.

19 Advances to customers (continued)

(f) Segmental analysis of advances to customers by geographical area

Advances to customers by geographical area are classified according to the location of the counterparties after taking into account the transfer of risk. In general, risk transfer applies when an advance is guaranteed by a party located in an area that is different from that of the counterparty. At 30 June 2006, over 90 per cent of the Group's advances to customers, including related impaired advances and overdue advances, were classified under Hong Kong (unchanged from the positions at 30 June 2005 and 31 December 2005).

(g) Gross advances to customers by industry sector

The analysis of gross advances to customers by industry sector based on categories and definitions used by the Hong Kong Monetary Authority ("HKMA") is as follows:

	At 30 June 2006	At 30 June 2005	At 31 December 2005
Gross advances to customers for use in Hong Kong			
Industrial, commercial and financial sectors			
• property development	15,728	15,048	16,446
• property investment	47,617	41,986	45,964
• financial concerns	2,108	4,399	968
• stockbrokers	288	298	221
• wholesale and retail trade	5,972	5,244	5,562
• manufacturing	6,894	6,305	6,429
• transport and transport equipment	11,578	12,080	11,919
• other	20,615	25,000	22,960
	110,800	110,360	110,469
Individuals			
• advances for the purchase of flats under the Government Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	21,377	24,713	22,879
• advances for the purchase of other residential properties	82,778	81,545	81,318
• credit card advances	7,585	6,583	7,735
• other	8,058	7,385	7,563
	119,798	120,226	119,495
Total gross advances for use in Hong Kong	230,598	230,586	229,964
Trade finance	18,968	16,910	15,874
Gross advances for use outside Hong Kong	17,827	14,217	15,876
Gross advances to customers (note 19(a))	267,393	261,713	261,714

20 Financial investments

	At 30 June 2006	At 30 June 2005	At 31 December 2005
Available-for-sale at fair value:			
• debt securities	197,934	183,030	177,813
• equity shares	1,656	1,560	1,360
Held-to-maturity debt securities at amortised cost	12,365	8,361	10,731
	211,955	192,951	189,904
Fair value of held-to-maturity debt securities	11,853	8,818	10,778
Treasury bills	78	4,604	4,816
Certificates of deposit	25,572	31,738	27,048
Other debt securities	184,649	155,049	156,680
Debt securities	210,299	191,391	188,544
Equity shares	1,656	1,560	1,360
	211,955	192,951	189,904
Debt securities:			
• listed in Hong Kong	2,999	5,147	3,008
• listed outside Hong Kong	1,898	1,676	1,947
	4,897	6,823	4,955
• unlisted	205,402	184,568	183,589
	210,299	191,391	188,544
Equity shares:			
• listed in Hong Kong	1,214	678	1,049
• listed outside Hong Kong	220	132	186
	1,434	810	1,235
• unlisted	222	750	125
	1,656	1,560	1,360
	211,955	192,951	189,904
Fair value of listed financial investments	6,305	7,675	6,209

20 Financial investments (continued)

	<i>At 30 June</i> 2006	<i>At 30 June</i> 2005	<i>At 31 December</i> 2005
Debt securities:			
Issued by public bodies:			
• central governments and central banks	10,306	19,603	15,981
• other public sector entities	7,892	10,753	8,667
	18,198	30,356	24,648
Issued by other bodies:			
• banks and other financial institutions	176,785	145,843	149,557
• corporate entities	15,316	15,192	14,339
	192,101	161,035	163,896
	210,299	191,391	188,544
Equity shares:			
Issued by corporate entities	1,656	1,560	1,360
	211,955	192,951	189,904

21 Investments in associates

	<i>At 30 June</i> 2006	<i>At 30 June</i> 2005	<i>At 31 December</i> 2005
Share of net assets	2,945	2,138	2,611
Goodwill	322	311	318
	3,267	2,449	2,929

22 Intangible assets

	<i>At 30 June</i> 2006	<i>At 30 June</i> 2005	<i>At 31 December</i> 2005
Value of in-force long-term assurance business	1,750	1,409	1,565
Internal developed software	93	–	56
Other intangible assets	14	17	15
	1,857	1,426	1,636

23 Other assets

	At 30 June 2006	At 30 June 2005	At 31 December 2005
Items in the course of collection from other banks	4,652	3,858	8,068
Prepayments and accrued income	4,045	2,727	3,016
Deferred tax assets	1	7	9
Non current assets held for sale	232	237	216
Acceptances and endorsements	2,701	2,514	2,371
Other accounts	3,314	1,574	1,545
	14,945	10,917	15,225

In accordance with Hong Kong Accounting Standard 39 "Financial Instruments: Recognition and Measurement" ("HKAS 39"), acceptances and endorsements are recognised on the balance sheet in "Other assets" and "Other liabilities".

24 Current, savings and other deposit accounts

	At 30 June 2006	At 30 June 2005	At 31 December 2005
Current, savings and other deposit accounts:			
• as per consolidated balance sheet	448,097	430,395	430,995
• structured deposits reported as trading liabilities (note 25)	33,414	7,475	24,422
	481,511	437,870	455,417
By type:			
• demand and current accounts	26,579	29,583	27,248
• savings accounts	195,488	212,344	188,839
• time and other deposits	259,444	195,943	239,330
	481,511	437,870	455,417

25 Trading liabilities

	At 30 June 2006	At 30 June 2005	At 31 December 2005
Structured certificates of deposit and other debt securities in issue (note 26)	15,056	9,836	13,616
Structured deposits (note 24)	33,414	7,475	24,422
Short positions in securities	13,160	7,047	7,766
	61,630	24,358	45,804

Trading liabilities include customer deposits and certificates of deposit with embedded options or other derivatives, the market risk of which was managed in the trading book.

26 Certificates of deposit and other debt securities in issue

	<i>At 30 June</i> 2006	<i>At 30 June</i> 2005	<i>At 31 December</i> 2005
Certificates of deposit and other debt securities in issue:			
• as per consolidated balance sheet	8,312	11,158	10,023
• structured certificates of deposit and other debt securities in issue reported as trading liabilities (note 25)	15,056	9,836	13,616
	23,368	20,994	23,639
By type:			
• certificates of deposit in issue	19,893	20,839	22,525
• other debt securities in issue	3,475	155	1,114
	23,368	20,994	23,639

27 Other liabilities

	<i>At 30 June</i> 2006	<i>At 30 June</i> 2005	<i>At 31 December</i> 2005
Items in the course of transmission to other banks	5,022	5,629	6,517
Accruals	1,864	1,124	1,653
Acceptances and endorsements	2,701	2,514	2,371
Other	1,234	1,113	3,597
	10,821	10,380	14,138

In accordance with HKAS 39, acceptances and endorsements are recognised on the balance sheet in "Other assets" and "Other liabilities".

28 Subordinated liabilities

Nominal value	Description	At 30 June 2006	At 30 June 2005	At 31 December 2005
Amount owed to third parties				
HK\$1,500 million	Callable floating rate subordinated notes due June 2015	1,491	1,496	1,495
HK\$1,000 million	4.125% callable fixed rate subordinated notes due June 2015	950	995	967
US\$450 million	Callable floating rate subordinated notes due July 2016	3,495	–	–
Amount owed to HSBC Group undertakings				
US\$260 million	Callable floating rate subordinated loan debt due December 2015	2,019	–	2,016
		7,955	2,491	4,478
Representing:				
• measured at amortised cost		7,005	1,496	3,511
• designated at fair value		950	995	967
		7,955	2,491	4,478

29 Shareholders' funds

	At 30 June 2006	At 30 June 2005	At 31 December 2005
Share capital	9,559	9,559	9,559
Retained profits	28,627	26,222	26,052
Premises revaluation reserve	3,522	3,387	3,543
Cash flow hedges reserve	(532)	(256)	(483)
Available-for-sale investment reserve	37	294	(17)
Capital redemption reserve	99	99	99
Other reserves	303	92	185
Total reserves	32,056	29,838	29,379
	41,615	39,397	38,938
Proposed dividends	2,103	2,103	3,633
Shareholders' funds	43,718	41,500	42,571
	29.0%	29.7%	25.2%
Return on average shareholders' funds			

Save for the contracted issuance of subordinated notes of US\$450 million, there was no purchase, sale or redemption of the Group's listed securities by the Bank or any of its subsidiaries during the six months ended 30 June 2006.

30 Capital resources management

	At 30 June 2006	At 30 June 2005	At 31 December 2005
Capital base			
Tier 1 capital			
• share capital	9,559	9,559	9,559
• retained profits	25,002	21,829	21,439
• classified as regulatory reserve	(511)	(468)	(510)
• capital redemption reserve	99	99	99
• less: goodwill	(322)	(311)	(318)
• total	33,827	30,708	30,269
Tier 2 capital			
• property revaluation reserve	4,443	4,710	5,114
• available-for-sale investment and equity revaluation reserve	24	350	(5)
• collective impairment allowances	511	468	510
• regulatory reserve	511	468	510
• term subordinated debt	7,955	2,491	4,479
• total	13,444	8,487	10,608
Unconsolidated investments and other deductions	(3,779)	(2,871)	(3,444)
Total capital base after deductions	43,492	36,324	37,433
Risk-weighted assets			
On-balance sheet	290,447	276,339	277,617
Off-balance sheet	14,962	17,698	14,739
Total risk-weighted assets	305,409	294,037	292,356
Total risk-weighted assets adjusted for market risk	306,668	292,331	291,570
Capital adequacy ratios			
After adjusting for market risk			
• tier 1*	11.0%	10.5%	10.4%
• total *	14.2%	12.4%	12.8%
Before adjusting for market risk			
• tier 1	11.1%	10.4%	10.4%
• total	14.2%	12.4%	12.8%

* The capital ratios take into account market risks in accordance with the relevant HKMA guideline under the Supervisory Policy Manual.

In accordance with the HKMA guideline "Impact of the New Hong Kong Accounting Standards on Authorised Institutions' Capital Base and Regulatory Reporting", the Group has earmarked a "regulatory reserve" from retained profits. This regulatory reserve is included as tier 2 capital together with the Group's collective impairment allowances.

31 Liquidity ratio

The average liquidity ratio for the period, calculated in accordance with the Fourth Schedule of the Hong Kong Banking Ordinance, is as follows:

	<i>Half-year ended 30 June 2006</i>	<i>Half-year ended 30 June 2005</i>	<i>Half-year ended 31 December 2005</i>
The Bank and its major banking subsidiaries	50.9%	43.6%	46.6%

32 Reconciliation of cash flow statement

(a) Reconciliation of operating profit to net cash flow from operating activities

	<i>Half-year ended 30 June 2006</i>	<i>Half-year ended 30 June 2005</i>
Operating profit	6,353	5,632
Net interest income	(6,375)	(5,264)
Dividend income	(31)	(37)
Loan impairment charges and other credit risk provisions	34	302
Depreciation	150	135
Amortisation of intangible assets	4	4
Amortisation of available-for-sale investments	(222)	7
Amortisation of held-to-maturity debt securities	–	1
Advances written off net of recoveries	(166)	(112)
Interest received	10,530	5,091
Interest paid	(6,609)	(2,537)
Operating profit before changes in working capital	3,668	3,222
Change in treasury bills and certificates of deposit with original maturity more than three months	4,505	1,277
Change in placings with and advances to banks maturing after one month	(6,190)	(5,350)
Change in trading assets	4,831	3,132
Change in financial assets designated at fair value	78	299
Change in derivative financial instruments	18	(167)
Change in advances to customers	(5,693)	(8,856)
Change in other assets	(2,271)	(171)
Change in current, savings and other deposit accounts	17,102	(9,789)
Change in deposits from banks	10,080	22,804
Change in trading liabilities	15,826	7,817
Change in certificates of deposit and other debt securities in issue	(1,711)	(1,454)
Change in other liabilities	(600)	(731)
Change in liabilities to customers under insurance contract	10	–
Change in financial liabilities designated at fair value	(17)	(1)
Elimination of exchange differences and other non-cash items	(1,149)	(1,094)
Cash generated from operating activities	38,487	10,938
Taxation paid	(407)	(222)
Net cash inflow from operating activities	38,080	10,716

32 Reconciliation of cash flow statement (continued)

(b) Analysis of the balances of cash and cash equivalents

	<i>At 30 June 2006</i>	<i>At 30 June 2005</i>
Cash and balances with banks and other financial institutions	13,763	7,816
Placings with and advances to banks and other financial institutions maturing within one month	59,056	41,614
Treasury bills	6,852	1,033
Certificates of deposit	1,191	2
	80,862	50,465

33 Contingent liabilities, commitments and derivatives

Contract amount, credit equivalent amount and risk-weighted amount

	<i>Contract amount</i>	<i>Credit equivalent amount</i>	<i>Risk- weighted amount</i>
At 30 June 2006			
Contingent liabilities:			
Guarantees	3,604	3,364	3,172
Commitments:			
Documentary credits and short-term trade-related transactions	8,820	1,770	1,755
Undrawn formal standby facilities, credit lines and other commitments to lend:			
• under one year	124,080	–	–
• one year and over	19,454	9,727	8,953
Other	227	227	227
	152,581	11,724	10,935
Exchange rate contracts:			
Spot and forward foreign exchange	253,985	2,404	526
Other exchange rate contracts	49,693	414	97
	303,678	2,818	623
Interest rate contracts:			
Interest rate swaps	155,362	1,627	340
Other interest rate contracts	4,220	10	2
	159,582	1,637	342
Other derivative contracts	4,916	267	65

33 Contingent liabilities, commitments and derivatives (continued)**Contract amount, credit equivalent amount and risk-weighted amount (continued)**

	Contract amount	Credit equivalent amount	Risk- weighted amount
<i>At 30 June 2005</i>			
Contingent liabilities:			
Guarantees	6,266	6,035	3,336
Commitments:			
Documentary credits and short-term trade-related transactions	8,845	1,782	1,764
Undrawn formal standby facilities, credit lines and other commitments to lend:			
• under one year	100,918	–	–
• one year and over	25,593	12,796	11,770
Other	26	26	26
	135,382	14,604	13,560
Exchange rate contracts:			
Spot and forward foreign exchange	131,827	1,346	341
Other exchange rate contracts	31,916	382	118
	163,743	1,728	459
Interest rate contracts:			
Interest rate swaps	169,762	1,476	406
Other interest rate contracts	1,669	8	3
	171,431	1,484	409
Other derivative contracts	311	17	9

33 Contingent liabilities, commitments and derivatives (continued)

Contract amount, credit equivalent amount and risk-weighted amount (continued)

	Contract amount	Credit equivalent amount	Risk- weighted amount
<i>At 31 December 2005</i>			
Contingent liabilities:			
Guarantees	4,133	3,907	3,131
Commitments:			
Documentary credits and short-term trade-related transactions	7,402	1,480	1,480
Undrawn formal standby facilities, credit lines and other commitments to lend:			
• under one year	109,369	–	–
• one year and over	20,385	10,193	9,158
Other	220	220	220
	137,376	11,893	10,858
Exchange rate contracts:			
Spot and forward foreign exchange	188,088	1,426	333
Other exchange rate contracts	15,176	193	48
	203,264	1,619	381
Interest rate contracts:			
Interest rate swaps	161,083	1,472	308
Other interest rate contracts	4,255	20	4
	165,338	1,492	312
Other derivative contracts	1,194	86	17

The tables above give the nominal contract, credit equivalent and risk-weighted amounts of off-balance sheet transactions. The credit equivalent amounts are calculated for the purposes of deriving the risk-weighted amounts. These are assessed in accordance with the Third Schedule of the Hong Kong Banking Ordinance ("the Third Schedule") on capital adequacy and depend on the status of the counterparty and the maturity characteristics. The risk weights used range from 0 per cent to 100 per cent for contingent liabilities and commitments, and from 0 per cent to 50 per cent for exchange rate, interest rate and other derivative contracts.

In accordance with the Third Schedule, contingent liabilities and commitments are credit-related instruments which include acceptances and endorsements, letters of credit, guarantees and commitments to extend credit. The risk involved is essentially the same as the credit risk involved in extending loan facilities to customers. These transactions are, therefore, subject to the same credit origination, portfolio maintenance and collateral requirements as for customers applying for loans. As the facilities may expire without being drawn upon, the total of the contract amounts is not representative of future liquidity requirements.

33 Contingent liabilities, commitments and derivatives (continued)**Contract amount, credit equivalent amount and risk-weighted amount (continued)**

In accordance with HKAS 39, acceptances and endorsements are recognised on the balance sheet in "Other assets" and "Other liabilities". These acceptances and endorsements are included in the capital adequacy calculation as contingencies in accordance with the Third Schedule.

Off-balance sheet financial instruments arise from futures, forward, swap and option transactions undertaken in the foreign exchange, interest rate and equity markets.

The contract amounts of these instruments indicate the volume of transactions outstanding at the balance sheet date and do not represent amounts at risk. The credit equivalent amount of these instruments is measured as the sum of positive marked-to-market values and the potential future credit exposure in accordance with the Third Schedule.

Derivative financial instruments are held for trading, as financial instruments designated at fair value, or designated as either fair value hedge or cash flow hedges. The following table shows the nominal contract amounts and marked-to-market value of assets and liabilities of each class of derivatives.

	At 30 June 2006		<i>At 30 June 2005</i>		<i>At 31 December 2005</i>	
	Trading/ designated at fair value	Hedging	<i>Trading/ designated at fair value</i>	<i>Hedging</i>	<i>Trading/ designated at fair value</i>	<i>Hedging</i>
Contract amounts:						
Interest rate contracts	107,608	51,974	103,968	67,463	102,233	63,105
Exchange rate contracts	303,678	–	163,743	–	203,264	–
Other derivative contracts	4,916	–	311	–	1,194	–
	416,202	51,974	268,022	67,463	306,691	63,105
Derivative assets:						
Interest rate contracts	688	480	675	223	481	454
Exchange rate contracts	983	–	647	–	776	–
Other derivative contracts	10	–	7	–	4	–
	1,681	480	1,329	223	1,261	454
Derivative liabilities:						
Interest rate contracts	999	507	847	591	998	457
Exchange rate contracts	578	–	412	–	310	–
Other derivative contracts	172	–	7	–	27	–
	1,749	507	1,266	591	1,335	457

The above derivative assets and liabilities, being the positive or negative marked-to-market value of the respective derivative contracts, represent gross replacement costs, as none of these contracts are subject to any bilateral netting arrangements.

34 Accounting policies

The accounting policies applied in preparing this interim report are the same as those applied in preparing the financial statements for the year ended 31 December 2005, as disclosed in the Annual Report and Financial Statements for 2005 except for the following:

Amendments to Hong Kong Accounting Standard 39 (“HKAS 39”) and Hong Kong Financial Reporting Standard 4 “Financial Instruments: Recognition and Measurement and Insurance Contracts - Financial Guarantee Contracts”

In prior years, financial guarantee contracts were accounted for under HKAS 37 “Provisions, Contingent Liabilities and Contingent Assets” as contingent liabilities and were disclosed as off-balance sheet items.

With effect from 1 January 2006 and in accordance with the above amendment, financial guarantee contracts issued are recognised as financial liabilities and reported under “Other liabilities”. Financial guarantees are recognised initially at fair value and subsequently measured at the higher of (a) the amount as provisions determined in accordance with HKAS 37; and (b) the amount initially recognised less cumulative amortisation.

Financial liabilities recorded under “Other liabilities” at 30 June 2006 amounted to HK\$4 million. No restatement of comparative figures was made as the amounts were immaterial.

35 Statement of compliance

This interim report has been prepared in accordance with Hong Kong Accounting Standard (“HKAS”) 34 “Interim Financial Reporting”. It also complies with the module on “Interim Financial Disclosure by Locally Incorporated Authorised Institutions” under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority (“HKMA”).

36 Statutory accounts

The information in this interim report is not audited and does not constitute statutory accounts.

Certain financial information in this interim report is extracted from the statutory accounts for the year ended 31 December 2005, which have been delivered to the Registrar of Companies and the HKMA. The auditors expressed an unqualified opinion on those statutory accounts in their report dated 6 March 2006. The Annual Report and Financial Statements for the year ended 31 December 2005, which includes the statutory accounts, can be obtained on request from the Legal and Company Secretarial Services Department, Level 10, 83 Des Voeux Road Central, Hong Kong; or from Hang Seng Bank’s website <http://www.hangseng.com>.

37 Comparative figures

Certain comparative figures have been reclassified to conform with the current period’s presentation.

38 Property revaluation

A revaluation of Hang Seng’s premises and investment properties in the Hong Kong SAR was performed in June 2006 to reflect property market movements in the first half of 2006. The Group’s premises and investment properties were revalued by DTZ Debenham Tie Leung Limited, an independent professional valuer, and carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of the valuation of premises was open market value for existing use and the basis of valuation for investment properties was open market value. The revaluation surplus for Group premises amounted to HK\$582 million, of which HK\$13 million was a reversal of revaluation deficits previously charged to the income statement. The balance of HK\$569 million was credited to the property revaluation reserve. Revaluation gains on investment properties of HK\$305 million were recognised through the income statement in accordance with HKAS 40. The related deferred tax provisions for Group premises and investment properties were HK\$102 million and HK\$53 million respectively.

39 Immediate and ultimate holding companies

The immediate and ultimate holding companies of the Bank are The Hongkong and Shanghai Banking Corporation Limited (incorporated in Hong Kong) and HSBC Holdings plc (incorporated in England) respectively.