HANG SENG BANK

# 2010 Interim Report

CONTENTS

# RESULTS IN BRIEF

| | ***30 June 2010*** | *30 June 2009 (restated)* | *31 December 2009 (restated)* |
|---|---|---|---|
| **For the half-year ended** | **HK$m** | HK$m | HK$m |
| Operating profit excluding loan impairment charges and other credit risk provisions | **6,850** | 7,308 | 6,718 |
| Operating profit | **6,697** | 6,687 | 6,527 |
| Profit before tax | **8,103** | 7,599 | 7,801 |
| Profit attributable to shareholders | **6,964** | 6,426 | 6,712 |
| | **HK$** | HK$ | HK$ |
| Earnings per share | **3.64** | 3.36 | 3.51 |
| Dividends per share | **2.20** | 2.20 | 3.00 |
| **At period-end** | **HK$m** | HK$m | HK$m |
| Shareholders' funds | **64,220** | 56,830 | 62,148 |
| Total assets | **871,087** | 794,395 | 830,668 |
| **Ratios** | **%** | % | % |
| *For the half-year ended* | | | |
| Return on average shareholders' funds | **22.8** | 23.5 | 22.4 |
| Cost efficiency ratio | **33.8** | 30.9 | 34.4 |
| Average liquidity ratio | **42.0** | 47.5 | 48.7 |
| *At period-end* | | | |
| Capital adequacy ratio * | **12.9** | 17.1 | 16.3 |
| Core capital ratio * | **11.1** | 12.9 | 12.6 |

* *Capital ratios at 30 June 2010 were compiled in accordance with the Banking (Capital) Rules ("the Capital Rules") issued by the Hong Kong Monetary Authority ("HKMA") under section 98A of the Hong Kong Banking Ordinance for the implementation of Basel II, which came into effect on 1 January 2007. Having obtained approval from the HKMA to adopt the advanced internal ratings-based approach ("AIRB") to calculate the risk-weighted assets for credit risk from 1 January 2009, the Bank used the AIRB approach to calculate its credit risk exposure at 30 June 2010. The standardised (operational risk) approach and internal models approach were used to calculate its operational risk and market risk respectively.*

*The basis of consolidation for calculation of capital ratios under the Capital Rules follows the basis of consolidation for financial reporting with the exclusion of subsidiaries which are "regulated financial entities" (e.g. insurance and securities companies) as defined by the Capital Rules. Accordingly, the investment cost of these unconsolidated regulated financial entities is deducted from the capital base.*

Our efforts to position Hang Seng for long-term growth yielded encouraging results in the first half of 2010. Our trusted brand and comprehensive portfolio of products and services helped us expand our customer base in both Hong Kong and mainland China and increase our income from core customer groups despite competitive operating conditions.

We recorded good growth in fee income, but the persistence of low interest rates continued to constrain interest-based revenue streams, particularly under Treasury.

We enhanced our position as a leader in wealth management by using our excellent time-to-market capabilities to capture the shift in investor preference and by extending our range of corporate wealth management products.

As economic conditions improved, we leveraged our strong balance sheet to grow lending to both personal and business customers.

Our initiatives to improve service delivery and access for SMEs, together with our active participation in Hong Kong government-organised lending schemes, helped reinforce our reputation as a trusted banking partner for local industry. Close collaboration between our Commercial Banking teams in Hong Kong and on the Mainland and the expansion of our renminbi services are helping us win a greater share of cross-border business.

We strengthened our platform for future growth on the Mainland. We expanded our network of outlets and the deposit base and deepened local strategic alliances. We took up our full entitlement under a rights share issue by our Mainland partner, Industrial Bank.

## Financial Performance

Profit attributable to shareholders rose to HK$6,964 million – up 8.4 per cent and 3.8 per cent compared with the first and second halves of last year respectively. Earnings per share rose by 8.3 per cent compared with a year earlier to reach HK$3.64.

At HK$8,103 million, profit before tax was up 6.6 per cent compared with the first half of 2009 and 3.9 per cent compared with the second half.

Operating profit excluding loan impairment charges and other credit risk provisions fell by HK$458 million, or 6.3 per cent, to HK$6,850 million, due mainly to the 7.7 per cent drop in net interest income. Compared with the second half of last year, operating profit excluding loan impairment charges and other credit risk provisions was up 2 per cent.

Operating profit increased by 0.1 per cent compared with the first half of last year and 2.6 per cent compared with the second half to reach HK$6,697 million, reflecting improved economic conditions and effective credit risk management.

Increases in performance-related pay, marketing to support business growth and investment in our Mainland operations resulted in a HK$236 million, or 7.2 per cent, rise in operating expenses to HK$3,504 million. Excluding our Mainland business, operating costs were up 6.1 per cent.

Our cost efficiency ratio was 33.8 per cent – compared with 30.9 per cent in the first half of 2009 and 34.4 per cent in the second half.

Return on average shareholders' funds was 22.8 per cent, compared with 23.5 per cent and 22.4 per cent for the first and second halves of 2009. Return on average total assets was 1.7 per cent – the same as the first half of last year and up 0.1 percentage points on the second half.

At 30 June 2010, our capital adequacy ratio was 12.9 per cent, compared with 16.3 per cent at last year-end. This decline was due mainly to our participation in Industrial Bank's rights issue, the repayment of HK$2.5 billion in subordinated debt and the rise in risk-weighted assets. Our core capital ratio was 11.1 per cent, down 1.5 percentage points.

The Directors have declared a second interim dividend of HK$1.10 per share, payable on 1 September 2010. This brings the total distribution for the first half of 2010 to HK$2.20 per share, the same as in the first half of 2009.

## Outlook

The global economy has rebounded from the international financial crisis on the back of large-scale fiscal and monetary stimulus. However, this recovery has been uneven, with solid improvements in key emerging economies but slower progress in many advanced economies.

The rebound supported an upswing in exports and GDP growth in both Hong Kong and the Mainland during the first half of 2010. Looking ahead, overseas trade activity will likely grow at a more modest pace in the second half of the year as governments around the world begin to rein in their stimulus programmes. Officials in several major export markets have announced plans to cut spending and implement tax hikes in a bid to restore fiscal discipline and tackle serious challenges such as high levels of sovereign debt.

On the Mainland, the domestic sector will remain strong. The authorities are taking steps to curb escalating property prices, but steady income growth and government measures to support private consumption will continue to drive demand. In Hong Kong, improving labour market conditions and rising consumer confidence should help underpin domestic-led growth.

Against this backdrop, we will continue to leverage our competitive strengths – including our widely respected brand, strong customer relationships and excellent market knowledge – to enhance our leading position in target areas and capitalise on emerging opportunities to achieve long-term growth for shareholders.

**Raymond Ch'ien**
*Chairman*
Hong Kong, 2 August 2010

Competition intensified in the first half of 2010 as banks sought to capitalise on increased trade flows and an upswing in investment sentiment. Hang Seng's leading market position and fast response to the changing needs of customers proved powerful tools in capturing business. We achieved growth in our customer base and income in key segments and further aligned our operations to support the continued expansion of core revenue drivers.

In the low interest rate environment, we took successful steps to further diversify our revenue base – leveraging our strong wealth management capabilities and comprehensive range of cross-border services for commercial customers to increase fee-based income. With excellent growth in investment fund sales revenue, we consolidated our position as a leading fund distributor in Hong Kong.

We used our balance sheet strength and good credit risk management to expand lending and gained market share in the competitive credit card sector. Increases in net interest income from advances and returns on the life insurance investment funds portfolio partly offset the declines in contributions from Treasury's balance sheet management portfolio and deposits.

We expanded renminbi services for commercial customers and became the first bank in Hong Kong to establish a renminbi prime rate, underscoring our position as a market leader for cross-border commercial banking and our active support for Hong Kong's development as the primary centre for offshore renminbi financial services.

## Financial Highlights

Total assets increased by HK$40.4 billion, or 4.9 per cent, to HK$871.1 billion – underpinned by good growth in personal and business loan portfolios.

Average interest-earning assets rose by 7.8 per cent, but net interest income was down 7.7 per cent at HK$6,713 million, with the positive effects of the rise in lending to customers and increased returns on the life insurance investment funds portfolio outweighed by reduced contributions from the Treasury balance sheet management portfolio and deposits. Compared with the second half of 2009, net interest income was down 0.5 per cent. Net interest margin was 1.77 per cent, compared with 2.06 per cent for the first half of last year and 1.76 per cent for the second half.

We achieved a HK$443 million, or 23 per cent, increase in net fee income to HK$2,369 million. Using our strong wealth management platform as a springboard, we reacted swiftly to improving market confidence with new products and services, recording a 117.3 per cent rise in fee revenue from retail investment funds. Insurance agency fee income increased by 35 per cent. Fee income from traditional banking services also registered solid growth. Card services fee income rose by 12.6 per cent on the back of increases in card spending, receivables and the card base. The uptick in trade flows and our cross-border commercial banking capabilities supported growth in fees from remittances and trade services.

Trading income fell by 14 per cent to HK$890 million. Foreign exchange income was down 5.4 per cent, due mainly to the decline in net interest income from funding swaps.

Net operating income before loan impairment charges and other credit risk provisions was HK$10,354 million – down 2.1 per cent on the first half of 2009, but up 1.2 per cent on the second half.

We recorded further improvements in loan impairment charges and other credit risk provisions, which dropped to HK$153 million, compared with HK$621 million and HK$191 million in the first and second halves of last year. Annualised impairment charges as a percentage of average advances to customers were 0.09 per cent.

## Loans and Deposits

Gross advances to customers grew by HK$49.3 billion, or 14.2 per cent, to HK$395.9 billion.

Loans for use in Hong Kong increased by 12.2 per cent to HK$326.9 billion. In the improved economic conditions, we leveraged our balance sheet strength and good market knowledge to achieve an 18.4 per cent rise in loans to business customers – recording growth in most industry sectors. The robust property market supported double-digit increases in lending to property developers and property investors. Loans to the manufacturing and wholesale and retail trade sectors were up 23.5 per cent and 27.9 per cent respectively.

Lending to individuals (excluding mortgages under the Government Home Ownership Scheme) rose by 6.4 per cent. In a competitive market, we achieved a 6.1 per cent increase in residential mortgage lending. Credit card advances were up 3.4 per cent.

Recovering trade activity and Commercial Banking's strengthening cross-border services underpinned the 52.6 per cent rise in trade finance.

Increased renminbi-based lending to corporate customers in mainland China drove the 9.9 per cent rise to HK$39.7 billion in loans for use outside Hong Kong.

Customer deposits, including certificates of deposits and other debt securities in issue, grew by 1.3 per cent compared with last year-end. Deposits in savings accounts and certificates of deposit and other debt securities in issue both fell, but this was outweighed by increases in time deposits and deposits held in current accounts.

## Customer Groups

Personal Financial Services achieved a 13.6 per cent increase in profit before tax to HK$3,937 million. Operating profit excluding loan impairment charges grew by 10.2 per cent to HK$3,945 million. Operating profit was up 16.3 per cent at HK$3,843 million.

With narrow spreads on mortgage loans and deposits, we redeployed the commercial surplus to expand secured and unsecured lending. Along with improved returns on the life insurance investment funds portfolio, this supported the 4.5 per cent increase in net interest income to HK$4,194 million.

Wealth management business was a core driver of growth, with income up 14.6 per cent at HK$2,495 million. Investment income increased by 20.7 per cent. We took steps to capitalise on improved investor confidence – including launching the Hang Seng China A-Share Focus Fund. We achieved a 28-month high in investment fund sales in March and investment fund subscriptions increased five-fold during the first half of 2010 compared with the same period last year. Enhancements to investment service delivery channels contributed to the increases in turnover and the number of accounts for foreign exchange and gold margin trading.

Life insurance income grew by 9.5 per cent, with an 8.7 per cent rise in total policies in force and a 13.7 per cent increase in total annualised life insurance premiums.

Our strong portfolio of mortgage services supported year-on-year growth of 92.3 per cent in residential mortgage drawdowns. We ranked first for equitable mortgages and second for new mortgage registrations in the second quarter of this year.

A series of effective card utilisation campaigns drove increases of 17.8 per cent in credit card spending, 11.8 per cent in receivables and 6.1 per cent in the card base. We maintained our position as Hong Kong's second-largest issuer of credit cards, with over 1.9 million cards in circulation. In June, we launched the Hang Seng China UnionPay Credit Card to meet the growing customer need for more convenient spending across Hong Kong and the Mainland.

Year on year, total operating income from secured and unsecured lending rose by 28.1 per cent and 16.5 per cent respectively.

In February, we were named 'Best Local Private Bank in Hong Kong' and ranked the number one local bank in the 'Net-Worth-Specific Services – Super Affluent' category in *Euromoney*'s peer-nominated Private Banking Survey 2010.

Commercial Banking recorded a 65.1 per cent increase in profit before tax to HK$1,783 million. Operating profit excluding loan impairment charges rose by 31.1 per cent to HK$1,247 million, reflecting broad-based income growth. Operating profit was up 74 per cent at HK$1,197 million, with improvements in the economic environment and good credit risk management resulting in an 81 per cent decline in loan impairment charges.

Net interest income rose by 20 per cent to HK$1,184 million. We capitalised on the upswing in economic activity during the first half of 2010 to grow lending by 60.9 per cent, supporting an increase in net interest income from advances. Customer deposits rose by 23.9 per cent, but narrowing deposit spreads resulted in a drop in net interest income from deposits.

Non-interest income was up 22 per cent at HK$850 million. Net fee income grew by 23.9 per cent to HK$649 million, driven mainly by sales of investment and treasury products and a 19.2 per cent increase in trade finance and factoring fee revenue.

The strength of our cross-border proposition was an important competitive advantage in growing our Commercial Banking business. A comprehensive range of new renminbi services, closer cooperation between Commercial Banking teams in Hong Kong and on the Mainland, and an expanding network of strategic Mainland partners enhanced our service capabilities and coverage.

At 30 June 2010, we had over 4,000 cross-border renminbi trade settlement accounts and had facilitated a total of more than RMB4.2 billion in renminbi cross-border trade.

We further developed our corporate wealth management business, offering investment products in line with risk appetite and liquidity needs as well as a broad range of business insurance coverage. Corporate wealth management revenue grew by 37.1 per cent, increasing its contribution to Commercial Banking's total operating income to 15.1 per cent – up from 13.2 per cent in 2009.

We improved service access and banking convenience for SME customers by remodelling our Business Banking Centres, extending transaction cut-off times and expanding our Business e-Banking platform. At 30 June 2010, we had approved about 6,000 loan applications totalling more than HK$16.3 billion under Hong Kong government-initiated SME lending schemes.

Corporate Banking's profit before tax rose by 24.7 per cent to HK$560 million. Operating profit excluding loan impairment charges was up 7.5 per cent at HK$556 million, due largely to the 9.9 per cent increase in net interest income. Operating profit grew by 27.6 per cent to HK$555 million, reflecting a 98.8 per cent reduction in loan impairment charges.

Assisted by our cross-border services, good industry knowledge and long-term customer relationships, we provided facilities to high-quality borrowers in a competitive environment for lenders, with notable progress in loans to large Mainland enterprises with operations in Hong Kong.

Lending to corporate customers grew by 14.2 per cent compared with a year earlier. Customer deposits rose by 61.1 per cent.

Treasury recorded a profit before tax of HK$1,430 million – down 29.1 per cent due mainly to the 55 per cent fall in net interest income. Operating profit excluding credit risk provisions declined by 48.6 per cent to HK$927 million.

Low interest rates and ample market liquidity limited good investment opportunities under the balance sheet management portfolio. We maintained our prudent risk management approach while taking steps to defend the interest margin. We capitalised on market opportunities to dispose of selected instruments and invest in high-quality assets.

Initiatives with other customer groups to cross-sell Treasury products saw a more than tripling of income from foreign exchange options and other structured products.

## Mainland Business

Hang Seng Bank (China) Limited opened two cross-location sub-branches under CEPA VI – in Foshan and Zhongshan – bringing its total number of outlets to 38 across 13 cities.

We enhanced our Commercial Banking and wealth management offerings, and leveraged new and existing strategic alliances. This supported good growth in both the personal and commercial customer bases – which increased by 9 per cent and 11 per cent respectively compared with a year earlier.

Customer deposits were up 24.6 per cent on last year-end and 67.4 per cent year on year – improving balance sheet strength. We expanded lending while continuing to emphasise credit quality over loan portfolio size. Advances to customers increased by 13.2 per cent compared with 31 December 2009 and 36.8 per cent compared with 30 June 2009.

Hang Seng China's profit before tax recorded encouraging year-on-year growth, with the 16.4 per cent rise in total operating income and a decline in loan impairment charges slightly offset by increased investment in future business expansion.

Collaboration with strategic partners, Industrial Bank and Yantai Bank, continued to provide business synergy and extend our reach in regions with good economic growth potential.

## Technology

Technology plays an important role in our initiatives to offer greater customer convenience and choice and to improve efficiency. We added new services under both Personal e-Banking and Business e-Banking during the first half of 2010 and strengthened our mobile banking channel. The implementation of touchscreens and other refinements at ATMs is helping to shorten customer waiting times.

Personal e-Banking, which celebrates its 10th anniversary in 2010, passed a major milestone in the first half of the year, with the number of registered customers growing by 12.3 per cent year on year to surpass 1 million. Revenue generated via Personal e-Banking services increased by 4.5 per cent compared with the same period last year.

In May, we launched an iPhone application that enables users to keep track of their securities investments and provides on-the-move access to a broad range of market information. We will roll out more services via the mobile platform.

Enhanced investment trading services under Business e-Banking supported customer migration to our Internet channel, with online transactions as a percentage of total securities transactions reaching 61 per cent for the first half of 2010, compared with 47 per cent in 2009. The Business e-Banking customer base grew by 16.8 per cent year on year to about 83,000 and the number of online business banking transactions increased by 18.8 per cent.

## Corporate Responsibility

Hang Seng has a long track record of contributing to the development of society. As one of Hong Kong's largest listed companies in terms of market capitalisation, our top priorities are the provision of excellent financial services for customers, career development for staff and value for shareholders. We also aim to assist other sectors of our local communities through a broad range of environmental, youth development, sports and social welfare programmes.

In May, we received the Gold Award in the Financial, Insurance and Accounting Institutions Sector of the Hong Kong Awards for Environmental Excellence (HKAEE) in recognition of our commitment to continuous improvement of our environmental performance and raising awareness of green issues among our stakeholders. Our recent efforts to create a greener living environment include an agreement to donate HK$300,000 to Friends of the Earth (HK) to plant 10,000 saplings over the next three years.

Through the Hang Seng Athlete Incentive Awards Scheme, we provide support for top local athletes, who not only bring honour to Hong Kong but also provide lessons about the importance of commitment, determination and teamwork, and act as role models for future generations of sportsmen and sportswomen. In June, we announced a near-doubling of rewards for local medallists at the 16th Asian Games to be held in Guangzhou in November this year. Since 1996 we have awarded nearly HK$9 million in recognition of the achievements of Hong Kong sporting heroes.

More details of our corporate responsibility beliefs and activities as well as our relationships with stakeholders can be found in our online corporate responsibility report: http://www.hangseng.com/e_about_us/corporate_responsibility/2009/index.html

## Looking Ahead

Improvements in business and investment sentiment on the back of the economic upturn generated new opportunities during the first half of 2010.

However, the recovery remains fragile – particularly in major advanced economies that provide key export markets for Asia – clouding the outlook for Hong Kong's externally orientated economy for the rest of the year. A slowdown in external demand will also affect the Mainland, although robust domestic consumption should help underpin growth, albeit at a more moderate pace than in the first half of the year.

In an uncertain economic environment, we will continue to focus on providing excellent service to meet the changing needs of our diverse range of customers.

Our time-to-market strengths, comprehensive range of products and extensive distribution network – including mobile and online channels – will support the growth of our wealth management business and drive new customer acquisitions. We will continue to enhance our services in support of key personal customer segments, particularly Prestige Banking and young people.

We will further leverage our strong financial fundamentals to expand secured and unsecured lending while staying vigilant in managing credit risk.

Cross-border collaboration will remain central to establishing Hang Seng as a leading provider of Greater China commercial banking services. We will continue to strengthen our product and service suite to provide comprehensive financial solutions for companies with operations in both Hong Kong and the Mainland. We have enhanced our corporate e-banking platforms to support renminbi account enquiries and transaction instructions and we will capitalise on the recent expansion of the renminbi cross-border trade settlement scheme.

Treasury will continue to work closely with other customer groups to drive the growth of non-interest based business and explore new opportunities created by the enlarged scope of offshore renminbi financial services.

On the Mainland, we will deepen cooperation with existing strategic partners and build new alliances to enhance service delivery, expand product offerings and generate more cross-referral business. Along with brand-building initiatives, this will underpin growth in the customer and deposit bases. In May, we underlined our long-term commitment to this important market with a RMB510 million agreement to purchase a Mainland headquarters in Shanghai.

We will continue to make good use of our competitive strengths to further develop our core business drivers, reinforce our leadership in key lines, and tap new markets and customer segments in support of long-term growth and increasing value for shareholders.

**Margaret Leung**
*Vice-Chairman and Chief Executive*
Hong Kong, 2 August 2010

## FINANCIAL PERFORMANCE

### Income Statement

**Summary of financial performance**

| *Figures in HK$m* | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009 (restated)* | *Half-year ended 31 December 2009 (restated)* |
|---|---|---|---|
| Total operating income | **17,103** | 17,054 | 15,762 |
| Total operating expenses | **3,504** | 3,268 | 3,518 |
| Operating profit after loan impairment charges and other credit risk provisions | **6,697** | 6,687 | 6,527 |
| Profit before tax | **8,103** | 7,599 | 7,801 |
| Profit attributable to shareholders | **6,964** | 6,426 | 6,712 |
| Earnings per share (in HK$) | **3.64** | 3.36 | 3.51 |

Hang Seng Bank Limited ("the Bank") and its subsidiaries and associates ("the Group") reported an unaudited profit attributable to shareholders of HK$6,964 million for the first half of 2010, up 8.4 per cent compared with the first half of 2009. Earnings per share were up 8.3 per cent at HK$3.64. Compared with the second half of 2009, attributable profit rose by 3.8 per cent.

**Operating profit excluding loan impairment charges and other credit risk provisions fell by HK$458 million, or 6.3 per cent, to HK$6,850 million.**

In the low interest rate environment, net interest income was adversely affected by the continuing compression of deposit spreads and the re-pricing of assets at lower rates. Non-interest income registered encouraging growth as Asian economies strengthened and demand for wealth management products in Hong Kong and mainland China increased. While continuing to carefully manage costs, the Group made further investments in its business to drive income growth momentum – resulting in a 7.2 per cent increase in operating expenses compared with the same period last year.

**Despite average interest-earning assets increased by HK$55.1 billion, or 7.8 per cent, to HK$766.4 billion, net interest income fell by HK$562 million, or 7.7 per cent, to HK$6,713 million.**

| *Figures in HK$m* | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009* | *Half-year ended 31 December 2009* |
|---|---|---|---|
| Net interest income/(expense) arising from: | | | |
| – financial assets and liabilities that are not at fair value through profit and loss | **6,772** | 7,430 | 6,721 |
| – trading assets and liabilities | **(83)** | (196) | (38) |
| – financial instruments designated at fair value | **24** | 41 | 65 |
| | **6,713** | 7,275 | 6,748 |
| Average interest-earning assets | **766,382** | 711,253 | 762,234 |
| Net interest spread | **1.72%** | 1.99% | 1.71% |
| Net interest margin | **1.77%** | 2.06% | 1.76% |

The decrease in net interest income was primarily as a result of the low interest rate environment that has persisted since the second half of 2008. Although interest-earning assets increased, net interest income was impacted by the continuous compression of deposit spreads and the re-pricing of assets at lower rates.

Net interest margin narrowed by 29 basis points to 1.77 per cent while net interest spread declined by 27 basis points to 1.72 per cent when compared with the same period last year. The low interest rates impacted liability spreads, resulting in little room for the reduction of interest rates paid to customers. Treasury balance sheet management income was adversely affected by the re-pricing of assets at lower rates. Personal and commercial lending, credit cards and trade finance registered impressive growth during the first half of 2010 and helped to moderate the unfavourable impact of deposit spreads. Strong volume growth was recorded in the average balance of mortgage lending which offset the tighter spreads on mortgages in an intensely competitive home loans market. Interest income from the life insurance funds investment portfolio, which has bond investments as its major underlying assets, grew by 19.1 per cent.

The contribution from net free funds also dropped by 2 basis points to 0.05 per cent as a result of the decline in average market interest rates.

Compared with the second half of 2009, net interest income dropped marginally by HK$35 million, or 0.5 per cent, due mainly to fewer days in the period, notwithstanding that average interest-earning assets remained broadly stable with growth of 0.5 per cent and the net interest margin was up by 1 basis point.

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

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

| *Figures in HK$m* | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009* | *Half-year ended 31 December 2009* |
|---|---|---|---|
| Net interest income | **6,769** | 7,421 | 6,716 |
| Average interest-earning assets | **708,453** | 653,655 | 686,715 |
| Net interest spread | **1.89%** | 2.23% | 1.91% |
| Net interest margin | **1.93%** | 2.29% | 1.94% |

**Net fees income increased by HK$443 million, or 23.0 per cent, to HK$2,369 million, compared with the first half of 2009.**

With the improvements in the economic environment and investment sentiment, customer interest in wealth management products strengthened. The Group responded in a timely manner to this increased demand and launched new products, including the Hang Seng China A-Share Focus Fund. Fee income from retail investment fund sales grew by 117.3 per cent. The Group offers a wide spectrum of funds from both Hang Seng Investment Management and third-party providers and has established itself as one of the major fund distributors in Hong Kong. Private banking investment service fee income rose by 37.0 per cent, reflecting the improved client appetite for trading and structured investment products. With the Bank recording lower stock market trading turnover and keen price competition, income from stockbroking and related services decreased by 2.3 per cent.

Driven by a series of marketing campaigns, credit card business recorded impressive growth and gained market share. The Bank's customer loyalty scheme and card utilisation programmes helped boost card spending. In tandem with the growth in average card balances, card services income rose by 12.6 per cent compared with the same period last year. The increase in merchant income was supported by year-on-year increases of 6.1 per cent in the number of cards in circulation and 17.8 per cent in cardholder spending.

Insurance agency fee income rose by 35.0 per cent as the Bank enhanced its comprehensive range of health and wealth insurance solutions to cater for customer needs. Benefiting from the rebound in export markets, income from trade services and remittances registered good growth of 18.5 per cent and 20.8 per cent respectively. Fee income from account services and credit facilities also increased.

Compared with the second half of 2009, net fee income remained broadly at the same level. The increase in fee income from insurance agency service and retail investment funds was offset by the fall in fee revenue from stockbroking and related services which recorded solid growth in the second half of 2009 on the back of the rebound in equity markets.

**Trading income fell by HK$145 million, or 14.0 per cent, to HK$890 million, compared with the first half of 2009.**

Foreign exchange income decreased by 5.4 per cent, due mainly to the decrease in net interest income from funding swaps. Income from securities, derivatives and other trading fell by 90.5 per cent.

**Net income from financial instruments designated at fair value reported a revaluation gain of HK$132 million, compared with a revaluation loss of HK$195 million for the first half of 2009,** reflecting the more stable financial markets in the first half of 2010. The gain mainly reflects the fair value changes of assets supporting the linked insurance contracts and reported in "Net income/(loss) from financial instruments designated at fair value" with offsetting movements in the value of these contracts reported in the "Net insurance claims incurred and movement in policyholders' liabilities".

**Net earned insurance premiums fell by HK$299 million, or 4.5 per cent while net insurance claims incurred and movement in policyholders' liabilities rose by HK$271 million, or 4.2 per cent.**

**Analysis of income from wealth management business**

| *Figures in HK$m* | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009* | *Half-year ended 31 December 2009* |
|---|---|---|---|
| Investment income: | | | |
| – retail investment funds | **491** | 226 | 378 |
| – structured investment products* | **239** | 204 | 269 |
| – private banking service fee** | **80** | 58 | 100 |
| – stockbroking and related services | **673** | 689 | 877 |
| – margin trading and others | **72** | 76 | 65 |
| | **1,555** | 1,253 | 1,689 |
| Insurance income: | | | |
| – life insurance | **1,197** | 1,089 | 981 |
| – general insurance and others | **173** | 162 | 175 |
| | **1,370** | 1,251 | 1,156 |
| Total | **2,925** | 2,504 | 2,845 |

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

** *Income from private banking includes income reported under net fee income on investment services and profit generated from selling of structured investment products in issue, reported under trading income.*

Wealth management income rose by 16.8 per cent to HK$2,925 million during the first half of 2010. Investment services income increased by 24.1 per cent, mainly reflecting strong growth in revenue from retail investment fund sales. Income from insurance business grew by 9.5 per cent. Compared with the second half of 2009, wealth management income rose by 2.8 per cent.

With the strengthening of major economies in Asia, demand for investment products increased. The Bank used its time-to-market strength to launch and promote products and services designed to capture new business flows. Investment funds turnover and sales income rose by 503.2 per cent and 117.3 per cent respectively year on year. Income from structured investment products increased by 17.2 per cent. Securities broking and related services income declined by 2.3 per cent as a result of lower stock market turnover activity recorded by the Bank and intense pricing competition in the market.

Private banking benefited from the improved investment sentiment, recording a 37.9 per cent rise in service fee income.

Leveraging its strong customer relationships, the Group continued to enhance a leading position in the retirement savings insurance sector through the promotion of products such as the Smart Income Plan and Target Income Life Insurance Plan. Total policies in force grew by 8.7 per cent year on year. Net interest income and fee income rose by 20.1 per cent as a result of the growth in the size of the life insurance funds investment portfolio which held bond investments as its underlying major assets. Investment returns on life insurance funds improved from a loss of HK$133 million in the first half of 2009 to a gain of HK$97 million in the first half of 2010. The gains are mainly the fair value changes of assets supporting linked insurance contracts and reported under "Net income/(loss) from financial instruments designated at fair value", with offsetting movements in the value of these contracts reported under "Net insurance claims incurred and movement in policyholders' liabilities". Movement in present value of in-force insurance business ("PVIF") increased, due mainly to the growth in volume and profitability of new business written in the first half of 2010 as well as increases in natural premiums paid up and maturing policies, which had little impact on PVIF movement in the first half of 2010 but contributed to higher profit release in 2009.

General insurance income increased by 6.8 per cent to HK$173 million.

| *Figures in HK$m* | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009* | *Half-year ended 31 December 2009* |
|---|---|---|---|
| Life insurance: | | | |
| – net interest income and fee income | **1,142** | 951 | 1,061 |
| – investment returns on life insurance funds | **97** | (133) | 150 |
| – net earned insurance premiums | **6,189** | 6,502 | 4,691 |
| – net insurance claims incurred and movement in policyholders' liabilities* | **(6,698)** | (6,433) | (5,479) |
| – movement in present value of in-force long-term insurance business | **467** | 202 | 558 |
| | **1,197** | 1,089 | 981 |
| General insurance and others | **173** | 162 | 175 |
| Total | **1,370** | 1,251 | 1,156 |

* *Including premium and investment reserves*

**Operating expenses rose by HK$236 million, or 7.2 per cent, compared with the first half of 2009,** reflecting the Bank's investments to support business growth while continuing to carefully manage costs in the difficult operating environment. Excluding Mainland business, operating expenses rose by 6.1 per cent. Compared with the second half of 2009, operating expenses were maintained at broadly the same level.

Employee compensation and benefits increased by HK$104 million, or 6.2 per cent. Salaries and other costs rose by 0.1 per cent, reflecting the combined effects of the increase in annual salary increment and reduction in average headcount. Recognition of good staff performance led to a rise in performance-related pay expenses. General and administrative expenses were up 8.1 per cent, attributable to more marketing and advertising to support business growth. Rental expenses rose due to increased rents for branches in Hong Kong as well as new branches on the Mainland. Depreciation charges were up 7.0 per cent, mainly reflecting increases in depreciation on the Bank's headquarters building in Hong Kong.

| ***Staff numbers* by region*** | ***At 30 June 2010*** | *At 30 June 2009* | *At 31 December 2009* |
|---|---|---|---|
| Hong Kong | **7,933** | 7,972 | 7,834 |
| Mainland | **1,497** | 1,411 | 1,449 |
| Others | **58** | 55 | 59 |
| Total | **9,488** | 9,438 | 9,342 |

* *Full-time equivalent*

The Group's number of full-time equivalent staff rose by 146 compared with 2009 year-end – mainly in the Hong Kong operations. Headcount for the Mainland operations also rose when compared with last year-end as a result of the expansion of Hang Seng China's Mainland business.

The cost efficiency ratio for the first half of 2010 was 33.8 per cent, compared with 30.9 per cent for the first half of 2009, due primarily to the combined effects of the reduction in net operating income before impairment charges and other credit risk provisions and the increase in operating expenses. Compared with the second half of 2009, the cost efficiency ratio improved by 0.6 percentage points.

**Operating profit** grew by HK$10 million, or 0.1 per cent, to HK$6,697 million, after accounting for the HK$468 million improvement in **loan impairment charges and other credit risk provisions**. Compared with the second half of 2009, operating profit was up HK$170 million, or 2.6 per cent.

**Loan impairment charges and other credit risk provisions dropped by HK$468 million, or 75.4 per cent, to HK$153 million year-on-year.**

| *Figures in HK$m* | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009* | *Half-year ended 31 December 2009* |
|---|---|---|---|
| Loan impairment charges: | | | |
| – individually assessed | **(77)** | (288) | (22) |
| – collectively assessed | **(76)** | (333) | (169) |
| | **(153)** | (621) | (191) |
| Of which: | | | |
| – new and additional | **(281)** | (709) | (395) |
| – releases | **98** | 61 | 169 |
| – recoveries | **30** | 27 | 35 |
| | **(153)** | (621) | (191) |
| Other credit risk provision | **–** | – | – |
| Loan impairment charges and other credit risk provisions | **(153)** | (621) | (191) |

Individually assessed provisions fell by HK$211 million, due mainly to lower impairment charges on commercial banking customers in the first half of 2010, supported by the improvement in the credit environment compared to the credit conditions in the same period last year and the Bank's good risk management control measures.

Collectively assessed provisions dropped by HK$257 million, due largely to the fall in credit card delinquencies. In line with the declining bankruptcy trend, impairment provisions for personal loan portfolios were lower. Impairment allowances for loans not individually identified as impaired also decreased as a result of lower historical loss rates, driven by the improvement in the global credit markets.

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

| | ***At 30 June 2010*** | *At 30 June 2009* | *At 31 December 2009* |
|---|---|---|---|
| | **%** | % | % |
| Loan impairment allowances: | | | |
| – individually assessed | **0.28** | 0.46 | 0.33 |
| – collectively assessed | **0.18** | 0.26 | 0.23 |
| Total loan impairment allowances | **0.46** | 0.72 | 0.56 |

**Profit before tax** increased by 6.6 per cent to HK$8,103 million after taking into account a 25.5 per cent (or HK$14 million) rise in **gains less losses from financial investments and fixed assets**; a 62.8 per cent (or HK$59 million) increase in **net surplus on property revaluation**; and a 55.2 per cent (or HK$421 million) increase in **share of profits from associates**, mainly Industrial Bank Co., Ltd. and a property investment company.

**Gains less losses from financial investments and fixed assets amounted to HK$69 million, an increase of HK$14 million compared with the first half of 2009.**

Net gains from disposal of available-for-sale equity securities fell by HK$149 million, or 93.7 per cent, attributable to the profit realised from the disposal of Visa Inc. in the first half of 2009. In the difficult interest rate environment, we capitalized on market opportunities to dispose of selected instruments and invest in high-quality assets. As a result, there was a HK$62 million gain on the disposal of available-for-sale debt securities – reflecting the profit realised from the disposal of government-guaranteed debt securities – compared with a loss of HK$95 million on the disposal of certain debt securities in the first half of 2009.

**Net surplus on property revaluation amounted to HK$153 million, an increase of 62.8 per cent compared with the first half of 2009.**

| *Figures in HK$m* | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009* | *Half-year ended 31 December 2009* |
|---|---|---|---|
| Surplus of revaluation on investment properties | **152** | 93 | 157 |
| Reversal of revaluation deficit on premises | **1** | 1 | 1 |
| | **153** | 94 | 158 |

The Group's premises and investment properties were revalued at 30 June 2010 by DTZ Debenham Tie Leung Limited. The valuation was carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of the valuation of premises was open market value for existing use and the basis of valuation for investment properties was open market value. The net revaluation surplus for Group premises amounted to HK$691 million, of which HK$690 million was credited to premises revaluation reserve and HK$1 million was credited to the income statement. Revaluation gains of HK$152 million on investment properties were recognised through the income statement. The related deferred tax provisions for Group premises and investment properties were HK$114 million and HK$25 million respectively.

The revaluation exercise also covered business premises/investment properties reclassified as properties held for sale. In accordance with HKFRS 5, there was no revaluation gain/loss recognised through the income statement.

## Customer Group Performance

The table below sets out the profit before tax contributed by the customer groups for the periods stated.

| *Figures in HK$m* | *Personal Financial Services* | *Commercial Banking* | *Corporate Banking* | *Treasury* | *Other* | *Total reportable segments* |
|---|---|---|---|---|---|---|
| ***Half-year ended 30 June 2010*** | | | | | | |
| Profit before tax | **3,937** | **1,783** | **560** | **1,430** | **393** | **8,103** |
| Share of profit before tax | **48.6%** | **22.0%** | **6.9%** | **17.6%** | **4.9%** | **100.0%** |
| *Half-year ended 30 June 2009 (restated)* | | | | | | |
| Profit before tax | 3,467 | 1,080 | 449 | 2,017 | 586 | 7,599 |
| Share of profit before tax | 45.6% | 14.2% | 5.9% | 26.6% | 7.7% | 100.0% |
| *Half-year ended 31 December 2009 (restated)* | | | | | | |
| Profit before tax | 3,791 | 1,557 | 466 | 1,376 | 611 | 7,801 |
| Share of profit before tax | 48.6% | 20.0% | 6.0% | 17.6% | 7.8% | 100.0% |

**Personal Financial Services ("PFS")** reported a profit before tax of HK$3,937 million, representing growth of 13.6 per cent compared with the same period last year. Operating profit excluding loan impairment charges was up 10.2 per cent at HK$3,945 million. Investment and insurance were the key growth drivers as market sentiment improved during the first half of the year.

Despite narrowing spreads on deposits and mortgage loans in the low interest rate environment, net interest income grew to HK$4,194 million – up 4.5 per cent compared with the first half of last year – attributable to the successful deployment of the commercial surplus to achieve growth in secured and unsecured lending portfolios.

Riding on the buoyant property market, the Bank's residential mortgage business achieved good growth and maintained a leading market position. Despite strong competition among lenders, income from secured lending and residential mortgage drawdowns grew by 28.1 per cent and 92.3 per cent respectively compared with the first half of last year. Hang Seng ranked first for equitable mortgages and second for new mortgage registrations in the second quarter of this year, with a market share of 21.6 per cent and 15.8 per cent respectively in June 2010.

Total operating income from unsecured lending was up 16.5 per cent year-on-year. Supported by effective marketing campaigns, the credit card business registered impressive growth and gained market share. The card base grew by 6.1 per cent to exceed 1.9 million, helping the Bank maintain its number two position for the credit card business in Hong Kong in terms of cards in issue. Card receivables rose by 11.8 per cent to HK$14.3 billion. The Bank outperformed its peers for card spending, which rose by 17.8 per cent compared with the first half of last year to HK$32.4 billion. Hang Seng made an important milestone in launching a Hong Kong dollar China UnionPay (CUP) Credit Card in June 2010, offering cardholders' convenience via the extensive CUP merchant network in Hong Kong, mainland China and overseas countries. Personal loans were up 31.0 per cent year-on-year, with a total loan balance of HK$4.3 billion.

Wealth management income increased by 14.6 per cent to HK$2,495 million. Income from investment rose by 20.7 per cent to HK$1,295 million as the Bank capitalised on increased investor appetite with the launch of timely investment products – including the Hang Seng China A-Share Focus Fund and tailor-made structured products – that helped boost sales and turnover. Investment fund subscription in the first half of 2010 increased five-fold year-on-year.

Income from insurance grew by 8.6 per cent, as we managed to diversify our product mix to offer a wide range of endowment, protection or investment-linked solutions to cater for customer needs. Total policies in force and total annualised life insurance premiums rose by 8.7 per cent and 13.7 per cent respectively.

Personal e-Banking achieved landmark growth with over 1.03 million registered customers – a year-on-year increase of 12.3 per cent. Hang Seng was among the first banks in Hong Kong to launch a customised iPhone application that provides a comprehensive platform for obtaining up-to-date investment information.

**Commercial Banking ("CMB")** reported a strong 65.1 per cent increase in profit before tax to reach HK$1,783 million. CMB's contribution to the Bank's total profit before tax increased to 22.0 per cent, up 7.8 percentage points compared with the first half of 2009. Operating profit excluding loan impairment charges rose by 31.1 per cent to HK$1,247 million, driven mainly by growth in net interest income from advances and net fee income. On the back of improving market conditions and a continuing emphasis on good risk management, loan impairment charges fell by 81.0 per cent.

CMB capitalised on recovering global demand and the rebound of export markets to grow customer advances by 60.9 per cent, which supported the 37.3 per cent increase in net interest income from lending year-on-year. With an influx of liquidity into the region and continuing investor caution, customer deposits rose by 23.9 per cent year-on-year. Net interest income from deposits decreased by 17.6 per cent, reflecting the adverse effects of the low interest rate environment on deposit spreads.

In response to the *Elucidation of Supervisory Principles and Operational Arrangements regarding RMB Business in Hong Kong* released by Hong Kong Monetary Authority in February, CMB expanded the scope of renminbi banking services offered to commercial customers. In addition to renminbi trade settlement services, the Bank established the first renminbi Prime Rate in Hong Kong in March 2010, substantiating Hang Seng's position as a commercial banking leader in the Greater China region and contributing to the development of Hong Kong as the key centre for offshore renminbi banking and financial services. A full suite of renminbi commercial banking products was launched in March, including renminbi commercial finance, renminbi current account, renminbi overdraft and renminbi factoring. By 30 June 2010, more than 4,000 cross-border renminbi trade settlement accounts had been opened, with total turnover from cross-border renminbi trade business routed through the Bank amounting to over RMB4.2 billion.

To assist commercial customers with cross-border operations, CMB continued to collaborate with China Export and Credit Insurance Corporation (Sinosure), as well as Hang Seng China and our strategic Mainland partner Industrial Bank. Strengthening these partnerships has augmented CMB's capacity to offer one-stop commercial banking solutions and capture an increasing share of cross-border business flows.

CMB worked to provide competitive corporate wealth management products for its customers, especially those in the top-end segment. Enhanced corporate insurance products were marketed to customers using different selling angles, including as wealth management, investment and funding tools. With the sovereign debt crisis in Europe serving to prolong uncertainty in financial markets, momentum was maintained in investment services business with the up-skilling of the sales force, and a greater emphasis on more defensive investment instruments and treasury hedging solutions. Income derived from corporate wealth management business recorded an encouraging growth of 37.1 per cent, increasing its contribution to CMB's total operating income by 1.9 percentage points compared with 2009 to reach 15.1 per cent.

In support of the SME community, Business Banking Centres in prime commercial locations were refurbished to enhance service delivery.

The Bank continued to be an active player in government-backed SME loan schemes. Since the launch of the SME Loan Guarantee Scheme and Special Loan Guarantee Scheme in late 2008, the Bank has approved about 6,000 applications with a total loan amount of more than HK$16.3 billion at 30 June 2010.

CMB customers continued to migrate to online and automated banking channels, supported by the expansion of service offerings. At 30 June 2010, over 82,900 customers had registered for the Bank's Business e-Banking service – up 16.8 per cent compared with a year earlier. The number of online business banking transactions grew by 18.8 per cent.

**Corporate Banking ("CIB")** capitalised on economic recovery in Hong Kong and on the Mainland to record a 7.5 per cent rise in operating profit excluding loan impairment charges to HK$556 million. Profit before tax was up 24.7 per cent at HK$560 million, due mainly to a 98.8 per cent improvement in loan impairment charges. Improvements in the economic environment combined with low interest rates and the increasing availability of investment opportunities helped to support increased customer demand for funding. This created new opportunities to expand lending, but intensifying competition among banks to book loan assets drove down margins compared with 2009. With changes in the market environment on the Mainland, CIB put more emphasis on lending in Hong Kong and made good progress in expanding its business among key customer segments, including large Mainland-owned companies with operations in Hong Kong. Working closely with colleagues in Hang Seng China, CIB provided customers with effective cross-border banking support. This helped strengthen relationships, enabling CIB to capture an increasing share of business from these customers in areas such as deposits.

CIB's loan and deposit balances grew by 16.6 per cent and 45.0 per cent respectively compared with the end of December 2009. Net interest income increased by 9.9 per cent compared with a year earlier. Loan impairment charges decreased, resulting in a 27.6 per cent rise in operating profit after impairment compared with the same period last year.

**Treasury ("TRY")** reported a 29.1 per cent drop in profit before tax to HK$1,430 million, mainly reflecting the weak performance of net interest income.

With the fragility of the economic recovery and sovereign risks in Europe, global interest rates continued to hover at low levels in the first half of 2010. Coupled with ample liquidity in the local market, this served to limit good investment opportunities in the balance sheet management portfolio. Re-pricing of matured investments resulted in a significant drop in the interest margin. Overall, net interest income fell by 55.0 per cent to HK$609 million.

In the difficult interest rate environment, Treasury closely monitored market opportunities to dispose of assets and prudently invested in selective quality securities. The mix of investments in the balance sheet management portfolio was improved. For the first six months of 2010, disposal gains of over HK$60 million were generated, contributing to the Bank's bottom line.

With high market volatility and tightening regulatory requirements for sales of investment products to the retail segment posing challenges for proprietary trading and product sales, Treasury worked to sustain trading business momentum by promoting sales of renminbi-linked products and hedging instruments, including foreign exchange options. Income contribution from sales of vanilla and exotic foreign exchange options grew six-fold compared with the same period last year. However, with a HK$82 million drop in funding swap income for the first half of 2010, net trading income fell by 17.9 per cent to HK$506 million. If the volatile funding swap income (described below) is excluded, net trading income decreased by HK$28 million, or 6.8 per cent.

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

## Mainland Business

Including two cross-city sub-branches that opened in Guangdong Province under CEPA VI during the first half of 2010, Hang Seng Bank (China) Limited now operates a network of 38 outlets in Beijing, Shanghai, Guangzhou, Dongguan, Shenzhen, Fuzhou, Nanjing, Hangzhou, Ningbo, Tianjin, Kunming, Foshan and Zhongshan. The Bank has a branch in Shenzhen for foreign currency wholesale business and a representative office in Xiamen.

Strong growth was recorded in gross customer advances, which rose by 13.2 per cent to HK$32.1 billion when compared with last year-end. With the further development of wealth management business and Commercial Banking's growing service capabilities, there was good growth in both personal and commercial customer bases, with total customers increasing by 9.1 per cent year-on-year. This increase in the Mainland customer base helped underpin a 24.6 per cent rise in customer deposits when compared with last year-end.

Total operating income grew by 16.4 per cent, supported by the 10.1 per cent increase in net interest income and the 84.4 per cent rise in other operating income. The improvement in other operating income was partly offset by increased exchange losses from the revaluation of US dollar capital funds against the renminbi during the first half of 2010. Profit before tax also recorded encouraging growth of 144.0 per cent when compared with the same period last year.

To reinforce the Group's long-term commitment to the Mainland market and support the continued development of Hang Seng China's business, in May this year Hang Seng China signed a RMB510 million agreement to acquire headquarter premises in Shanghai.

The Bank's strategic alliance with Industrial Bank continues to yield encouraging results. The Bank took up its full share entitlement under a rights issue by Industrial Bank and increased its equity interest in the Mainland bank from 12.78 per cent to 12.80 per cent at 30 June 2010.

## Economic Profit

Economic profit is calculated from post-tax profit, adjusted for any surplus/deficit arising from property revaluation, depreciation attributable to the revaluation surplus and impairment of purchased goodwill and takes into account the cost of capital invested by the Bank's shareholders.

For the first half of year 2010, economic profit was HK$4,245 million, an increase of HK$330 million, or 8.4 per cent, compared with the same period last year. Return on invested capital (post-tax profit, adjusted for the property revaluation surplus net of deferred tax, depreciation attributable to the revaluation surplus and impairment of purchased goodwill), rose by HK$491 million. Cost of capital rose by HK$161 million, in line with the increase in invested capital with the accumulation of retained profits.

| | ***Half-year ended 30 June 2010*** | | *Half-year ended 30 June 2009* | | *Half-year ended 31 December 2009* | |
|---|---|---|---|---|---|---|
| | ***HK$ million*** | ***%*** | *HK$ million* | *%* | *HK$ million* | *%* |
| Average invested capital | **56,856** | | 52,069 | | 53,791 | |
| Return on invested capital* | **6,933** | **24.6** | 6,442 | 24.9 | 6,707 | 24.8 |
| Cost of capital | **(2,688)** | **(9.5)** | (2,527) | (9.8) | (2,250) | (8.3) |
| Economic profit | **4,245** | **15.1** | 3,915 | 15.1 | 4,457 | 16.5 |

* *Return on invested capital is based on post-tax profit excluding any surplus/deficit arising from property revaluation, depreciation attributable to the revaluation surplus and impairment of purchased goodwill.*

## Statement of Financial Position

**Total assets** increased by HK$40.4 billion, or 4.9 per cent, to HK$871.1 billion. Customer advances rose by 14.4 per cent with encouraging growth in corporate and retail lending, Mainland loans and trade finance. Benefiting from the robust property market, the Bank achieved strong growth in residential mortgages in intensely competitive operating conditions – sustaining a leading position and gaining market share. Customer deposits rose by HK$8.6 billion, or 1.3 per cent, to HK$672.2 billion, with improved investor sentiment tempered by continuing caution in identifying investment opportunities. At 30 June 2010, the advances-to-deposits ratio was 58.6 per cent, compared with 51.9 per cent at the end of December 2009. Treasury continued to take a prudent approach in managing its balance sheet management investments. Surplus funds were redeployed to interbank placements and available-for-sale debt securities to attain yield enhancement in the more stable financial markets. As a result, financial investments rose by 2.4 per cent – primarily in high-quality debt securities, including government-guaranteed debt securities.

### Advances to customers

Gross advances to customers grew by HK$49.3 billion, or 14.2 per cent, to HK$395.9 billion compared with the end of 2009.

Loans for use in Hong Kong increased by HK$35.7 billion, or 12.2 per cent, with expansion recorded in most industry sectors. The Bank proactively managed its loan book and took steps to capture business opportunities arising from the improving credit environment and strong property market. Lending to the property development, property investment and financial concerns (including financial vehicles) sectors grew by 19.5 per cent, 17.5 per cent and 24.8 per cent respectively. Lending to stockbrokers rose sharply by 451.3 per cent, reflecting increased IPO-related financing. The Bank was an active participant in Hong Kong government-organised schemes to support SMEs, and recorded loan growth of 27.9 per cent to the wholesale and retail trade sector and 23.5 per cent to manufacturing. The decline in lending to transport and transport equipment was due mainly to loan repayments in the first half of the year. Growth in lending to "Other" was attributable to certain new working capital financing for large corporate customers.

Lending to individuals rose by 5.3 per cent against last year-end. Excluding the fall in Government Home Ownership Scheme mortgages, lending to individuals grew by 6.4 per cent. In the buoyant property market, the Bank sustained a leading position for mortgage business based on a competitive pricing strategy and premium service. Residential mortgage lending to individuals increased by 6.1 per cent, despite intense competition and new government measures to regulate property sales. Credit card advances grew by 3.4 per cent, supported by a year-on-year rise of 6.1 per cent in the number of cards in circulation and a 17.8 per cent increase in cardholder spending. Other loans to individuals were up 11.7 per cent, reflecting the Bank's successful efforts to prudently expand personal lending.

Benefiting from recovering global demand and the rebound in export markets, the Bank grew trade finance lending by 52.6 per cent. Commercial Banking took steps to expand trade finance business by maintaining close relationships with strategic partners to support cross-border renminbi trade business and grow trade refinancing lending to other banks on the Mainland.

Loans for use outside Hong Kong rose by HK$3.6 billion, or 9.9 per cent, compared with the end of 2009, driven largely by lending on the Mainland. The Mainland loan portfolio increased by 13.2 per cent to HK$32.1 billion, underpinned by the expansion of renminbi lending to corporate borrowers.

### Customer deposits

Customer deposits and certificates of deposit and other debt securities in issue stood at HK$672.2 billion at 30 June 2010 – a rise of 1.3 per cent over the end of 2009 and 6.8 per cent year-on-year. Higher growth was recorded in time deposits and current account balances, but this was partly offset by the fall in savings balances. Structured deposits and other structured certificates of deposit and other debt securities in issue fell, due primarily to reduced demand for these investment-related products in the uncertain market conditions. Deposits with Hang Seng China rose by 24.6 per cent, driven mainly by renminbi deposits.

## CONSOLIDATED INCOME STATEMENT

*unaudited*

| *(Expressed in millions of Hong Kong dollars)* | *note* | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009 (restated)* | *Half-year ended 31 December 2009 (restated)* |
|---|---|---|---|---|
| Interest income | 4 | **7,665** | 8,775 | 7,615 |
| Interest expense | 5 | **(952)** | (1,500) | (867) |
| **Net interest income** | | **6,713** | 7,275 | 6,748 |
| Fee income | | **2,835** | 2,327 | 2,863 |
| Fee expense | | **(466)** | (401) | (468) |
| **Net fee income** | 6 | **2,369** | 1,926 | 2,395 |
| Trading income | 7 | **890** | 1,035 | 888 |
| Net income/(loss) from financial instruments designated at fair value | 8 | **132** | (195) | 120 |
| Dividend income | 9 | **4** | 5 | 11 |
| Net earned insurance premiums | | **6,359** | 6,658 | 4,861 |
| Other operating income | 10 | **636** | 350 | 739 |
| **Total operating income** | | **17,103** | 17,054 | 15,762 |
| Net insurance claims incurred and movement in policyholders' liabilities | | **(6,749)** | (6,478) | (5,526) |
| **Net operating income before loan impairment charges and other credit risk provisions** | | **10,354** | 10,576 | 10,236 |
| Loan impairment charges and other credit risk provisions | 11 | **(153)** | (621) | (191) |
| **Net operating income** | | **10,201** | 9,955 | 10,045 |
| Employee compensation and benefits | | **(1,773)** | (1,669) | (1,709) |
| General and administrative expenses | | **(1,376)** | (1,273) | (1,460) |
| Depreciation of premises, plant and equipment | | **(306)** | (286) | (305) |
| Amortisation of intangible assets | | **(49)** | (40) | (44) |
| **Total operating expenses** | 12 | **(3,504)** | (3,268) | (3,518) |
| **Operating profit** | | **6,697** | 6,687 | 6,527 |
| Gains less losses from financial investments and fixed assets | 13 | **69** | 55 | 131 |
| Net surplus on property revaluation | | **153** | 94 | 158 |
| Share of profits from associates | | **1,184** | 763 | 985 |
| **Profit before tax** | | **8,103** | 7,599 | 7,801 |
| Tax expense | 14 | **(1,139)** | (1,173) | (1,089) |
| **Profit for the period** | | **6,964** | 6,426 | 6,712 |
| Profit attributable to shareholders | | **6,964** | 6,426 | 6,712 |
| *(Figures in HK$)* | | | | |
| Earnings per share | 15 | **3.64** | 3.36 | 3.51 |

Details of dividends payable to shareholders of the Bank attributable to the profit for the half year are set out in note 16.

The notes on pages 27 to 71 form part of this interim financial report.

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

*unaudited*

| (Expressed in millions of Hong Kong dollars) | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009 (restated)* | *Half-year ended 31 December 2009 (restated)* |
|---|---|---|---|
| **Profit for the period** | **6,964** | 6,426 | 6,712 |
| **Other comprehensive income** | | | |
| Premises: | | | |
| – unrealised surplus on revaluation of premises | **690** | 535 | 940 |
| – deferred taxes | **(114)** | (79) | (103) |
| Available-for-sale investment reserve: | | | |
| – fair value changes taken to/(from) equity: | | | |
| – on debt securities | **774** | 1,934 | 1,974 |
| – on equity shares | **(30)** | 28 | 52 |
| – fair value changes transferred (to)/from income statement: | | | |
| – on impairment | **–** | 4 | – |
| – on hedged items | **(441)** | 114 | (33) |
| – on disposal | **(72)** | (64) | 55 |
| – share of changes in equity of associates: | | | |
| – fair value changes | **108** | 73 | (99) |
| – deferred taxes | **(34)** | (270) | (202) |
| Cash flow hedge reserve: | | | |
| – fair value changes taken to equity | **127** | 194 | 213 |
| – fair value changes transferred to income statement | **(261)** | (511) | (353) |
| – deferred taxes | **23** | 48 | 21 |
| Defined benefit plans: | | | |
| – actuarial (losses)/gains on defined benefit plans | **(183)** | 1,520 | 357 |
| – deferred taxes | **30** | (251) | (58) |
| Exchange differences on translation of: | | | |
| – financial statements of overseas branches, subsidiaries and associates | **176** | (12) | 15 |
| – others | **13** | 5 | 5 |
| **Other comprehensive income for the period, net of tax** | **806** | 3,268 | 2,784 |
| **Total comprehensive income for the period** | **7,770** | 9,694 | 9,496 |
| Total comprehensive income for the period attributable to shareholders | **7,770** | 9,694 | 9,496 |

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

*unaudited*

| (Expressed in millions of Hong Kong dollars) | note | **At 30 June 2010** | At 30 June 2009 (restated) | At 31 December 2009 (restated) |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and balances with banks and other financial institutions | 19 | **30,065** | 51,065 | 22,086 |
| Placings with and advances to banks and other financial institutions | 20 | **104,711** | 55,223 | 104,551 |
| Trading assets | 21 | **35,559** | 84,517 | 66,597 |
| Financial assets designated at fair value | 22 | **6,160** | 6,025 | 5,450 |
| Derivative financial instruments | 23 | **4,645** | 4,927 | 5,050 |
| Advances to customers | 24 | **394,110** | 325,371 | 344,621 |
| Financial investments | 25 | **247,280** | 225,338 | 241,502 |
| Investments in associates | 26 | **13,841** | 9,329 | 10,226 |
| Investment properties | 27 | **3,013** | 2,716 | 2,872 |
| Premises, plant and equipment | 28 | **12,853** | 11,704 | 12,414 |
| Intangible assets | 29 | **4,706** | 3,621 | 4,214 |
| Other assets | 30 | **14,134** | 14,534 | 11,069 |
| Deferred tax assets | | **10** | 25 | 16 |
| Total assets | | **871,087** | 794,395 | 830,668 |
| **LIABILITIES AND EQUITY** | | | | |
| **Liabilities** | | | | |
| Current, savings and other deposit accounts | 31 | **650,859** | 591,267 | 636,369 |
| Deposits from banks | | **12,962** | 4,603 | 4,870 |
| Trading liabilities | 32 | **40,789** | 53,387 | 38,391 |
| Financial liabilities designated at fair value | | **446** | 1,452 | 1,456 |
| Derivative financial instruments | 23 | **5,516** | 8,778 | 4,251 |
| Certificates of deposit and other debt securities in issue | 33 | **1,360** | 2,294 | 1,826 |
| Other liabilities | 34 | **23,863** | 14,328 | 15,285 |
| Liabilities to customers under insurance contracts | | **59,547** | 49,479 | 54,240 |
| Current tax liabilities | | **963** | 739 | 52 |
| Deferred tax liabilities | | **2,709** | 1,926 | 2,460 |
| Subordinated liabilities | 35 | **7,853** | 9,312 | 9,320 |
| Total liabilities | | **806,867** | 737,565 | 768,520 |
| **Equity** | | | | |
| Share capital | | **9,559** | 9,559 | 9,559 |
| Retained profits | | **40,474** | 36,116 | 37,752 |
| Other reserves | | **12,084** | 9,052 | 11,204 |
| Proposed dividends | | **2,103** | 2,103 | 3,633 |
| Shareholders' funds | 36 | **64,220** | 56,830 | 62,148 |
| Total equity and liabilities | | **871,087** | 794,395 | 830,668 |

The notes on pages 27 to 71 form part of this interim financial report.

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

*unaudited*

| (Expressed in millions of Hong Kong dollars) | **Half-year ended 30 June 2010** | Half-year ended 30 June 2009 (restated) | Half-year ended 31 December 2009 (restated) |
|---|---|---|---|
| **Share capital** | | | |
| At beginning and end of period | **9,559** | 9,559 | 9,559 |
| **Retained profits (including proposed dividends)** | | | |
| At beginning of period | **41,385** | 38,260 | 38,219 |
| Dividends to shareholders | | | |
| – dividends approved in respect of the previous year | **(3,633)** | (5,736) | – |
| – dividends declared in respect of the current period | **(2,103)** | (2,103) | (4,206) |
| Transfer | **105** | 98 | 357 |
| Total comprehensive income for the period | **6,823** | 7,700 | 7,015 |
| | **42,577** | 38,219 | 41,385 |
| **Other reserves** | | | |
| **Premises revaluation reserve** | | | |
| At beginning of period | **7,885** | 7,047 | 7,405 |
| Transfer | **(105)** | (98) | (357) |
| Total comprehensive income for the period | **576** | 456 | 837 |
| | **8,356** | 7,405 | 7,885 |
| **Available-for-sale investment reserve** | | | |
| At beginning of period | **(257)** | (3,823) | (2,004) |
| Total comprehensive income for the period | **305** | 1,819 | 1,747 |
| | **48** | (2,004) | (257) |
| **Cash flow hedge reserve** | | | |
| At beginning of period | **174** | 562 | 293 |
| Total comprehensive income for the period | **(111)** | (269) | (119) |
| | **63** | 293 | 174 |
| **Foreign exchange reserve** | | | |
| At beginning of period | **1,382** | 1,379 | 1,367 |
| Total comprehensive income for the period | **176** | (12) | 15 |
| | **1,558** | 1,367 | 1,382 |
| **Other reserve** | | | |
| At beginning of period | **2,020** | 1,984 | 1,991 |
| Cost of share-based payment arrangements | **38** | 7 | 28 |
| Total comprehensive income for the period | **1** | – | 1 |
| | **2,059** | 1,991 | 2,020 |
| **Total equity** | | | |
| At beginning of period | **62,148** | 54,968 | 56,830 |
| Dividends to shareholders | **(5,736)** | (7,839) | (4,206) |
| Cost of share-based payment arrangements | **38** | 7 | 28 |
| Total comprehensive income for the period | **7,770** | 9,694 | 9,496 |
| | **64,220** | 56,830 | 62,148 |

# CONSOLIDATED CASH FLOW STATEMENT

*unaudited*

| *(Expressed in millions of Hong Kong dollars)* | *note* | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009* |
|---|---|---|---|
| **Net cash (outflow)/inflow from operating activities** | 37(a) | **(33,732)** | 102,831 |
| **Cash flows from investing activities** | | | |
| Dividends received from associates | | **397** | 358 |
| Purchase of an interest in an associate | | **(2,626)** | – |
| Purchase of available-for-sale investments | | **(16,913)** | (35,448) |
| Purchase of held-to-maturity debt securities | | **(479)** | (130) |
| Proceeds from sale or redemption of available-for-sale investments | | **23,331** | 26,397 |
| Proceeds from redemption of held-to-maturity debt securities | | **238** | 132 |
| Purchase of fixed assets and intangible assets | | **(132)** | (157) |
| Interest received from available-for-sale investments | | **783** | 2,142 |
| Dividends received from available-for-sale investments | | **3** | 4 |
| Net cash inflow/(outflow) from investing activities | | **4,602** | (6,702) |
| **Cash flows from financing activities** | | | |
| Dividends paid | | **(5,736)** | (7,839) |
| Interest paid for subordinated liabilities | | **(29)** | (86) |
| Repayment of subordinated liabilities | | **(2,500)** | – |
| Net cash outflow from financing activities | | **(8,265)** | (7,925) |
| **(Decrease)/increase in cash and cash equivalents** | | **(37,395)** | 88,204 |
| **Cash and cash equivalents at 1 January** | | **136,759** | 76,116 |
| Effect of foreign exchange rate changes | | **1,068** | 1,895 |
| **Cash and cash equivalents at 30 June** | 37(b) | **100,432** | 166,215 |

The notes on pages 27 to 71 form part of this interim financial report.

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

## 1 Basis of preparation

This interim financial report has been prepared in accordance with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and in compliance with Hong Kong Accounting Standard (HKAS) 34, Interim Financial Reporting, issued by the Hong Kong Institute of Certified Public Accountants (HKICPA). It also contains the disclosure information required under the Banking (Disclosure) Rules issued by the Hong Kong Monetary Authority (the "HKMA").

The preparation of an interim financial report in conformity with HKAS 34 requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses on a year to date basis. Actual results may differ from these estimates.

The interim financial report is unaudited, but has been reviewed by KPMG in accordance with Hong Kong Standards on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*, issued by HKICPA. KPMG's independent review report to the Board of Directors is included on page 72.

## 2 Accounting policies

This interim report has been prepared on a basis consistent with the accounting policies adopted in the 2009 accounts except for the following:

Following the adoption of the amendments to HKAS 17 "Leases", the Group has reclassified interests in leasehold land held under long leases from operating leases to finance leases. Before the amendment, these leases were recorded at historical cost and amortised over the term of the lease. With these leases reclassified as finance leases, they are carried at valuation and included under "Premises, plant and equipment", with the difference between the amortised cost and valuation recognised in the premises revaluation reserve. The corresponding prior-year comparatives have been adjusted accordingly.

The major lines of the financial statements that have been affected are as follows:

| | *As reported* | *Adjustment* | *Restated* |
|---|---|---|---|
| Half-year ended 30 June 2009 | | | |
| Profit for the period | 6,451 | (25) | 6,426 |
| Total comprehensive income | 9,467 | 227 | 9,694 |
| | | | |
| As at 31 December 2009 | | | |
| Premises, plant and equipment | 7,178 | 5,236 | 12,414 |
| Premises revaluation reserve | 3,994 | 3,891 | 7,885 |
| Retained profits | 37,719 | 33 | 37,752 |

Certain key ratios for comparative periods have also been restated to conform with the current period presentation.

## 3 Basis of consolidation

This interim financial report covers the consolidated positions of Hang Seng Bank Limited and all its subsidiaries, unless otherwise stated, and include the attributable share of the results and reserves of its associates. For regulatory reporting, the basis of consolidation are different from the basis of consolidation for accounting purposes. They are set out in note 38.

## 4 Interest income

| | **Half-year ended 30 June 2010** | Half-year ended 30 June 2009 | Half-year ended 31 December 2009 |
|---|---|---|---|
| Interest income arising from: | | | |
| – financial assets that are not at fair value through profit and loss | **7,526** | 8,545 | 7,405 |
| – trading assets | **112** | 180 | 140 |
| – financial assets designated at fair value | **27** | 50 | 70 |
| | **7,665** | 8,775 | 7,615 |
| of which: | | | |
| – interest income from listed investments | **614** | 1,020 | 781 |
| – interest income from unlisted investments | **1,535** | 1,960 | 1,609 |
| – interest income from impaired financial assets | **35** | 19 | 27 |

## 5 Interest expense

| | **Half-year ended 30 June 2010** | Half-year ended 30 June 2009 | Half-year ended 31 December 2009 |
|---|---|---|---|
| Interest expense arising from: | | | |
| – financial liabilities that are not at fair value through profit and loss | **754** | 1,115 | 684 |
| – trading liabilities | **195** | 376 | 178 |
| – financial liabilities designated at fair value | **3** | 9 | 5 |
| | **952** | 1,500 | 867 |
| of which: | | | |
| – interest expense from debt securities in issue maturing after five years | **–** | – | – |
| – interest expense from customer accounts maturing after five years | **–** | – | – |
| – interest expense from subordinated liabilities | **29** | 86 | 40 |

## 6 Net fee income

| | **_Half-year ended 30 June 2010_** | _Half-year ended 30 June 2009_ | _Half-year ended 31 December 2009_ |
|---|---|---|---|
| – stockbroking and related services | **673** | 689 | 877 |
| – retail investment funds | **491** | 226 | 378 |
| – structured investment products | **11** | 5 | 23 |
| – insurance agency | **139** | 103 | 87 |
| – account services | **180** | 143 | 148 |
| – private banking service fee | **63** | 46 | 83 |
| – remittances | **122** | 101 | 116 |
| – cards | **742** | 659 | 754 |
| – credit facilities | **91** | 67 | 68 |
| – trade services | **205** | 173 | 206 |
| – other | **118** | 115 | 123 |
| Fee income | **2,835** | 2,327 | 2,863 |
| Fee expense | **(466)** | (401) | (468) |
| | **2,369** | 1,926 | 2,395 |
| of which: | | | |
| Net fee income, other than amounts included in determining the effective interest rate, arising from financial assets or financial liabilities that are not held for trading nor designated at fair value | **921** | 774 | 884 |
| – fee income | **1,217** | 1,041 | 1,176 |
| – fee expense | **(296)** | (267) | (292) |
| Net fee income on trust and other fiduciary activities where the Group holds or invests on behalf of its customers | **231** | 166 | 217 |
| – fee income | **331** | 235 | 322 |
| – fee expense | **(100)** | (69) | (105) |

## 7 Trading income

| | **Half-year ended 30 June 2010** | Half-year ended 30 June 2009 | Half-year ended 31 December 2009 |
|---|---|---|---|
| Foreign exchange | **880** | 930 | 862 |
| (Losses)/gains from hedging activities: | | | |
| – fair value hedge | | | |
| – on hedging instruments | **(451)** | 116 | (42) |
| – on the hedged items attributable to the hedged risk | **441** | (114) | 33 |
| – cash flow hedge | | | |
| – net hedging income/(loss) | **–** | 18 | (2) |
| Securities, derivatives and other trading activities | **20** | 85 | 37 |
| | **890** | 1,035 | 888 |

## 8 Net income/(loss) from financial instruments designated at fair value

| | **Half-year ended 30 June 2010** | Half-year ended 30 June 2009 | Half-year ended 31 December 2009 |
|---|---|---|---|
| Net income/(loss) on assets designated at fair value which back insurance and investment contracts | **147** | (170) | 116 |
| Net change in fair value of other financial instruments designated at fair value | **(15)** | (25) | 4 |
| | **132** | (195) | 120 |
| of which dividend income from: | | | |
| – listed investments | **–** | – | 1 |
| – unlisted investments | **–** | – | 1 |
| | **–** | – | 2 |

## 9 Dividend income

| | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009* | *Half-year ended 31 December 2009* |
|---|---|---|---|
| Dividend income: | | | |
| – listed investments | **1** | 1 | 2 |
| – unlisted investments | **3** | 4 | 9 |
| | **4** | 5 | 11 |

## 10 Other operating income

| | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009* | *Half-year ended 31 December 2009* |
|---|---|---|---|
| Rental income from investment properties | **78** | 73 | 76 |
| Movement in present value of in-force long-term insurance business | **467** | 202 | 558 |
| Other | **91** | 75 | 105 |
| | **636** | 350 | 739 |

## 11 Loan impairment charges and other credit risk provisions

| | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009* | *Half-year ended 31 December 2009* |
|---|---|---|---|
| Loan impairment charges (note 24(b)): | | | |
| – individually assessed | **(77)** | (288) | (22) |
| – collectively assessed | **(76)** | (333) | (169) |
| | **(153)** | (621) | (191) |
| of which: | | | |
| – new and additional | **(281)** | (709) | (395) |
| – releases | **98** | 61 | 169 |
| – recoveries | **30** | 27 | 35 |
| | **(153)** | (621) | (191) |
| Other credit risk provisions | **–** | – | – |
| | **(153)** | (621) | (191) |

There was no impairment charge (nil for the first and second halves of 2009) provided for available-for-sale debt securities by the Group. There was also no impairment loss made in relation to held-to-maturity investments for the periods indicated.

## 12 Operating expenses

| | Half-year ended 30 June 2010 | Half-year ended 30 June 2009 (restated) | Half-year ended 31 December 2009 (restated) |
|---|---|---|---|
| Employee compensation and benefits: | | | |
| – salaries and other costs | **1,403** | 1,401 | 1,313 |
| – performance-related pay | **236** | 123 | 254 |
| – retirement benefit costs | | | |
| – defined benefit scheme | **96** | 107 | 106 |
| – defined contribution scheme | **38** | 38 | 36 |
| | **1,773** | 1,669 | 1,709 |
| General and administrative expenses: | | | |
| – rental expenses | **227** | 210 | 220 |
| – other premises and equipment | **428** | 442 | 458 |
| – marketing and advertising expenses | **234** | 174 | 208 |
| – other operating expenses | **487** | 447 | 574 |
| | **1,376** | 1,273 | 1,460 |
| Depreciation of business premises and equipment (note 28) | **306** | 286 | 305 |
| Amortisation of intangible assets | **49** | 40 | 44 |
| | **3,504** | 3,268 | 3,518 |

## 13 Gains less losses from financial investments and fixed assets

| | Half-year ended 30 June 2010 | Half-year ended 30 June 2009 | Half-year ended 31 December 2009 |
|---|---|---|---|
| Net gains from disposal of available-for-sale equity securities | **10** | 159 | 2 |
| Net gains/(losses) from disposal of available-for-sale debt securities | **62** | (95) | (57) |
| Impairment of available-for-sale equity securities | **–** | (4) | – |
| Gains less losses on disposal of assets held for sale | **–** | – | 187 |
| Gains less losses on disposal of fixed assets | **(3)** | (5) | (1) |
| | **69** | 55 | 131 |

There were no impairment losses or gains less losses on disposal of held-to-maturity debt securities, loans and receivables and financial liabilities measured at amortised cost for the periods indicated.

## 14 Tax expense

Taxation in the consolidated income statement represents:

| | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009 (restated)* | *Half-year ended 31 December 2009 (restated)* |
|---|---|---|---|
| **Current tax – provision for Hong Kong profits tax** | | | |
| Tax for the period | **933** | 977 | 867 |
| Adjustment in respect of prior periods | **(19)** | (3) | – |
| | **914** | 974 | 867 |
| **Current tax – taxation outside Hong Kong** | | | |
| Tax for the period | **39** | 3 | 47 |
| **Deferred tax** | | | |
| Origination and reversal of temporary differences | **186** | 196 | 175 |
| **Total tax expenses** | **1,139** | 1,173 | 1,089 |

The current tax provision is based on the estimated assessable profit for the first half of 2010, and is determined for the Bank and its subsidiaries operating in the Hong Kong SAR by using the Hong Kong profits tax rate of 16.5 per cent (2009: 16.5 per cent). For subsidiaries and branches operating in other jurisdictions, the appropriate tax rates prevailing in the relevant countries are used. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised.

## 15 Earnings per share

The calculation of earnings per share for the first half of 2010 is based on earnings of HK$6,964 million (HK$6,426 million and HK$6,712 million for the first and second halves of 2009 respectively) and on the weighted average number of ordinary shares in issue of 1,911,842,736 shares (unchanged from the first and second halves of 2009).

## 16 Dividends per share

| | Half-year ended 30 June 2010 | | Half-year ended 30 June 2009 | | Half-year ended 31 December 2009 | |
|---|---|---|---|---|---|---|
| | HK$ per share | HK$ million | HK$ per share | HK$ million | HK$ per share | HK$ million |
| 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 |

## 17 Segmental analysis

The Group's business comprises five customer groups. To be consistent with the way in which information is reported internally for the purposes of resource allocation and performance assessment, the Group identified the following five reportable segments.

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 balance sheet management 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.

### *(a) Segmental result*

For the purpose of segmental analysis, the allocation of revenue reflects the benefits of capital and other funding resources allocated to the customer groups by way of internal capital allocation and fund transfer-pricing mechanisms. Cost allocation is based on the direct costs incurred by the respective customer groups and apportionment of management overheads. Rental charges at market rates for usage of premises are reflected in other operating income for the "Other" customer group and total operating expenses for the respective customer groups.

## 17 Segmental analysis *(continued)*

### (a) Segmental result *(continued)*

| | Personal Financial Services | Commercial Banking | Corporate Banking | Treasury | Other | Total reportable segments | Inter-segment elimination | Total |
|---|---|---|---|---|---|---|---|---|
| *Half-year ended 30 June 2010* | | | | | | | | |
| Net interest income | 4,194 | 1,184 | 641 | 609 | 85 | 6,713 | – | 6,713 |
| Net fee income/(expense) | 1,585 | 649 | 90 | (12) | 57 | 2,369 | – | 2,369 |
| Trading income/(loss) | 249 | 145 | 4 | 506 | (14) | 890 | – | 890 |
| Net income/(loss) from financial instruments designated at fair value | 148 | – | – | (2) | (14) | 132 | – | 132 |
| Dividend income | – | – | – | – | 4 | 4 | – | 4 |
| Net earned insurance premiums | 6,232 | 126 | 1 | – | – | 6,359 | – | 6,359 |
| Other operating income | 541 | 9 | – | (1) | 313 | 862 | (226) | 636 |
| **Total operating income** | 12,949 | 2,113 | 736 | 1,100 | 431 | 17,329 | (226) | 17,103 |
| Net insurance claims incurred and movement in policyholders' liabilities | (6,670) | (79) | – | – | – | (6,749) | – | (6,749) |
| **Net operating income before loan impairment charges and other credit risk provisions** | 6,279 | 2,034 | 736 | 1,100 | 431 | 10,580 | (226) | 10,354 |
| Loan impairment charges and other credit risk provisions | (102) | (50) | (1) | – | – | (153) | – | (153) |
| **Net operating income** | 6,177 | 1,984 | 735 | 1,100 | 431 | 10,427 | (226) | 10,201 |
| Total operating expenses* | (2,334) | (787) | (180) | (173) | (256) | (3,730) | 226 | (3,504) |
| **Operating profit** | 3,843 | 1,197 | 555 | 927 | 175 | 6,697 | – | 6,697 |
| Gains less losses from financial investments and fixed assets | – | – | 5 | 62 | 2 | 69 | – | 69 |
| Net surplus on property revaluation | – | – | – | – | 153 | 153 | – | 153 |
| Share of profits from associates | 94 | 586 | – | 441 | 63 | 1,184 | – | 1,184 |
| **Profit before tax** | 3,937 | 1,783 | 560 | 1,430 | 393 | 8,103 | – | 8,103 |
| Share of profit before tax | 48.6% | 22.0% | 6.9% | 17.6% | 4.9% | 100.0% | – | 100.0% |
| Operating profit excluding loan impairment charges and other credit risk provisions | 3,945 | 1,247 | 556 | 927 | 175 | 6,850 | – | 6,850 |
| ** Depreciation/amortisation included in total operating expenses* | (88) | (16) | (3) | (2) | (246) | (355) | – | (355) |
| *At 30 June 2010* | | | | | | | | |
| Total assets | 244,132 | 128,459 | 115,306 | 348,071 | 35,119 | 871,087 | – | 871,087 |
| Total liabilities | 546,668 | 132,261 | 54,456 | 37,866 | 35,616 | 806,867 | – | 806,867 |
| Investments in associates | 1,049 | 5,913 | – | 4,466 | 2,413 | 13,841 | – | 13,841 |

## 17 Segmental analysis *(continued)*

### (a) *Segmental result (continued)*

| | Personal Financial Services | Commercial Banking | Corporate Banking | Treasury | Other | Total reportable segments | Inter-segment elimination | Total |
|---|---|---|---|---|---|---|---|---|
| *Half-year ended 30 June 2009 (restated)* | | | | | | | | |
| Net interest income | 4,015 | 987 | 583 | 1,353 | 337 | 7,275 | – | 7,275 |
| Net fee income/(expense) | 1,294 | 524 | 79 | (19) | 48 | 1,926 | – | 1,926 |
| Trading income/(loss) | 317 | 115 | 10 | 616 | (23) | 1,035 | – | 1,035 |
| Net loss from financial instruments designated at fair value | (170) | – | – | (9) | (16) | (195) | – | (195) |
| Dividend income | 1 | – | – | – | 4 | 5 | – | 5 |
| Net earned insurance premiums | 6,549 | 108 | 1 | – | – | 6,658 | – | 6,658 |
| Other operating income | 264 | 15 | 1 | – | 307 | 587 | (237) | 350 |
| **Total operating income** | 12,270 | 1,749 | 674 | 1,941 | 657 | 17,291 | (237) | 17,054 |
| Net insurance claims incurred and movement in policyholders' liabilities | (6,413) | (65) | – | – | – | (6,478) | – | (6,478) |
| **Net operating income before loan impairment charges and other credit risk provisions** | 5,857 | 1,684 | 674 | 1,941 | 657 | 10,813 | (237) | 10,576 |
| Loan impairment charges and other credit risk provisions | (274) | (263) | (82) | (2) | – | (621) | – | (621) |
| **Net operating income** | 5,583 | 1,421 | 592 | 1,939 | 657 | 10,192 | (237) | 9,955 |
| Total operating expenses* | (2,278) | (733) | (157) | (137) | (200) | (3,505) | 237 | (3,268) |
| **Operating profit** | 3,305 | 688 | 435 | 1,802 | 457 | 6,687 | – | 6,687 |
| Gains less losses from financial investments and fixed assets | 96 | 53 | 14 | (95) | (13) | 55 | – | 55 |
| Net surplus on property revaluation | – | – | – | – | 94 | 94 | – | 94 |
| Share of profits from associates | 66 | 339 | – | 310 | 48 | 763 | – | 763 |
| **Profit before tax** | 3,467 | 1,080 | 449 | 2,017 | 586 | 7,599 | – | 7,599 |
| Share of profit before tax | 45.6% | 14.2% | 5.9% | 26.6% | 7.7% | 100.0% | – | 100.0% |
| Operating profit excluding loan impairment charges and other credit risk provisions | 3,579 | 951 | 517 | 1,804 | 457 | 7,308 | – | 7,308 |
| ** Depreciation/amortisation included in total operating expenses* | (82) | (15) | (4) | (2) | (223) | (326) | – | (326) |
| *At 30 June 2009* | | | | | | | | |
| Total assets | 218,251 | 84,180 | 90,115 | 366,245 | 35,604 | 794,395 | – | 794,395 |
| Total liabilities | 542,284 | 106,419 | 32,593 | 27,141 | 29,128 | 737,565 | – | 737,565 |
| Investments in associates | 683 | 3,608 | – | 2,666 | 2,372 | 9,329 | – | 9,329 |

## 17 Segmental analysis *(continued)*

### (a) Segmental result (continued)

| | Personal Financial Services | Commercial Banking | Corporate Banking | Treasury | Other | Total reportable segments | Inter-segment elimination | Total |
|---|---|---|---|---|---|---|---|---|
| *Half-year ended 31 December 2009 (restated)* | | | | | | | | |
| Net interest income | 4,180 | 1,024 | 575 | 809 | 160 | 6,748 | – | 6,748 |
| Net fee income/(expense) | 1,706 | 590 | 66 | (16) | 49 | 2,395 | – | 2,395 |
| Trading income/(loss) | 345 | 130 | (2) | 438 | (23) | 888 | – | 888 |
| Net income/(loss) from financial instruments designated at fair value | 116 | – | – | 14 | (10) | 120 | – | 120 |
| Dividend income | 1 | 6 | – | – | 4 | 11 | – | 11 |
| Net earned insurance premiums | 4,744 | 117 | – | – | – | 4,861 | – | 4,861 |
| Other operating income | 634 | 14 | – | – | 325 | 973 | (234) | 739 |
| **Total operating income** | 11,726 | 1,881 | 639 | 1,245 | 505 | 15,996 | (234) | 15,762 |
| Net insurance claims incurred and movement in policyholders' liabilities | (5,455) | (69) | (2) | – | – | (5,526) | – | (5,526) |
| **Net operating income before loan impairment (charges)/releases and other credit risk provisions** | 6,271 | 1,812 | 637 | 1,245 | 505 | 10,470 | (234) | 10,236 |
| Loan impairment (charges)/releases and other credit risk provisions | (180) | (15) | 4 | – | – | (191) | – | (191) |
| **Net operating income** | 6,091 | 1,797 | 641 | 1,245 | 505 | 10,279 | (234) | 10,045 |
| Total operating expenses* | (2,393) | (774) | (175) | (131) | (279) | (3,752) | 234 | (3,518) |
| **Operating profit** | 3,698 | 1,023 | 466 | 1,114 | 226 | 6,527 | – | 6,527 |
| Gains less losses from financial investments and fixed assets | – | – | – | (57) | 188 | 131 | – | 131 |
| Net surplus on property revaluation | – | – | – | – | 158 | 158 | – | 158 |
| Share of profits from associates | 93 | 534 | – | 319 | 39 | 985 | – | 985 |
| **Profit before tax** | 3,791 | 1,557 | 466 | 1,376 | 611 | 7,801 | – | 7,801 |
| Share of profit before tax | 48.6% | 20.0% | 6.0% | 17.6% | 7.8% | 100.0% | – | 100.0% |
| Operating profit excluding loan impairment charges and other credit risk provisions | 3,878 | 1,038 | 462 | 1,114 | 226 | 6,718 | – | 6,718 |
| ** Depreciation/amortisation included in total operating expenses* | (91) | (16) | (3) | (2) | (237) | (349) | – | (349) |
| *At 31 December 2009* | | | | | | | | |
| Total assets | 234,723 | 96,490 | 88,135 | 377,561 | 33,759 | 830,668 | – | 830,668 |
| Total liabilities | 554,357 | 123,996 | 37,477 | 21,503 | 31,187 | 768,520 | – | 768,520 |
| Investments in associates | 847 | 4,284 | – | 2,707 | 2,388 | 10,226 | – | 10,226 |

## 17 Segmental analysis *(continued)*

### *(b) Geographic information*

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

| | Half-year ended 30 June 2010 | | Half-year ended 30 June 2009 (restated) | | Half-year ended 31 December 2009 (restated) | |
|---|---|---|---|---|---|---|
| | | % | | % | | % |
| **Total operating income** | | | | | | |
| Hong Kong | **16,095** | **94** | 16,058 | 94 | 14,865 | 94 |
| Americas | **440** | **3** | 499 | 3 | 386 | 2 |
| Mainland and other | **568** | **3** | 497 | 3 | 511 | 4 |
| | **17,103** | **100** | 17,054 | 100 | 15,762 | 100 |
| **Profit before tax** | | | | | | |
| Hong Kong | **6,479** | **80** | 6,372 | 84 | 6,453 | 83 |
| Americas | **425** | **5** | 449 | 6 | 350 | 4 |
| Mainland and other | **1,199** | **15** | 778 | 10 | 998 | 13 |
| | **8,103** | **100** | 7,599 | 100 | 7,801 | 100 |

## 17 Segmental analysis *(continued)*

### *(b)* ***Geographic information*** *(continued)*

| | **At 30 June 2010** | | At 30 June 2009 (restated) | | At 31 December 2009 (restated) | |
|---|---|---|---|---|---|---|
| | | **%** | | % | | % |
| **Total assets** | | | | | | |
| Hong Kong | **737,526** | **85** | 684,863 | 86 | 710,167 | 85 |
| Americas | **63,322** | **7** | 60,265 | 8 | 63,808 | 8 |
| Mainland and other | **70,239** | **8** | 49,267 | 6 | 56,693 | 7 |
| | **871,087** | **100** | 794,395 | 100 | 830,668 | 100 |
| **Total liabilities** | | | | | | |
| Hong Kong | **765,674** | **95** | 708,439 | 96 | 734,618 | 96 |
| Americas | **1,403** | **–** | 1,169 | – | 1,109 | – |
| Mainland and other | **39,790** | **5** | 27,957 | 4 | 32,793 | 4 |
| | **806,867** | **100** | 737,565 | 100 | 768,520 | 100 |
| **Interest in associates** | | | | | | |
| Hong Kong | **946** | **7** | 899 | 10 | 916 | 9 |
| Americas | **–** | **–** | – | – | – | – |
| Mainland and other | **12,895** | **93** | 8,430 | 90 | 9,310 | 91 |
| | **13,841** | **100** | 9,329 | 100 | 10,226 | 100 |
| **Non-current assets*** | | | | | | |
| Hong Kong | **20,266** | **99** | 17,724 | 98 | 19,183 | 98 |
| Americas | **–** | **–** | – | – | – | – |
| Mainland and other | **306** | **1** | 317 | 2 | 317 | 2 |
| | **20,572** | **100** | 18,041 | 100 | 19,500 | 100 |
| **Contingent liabilities and commitments** | | | | | | |
| Hong Kong | **207,096** | **89** | 193,094 | 92 | 198,996 | 92 |
| Americas | **–** | **–** | – | – | – | – |
| Mainland and other | **24,947** | **11** | 15,786 | 8 | 18,038 | 8 |
| | **232,043** | **100** | 208,880 | 100 | 217,034 | 100 |

** Non-current assets consist of properties, plant and equipment, goodwill and other intangible assets.*

## 18 Analysis of assets and liabilities by remaining maturity

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

| | *Repayable on demand* | *One month or less but not on demand* | *Over one month but within three months* | *Over three months but within one year* | *Over one year but within five years* | *Over five years* | *Trading* | *No contractual maturity* | *Total* |
|---|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | | |
| Cash and balances with banks and other financial institutions | **30,065** | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **30,065** |
| Placings with and advances to banks and other financial institutions | **10,863** | **46,693** | **40,447** | **6,708** | **–** | **–** | **–** | **–** | **104,711** |
| Trading assets | **–** | **–** | **–** | **–** | **–** | **–** | **35,559** | **–** | **35,559** |
| Financial assets designated at fair value | **–** | **116** | **–** | **441** | **3,949** | **65** | **–** | **1,589** | **6,160** |
| Derivative financial instruments | **–** | **39** | **69** | **73** | **118** | **3** | **4,343** | **–** | **4,645** |
| Advances to customers | **11,643** | **31,495** | **29,546** | **59,467** | **136,844** | **125,115** | **–** | **–** | **394,110** |
| Financial investments: | | | | | | | | | |
| – available-for-sale investments | **–** | **7,869** | **12,666** | **79,334** | **91,860** | **1,369** | **–** | **989** | **194,087** |
| – held-to-maturity debt securities | **–** | **88** | **344** | **1,450** | **22,048** | **29,263** | **–** | **–** | **53,193** |
| Investments in associates | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **13,841** | **13,841** |
| Investment properties | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **3,013** | **3,013** |
| Premises, plant and equipment | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **12,853** | **12,853** |
| Intangible assets | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **4,706** | **4,706** |
| Other assets | **5,636** | **2,404** | **2,687** | **2,922** | **124** | **16** | **–** | **345** | **14,134** |
| Deferred tax assets | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **10** | **10** |
| **At 30 June 2010** | **58,207** | **88,704** | **85,759** | **150,395** | **254,943** | **155,831** | **39,902** | **37,346** | **871,087** |
| At 30 June 2009 *(restated)* | 96,279 | 48,310 | 73,378 | 78,624 | 248,596 | 131,588 | 88,720 | 28,900 | 794,395 |
| At 31 December 2009 *(restated)* | 40,250 | 115,923 | 69,162 | 106,433 | 255,737 | 140,491 | 71,256 | 31,416 | 830,668 |

## 18 Analysis of assets and liabilities by remaining maturity *(continued)*

| | *Repayable on demand* | *One month or less but not on demand* | *Over one month but within three months* | *Over three months but within one year* | *Over one year but within five years* | *Over five years* | *Trading* | *No contractual maturity* | *Total* |
|---|---|---|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | | | | |
| Current, savings and other deposit accounts | **505,254** | **86,307** | **35,505** | **22,808** | **985** | **–** | **–** | **–** | **650,859** |
| Deposits from banks | **7,925** | **4,657** | **238** | **25** | **117** | **–** | **–** | **–** | **12,962** |
| Trading liabilities | **–** | **–** | **–** | **–** | **–** | **–** | **40,789** | **–** | **40,789** |
| Financial liabilities designated at fair value | **3** | **–** | **–** | **–** | **–** | **–** | **–** | **443** | **446** |
| Derivative financial instruments | **–** | **–** | **3** | **38** | **1,005** | **101** | **4,369** | **–** | **5,516** |
| Certificates of deposit and other debt securities in issue: | | | | | | | | | |
| – certificates of deposit in issue | **–** | **–** | **534** | **668** | **158** | **–** | **–** | **–** | **1,360** |
| Other liabilities | **12,310** | **2,864** | **3,564** | **2,319** | **114** | **117** | **–** | **2,575** | **23,863** |
| Liabilities to customers under insurance contracts | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **59,547** | **59,547** |
| Current tax liabilities | **–** | **–** | **–** | **963** | **–** | **–** | **–** | **–** | **963** |
| Deferred tax liabilities | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **2,709** | **2,709** |
| Subordinated liabilities | **–** | **–** | **–** | **2,024** | **5,829** | **–** | **–** | **–** | **7,853** |
| **At 30 June 2010** | **525,492** | **93,828** | **39,844** | **28,845** | **8,208** | **218** | **45,158** | **65,274** | **806,867** |
| At 30 June 2009 *(restated)* | 444,461 | 91,614 | 51,437 | 23,776 | 9,943 | 216 | 61,559 | 54,559 | 737,565 |
| At 31 December 2009 *(restated)* | 503,037 | 86,183 | 40,268 | 29,670 | 7,698 | 129 | 41,972 | 59,563 | 768,520 |

## 18 Analysis of assets and liabilities by remaining maturity *(continued)*

| | Repayable on demand | One month or less but not on demand | Over one month but within three months | Over three months but within one year | Over one year but within five years | Over five years | Trading | No contractual maturity | Total |
|---|---|---|---|---|---|---|---|---|---|
| of which: | | | | | | | | | |
| Certificates of deposit included in: | | | | | | | | | |
| – trading assets | – | – | – | – | – | – | – | – | – |
| – financial assets designated at fair value | – | 10 | – | – | – | – | – | – | 10 |
| – available-for-sale investments | – | 1,271 | – | 1,506 | 1,866 | 117 | – | 52 | 4,812 |
| – held-to-maturity debt securities | – | – | 19 | 209 | 882 | 1,083 | – | – | 2,193 |
| **At 30 June 2010** | **–** | **1,281** | **19** | **1,715** | **2,748** | **1,200** | **–** | **52** | **7,015** |
| At 30 June 2009 | – | 891 | 1,359 | 3,567 | 2,297 | 1,472 | – | 22 | 9,608 |
| At 31 December 2009 | – | – | 1,516 | 2,352 | 2,967 | 922 | – | 37 | 7,794 |
| Debt securities included in: | | | | | | | | | |
| – trading assets | – | – | – | – | – | – | 34,359 | – | 34,359 |
| – financial assets designated at fair value | – | 106 | – | 441 | 3,949 | 65 | – | 8 | 4,569 |
| – available-for-sale investments | – | 6,598 | 12,666 | 77,828 | 89,994 | 1,252 | – | 636 | 188,974 |
| – held-to-maturity debt securities | – | 88 | 325 | 1,241 | 21,166 | 28,180 | – | – | 51,000 |
| **At 30 June 2010** | **–** | **6,792** | **12,991** | **79,510** | **115,109** | **29,497** | **34,359** | **644** | **278,902** |
| At 30 June 2009 | 6,699 | 12,092 | 22,161 | 23,690 | 130,027 | 26,094 | 83,766 | 292 | 304,821 |
| At 31 December 2009 | – | 18,081 | 15,212 | 48,249 | 131,132 | 25,187 | 66,590 | 427 | 304,878 |
| Certificates of deposit in issue included in: | | | | | | | | | |
| – trading liabilities | – | – | – | – | – | – | 214 | – | 214 |
| – financial liabilities designated at fair value | – | – | – | – | – | – | – | – | – |
| – issue at amortised cost | – | – | 534 | 668 | 158 | – | – | – | 1,360 |
| **At 30 June 2010** | **–** | **–** | **534** | **668** | **158** | **–** | **214** | **–** | **1,574** |
| At 30 June 2009 | – | – | 419 | 949 | 926 | – | 912 | – | 3,206 |
| At 31 December 2009 | – | 159 | 171 | 1,177 | 319 | – | 478 | – | 2,304 |

## 19 Cash and balances with banks and other financial institutions

| | **At 30 June 2010** | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Cash in hand | **3,992** | 3,621 | 4,299 |
| Balances with central banks | **9,404** | 31,637 | 3,397 |
| Balances with banks and other financial institutions | **16,669** | 15,807 | 14,390 |
| | **30,065** | 51,065 | 22,086 |

## 20 Placings with and advances to banks and other financial institutions

| | **At 30 June 2010** | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Placings with and advances to banks and other financial institutions maturing within one month | **57,557** | 28,456 | 76,579 |
| Placings with and advances to banks and other financial institutions maturing after one month but less than one year | **47,154** | 26,767 | 27,972 |
| Placings with and advances to banks and other financial institutions maturing after one year | **–** | – | – |
| | **104,711** | 55,223 | 104,551 |
| of which: | | | |
| Placings with and advances to central banks | **4,421** | 7,218 | 7,924 |

There were no overdue advances, impaired advances and rescheduled advances to banks and other financial institutions for the periods indicated.

## 21 Trading assets

| | *At 30 June 2010* | *At 30 June 2009* | *At 31 December 2009* |
|---|---|---|---|
| Treasury bills | **30,156** | 79,426 | 62,028 |
| Certificates of deposit | **–** | – | – |
| Other debt securities | **4,203** | 4,340 | 4,562 |
| Debt securities | **34,359** | 83,766 | 66,590 |
| Equity shares | **–** | 1 | 6 |
| **Total trading securities** | **34,359** | 83,767 | 66,596 |
| Other* | **1,200** | 750 | 1 |
| **Total trading assets** | **35,559** | 84,517 | 66,597 |
| **Debt securities:** | | | |
| – listed in Hong Kong | **3,043** | 2,872 | 2,712 |
| – listed outside Hong Kong | **109** | 153 | 157 |
| | **3,152** | 3,025 | 2,869 |
| – unlisted | **31,207** | 80,741 | 63,721 |
| | **34,359** | 83,766 | 66,590 |
| **Equity shares:** | | | |
| – listed in Hong Kong | **–** | 1 | 6 |
| – unlisted | **–** | – | – |
| | **–** | 1 | 6 |
| **Total trading securities** | **34,359** | 83,767 | 66,596 |
| **Debt securities** | | | |
| Issued by public bodies: | | | |
| – central governments and central banks | **34,043** | 83,168 | 65,817 |
| – other public sector entities | **85** | 373 | 369 |
| | **34,128** | 83,541 | 66,186 |
| Issued by other bodies: | | | |
| – banks and other financial institutions | **118** | 80 | 292 |
| – corporate entities | **113** | 145 | 112 |
| | **231** | 225 | 404 |
| | **34,359** | 83,766 | 66,590 |
| **Equity shares** | | | |
| Issued by corporate entities | **–** | 1 | 6 |
| **Total trading securities** | **34,359** | 83,767 | 66,596 |

* *This represents amount receivable from counterparties on trading transactions not yet settled.*

## 22 Financial assets designated at fair value

| | **At 30 June 2010** | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Certificates of deposit | **10** | 139 | 129 |
| Other debt securities | **4,569** | 5,481 | 4,798 |
| Debt securities | **4,579** | 5,620 | 4,927 |
| Equity shares | **1,581** | 405 | 523 |
| | **6,160** | 6,025 | 5,450 |
| **Debt securities:** | | | |
| – listed in Hong Kong | **3** | 559 | 3 |
| – listed outside Hong Kong | **195** | 271 | 194 |
| | **198** | 830 | 197 |
| – unlisted | **4,381** | 4,790 | 4,730 |
| | **4,579** | 5,620 | 4,927 |
| **Equity shares:** | | | |
| – listed in Hong Kong | **157** | 34 | 21 |
| – listed outside Hong Kong | **57** | 54 | 69 |
| | **214** | 88 | 90 |
| – unlisted | **1,367** | 317 | 433 |
| | **1,581** | 405 | 523 |
| | **6,160** | 6,025 | 5,450 |
| **Debt securities** | | | |
| Issued by public bodies: | | | |
| – central governments and central banks | **151** | 556 | 154 |
| – other public sector entities | **138** | 409 | 168 |
| | **289** | 965 | 322 |
| Issued by other bodies: | | | |
| – banks and other financial institutions | **4,165** | 4,441 | 4,464 |
| – corporate entities | **125** | 214 | 141 |
| | **4,290** | 4,655 | 4,605 |
| | **4,579** | 5,620 | 4,927 |
| **Equity shares** | | | |
| Issued by corporate entities | **1,581** | 405 | 523 |
| | **6,160** | 6,025 | 5,450 |

## 23 Derivative financial instruments

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 Group primarily traded over-the-counter derivatives and also participated in exchange traded derivatives. 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 2010 | | | At 30 June 2009 | | | At 31 December 2009 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Contract amounts | Derivative assets | Derivative liabilities | Contract amounts | Derivative assets | Derivative liabilities | Contract amounts | Derivative assets | Derivative liabilities |
| **Derivatives held for trading** | | | | | | | | | |
| Exchange rate contracts: | | | | | | | | | |
| – spot and forward foreign exchange | 505,567 | 1,545 | 1,733 | 480,218 | 1,797 | 1,640 | 382,260 | 2,289 | 608 |
| – currency swaps | 19,922 | 224 | 110 | 17,550 | 254 | 143 | 20,837 | 261 | 132 |
| – currency options purchased | 54,004 | 481 | – | 18,839 | 78 | – | 30,561 | 83 | – |
| – currency options written | 61,431 | – | 561 | 27,895 | – | 155 | 40,105 | – | 197 |
| – other exchange rate contracts | 245 | 10 | 1 | 138 | 3 | 2 | 226 | 3 | 1 |
| | 641,169 | 2,260 | 2,405 | 544,640 | 2,132 | 1,940 | 473,989 | 2,636 | 938 |
| Interest rate contracts: | | | | | | | | | |
| – interest rate swaps | 178,229 | 1,650 | 1,687 | 156,373 | 1,780 | 1,838 | 162,662 | 1,552 | 1,622 |
| – interest rate options purchased | 143 | – | – | 142 | – | – | 143 | – | – |
| – interest rate options written | 142 | – | – | 142 | – | – | 142 | – | – |
| – other interest rate contracts | 39 | – | – | 4,689 | – | 3 | 407 | – | 1 |
| | 178,553 | 1,650 | 1,687 | 161,346 | 1,780 | 1,841 | 163,354 | 1,552 | 1,623 |
| Equity and other contracts: | | | | | | | | | |
| – equity swaps | 5,767 | 44 | 258 | 12,210 | 8 | 4,348 | 5,706 | 29 | 994 |
| – equity options purchased | 4,998 | 126 | – | 1,289 | 85 | – | 1,705 | 91 | – |
| – equity options written | 1,220 | – | 4 | 854 | – | 20 | 1,317 | – | 13 |
| – other equity contracts | – | – | – | 38 | – | – | 6 | – | – |
| – spot and forward contracts and other | 3,409 | 263 | 2 | 2,337 | 169 | – | 2,651 | 333 | – |
| | 15,394 | 433 | 264 | 16,728 | 262 | 4,368 | 11,385 | 453 | 1,007 |
| Total derivatives held for trading | 835,116 | 4,343 | 4,356 | 722,714 | 4,174 | 8,149 | 648,728 | 4,641 | 3,568 |

## 23 Derivative financial instruments *(continued)*

| | At 30 June 2010 | | | At 30 June 2009 | | | At 31 December 2009 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Contract amounts | Derivative assets | Derivative liabilities | Contract amounts | Derivative assets | Derivative liabilities | Contract amounts | Derivative assets | Derivative liabilities |
| **Derivatives embedded in financial assets designated at fair value** | | | | | | | | | |
| Exchange rate contracts: | | | | | | | | | |
| – spot and forward foreign exchange | 134 | – | 2 | 70 | – | – | 89 | 1 | – |
| Interest rate contracts: | | | | | | | | | |
| – interest rate swaps | 140 | – | 11 | 1,683 | 29 | 23 | 1,160 | 17 | 13 |
| | 274 | – | 13 | 1,753 | 29 | 23 | 1,249 | 18 | 13 |
| **Cash flow hedge derivatives** | | | | | | | | | |
| Interest rate contracts: | | | | | | | | | |
| – interest rate swaps | 71,889 | 268 | 44 | 44,931 | 696 | 14 | 45,526 | 366 | 13 |
| **Fair value hedge derivatives** | | | | | | | | | |
| Interest rate contracts: | | | | | | | | | |
| – interest rate swaps | 22,572 | 34 | 1,103 | 16,035 | 28 | 592 | 21,028 | 25 | 657 |
| **Total derivatives** | 929,851 | 4,645 | 5,516 | 785,433 | 4,927 | 8,778 | 716,531 | 5,050 | 4,251 |

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.

## 24 Advances to customers

### (a) Advances to customers

| | At 30 June 2010 | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Gross advances to customers | **395,935** | 327,731 | 346,586 |
| Less: loan impairment allowances | | | |
| – individually assessed | **(1,099)** | (1,492) | (1,151) |
| – collectively assessed | **(726)** | (868) | (814) |
| | **394,110** | 325,371 | 344,621 |
| Included in advances to customers are: | | | |
| – trade bills | **7,636** | 2,773 | 2,802 |
| Less: loan impairment allowances | **(39)** | (39) | (42) |
| | **7,597** | 2,734 | 2,760 |

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

| | At 30 June 2010 | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| | **%** | % | % |
| Loan impairment allowances: | | | |
| – individually assessed | **0.28** | 0.46 | 0.33 |
| – collectively assessed | **0.18** | 0.26 | 0.23 |
| Total loan impairment allowances | **0.46** | 0.72 | 0.56 |

## 24 Advances to customers *(continued)*

### *(b) Loan impairment allowances against advances to customers*

| | *Individually assessed* | *Collectively assessed* | *Total* |
|---|---|---|---|
| At 1 January 2010 | **1,151** | **814** | **1,965** |
| Amounts written off | **(129)** | **(184)** | **(313)** |
| Recoveries of advances written off in previous years (note 11) | **9** | **21** | **30** |
| New impairment allowances charged to income statement (note 11) | **114** | **167** | **281** |
| Impairment allowances released to income statement (note 11) | **(37)** | **(91)** | **(128)** |
| Unwinding of discount of loan impairment allowances recognised as "interest income" | **(9)** | **(1)** | **(10)** |
| At 30 June 2010 | **1,099** | **726** | **1,825** |
| At 1 January 2009 | 1,241 | 802 | 2,043 |
| Amounts written off | (29) | (283) | (312) |
| Recoveries of advances written off in previous years (note 11) | 9 | 18 | 27 |
| New impairment allowances charged to income statement (note 11) | 358 | 351 | 709 |
| Impairment allowances released to income statement (note 11) | (70) | (18) | (88) |
| Unwinding of discount of loan impairment allowances recognised as "interest income" | (17) | (2) | (19) |
| At 30 June 2009 | 1,492 | 868 | 2,360 |
| At 1 July 2009 | 1,492 | 868 | 2,360 |
| Amounts written off | (365) | (243) | (608) |
| Recoveries of advances written off in previous years (note 11) | 15 | 20 | 35 |
| New impairment allowances charged to income statement (note 11) | 206 | 189 | 395 |
| Impairment allowances released to income statement (note 11) | (184) | (20) | (204) |
| Unwinding of discount of loan impairment allowances recognised as "interest income" | (13) | – | (13) |
| At 31 December 2009 | 1,151 | 814 | 1,965 |

## 24 Advances to customers *(continued)*

### *(c) Impaired advances and allowances*

| | **At 30 June 2010** | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Gross impaired advances | **2,429** | 3,742 | 2,508 |
| Individually assessed allowances | **(1,099)** | (1,492) | (1,151) |
| Net impaired advances | **1,330** | 2,250 | 1,357 |
| Individually assessed allowances as a percentage of gross impaired advances | **45.2%** | 39.9% | 45.9% |
| Gross impaired advances as a percentage of gross advances to customers | **0.6%** | 1.1% | 0.7% |

Impaired advances are those advances where objective evidence exists that full repayment of principal or interest is considered unlikely.

| | **At 30 June 2010** | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Gross individually assessed impaired advances | **2,280** | 3,650 | 2,434 |
| Individually assessed allowances | **(1,099)** | (1,492) | (1,151) |
| | **1,181** | 2,158 | 1,283 |
| Gross individually assessed impaired advances as a percentage of gross advances to customers | **0.6%** | 1.1% | 0.7% |
| Amount of collateral which has been taken into account in respect of individually assessed impaired advances to customers | **862** | 2,105 | 1,024 |

Collateral includes any tangible security that carries a fair market value and is readily marketable. This includes (but is not limited to) cash and deposits, stocks and bonds, mortgages over properties and charges over other fixed assets such as plant and equipment. Where collateral values are greater than gross advances, only the amount of collateral up to the gross advance was included.

## 24 Advances to customers *(continued)*

### *(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 2010** | | At 30 June 2009 | | At 31 December 2009 | |
|---|---|---|---|---|---|---|
| | | **%** | | % | | % |
| Gross advances to customers which have been overdue with respect to either principal or interest for periods of: | | | | | | |
| – more than three months but not more than six months | **179** | **0.1** | 628 | 0.2 | 241 | 0.1 |
| – more than six months but not more than one year | **164** | **–** | 830 | 0.3 | 353 | 0.1 |
| – more than one year | **1,055** | **0.3** | 500 | 0.1 | 864 | 0.2 |
| | **1,398** | **0.4** | 1,958 | 0.6 | 1,458 | 0.4 |
| of which: | | | | | | |
| – individually impaired allowances | **(955)** | | (1,268) | | (984) | |
| – covered portion of overdue loans and advances | **588** | | 1,165 | | 553 | |
| – uncovered portion of overdue loans and advances | **810** | | 793 | | 905 | |
| – current market value of collateral held against the covered portion of overdue loans and advances | **895** | | 1,435 | | 1,095 | |

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.

## 24 Advances to customers *(continued)*

### *(e) Rescheduled advances*

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

| | | *At 30 June 2010* | | *At 30 June 2009* | | *At 31 December 2009* |
|---|---|---|---|---|---|---|
| | | % | | % | | % |
| Rescheduled advances to customers | **258** | **0.1** | 666 | 0.2 | 703 | 0.2 |

Rescheduled advances are those advances that have been rescheduled or renegotiated for reasons related to the borrower's financial difficulties. This will normally involve the granting of concessionary terms and resetting the overdue account to non-overdue status.

Rescheduled advances to customers are stated net of any advances which have subsequently become overdue for more than three months and which are included in "Overdue advances" (note d).

### *(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 2010, about 90 per cent (over 90 per cent at 30 June 2009 and about 90 per cent at 31 December 2009) of the Group's advances to customers, including related impaired advances and overdue advances, were classified under Hong Kong. There was no geographical segment other than Hong Kong to which the Bank's advances to customers is not less than 10 per cent of the total loans and advances.

## 24 Advances to customers *(continued)*

### *(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 HKMA is as follows:

| | ***At 30 June 2010*** | | *At 30 June 2009* | | *At 31 December 2009* | |
|---|---|---|---|---|---|---|
| | | ***% of gross advances covered by collateral*** | | *% of gross advances covered by collateral* | | *% of gross advances covered by collateral* |
| **Gross advances to customers for use in Hong Kong** | | | | | | |
| **Industrial, commercial and financial sectors** | | | | | | |
| – property development | **28,226** | **33.7** | 22,865 | 34.6 | 23,618 | 36.1 |
| – property investment | **88,418** | **80.8** | 66,060 | 89.7 | 75,264 | 82.3 |
| – financial concerns | **3,395** | **25.8** | 2,130 | 35.4 | 2,720 | 33.9 |
| – stockbrokers | **2,646** | **20.0** | 2,736 | 13.1 | 480 | 42.9 |
| – wholesale and retail trade | **9,993** | **43.0** | 6,489 | 54.2 | 7,812 | 49.5 |
| – manufacturing | **14,924** | **28.4** | 11,350 | 31.5 | 12,080 | 30.4 |
| – transport and transport equipment | **5,565** | **60.9** | 8,031 | 77.4 | 6,503 | 83.3 |
| – recreational activities | **37** | **41.0** | 28 | 57.1 | 37 | 41.4 |
| – information technology | **1,227** | **1.8** | 1,265 | 3.8 | 1,247 | 2.4 |
| – other | **28,083** | **44.7** | 25,348 | 45.5 | 24,405 | 43.9 |
| | **182,514** | **58.6** | 146,302 | 63.7 | 154,166 | 61.8 |
| **Individuals** | | | | | | |
| – advances for the purchase of flats under the Government Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme | **14,179** | **99.8** | 15,740 | 99.9 | 14,647 | 99.9 |
| – advances for the purchase of other residential properties | **102,566** | **99.9** | 91,656 | 99.7 | 96,651 | 99.7 |
| – credit card advances | **14,289** | **–** | 12,780 | – | 13,818 | – |
| – other | **13,363** | **34.5** | 10,992 | 34.6 | 11,961 | 45.3 |
| | **144,397** | **83.9** | 131,168 | 84.5 | 137,077 | 84.9 |
| **Total gross advances for use in Hong Kong** | **326,911** | **69.8** | 277,470 | 73.6 | 291,243 | 72.7 |
| **Trade finance** | **29,319** | **27.4** | 18,878 | 38.4 | 19,215 | 35.6 |
| **Gross advances for use outside Hong Kong** | **39,705** | **62.4** | 31,383 | 61.6 | 36,128 | 55.4 |
| **Gross advances to customers** | **395,935** | **65.9** | 327,731 | 70.4 | 346,586 | 68.8 |

## 25 Financial investments

| | At 30 June 2010 | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Financial investments: | | | |
| – which may be repledged or resold by counterparties | **435** | 309 | 141 |
| – which may not be repledged or resold or are not subject to repledge or resale by counterparties | **246,845** | 225,029 | 241,361 |
| | **247,280** | 225,338 | 241,502 |
| Available-for-sale at fair value: | | | |
| – debt securities | **193,786** | 180,413 | 192,486 |
| – equity shares | **301** | 295 | 347 |
| Held-to-maturity debt securities at amortised cost | **53,193** | 44,630 | 48,669 |
| | **247,280** | 225,338 | 241,502 |
| Treasury bills | **62,962** | 35,778 | 53,973 |
| Certificates of deposit | **7,005** | 9,469 | 7,665 |
| Other debt securities | **177,012** | 179,796 | 179,517 |
| Debt securities | **246,979** | 225,043 | 241,155 |
| Equity shares | **301** | 295 | 347 |
| | **247,280** | 225,338 | 241,502 |

There was no overdue debt securities at 30 June 2010 and the comparative periods for the Group.

## 25 Financial investments *(continued)*

### *(a) Held-to-maturity debt securities*

| | **At 30 June 2010** | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Listed in Hong Kong | **828** | 925 | 634 |
| Listed outside Hong Kong | **6,067** | 4,465 | 5,627 |
| | **6,895** | 5,390 | 6,261 |
| Unlisted | **46,298** | 39,240 | 42,408 |
| | **53,193** | 44,630 | 48,669 |
| Issued by public bodies: | | | |
| – central governments and central banks | **293** | 197 | 244 |
| – other public sector entities | **7,595** | 6,220 | 7,235 |
| | **7,888** | 6,417 | 7,479 |
| Issued by other bodies: | | | |
| – banks and other financial institutions | **34,363** | 31,179 | 32,145 |
| – corporate entities | **10,942** | 7,034 | 9,045 |
| | **45,305** | 38,213 | 41,190 |
| | **53,193** | 44,630 | 48,669 |
| Fair value of held-to-maturity debt securities: | | | |
| – listed | **7,354** | 5,359 | 6,384 |
| – unlisted | **48,974** | 39,464 | 43,421 |
| | **56,328** | 44,823 | 49,805 |

There was no held-to-maturity debt securities determined to be impaired at 30 June 2010 and the comparative periods for the Group.

## 25 Financial investments *(continued)*

### (b) *Available-for-sale debt securities*

| | **At 30 June 2010** | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Listed in Hong Kong | **8,340** | 4,601 | 6,973 |
| Listed outside Hong Kong | **67,764** | 61,326 | 60,991 |
| | **76,104** | 65,927 | 67,964 |
| Unlisted | **117,682** | 114,486 | 124,522 |
| | **193,786** | 180,413 | 192,486 |
| Issued by public bodies: | | | |
| – central governments and central banks | **78,437** | 44,281 | 64,532 |
| – other public sector entities | **13,352** | 3,243 | 17,830 |
| | **91,789** | 47,524 | 82,362 |
| Issued by other bodies: | | | |
| – banks and other financial institutions | **95,099** | 123,461 | 101,167 |
| – corporate entities | **6,898** | 9,428 | 8,957 |
| | **101,997** | 132,889 | 110,124 |
| | **193,786** | 180,413 | 192,486 |

For the periods indicated, there was no available-for-sale debt securities individually determined to be impaired on the basis that there was objective evidence of impairment in the value of the debt securities for the Group.

### (c) *Available-for-sale equity shares*

| | **At 30 June 2010** | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Listed in Hong Kong | **45** | 48 | 60 |
| Listed outside Hong Kong | **58** | 64 | 85 |
| | **103** | 112 | 145 |
| Unlisted | **198** | 183 | 202 |
| | **301** | 295 | 347 |
| Issued by corporate entities | **301** | 295 | 347 |

At 30 June 2010 and 31 December 2009, there was no available-for-sale securities individually determined to be impaired for the Group. At 30 June 2009, certain available-for-sale equity shares of the Group were individually determined to be impaired. Impairment losses on these investments were recognised in the income statement.

## 25 Financial investments *(continued)*

***(d)*** The following table presents an analysis of debt securities by rating agency designation at the end of the reporting periods, based on Standard and Poor's ratings or their equivalent to the respective issues of the financial securities. If major rating agencies have different ratings for the same debt securities, the securities are reported against the lower rating. In the absence of such issue ratings, the ratings designated for the issuers are reported.

| | ***At 30 June 2010*** | *At 30 June 2009* | *At 31 December 2009* |
|---|---|---|---|
| AAA | **87,424** | 86,125 | 74,339 |
| AA- to AA+ | **94,497** | 67,826 | 98,811 |
| A- to A+ | **59,869** | 58,544 | 58,749 |
| B+ to BBB+ | **2,048** | 7,978 | 5,094 |
| B and lower | **–** | 151 | – |
| Unrated | **3,141** | 4,419 | 4,162 |
| | **246,979** | 225,043 | 241,155 |

## 26 Investments in associates

| | ***At 30 June 2010*** | *At 30 June 2009* | *At 31 December 2009* |
|---|---|---|---|
| Share of net assets | **13,310** | 8,782 | 9,691 |
| Intangible assets | **94** | 119 | 106 |
| Goodwill | **437** | 428 | 429 |
| | **13,841** | 9,329 | 10,226 |

The Bank participated Industrial Bank Co., Ltd's ("Industrial Bank") rights issue in the first half of 2010 at an investment cost of RMB2.3 billion. This increased the Bank's equity interest in Industrial Bank from 12.78 per cent to 12.80 per cent as at 30 June 2010.

## 27 Investment properties

| | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009* | *Half-year ended 31 December 2009* |
|---|---|---|---|
| Beginning of the period | **2,872** | 2,593 | 2,716 |
| Surplus on revaluation credited to income statement | **152** | 93 | 157 |
| Transfer (to)/from assets held for sale | **(17)** | 17 | (1) |
| Transfer from premises (note 28) | **6** | 13 | – |
| End of the period | **3,013** | 2,716 | 2,872 |

## 28 Premises, plant and equipment

***Movement of premises, plant and equipment***

| | *Premises* | *Plant and equipment* | *Total* |
|---|---|---|---|
| Cost or valuation: | | | |
| At 1 January 2010 | **11,638** | **3,387** | **15,025** |
| Exchange adjustments | **1** | **4** | **5** |
| Additions | **–** | **58** | **58** |
| Disposals | **–** | **(31)** | **(31)** |
| Elimination of accumulated depreciation on revalued premises | **(157)** | **–** | **(157)** |
| Surplus on revaluation: | | | |
| – credited to premises revaluation reserve | **690** | **–** | **690** |
| – credited to income statement | **1** | **–** | **1** |
| Transfer to investment properties (note 27) | **(6)** | **–** | **(6)** |
| At 30 June 2010 | **12,167** | **3,418** | **15,585** |
| Accumulated depreciation: | | | |
| At 1 January 2010 | **–** | **(2,611)** | **(2,611)** |
| Exchange adjustments | **–** | **(1)** | **(1)** |
| Charge for the period (note 12) | **(159)** | **(147)** | **(306)** |
| Written off on disposal | **–** | **29** | **29** |
| Elimination of accumulated depreciation on revalued premises | **157** | **–** | **157** |
| At 30 June 2010 | **(2)** | **(2,730)** | **(2,732)** |
| Net book value at 30 June 2010 | **12,165** | **688** | **12,853** |

## 28 Premises, plant and equipment *(continued)*

***Movement of premises, plant and equipment*** *(continued)*

| | *Premises (restated)* | *Plant and equipment* | *Total* |
|---|---|---|---|
| Cost or valuation: | | | |
| At 1 January 2009 | 10,714 | 3,421 | 14,135 |
| Exchange adjustments | – | (1) | (1) |
| Additions | – | 84 | 84 |
| Disposals | – | (142) | (142) |
| Elimination of accumulated depreciation on revalued premises | (140) | – | (140) |
| Surplus on revaluation: | | | |
| – credited to premises revaluation reserve | 535 | – | 535 |
| – credited to income statement | 1 | – | 1 |
| Transfer to assets held for sale | (253) | – | (253) |
| Transfer to investment properties (note 27) | (13) | – | (13) |
| At 30 June 2009 | 10,844 | 3,362 | 14,206 |
| Accumulated depreciation: | | | |
| At 1 January 2009 | – | (2,492) | (2,492) |
| Exchange adjustments | – | (1) | (1) |
| Charge for the period (note 12) | (142) | (144) | (286) |
| Written off on disposal | – | 137 | 137 |
| Elimination of accumulated depreciation on revalued premises | 140 | – | 140 |
| At 30 June 2009 | (2) | (2,500) | (2,502) |
| Net book value at 30 June 2009 | 10,842 | 862 | 11,704 |
| Cost or valuation: | | | |
| At 1 July 2009 | 10,844 | 3,362 | 14,206 |
| Exchange adjustments | – | 1 | 1 |
| Additions | – | 76 | 76 |
| Disposals | – | (50) | (50) |
| Elimination of accumulated depreciation on revalued premises | (147) | – | (147) |
| Surplus on revaluation: | | | |
| – credited to premises revaluation reserve | 940 | – | 940 |
| – credited to income statement | 1 | – | 1 |
| Transfer to assets held for sale | – | – | – |
| Transfer to investment properties (note 27) | – | – | – |
| Other | – | (2) | (2) |
| At 31 December 2009 | 11,638 | 3,387 | 15,025 |
| Accumulated depreciation: | | | |
| At 1 July 2009 | (2) | (2,500) | (2,502) |
| Exchange adjustments | – | 1 | 1 |
| Charge for the period (note 12) | (145) | (160) | (305) |
| Written off on disposal | – | 48 | 48 |
| Transfer to assets held for sale | – | – | – |
| Elimination of accumulated depreciation on revalued premises | 147 | – | 147 |
| At 31 December 2009 | – | (2,611) | (2,611) |
| Net book value at 31 December 2009 | 11,638 | 776 | 12,414 |

## 28 Premises, plant and equipment *(continued)*

In May 2010, Hang Seng Bank (China) Limited entered into a conditional agreement with HSBC Bank (China) Company Limited to purchase a property situated in Shanghai, PRC together with the naming and signage rights for a total consideration of RMB510 million. The transaction is scheduled to be completed in the second half of 2010 subject to fulfilment of certain conditions precedent regarding regulatory and government approvals. The initial deposit of RMB51 million paid by Hang Seng Bank (China) Limited upon signing of the sale and purchase agreement was included in "other assets".

## 29 Intangible assets

| | **At 30 June 2010** | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Present value of in-force long-term insurance business | **3,933** | 2,909 | 3,466 |
| Internally developed software | **408** | 357 | 385 |
| Acquired software | **36** | 26 | 34 |
| Goodwill | **329** | 329 | 329 |
| | **4,706** | 3,621 | 4,214 |

## 30 Other assets

| | **At 30 June 2010** | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Items in the course of collection from other banks | **5,393** | 7,059 | 4,343 |
| Prepayments and accrued income | **2,160** | 2,263 | 1,835 |
| Assets held for sale | | | |
| – repossessed assets | **19** | 59 | 47 |
| – other assets held for sale | **18** | 254 | – |
| Acceptances and endorsements | **4,662** | 3,388 | 3,584 |
| Retirement benefit assets | **77** | 64 | 86 |
| Other accounts | **1,805** | 1,447 | 1,174 |
| | **14,134** | 14,534 | 11,069 |

There are no significant impaired, overdue or rescheduled other assets at the period-end.

## 31 Current, savings and other deposit accounts

| | **At 30 June 2010** | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Current, savings and other deposit accounts: | | | |
| – as stated in consolidated statement of financial position | **650,859** | 591,267 | 636,369 |
| – structured deposits reported as trading liabilities (note 32) | **17,499** | 28,306 | 22,212 |
| | **668,358** | 619,573 | 658,581 |
| By type: | | | |
| – demand and current accounts | **54,432** | 43,594 | 53,450 |
| – savings accounts | **426,942** | 380,090 | 437,440 |
| – time and other deposits | **186,984** | 195,889 | 167,691 |
| | **668,358** | 619,573 | 658,581 |

## 32 Trading liabilities

| | At 30 June 2010 | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Structured certificates of deposit in issue (note 33) | **214** | 912 | 478 |
| Other debt securities in issue (note 33) | **2,294** | 6,417 | 2,769 |
| Structured deposits (note 31) | **17,499** | 28,306 | 22,212 |
| Short positions in securities and other | **20,782** | 17,752 | 12,932 |
| | **40,789** | 53,387 | 38,391 |

## 33 Certificates of deposit and other debt securities in issue

| | At 30 June 2010 | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Certificates of deposit and other debt securities in issue: | | | |
| – as stated in consolidated statement of financial position | **1,360** | 2,294 | 1,826 |
| – structured certificates of deposit in issue reported as trading liabilities (note 32) | **214** | 912 | 478 |
| – other debt securities in issue reported as trading liabilities (note 32) | **2,294** | 6,417 | 2,769 |
| | **3,868** | 9,623 | 5,073 |
| By type: | | | |
| – certificates of deposit in issue | **1,574** | 3,206 | 2,304 |
| – other debt securities in issue | **2,294** | 6,417 | 2,769 |
| | **3,868** | 9,623 | 5,073 |

## 34 Other liabilities

| | At 30 June 2010 | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|
| Items in the course of transmission to other banks | **12,540** | 5,644 | 6,304 |
| Accruals | **1,930** | 2,106 | 2,039 |
| Acceptances and endorsements | **4,662** | 3,388 | 3,584 |
| Retirement benefit liabilities | **1,903** | 2,071 | 1,712 |
| Other | **2,828** | 1,119 | 1,646 |
| | **23,863** | 14,328 | 15,285 |

## 35 Subordinated liabilities

| Nominal value | Description | At 30 June 2010 | At 30 June 2009 | At 31 December 2009 |
|---|---|---|---|---|
| **Amount owed to third parties** | | | | |
| HK$1,500 million | Callable floating rate subordinated notes due June 2015 [(1)] | – | 1,499 | 1,499 |
| HK$1,000 million | 4.125% callable fixed rate subordinated notes due June 2015 [(1)] | – | 1,017 | 1,003 |
| US$450 million | Callable floating rate subordinated notes due July 2016 [(2)] | **3,498** | 3,479 | 3,483 |
| US$300 million | Callable floating rate subordinated notes due July 2017 [(3)] | **2,331** | 2,319 | 2,321 |
| **Amount owed to HSBC Group undertakings** | | | | |
| US$260 million | Callable floating rate subordinated loan debt due December 2015 [(4)] | **2,024** | 2,015 | 2,017 |
| | | **7,853** | 10,329 | 10,323 |
| Representing: | | | | |
| – measured at amortised cost | | **7,853** | 9,312 | 9,320 |
| – designated at fair value | | – | 1,017 | 1,003 |
| | | **7,853** | 10,329 | 10,323 |

The above subordinated notes and loan each carries a one-time call option exercisable by the Group on a day falling five years plus one day after the relevant date of issue/drawdown.

(1) The Bank has exercised its option to redeem these subordinated notes at par of HK$2,500 million in aggregate in June 2010.

(2) Interest rate at three-month US dollar LIBOR plus 0.30 per cent, payable quarterly, to the call option date. Thereafter, it will be reset to three-month US dollar LIBOR plus 0.80 per cent, payable quarterly.

(3) Interest rate at three-month US dollar LIBOR plus 0.25 per cent, payable quarterly, to the call option date. Thereafter, it will be reset to three-month US dollar LIBOR plus 0.75 per cent, payable quarterly.

(4) Interest rate at three-month US dollar LIBOR plus 0.31 per cent, payable quarterly, to the call option date. Thereafter, it will be reset to three-month US dollar LIBOR plus 0.81 per cent, payable quarterly.

No subordinated debt was issued during the first half of 2010. The outstanding subordinated notes, which qualify as supplementary capital, serve to help the Bank maintain a more balanced capital structure and support business growth.

## 36 Shareholders' funds

| | **At 30 June 2010** | At 30 June 2009 (restated) | At 31 December 2009 (restated) |
|---|---|---|---|
| Share capital | **9,559** | 9,559 | 9,559 |
| Retained profits | **40,474** | 36,116 | 37,752 |
| Premises revaluation reserve | **8,356** | 7,405 | 7,885 |
| Cash flow hedge reserve | **63** | 293 | 174 |
| Available-for-sale investment reserve: | | | |
| – on debt securities | **(156)** | (2,191) | (496) |
| – on equity securities | **204** | 187 | 239 |
| Capital redemption reserve | **99** | 99 | 99 |
| Other reserves | **3,518** | 3,259 | 3,303 |
| Total reserves | **52,558** | 45,168 | 48,956 |
| | **62,117** | 54,727 | 58,515 |
| Proposed dividends | **2,103** | 2,103 | 3,633 |
| Shareholders' funds | **64,220** | 56,830 | 62,148 |
| Return on average shareholders' funds | **22.8%** | 23.5% | 22.4% |

To satisfy the provisions of the Hong Kong Banking Ordinance and local regulatory requirements for prudential supervision purposes, the Group has earmarked a "regulatory reserve" directly from retained profits. As at 30 June 2010, the effect of this requirement is to restrict the amount of reserves which can be distributed by the Group to shareholders by HK$1,254 million (HK$770 million and HK$920 million at 30 June 2009 and 31 December 2009 respectively).

Save for the redemption of all the (1) Series A – HK$1,000 million 4.125 per cent subordinated notes due 2015 and (2) Series B – HK$1,500 million floating rate subordinated notes due 2015, both at par on 24 June 2010, there was no purchase, sale or redemption by the Bank, or any of its subsidiaries, of the Bank's securities during the first half of 2010.

## 37 Reconciliation of cash flow statement

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

| | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009* |
|---|---|---|
| Operating profit | **6,697** | 6,687 |
| Net interest income | **(6,713)** | (7,275) |
| Dividend income | **(4)** | (5) |
| Loan impairment charges and other credit risk provisions | **153** | 621 |
| Impairment of available-for-sale equity securities | **–** | 4 |
| Depreciation | **306** | 286 |
| Amortisation of intangible assets | **49** | 40 |
| Amortisation of available-for-sale investments | **68** | 19 |
| Amortisation of held-to-maturity debt securities | **2** | 1 |
| Advances written off net of recoveries | **(283)** | (285) |
| Interest received | **7,090** | 6,132 |
| Interest paid | **(943)** | (769) |
| **Operating profit before changes in working capital** | **6,422** | 5,456 |
| Change in treasury bills and certificates of deposit with original maturity more than three months | **(9,028)** | (10,310) |
| Change in placings with and advances to banks maturing after one month | **(19,182)** | (4,213) |
| Change in trading assets | **6,367** | 92,246 |
| Change in financial assets designated at fair value | **189** | 37 |
| Change in derivative financial instruments | **1,670** | (3,990) |
| Change in advances to customers | **(49,359)** | 3,415 |
| Change in other assets | **(12,352)** | (7,063) |
| Change in financial liabilities designated at fair value | **(2)** | 22 |
| Change in current, savings and other deposit accounts | **14,490** | 29,084 |
| Change in deposits from banks | **8,091** | (6,833) |
| Change in trading liabilities | **2,398** | 5,105 |
| Change in certificates of deposit and other debt securities in issue | **(466)** | (478) |
| Change in other liabilities | **17,672** | 3,161 |
| Elimination of exchange differences and other non-cash items | **(605)** | (2,497) |
| **Cash (used in)/generated from operating activities** | **(33,695)** | 103,142 |
| Taxation paid | **(37)** | (311) |
| **Net cash (outflow)/inflow from operating activities** | **(33,732)** | 102,831 |

## 37 Reconciliation of cash flow statement *(continued)*

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

| | At 30 June 2010 | At 30 June 2009 |
|---|---|---|
| Cash and balances with banks and other financial institutions | **30,065** | 51,065 |
| Placings with and advances to banks and other financial institutions maturing within one month | **55,784** | 27,539 |
| Treasury bills | **13,851** | 87,611 |
| Certificates of deposit | **732** | – |
| | **100,432** | 166,215 |

The balances of cash and cash equivalents included cash balances with central banks and financial institutions that are subject to exchange control and regulatory restrictions, amounting to HK$7,822 million at 30 June 2010 (HK$6,048 million at 30 June 2009).

## 38 Contingent liabilities, commitments and derivatives

The tables below give the contract amounts, credit equivalent amounts and risk-weighted amounts of off-balance sheet transactions. The information is consistent with that in the "Capital Adequacy Ratio" return submitted to the Hong Kong Monetary Authority by the Group. The return is prepared on a consolidated basis as specified by the Hong Kong Monetary Authority under the requirement of section 98(2) of the Banking Ordinance.

For the purposes of these financial statements, acceptances and endorsements are recognised on the statement of financial position in "Other assets" and "Other liabilities" in accordance with HKAS 39. For the purpose of the Banking (Capital) Rules ("the Capital Rules"), acceptances and endorsements are included in the capital adequacy calculation as if they were contingencies. The contract amount of acceptances and endorsements included in the below tables were HK$4,662 million (HK$3,388 million and HK$3,584 million at 30 June 2009 and 31 December 2009 respectively).

Contingent liabilities and commitments are credit-related instruments. The contract amounts represent the amounts at risk should the contracts be fully drawn upon and the customers default. Since a significant portion of guarantees and commitments is expected to expire without being drawn upon, the total of the contract amounts is not representative of future liquidity requirements.

Derivatives arise from futures, forward, swap and option transactions undertaken by the Group in the foreign exchange, interest rate, equity, credit and commodity markets. The contract amounts of these instruments indicate the volume of transactions outstanding at the end of the reporting period; they do not represent amounts at risk.

The credit equivalent amounts are calculated for the purposes of deriving the risk-weighted amounts. These are assessed in accordance with the Capital Rules and depend on the status of the counterparty and maturity characteristics of the instrument.

The netting adjustments represent amounts where the Group has in place legally enforceable rights of offset with individual counterparties to offset the gross amount of positive marked-to-market assets with any negative marked-to-market liabilities with the same customer. These offsets are recognised by the HKMA in the calculation of risk assets for the capital adequacy ratio.

## 38 Contingent liabilities, commitments and derivatives *(continued)*

With the Capital Rules effective from 1 January 2007, the Group uses the approaches approved by the Hong Kong Monetary Authority to calculate the capital adequacy ratio in accordance with the Capital Rules. The risk-weighted assets were calculated based on the "advanced internal ratings-based approach".

| | *Contract amounts* | *Credit equivalent amounts* | *Risk-weighted amounts* |
|---|---|---|---|
| ***At 30 June 2010*** | | | |
| Direct credit substitutes | **3,377** | **3,246** | **2,182** |
| Transaction-related contingencies | **889** | **540** | **389** |
| Trade-related contingencies | **10,897** | **3,061** | **1,736** |
| Forward asset purchases | **44** | **44** | **44** |
| Undrawn formal standby facilities, credit lines and other commitments to lend: | | | |
| – not unconditionally cancellable* | **31,767** | **16,115** | **7,736** |
| – unconditionally cancellable | **168,893** | **57,439** | **16,463** |
| | **215,867** | **80,445** | **28,550** |
| Exchange rate contracts: | | | |
| – spot and forward foreign exchange | **431,420** | **5,701** | **950** |
| – currency swaps | **19,922** | **870** | **229** |
| – currency option purchased | **54,001** | **1,618** | **1,206** |
| – other exchange rate contracts | **245** | **12** | **1** |
| | **505,588** | **8,201** | **2,386** |
| Interest rate contracts: | | | |
| – interest rate swaps | **272,830** | **2,638** | **558** |
| – interest rate options purchased | **143** | **–** | **–** |
| | **272,973** | **2,638** | **558** |
| Equity and other contracts: | | | |
| – equity swaps | **5,767** | **396** | **55** |
| – equity options purchased | **1,215** | **77** | **45** |
| – other equity contracts | **–** | **–** | **–** |
| | **6,982** | **473** | **100** |

* *The contract amount for undrawn formal standby facilities, credit lines and other commitments to lend with original maturity of "not more than one year" and "more than one year" as at 30 June 2010 were HK$15,903 million and HK$15,864 million respectively.*

## 38 Contingent liabilities, commitments and derivatives *(continued)*

| | *Contract amounts* | *Credit equivalent amounts* | *Risk-weighted amounts* |
|---|---|---|---|
| *At 30 June 2009* | | | |
| Direct credit substitutes | 3,063 | 3,063 | 1,659 |
| Transaction-related contingencies | 570 | 347 | 161 |
| Trade-related contingencies | 8,905 | 2,195 | 1,415 |
| Forward asset purchases | 27 | 27 | 27 |
| Undrawn formal standby facilities, credit lines and other commitments to lend: | | | |
| – not unconditionally cancellable | 30,624 | 16,776 | 7,399 |
| – unconditionally cancellable | 149,008 | 51,948 | 12,208 |
| | 192,197 | 74,356 | 22,869 |
| Exchange rate contracts: | | | |
| – spot and forward foreign exchange | 408,031 | 5,633 | 597 |
| – currency swaps | 17,550 | 1,050 | 235 |
| – currency option purchased | 18,781 | 335 | 136 |
| – other exchange rate contracts | 138 | 5 | – |
| | 444,500 | 7,023 | 968 |
| Interest rate contracts: | | | |
| – interest rate swaps | 219,022 | 3,121 | 402 |
| – interest rate options purchased | 142 | 1 | – |
| | 219,164 | 3,122 | 402 |
| Equity and other contracts: | | | |
| – equity swaps | 12,210 | 768 | 39 |
| – equity options purchased | 880 | 84 | 47 |
| – other equity contracts | – | – | – |
| | 13,090 | 852 | 86 |

## 38 Contingent liabilities, commitments and derivatives *(continued)*

| | *Contract amounts* | *Credit equivalent amounts* | *Risk-weighted amounts* |
|---|---|---|---|
| *At 31 December 2009* | | | |
| Direct credit substitutes | 3,121 | 2,987 | 1,785 |
| Transaction-related contingencies | 550 | 289 | 155 |
| Trade-related contingencies | 9,451 | 2,465 | 1,466 |
| Forward asset purchases | 36 | 36 | 36 |
| Undrawn formal standby facilities, credit lines and other commitments to lend: | | | |
| – not unconditionally cancellable | 29,069 | 16,447 | 7,720 |
| – unconditionally cancellable | 158,817 | 53,514 | 15,036 |
| | 201,044 | 75,738 | 26,198 |
| Exchange rate contracts: | | | |
| – spot and forward foreign exchange | 334,133 | 5,573 | 689 |
| – currency swaps | 20,837 | 1,090 | 250 |
| – currency option purchased | 30,561 | 548 | 239 |
| – other exchange rate contracts | 226 | 6 | – |
| | 385,757 | 7,217 | 1,178 |
| Interest rate contracts: | | | |
| – interest rate swaps | 230,376 | 2,640 | 413 |
| – interest rate options purchased | 143 | – | – |
| | 230,519 | 2,640 | 413 |
| Equity and other contracts: | | | |
| – equity swaps | 5,706 | 383 | 31 |
| – equity options purchased | 1,296 | 91 | 61 |
| – other equity contracts | – | – | – |
| | 7,002 | 474 | 92 |

## 39 Foreign currency positions

Foreign currency exposures include those arising from trading, non-trading and structural positions. The net option position is calculated on the basis of delta-weighted positions of all foreign exchange options contracts. At 30 June 2010, the US dollar ("US$"), Chinese renminbi ("RMB"), Euro ("EUR"), Pound Sterling ("GBP"), Swiss Franc ("CHF"), Australian dollar ("AUD") and Gold ("GOL") were the currencies in which the Group had non-structural foreign currency positions that were not less than 10 per cent of the total net position in all foreign currencies. The Group also had a RMB structural foreign currency position, which was not less than 10 per cent of the total net structural position in all foreign currencies.

The table below summarises the net structural and non-structural foreign currency positions of the Group.

| | *US$* | *RMB* | *EUR* | *GBP* | *CHF* | *AUD* | *GOL* | *Other foreign currencies* | *Total foreign currencies* |
|---|---|---|---|---|---|---|---|---|---|
| ***At 30 June 2010*** | | | | | | | | | |
| **Non-structural position** | | | | | | | | | |
| Spot assets | **230,684** | **52,221** | **8,852** | **8,183** | **248** | **20,071** | **525** | **59,005** | **379,789** |
| Spot liabilities | **(152,310)** | **(52,694)** | **(9,647)** | **(10,167)** | **(684)** | **(31,777)** | **(2,495)** | **(58,956)** | **(318,730)** |
| Forward purchases | **236,686** | **42,463** | **6,483** | **6,367** | **681** | **16,747** | **2,854** | **22,319** | **334,600** |
| Forward sales | **(315,026)** | **(42,216)** | **(5,826)** | **(4,447)** | **(208)** | **(5,096)** | **(851)** | **(22,296)** | **(395,966)** |
| Net option position | **(68)** | **–** | **70** | **4** | **–** | **92** | **–** | **(106)** | **(8)** |
| Net long/(short) non-structural position | **(34)** | **(226)** | **(68)** | **(60)** | **37** | **37** | **33** | **(34)** | **(315)** |
| **Structural positions** | **286** | **18,144** | **–** | **–** | **–** | **–** | **–** | **285** | **18,715** |
| *At 30 June 2009* | | | | | | | | | |
| **Non-structural position** | | | | | | | | | |
| Spot assets | 220,606 | 36,442 | 12,096 | 9,191 | 75 | 18,410 | 490 | 112,617 | 409,927 |
| Spot liabilities | (189,501) | (36,031) | (8,907) | (8,120) | (409) | (23,092) | (2,125) | (55,934) | (324,119) |
| Forward purchases | 227,596 | 27,145 | 8,362 | 4,081 | 513 | 9,354 | 2,210 | 31,010 | 310,271 |
| Forward sales | (251,599) | (27,633) | (11,504) | (5,210) | (162) | (4,692) | (567) | (87,732) | (389,099) |
| Net option position | 2 | – | (40) | 31 | – | (4) | – | 9 | (2) |
| Net long/(short) non-structural position | 7,104 | (77) | 7 | (27) | 17 | (24) | 8 | (30) | 6,978 |
| **Structural positions** | 285 | 13,589 | – | – | – | – | – | 235 | 14,109 |
| *At 31 December 2009* | | | | | | | | | |
| **Non-structural position** | | | | | | | | | |
| Spot assets | 214,379 | 41,638 | 12,558 | 9,980 | 85 | 20,619 | 816 | 99,534 | 399,609 |
| Spot liabilities | (164,511) | (41,564) | (9,427) | (9,163) | (552) | (28,370) | (2,387) | (60,145) | (316,119) |
| Forward purchases | 169,349 | 29,483 | 6,885 | 2,215 | 832 | 14,293 | 2,430 | 15,685 | 241,172 |
| Forward sales | (219,453) | (29,603) | (10,103) | (2,995) | (371) | (6,532) | (851) | (55,168) | (325,076) |
| Net option position | (4) | – | (1) | – | 2 | 7 | – | (1) | 3 |
| Net long/(short) non-structural position | (240) | (46) | (88) | 37 | (4) | 17 | 8 | (95) | (411) |
| **Structural positions** | 285 | 14,550 | – | – | – | – | – | 287 | 15,122 |

## 40 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 2009, 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 1 March 2010. The Annual Report and Financial Statements for the year ended 31 December 2009, 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 www.hangseng.com.

## 41 Comparative figures

As a result of the adoption of the amendments to HKAS 17 "Leases", certain comparative figures have been adjusted to conform with the current period's presentation and to provide comparative amounts in respect of items disclosed for the first time in 2010.

## 42 Property revaluation

The Group's premises and investment properties were revalued at 30 June 2010 by DTZ Debenham Tie Leung Limited. The valuation was carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of the valuation of premises was open market value for existing use and the basis of valuation for investment properties was open market value. The net revaluation surplus for Group premises amounted to HK$691 million, of which HK$690 million was credited to premises revaluation reserve and HK$1 million was credited to the income statement. Revaluation gains of HK$152 million on investment properties were recognised through the income statement. The related deferred tax provisions for Group premises and investment properties were HK$114 million and HK$25 million respectively.

The revaluation exercise also covered business premises/investment properties reclassified as properties held for sale. In accordance with HKFRS 5, there was no revaluation gain/loss recognised through the income statement.

## 43 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.

## Introduction

We have reviewed the interim financial report set out on pages 22 to 71 which comprises the consolidated statement of financial position of Hang Seng Bank Limited ("the Bank") as of 30 June 2010 and the related consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the six month period then ended and explanatory notes. The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of an interim financial report to be in compliance with the relevant provisions thereof and Hong Kong Accounting Standard 34 "Interim financial reporting" issued by the Hong Kong Institute of Certified Public Accountants. The directors are responsible for the preparation and presentation of the interim financial report in accordance with Hong Kong Accounting Standard 34.

Our responsibility is to form a conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

## Scope of review

We conducted our review in accordance with Hong Kong Standard on Review Engagements 2410, "Review of interim financial information performed by the independent auditor of the entity" issued by the Hong Kong Institute of Certified Public Accountants. A review of the interim financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly we do not express an audit opinion.

## Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the interim financial report as at 30 June 2010 is not prepared, in all material respects, in accordance with Hong Kong Accounting Standard 34 "Interim financial reporting".

**KPMG**
Certified Public Accountants
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

2 August 2010

These notes set out on pages 73 to 89 are supplementary to and should be read in conjunction with the consolidated financial statements set out on pages 22 to 71. The consolidated financial statement and these supplementary notes taken together comply with the Banking (Disclosure) Rules ("Rules") made under section 60A of the Banking Ordinance.

## 1 Basis of preparation

***(a)*** Except where indicated otherwise, the financial information contained in these supplementary notes has been prepared on a consolidated basis in accordance with Hong Kong Financial Reporting Standards. Some parts of these supplementary notes, however, are required by the Rules to be prepared on a different basis. In such cases, the Rules require that certain information is prepared on a basis which excluded some of the subsidiaries of the Bank.

Further information regarding subsidiaries that are not included in the consolidation for regulatory purpose is set out in note 2 to the supplementary notes to the financial statements.

***(b)*** The accounting policies applied in preparing these supplementary notes are the same as those applied in preparing the consolidated financial statements for the period ended 30 June 2010 as set out in note 2 to the financial statements.

## 2 Financial Risk Management

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

The Group's risk management policy is designed to identify and analyse risks, to set appropriate risk limits and to monitor these risks and limits continually by means of reliable and up-to-date management information systems. The Group's risk management policies and major control limits are approved by the Board of Directors and they are monitored and reviewed regularly by various management committees, including the Executive Committee, Audit Committee, Asset and Liability Management Committee ("ALCO"), Credit Committee and Risk Management Committee ("RMC") which was set up in July 2008 to centralise the risk management oversight function of the Bank and to review, analyse, evaluate, recognise and manage various risks of the Bank. RMC is constituted by the Board but reports to Executive Committee.

### *(a) Credit risk*

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

The Credit Risk Management ("CRM") function is mandated to provide centralised management of credit risk through:

- formulating credit policies on approval process, post disbursement monitoring, recovery process and large exposure;
- issuing guidelines on lending to specified market sectors, industries and products; the acceptability of specific classes of collateral or risk mitigations and valuation parameters for collateral;
- undertaking an independent review and objective assessment of credit risk for all commercial non-bank credit facilities in excess of designated amount prior to the facilities being committed to customers;
- controlling exposures to selected industries, counterparties, countries and portfolio types etc by setting limits;
- maintaining and developing credit risk rating/facility grading process to categorise exposures and facilitate focused management;

## 2 Financial Risk Management *(continued)*

### *(a) Credit risk* (continued)

- reporting to senior executives and various committees on aspects of the Group loan portfolio;
- managing and directing credit-related systems initiatives; and
- providing advice and guidance to business units on various credit-related issues.

**Impairment loan management and recovery**

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

**Risk rating framework**

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

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

**Collateral and other credit enhancements**

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

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

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured with the exception of asset-backed securities and similar instruments, which are secured by pools of financial assets.

## 2 Financial Risk Management *(continued)*

### *(a) Credit risk* *(continued)*

**Settlement risk**

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

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

**Concentration of credit risk**

Concentration of credit risk exists when changes in geographic, economic or industry factors similarly affect groups of counterparties whose aggregate credit exposure is material in relation to the Group's total exposures. The Group's portfolio of financial instrument is diversified along geographic, industry and product sectors. Analysis of geographical concentration of the Group's assets is disclosed in note 17 to the financial statements and credit risk concentration of respective financial assets is disclosed in notes 21, 22, 24 and 25.

### *(b) Liquidity risk*

Liquidity relates to the ability of a company to meet its obligations as they fall due. The Group maintains a stable and diversified funding base of core retail and corporate customer deposits as well as portfolios of highly liquid assets. The objective of the Group's liquidity and funding management is to ensure that all foreseeable funding commitments and deposit withdrawals can be met when due.

Management of liquidity is carried out both at Group and Bank level as well as in individual branches and subsidiaries. The Group requires branches and subsidiaries to maintain a strong liquidity position and to manage the liquidity structure of their assets, liabilities and commitments so that cash flows are approximately balanced and all funding obligations are met when due.

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

Compliance with liquidity requirements is monitored by the Asset and Liability Management Committee ("ALCO") and is reported to the Risk Management Committee, Executive Committee and the Board of Directors. This process includes:

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

## 2 Financial Risk Management *(continued)*

### *(b) Liquidity risk (continued)*

Current accounts and savings deposits payable on demand or at short notice form a significant part of the Group's overall funding. The Group places considerable importance on the stability of these deposits, which is achieved through the Group's retail banking activities and by maintaining depositor confidence in the Group's capital strength. Professional markets are accessed for the purposes of providing additional funding, maintaining a presence in local money markets and optimising asset and liability maturities. Although the contractual repayments of many customer accounts are on demand or short notice, in practice short-term deposit balances remain stable as inflows and outflows broadly match.

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

| | ***Half-year ended 30 June 2010*** | *Half-year ended 30 June 2009* | *Half-year ended 31 December 2009* |
|---|---|---|---|
| The Bank and its subsidiaries designated by the HKMA | **42.0%** | 47.5% | 48.7% |

### *(c) Market risk*

Market risk is the risk that foreign exchange rates, interest rates, equity and commodity prices and indices will move and result in profits or losses for the Group. The objective of the Group's market risk management is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the Group's status as a premier provider of financial products and services.

The Group separates exposures to market risk into either trading or non-trading portfolios. Trading portfolios include those positions arising from market-making, proprietary position-taking, strategic foreign exchange and other marked-to-market positions with trading intent. Non-trading portfolios primarily arise from the effective interest rate management of the Group's retail and commercial banking assets and liabilities.

The management of market risk is principally undertaken in Treasury using risk limits approved by the Risk Management Committee. Limits are set for each portfolio, product and risk type, with market liquidity being a principal factor in determining the level of limits set. The Group has dedicated standards, policies and procedures in place to control and monitor the market risk. An independent market risk control function is responsible for measuring market risk exposures, monitoring and reporting these exposures against the prescribed limits on a daily basis. The market risks which arise on each business are assessed and transferred to either Treasury for management, or to separate books managed under the supervision of the ALCO.

## 2 Financial Risk Management *(continued)*

### *(c)* ***Market risk*** *(continued)*

**Value at risk ("VAR")**

One of the principal tools used by the Group to monitor and limit market risk exposure is VAR. The Group has obtained approval from the HKMA to use its VAR model for calculation of market risk capital charge.

VAR is a technique which estimates the potential losses that could occur on risk positions taken due to movements in market rates and prices over a specified time horizon and to a given level of confidence. Historical simulation uses scenarios derived from historical market rates and takes account of the relationships between different markets and rates, for example, interest rates and foreign exchange rates. Movements in market prices are calculated by reference to market data from the last two years. The assumed holding period is a 1-day period with a 99 per cent level of confidence, reflecting the way the risk positions are managed.

VAR is calculated daily. The Group validates the accuracy of its VAR models by back-testing the actual daily profit and loss results which include both end of day market movements and intra-day trading outcomes, adjusted to remove non-modelled items such as fees and commissions, against the corresponding VAR numbers. Statistically, the Group would expect to see losses in excess of VAR only one per cent of the time over a one-year period. The actual number of excesses over this period can therefore be used to gauge how well the models are performing.

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

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;

- the use of a 1-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a 1-day holding period may be insufficient to liquidate or hedge all positions fully;

- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and

- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The Group recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures. Additionally, the Group applies a wide range of stress testing, both on individual portfolios and on the Group's consolidated positions. The Group's stress testing regime provides senior management with an assessment of the financial impact of identified extreme events on the market risk exposures of the Group.

## 2 Financial Risk Management *(continued)*

### *(c) Market risk* *(continued)*

The Group's VAR, both trading and non-trading, for all interest rate risk and foreign exchange risk positions and on individual risk portfolios during the first halves of 2010 and 2009 are shown in the table below:

**Value at risk**

| | ***At 30 June 2010*** | ***Minimum during the period*** | ***Maximum during the period*** | ***Average for the period*** |
|---|---|---|---|---|
| VAR for all interest rate risk and foreign exchange risk | **69** | **63** | **106** | **85** |
| VAR for foreign exchange risk (trading) | **2** | **1** | **10** | **3** |
| VAR for interest rate risk | | | | |
| - trading | **6** | **5** | **17** | **10** |
| - non-trading | **66** | **61** | **100** | **84** |

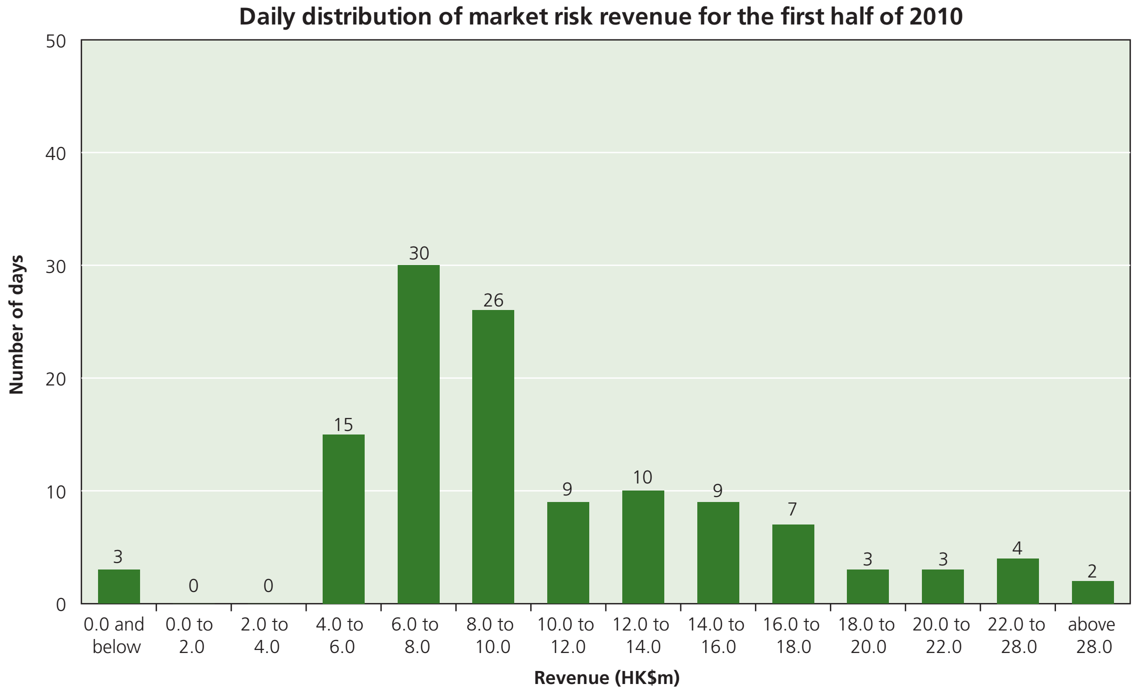
| | *At 30 June 2009* | *Minimum during the period* | *Maximum during the period* | *Average for the period* |
|---|---|---|---|---|
| VAR for all interest rate risk and foreign exchange risk | 105 | 46 | 110 | 81 |
| VAR for foreign exchange risk (trading) | 9 | 4 | 14 | 9 |
| VAR for interest rate risk | | | | |
| - trading | 8 | 5 | 13 | 7 |
| - non-trading | 95 | 46 | 105 | 79 |

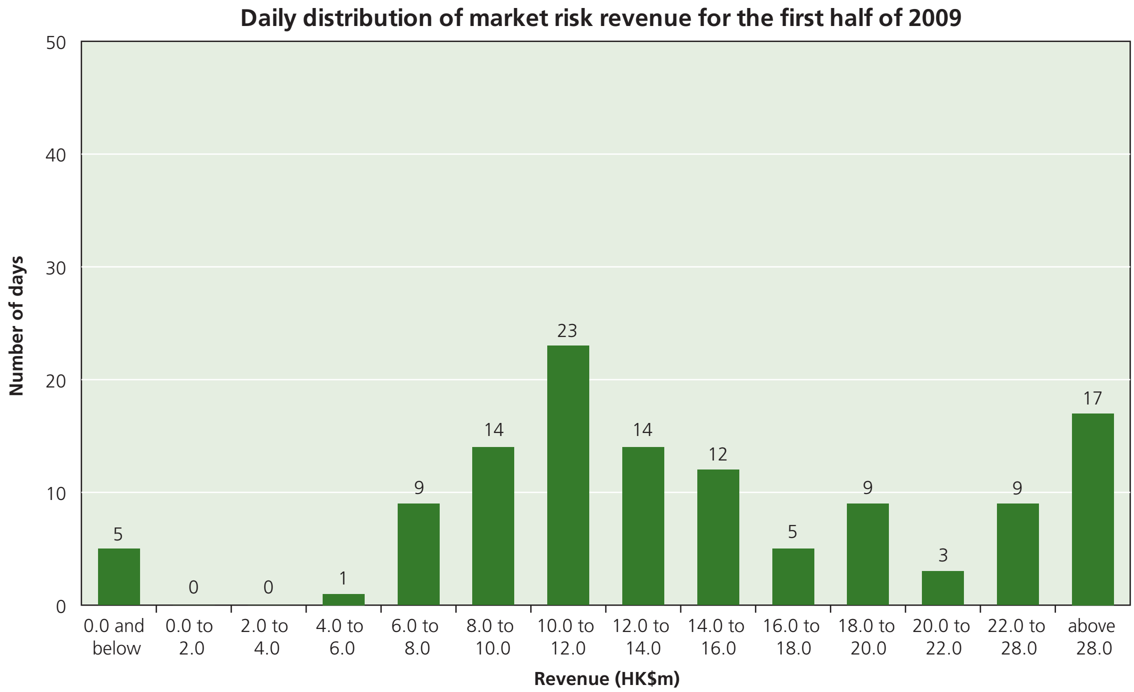
The average daily revenue earned from market risk-related treasury activities for the first half of 2010, including non-trading book net interest income and funding related to trading positions, was HK$10 million (HK$15 million for the first half of 2009). The standard deviation of these daily revenues was HK$7 million (HK$16 million for the first half of 2009).

## 2 Financial Risk Management *(continued)*

### *(c) Market risk (continued)*

An analysis of the frequency distribution of daily revenue shows that out of 121 trading days for the first half of 2010, losses were recorded on 3 days (5 days for the first half of 2009). The maximum daily loss was HK$35 million (HK$113 million for the first half of 2009). The most frequent result was a daily revenue of between HK$4 million and HK$14 million, with 90 occurrences. The highest daily revenue was HK$32 million (HK$62 million for the first half of 2009).



## 2 Financial Risk Management *(continued)*

### *(c)* ***Market risk*** *(continued)*

**Interest rate exposure**

Interest rate risks comprise those originating from treasury activities, both trading and non-trading portfolios which include structural interest rate exposures. Treasury manages interest rate risks within the limits approved by the Risk Management Committee and under the monitoring of both ALCO and Risk Management Committee.

Trading

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

Non-trading

The principal objective of market risk management of non-trading portfolios is to optimise net interest income. Interest rate risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. Structural interest rate risk arising from the differing repricing characteristics of commercial banking assets and liabilities, including non-interest bearing liabilities, such as shareholders' funds and some current accounts.

Analysis of these risks is complicated by having to make assumptions on optionality in certain product areas, for example, mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand, for example, current accounts. The prospective change in future net interest income from non-trading portfolios will be reflected in the current realisable value of these positions, should they be sold or closed prior to maturity. In order to manage this risk optimally, market risk in non-trading portfolios and structural interest rate risks are transferred to Treasury or to separate books managed under the supervision of the ALCO.

The transfer of market risk to books managed by Treasury or supervised by ALCO is usually achieved by a series of internal deals between the business units and these books. When the behavioural characteristics of a product differ from its contractual characteristics, the behavioural characteristics are assessed to determine the true underlying interest rate risk. ALCO regularly monitor all such behavioural assumptions and interest rate risk positions, to ensure they comply with interest rate risk limits established by the Risk Management Committee.

**Foreign exchange exposure**

The Group's foreign exchange exposures mainly comprise foreign exchange dealing by Treasury and currency exposures originated by its banking business. The latter are transferred to Treasury where they are centrally managed within foreign exchange position limits approved by the Risk Management Committee. Net option position is calculated on the basis of delta-weighted positions of all foreign exchange options contract. Structural foreign exchange positions arising from capital investments in associates, subsidiaries and branches outside Hong Kong, mainly in US dollar and Chinese renminbi, are managed by the ALCO.

## 2 Financial Risk Management *(continued)*

### *(d) Capital management*

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

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

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

The principal forms of capital are included in the following balances on the consolidated statement of financial position: called up share capital, retained profits, other reserves and subordinated liabilities. Capital also includes the collectively assessed impairment allowances held in respect of loans and advances and the regulatory reserve.

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

The Basel Committee on Banking Supervision has published a new capital adequacy framework, known as "Basel II", for calculating minimum capital requirements. With effect from 1 January 2007, the Hong Kong Monetary Authority adopted Basel II as set out in the Banking (Capital) Rules made under the Banking Ordinances. The new Rules, which replace the Third Schedule to the Banking Ordinance, stipulate the calculation methodology for capital adequacy ratio. Basel II is structured around three "pillars": minimum capital requirements, supervisory review process and market discipline. The supervisory objectives for Basel II are to promote safety and soundness in the financial system and maintain at least the current overall level of capital in the system; enhance competitive equality; constitute a more comprehensive approach to addressing risks; and focus on internationally active bank.

With respect to Pillar One minimum capital requirements, Basel II provides three approaches, of increasing sophistication, to the calculation of credit risk regulatory capital. The most basic, the Standardised Approach, requires banks to use external credit ratings to determine risk weightings applied to rated counterparties, and groups other counterparties into broad categories and applies standardised risk weightings to these categories. In the next level, the Foundation Internal Ratings-based Approach, allows banks to calculate their credit risk regulatory capital requirement on the basis of their internal assessment of the probability that a counterparty will default ("PD"), but with quantification of exposure at default ("EAD") and loss given default estimates ("LGD") being subject to standard supervisory parameters. Finally, the Advanced Internal Ratings-based Approach, will allow banks to use their own internal assessment of not only the probability of default but also the quantification of exposure at default and loss given default.

## 2 Financial Risk Management *(continued)*

### *(d) Capital management (continued)*

Expected losses are calculated by multiplying EAD by PD and LGD. The capital resources requirement under the IRB approaches is intended to cover unexpected losses and is derived from a formula specified in the regulatory rules, which incorporates these factors and other variables such as maturity and correlation.

For credit risk, with the HKMA approval, the Group has adopted the Advanced Internal Ratings-based Approach for the majority of its business with effect from 1 January 2009, with the remainder on the Standardised Approach.

Basel II also introduces capital requirements for operational risk and, again, contains three levels of sophistication. The capital required under the Basic Indicator Approach is a simple percentage of gross revenues, whereas under the Standardised Approach it is one of three different percentage of gross revenues allocated to each of eight defined business lines. Finally, the advanced measurement approach uses Bank's own statistical analysis and modelling of operational risk data to determine capital requirements. The Group has adopted the Standardised Approach to the determination of operational risk capital requirements.

For market risk, the Group is required to use a variety of approaches to calculate its market risk capital requirement. An internal model approach is adopted for calculating general market risk, while standardised (market risk) approach is adopted for calculating specific interest rate risk and equity risk.

Under Pillar Two, the Group has initiated its internal capital adequacy assessment process ("ICAAP") to comply with HKMA's requirement set out in the Supervisory Policy Manual "Supervisory Review Process". The Group will also align with HSBC Group guidance in setting up its ICAAP.

To comply with Pillar Three requirements which focuses on disclosure requirements and policies as prescribed by the Banking (Disclosure) Rules, the Group has formulated a disclosure policy which was approved by the Board with an aim of making relevant disclosures in accordance with the disclosure rules.

During the year, the Group has complied with all of the externally imposed capital requirements by the Hong Kong Monetary Authority.

(i) Capital adequacy ratios

Capital ratios at 30 June 2010 were compiled in accordance with the Banking (Capital) Rules ("the Capital Rules") issued by the HKMA under section 98A of the Hong Kong Banking Ordinance for the implementation of Basel II, which came into effect on 1 January 2007. Having obtained approval from the HKMA to adopt the "Advanced Internal Ratings-based Approach" ("AIRB") to calculate the risk-weighted assets for credit risk from 1 January 2009, the Bank used the AIRB approach to calculate its credit risk exposure.

## 2 Financial Risk Management *(continued)*

### *(d) Capital management (continued)*

(i) Capital adequacy ratios *(continued)*

The capital base after deductions used in the calculation of capital adequacy ratios and reported to HKMA is analysed as follows:

| | ***At 30 June 2010*** | *At 30 June 2009 (restated)* | *At 31 December 2009 (restated)* |
|---|---|---|---|
| **Capital base** | | | |
| Core capital: | | | |
| - share capital | **9,559** | 9,559 | 9,559 |
| - retained profits | **34,431** | 28,833 | 31,741 |
| - classified as regulatory reserve | **(1,254)** | (770) | (920) |
| - less: deduction from core capital | **(972)** | (547) | (561) |
| - less: 50 per cent of total unconsolidated investments and other deductions | **(9,086)** | (6,709) | (7,330) |
| - total core capital | **32,678** | 30,366 | 32,489 |
| Supplementary capital: | | | |
| - fair value gains on the revaluation of property | **5,894** | 5,513 | 5,829 |
| - fair value gains on the revaluation of available-for-sale investment and equity | **478** | 612 | 498 |
| - collectively assessed impairment allowances | **75** | 85 | 81 |
| - regulatory reserve | **138** | 85 | 101 |
| - surplus provision | **–** | – | – |
| - term subordinated debt | **7,893** | 10,367 | 10,354 |
| - less: 50 per cent of total unconsolidated investments and other deductions | **(9,086)** | (6,709) | (7,330) |
| - total supplementary capital | **5,392** | 9,953 | 9,533 |
| Total capital base after deductions | **38,070** | 40,319 | 42,022 |
| **Risk-weighted assets** | | | |
| - credit risk | **255,927** | 195,582 | 217,134 |
| - market risk | **1,405** | 1,476 | 1,278 |
| - operational risk | **37,576** | 38,863 | 39,017 |
| | **294,908** | 235,921 | 257,429 |
| Capital adequacy ratio | **12.9%** | 17.1% | 16.3% |
| Core capital ratio | **11.1%** | 12.9% | 12.6% |

There are no relevant capital shortfalls in any of the Group's subsidiaries as at 30 June 2010 which are not included in its consolidation group for regulatory purposes.

## 2 Financial Risk Management *(continued)*

### *(d)* ***Capital management*** *(continued)*

(ii) Basis of consolidation

The basis of consolidation for the calculation of capital ratios under the Capital Rules follows the basis of consolidation for financial reporting with the exclusion of subsidiaries which are "regulated financial entities" (e.g. insurance and securities companies) as defined by the Capital Rules. Accordingly, the investment costs of these unconsolidated regulated financial entities are deducted from the capital base.

**List of subsidiaries for financial reporting consolidation**

Everlasting International Limited
Fulcher Enterprises Company Limited
Full Wealth Investment Limited
Hang Seng Asset Management Pte Ltd
Hang Seng Bank (Bahamas) Limited
Hang Seng Bank (China) Limited
*Hang Seng Bank (Trustee) Limited
*Hang Seng Bank Trustee International Limited
Hang Seng Bullion Company Limited
Hang Seng Credit Limited
Hang Seng Credit (Bahamas) Limited
Hang Seng Data Services Limited
Hang Seng Finance Limited
Hang Seng Finance (Bahamas) Limited
Hang Seng Financial Information Limited
*Hang Seng Futures Limited
*Hang Seng General Insurance (Hong Kong) Company Limited
*Hang Seng Insurance Company Limited
*Hang Seng Insurance (Bahamas) Limited
*Hang Seng Investment Management Limited
*Hang Seng Investment Services Limited
*Hang Seng Life Limited
*Hang Seng (Nominee) Limited
Hang Seng Real Estate Management Limited
Hang Seng Security Management Limited
*Hang Seng Securities Limited
Haseba Investment Company Limited
Hayden Lake Limited
High Time Investments Limited
HSI International Limited
Hang Seng Indexes Company Limited
Imenson Limited
Mightyway Investments Limited
Silver Jubilee Limited
Yan Nin Development Company Limited

* *"regulated financial entities" as defined by the Banking (Capital) Rules and excluded from the basis of consolidation for regulatory reporting purpose.*

The Group operates subsidiaries in a number of countries and territories where capital will be governed by local rules and there may be restrictions on the transfer of regulatory capital and funds between members of the banking group.

## 2 Financial Risk Management *(continued)*

### *(e) Equities exposure*

The Group's equities exposures are mainly in long-term equity investments which are reported as "Financial investments" set out in note 25. Equities held for trading purpose are included under "Trading assets" set out in note 21. These are subject to trading limit and risk management control procedures and other market risk regime.

### *(f) Operational risk*

Operational risk is the risk of loss arising through fraud, unauthorised activities, error, omission, inefficiency, system failure or from external events. It is inherent to every business organisation and covers a wide spectrum of issues. The Group manages its operational risk through a controls-based environment in which the processes and controls are documented, authorisation is independent and transactions are reconciled and monitored. This is supported by periodic independent review of the internal control systems by internal audit. The operational risk management framework comprises assignment of responsibilities at senior management level, assessment of risk factors inherent in each business and operations units, information systems to record operational losses and analysis of loss events.

Operational risk is mitigated by adequate insurance coverage on assets and business losses. To reduce the impact and interruptions to business activities caused by system failure or natural disaster, back-up systems and contingency business resumption plans are in place for all business and critical operations functions. Operational risk management is coordinated by the Chief Technology and Services Officer and monitored by the Operational Risk Management Committee.

### *(g) Reputational risk*

Reputational risks can arise from social, ethical or environmental issues, or as a consequence of operational risk events. Standards are set and policies and procedures are established in all areas of reputational risk and are communicated to staff at all levels. These include treating customers fairly, conflicts of interest, money laundering deterrence, environmental impact and anti-corruption measures. The reputation downside to the Group is fully appraised before any strategic decision is taken.

## 3 Disclosure for selected exposures

### *(a) Holding of debt securities issued by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation*

The table below shows the Group's exposures to the senior debt securities (AAA rated) issued by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.

| | *Gross principal* | *Fair value* |
|---|---|---|
| **At 30 June 2010** | **45** | **47** |
| At 30 June 2009 | 46 | 48 |
| At 31 December 2009 | 45 | 47 |

The Group did not hold any asset-backed securities, mortgage-backed securities and collateralised debt obligations.

### *(b) Involvement with Special Purpose Entities (SPEs)*

From time to time, the Group enters into certain transactions with customers in the ordinary course of business which involve the establishment of SPEs. The use of SPEs is not a significant part of the Group's activities and the Group is not reliant on SPEs for any material part of its business operations or profitability.

## 4 Analysis of gross advances to customers by categories based on internal classification used by the Group

Gross advances, impaired advances, individually assessed and collectively assessed loan impairment allowances in respect of industry sectors which constitute not less than 10 per cent of gross advances to customers are analysed as follows:

| | | | ***Loan impairment allowances*** | |
|---|---|---|---|---|
| | ***Gross advances*** | ***Impaired advances*** | ***Individually assessed*** | ***Collectively assessed*** |
| ***At 30 June 2010*** | | | | |
| Residential mortgages | **124,572** | **225** | **(5)** | **(68)** |
| Commercial, industrial and international trade | **79,701** | **1,525** | **(954)** | **(472)** |
| Commercial real estate | **36,932** | **–** | **–** | **(2)** |
| Other property-related lending | **78,468** | **264** | **(47)** | **(50)** |
| *At 30 June 2009* | | | | |
| Residential mortgages | 110,438 | 605 | (16) | (97) |
| Commercial, industrial and international trade | 57,018 | 2,195 | (1,309) | (495) |
| Commercial real estate | 31,729 | 76 | – | (4) |
| Other property-related lending | 55,956 | 250 | (93) | (92) |
| *At 31 December 2009* | | | | |
| Residential mortgages | 116,746 | 308 | (5) | (87) |
| Commercial, industrial and international trade | 61,676 | 1,615 | (972) | (484) |
| Commercial real estate | 31,987 | 1 | – | (3) |
| Other property-related lending | 63,166 | 256 | (70) | (76) |

## 5 Non-bank Mainland exposures

The analysis of non-bank Mainland exposures is based on the categories of non-bank counterparties and the type of direct exposures defined by the HKMA under the Banking (Disclosure) Rules with reference to the HKMA return for non-bank Mainland exposures, which includes the Mainland exposures extended by the Bank and its overseas branches and overseas subsidiaries only.

| | *On-balance sheet exposure* | *Off-balance sheet exposure* | *Total exposures* | *Individually assessed allowances* |
|---|---|---|---|---|
| ***At 30 June 2010*** | | | | |
| Mainland entities | **10,759** | **2,321** | **13,080** | **–** |
| Companies and individuals outside Mainland where the credit is granted for use in Mainland | **6,628** | **2,456** | **9,084** | **47** |
| Other counterparties where the exposure is considered by the Bank to be non-bank Mainland exposure | **53** | **–** | **53** | **–** |
| | **17,440** | **4,777** | **22,217** | **47** |
| Exposures incurred by the Bank's mainland subsidiary | **31,635** | **19,952** | **51,587** | **189** |
| | **49,075** | **24,729** | **73,804** | **236** |
| *At 30 June 2009* | | | | |
| Mainland entities | 10,221 | 1,440 | 11,661 | – |
| Companies and individuals outside Mainland where the credit is granted for use in Mainland | 6,873 | 2,701 | 9,574 | 378 |
| Other counterparties where the exposure is considered by the Bank to be non-bank Mainland exposure | 19 | – | 19 | – |
| | 17,113 | 4,141 | 21,254 | 378 |
| Exposures incurred by the Bank's mainland subsidiary | 23,087 | 9,416 | 32,503 | 306 |
| | 40,200 | 13,557 | 53,757 | 684 |
| *At 31 December 2009* | | | | |
| Mainland entities | 9,241 | 1,911 | 11,152 | – |
| Companies and individuals outside Mainland where the credit is granted for use in Mainland | 6,644 | 2,653 | 9,297 | 50 |
| Other counterparties where the exposure is considered by the Bank to be non-bank Mainland exposure | 45 | – | 45 | – |
| | 15,930 | 4,564 | 20,494 | 50 |
| Exposures incurred by the Bank's mainland subsidiary | 28,038 | 10,095 | 38,133 | 183 |
| | 43,968 | 14,659 | 58,627 | 233 |

## 6 Cross-border claims

Cross-border claims include receivables and loans and advances, and balances due from banks and holdings of certificates of deposit, bills, promissory notes, commercial paper and other negotiable debt instruments, as well as accrued interest and overdue interest on these assets. Claims are classified according to the location of the counterparties after taking into account the transfer of risk. For a claim guaranteed by a party situated in a country different from the counterparty, the risk will be transferred to the country of the guarantor. For a claim on the branch of a bank or other financial institutions, the risk will be transferred to the country where its head office is situated. Claims on individual countries or areas, after risk transfer, amounting to 10 per cent or more of the aggregate cross-border claims are shown as follows:

| | *Banks & other financial institutions* | *Public sector entities* | *Sovereign & other* | *Total* |
|---|---|---|---|---|
| ***At 30 June 2010*** | | | | |
| Asia-Pacific excluding Hong Kong: | | | | |
| - China | **43,014** | **–** | **18,405** | **61,419** |
| - Japan | **9,350** | **–** | **7,389** | **16,739** |
| - Other | **28,966** | **1,375** | **8,318** | **38,659** |
| | **81,330** | **1,375** | **34,112** | **116,817** |
| The Americas: | | | | |
| - United States | **38,574** | **45** | **15,605** | **54,224** |
| - Other | **1,737** | **726** | **12,796** | **15,259** |
| | **40,311** | **771** | **28,401** | **69,483** |
| Europe: | | | | |
| - United Kingdom | **31,438** | **–** | **2,292** | **33,730** |
| - Other | **45,984** | **6,386** | **8,871** | **61,241** |
| | **77,422** | **6,386** | **11,163** | **94,971** |

## 6 Cross-border claims *(continued)*

| | *Banks & other financial institutions* | *Public sector entities* | *Sovereign & other* | *Total* |
|---|---|---|---|---|
| *At 30 June 2009* | | | | |
| Asia-Pacific excluding Hong Kong: | | | | |
| - China | 7,936 | – | 12,219 | 20,155 |
| - Japan | 4,630 | – | 66,654 | 71,284 |
| - Other | 27,358 | – | 8,725 | 36,083 |
| | 39,924 | – | 87,598 | 127,522 |
| The Americas: | | | | |
| - United States | 41,319 | 46 | 19,754 | 61,119 |
| - Other | 8,049 | – | 13,351 | 21,400 |
| | 49,368 | 46 | 33,105 | 82,519 |
| Europe: | | | | |
| - United Kingdom | 33,600 | – | 6,402 | 40,002 |
| - Other | 47,335 | – | 14,189 | 61,524 |
| | 80,935 | – | 20,591 | 101,526 |
| *At 31 December 2009* | | | | |
| Asia-Pacific excluding Hong Kong: | | | | |
| - China | 24,034 | – | 16,124 | 40,158 |
| - Japan | 8,320 | – | 45,952 | 54,272 |
| - Other | 37,436 | 589 | 8,140 | 46,165 |
| | 69,790 | 589 | 70,216 | 140,595 |
| The Americas: | | | | |
| - United States | 39,941 | 45 | 10,259 | 50,245 |
| - Other | 4,762 | 694 | 13,005 | 18,461 |
| | 44,703 | 739 | 23,264 | 68,706 |
| Europe: | | | | |
| - United Kingdom | 37,510 | – | 4,066 | 41,576 |
| - Other | 47,799 | 12,454 | 7,990 | 68,243 |
| | 85,309 | 12,454 | 12,056 | 109,819 |

## The Code for Securities Transactions by Directors

The Bank has adopted a Code for Securities Transactions by Directors on terms no less exacting than the required standards as set out in the Model Code for Securities Transactions by Directors of Listed Issuers (as set out in Appendix 10 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Listing Rules")). Specific enquiries have been made with all Directors who have confirmed that they have complied with the Bank's Code for Securities Transactions by Directors throughout the six months ended 30 June 2010.

## Changes in Directors' Biographical Details

Changes in Directors' biographical details since the date of the Annual Report 2009 of the Bank which are required to be disclosed pursuant to Rule 13.51(2) and Rule 13.51B(1) of the Listing Rules, are set out below.

**Dr Raymond CH'IEN Kuo Fung** GBS, CBE, JP

New appointment

- China Resources Power Holdings Company Limited[(1)] (Independent Non-executive Director)

**Mrs Margaret LEUNG** JP

New appointment

- Hang Seng Management College Limited (Chairman of the Board of Governors)
- The Community Chest of Hong Kong (Chairman of 2010-2011 Campaign Committee)

**Dr John CHAN Cho Chak** GBS, JP

New appointment

- Swire Properties Limited (Independent Non-executive Director)

**Mr William LEUNG Wing Cheung** BBS, JP

New appointment

- Hang Seng Management College Limited (Member of the Board of Governors)

Cessation of appointment

- Securities and Futures Commission (Member of Investor Education Advisory Committee)

**Dr Eric LI Ka Cheung** FCPA (Practising), GBS, OBE, JP

Cessation of appointment

- Meadville Holdings Limited[(2)] (Independent Non-executive Director and Chairman of Remuneration Committee)

**Mr Alexander Andrew FLOCKHART** CBE

New appointment

- HSBC Bank plc (Director)

**Mr Peter WONG Tung Shun** JP

New appointment

- HSBC Bank (Vietnam) Ltd (Vice-Chairman and Non-executive Director)

Cessation of appointment

- Hong Kong Exchanges and Clearing Limited[(1)] (Member of Risk Management Committee)
- Hong Kong Monetary Authority (Member of Banking Advisory Committee)
- Hong Kong Trade Development Council (Chairman of Financial Services Advisory Committee)

Notes:

(1) The securities of this company are listed on a securities market in Hong Kong or overseas.

(2) Meadville Holdings Limited has ceased to be a company listed on The Stock Exchange of Hong Kong Limited during the period under review.

(3) Updated biographical details of the Bank's Directors are also available on the website of the Bank.

Other than those disclosed above, there is no other information required to be disclosed pursuant to Rule 13.51B(1) of the Listing Rules.

## Directors' and Alternate Chief Executives' Interests

### Interests in Shares

As at 30 June 2010, the interests of the Directors and Alternate Chief Executives in the shares, underlying shares of equity derivatives and debentures of the Bank and its associated corporations (all within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) disclosed in accordance with the Listing Rules were detailed below.

| | Personal Interests (held as beneficial owner) | Family Interests (interests of spouse or child under 18) | Corporate Interests (interests of controlled corporation) | Other Interests | Total Interests | Total Interests as % of the relevant issued share capital |
|---|---|---|---|---|---|---|
| **Number of Ordinary Shares of HK$5 each in the Bank** | | | | | | |
| Directors: | | | | | | |
| Mrs Margaret Leung | 21,000 | – | – | – | 21,000 | 0.00 |
| Dr John C C Chan | – | – | – | 1,000[(1)] | 1,000 | 0.00 |
| **Number of Ordinary Shares of US$0.50 each in HSBC Holdings plc** | | | | | | |
| Directors: | | | | | | |
| Dr Raymond K F Ch'ien | 55,047 | – | – | – | 55,047 | 0.00 |
| Mrs Margaret Leung | 95,892 | – | – | 393,804[(6)] | 489,696 | 0.00 |
| Dr John C C Chan | 20,234 | – | – | 4,371[(1)] | 24,605 | 0.00 |
| Mr Alexander A Flockhart | 269,544 | – | – | 1,050,250[(6)] | 1,319,794 | 0.00 |
| Mr Jenkin Hui | 17,278 | – | 1,914,552[(2)] | – | 1,931,830 | 0.01 |
| Mr William W Leung | 37,209 | – | – | 38,291[(6)] | 75,500 | 0.00 |
| Dr Eric K C Li | – | 38,826 | – | – | 38,826 | 0.00 |
| Mr Iain J Mackay | – | – | – | 297,252[(6)] | 297,252 | 0.00 |
| Mrs Dorothy K Y P Sit | 41,585[(3)] | 1,031 | – | 47,704[(6)] | 90,320 | 0.00 |
| Mr Peter T S Wong | 245,721 | 17,444 | – | 302,844[(6)] | 566,009 | 0.00 |
| Alternate Chief Executives: | | | | | | |
| Mr Nixon L S Chan | 10,961 | – | – | 33,608[(6)] | 44,569 | 0.00 |
| Mr Andrew H C Fung | 4,064 | – | – | 42,321[(6)] | 46,385 | 0.00 |
| Mr Christopher H N Ho | 74,773[(4)] | 42,032[(5)] | – | 13,976[(6)] | 130,781 | 0.00 |
| Mr Andrew W L Leung | 4,428 | – | – | 834[(6)] | 5,262 | 0.00 |
| Mr David W H Tam | 21,618 | 9,014 | – | 21,143[(6)] | 51,775 | 0.00 |

Notes:

(1) 1,000 shares in the Bank and 4,371 shares in HSBC Holdings plc were held by a trust of which Dr John C C Chan and his wife were beneficiaries.

(2) Mr Jenkin Hui was entitled to fully control the voting power at general meetings of Parc Palais Incorporated, a private company, which beneficially held all of those shares referred to above as his corporate interests.

(3) 8,046 shares were jointly held by Mrs Dorothy K Y P Sit and her husband.

(4) 40,000 shares were the underlying shares of the Equity-linked Notes (**"ELN"**) due August 2010 held by Mr Christopher H N Ho.

(5) 10,800 shares were the underlying shares of the ELN due August 2010 held by Mr Christopher H N Ho's wife.

(6) These represented interests in (i) options granted to Directors and Alternate Chief Executives under the HSBC Share Option Plans to acquire ordinary shares of US$0.50 each in HSBC Holdings plc and (ii) conditional awards of ordinary shares of US$0.50 each in HSBC Holdings plc under the HSBC Share Plans made in favour of Directors and Alternate Chief Executives, as set against their respective names below:

| | Options (please refer to the options table below for details) | Conditional awards of shares under the HSBC Share Plans (please refer to the awards table below for further information) | Total |
|---|---|---|---|
| Directors: | | | |
| Mrs Margaret Leung | 4,197 | 389,607 | 393,804 |
| Mr Alexander A Flockhart | 4,529 | 1,045,721 | 1,050,250 |
| Mr William W Leung | 15,183 | 23,108 | 38,291 |
| Mr Iain J Mackay | 1,531 | 295,721 | 297,252 |
| Mrs Dorothy K Y P Sit | 5,818 | 41,886 | 47,704 |
| Mr Peter T S Wong | – | 302,844 | 302,844 |
| Alternate Chief Executives: | | | |
| Mr Nixon L S Chan | 16,296 | 17,312 | 33,608 |
| Mr Andrew H C Fung | 4,197 | 38,124 | 42,321 |
| Mr Christopher H N Ho | 5,961 | 8,015 | 13,976 |
| Mr Andrew W L Leung | – | 834 | 834 |
| Mr David W H Tam | 19,508 | 1,635 | 21,143 |

**Options**

As at 30 June 2010, the Directors and Alternate Chief Executives mentioned below held unlisted physically settled options to acquire the number of ordinary shares of US$0.50 each in HSBC Holdings plc set against their respective names. These options were granted for nil consideration by HSBC Holdings plc.

| | Options held as at 30 June 2010 | Options exercised/ cancelled during the Director's/ Alternate Chief Executive's term of office in the first half of the year | Exercise price per share | Date granted | Exercisable from | Exercisable until |
|---|---|---|---|---|---|---|
| Directors: | | | | | | |
| Mrs Margaret Leung | 4,197 | – | HK$37.8797 | 29 Apr 2009 | 1 Aug 2014 | 31 Jan 2015 |
| Mr Alexander A Flockhart | 4,529 | – | £3.3116 | 29 Apr 2009 | 1 Aug 2014 | 31 Jan 2015 |
| Mr William W Leung | 6,885 | – | £6.0216 | 2 May 2003 | 2 May 2006 | 1 May 2013 |
| | 7,459 | – | £7.2181 | 30 Apr 2004 | 30 Apr 2007 | 29 Apr 2014 |
| | 839 | – | HK$37.8797 | 29 Apr 2009 | 1 Aug 2010 | 31 Oct 2010 |
| | 15,183 | | | | | |
| Mr Iain J Mackay | 1,531 | – | US$11.8824 | 30 Apr 2008 | 1 Aug 2011 | 31 Jan 2012 |
| Mrs Dorothy K Y P Sit | 3,443 | – | £7.5919 | 23 Apr 2001 | 23 Apr 2004 | 22 Apr 2011 |
| | 2,375 | – | HK$37.8797 | 29 Apr 2009 | 1 Aug 2012 | 31 Jan 2013 |
| | 5,818 | | | | | |

| | Options held as at 30 June 2010 | Options exercised/ cancelled during the Director's/ Alternate Chief Executive's term of office in the first half of the year | Exercise price per share | Date granted | Exercisable from | Exercisable until |
|---|---|---|---|---|---|---|
| Alternate Chief Executives: | | | | | | |
| Mr Nixon L S | – | 5,738[1] | £6.5009 | 3 Apr 2000 | 3 Apr 2003 | 2 Apr 2010 |
| Chan | 4,820 | – | £7.5919 | 23 Apr 2001 | 23 Apr 2004 | 22 Apr 2011 |
| | 3,328 | – | £7.3244 | 7 May 2002 | 7 May 2005 | 6 May 2012 |
| | 3,615 | – | £6.0216 | 2 May 2003 | 2 May 2006 | 1 May 2013 |
| | 4,533 | – | £7.2181 | 30 Apr 2004 | 30 Apr 2009 | 29 Apr 2014 |
| | 16,296 | | | | | |
| Mr Andrew H C | | | | | | |
| Fung | 4,197 | – | HK$37.8797 | 29 Apr 2009 | 1 Aug 2014 | 31 Jan 2015 |
| Mr Christopher | 3,443 | – | £7.2181 | 30 Apr 2004 | 30 Apr 2009 | 29 Apr 2014 |
| H N Ho | 2,518 | – | HK$37.8797 | 29 Apr 2009 | 1 Aug 2012 | 31 Jan 2013 |
| | 5,961 | | | | | |
| Mr David W | 5,738 | – | £7.5919 | 23 Apr 2001 | 23 Apr 2004 | 22 Apr 2011 |
| H Tam | 6,311 | – | £7.3244 | 7 May 2002 | 7 May 2005 | 6 May 2012 |
| | 7,459 | – | £7.2181 | 30 Apr 2004 | 30 Apr 2009 | 29 Apr 2014 |
| | 19,508 | | | | | |

Note:

(1) As at the date of exercise, 26 March 2010, the market value per share was £6.8770.

**Conditional Awards of Shares**

As at 30 June 2010, the interests of the Directors and Alternate Chief Executives in the conditional awards of ordinary shares of US$0.50 each in HSBC Holdings plc made in favour of them under the HSBC Share Plans were as follows:

| | Awards held as at 1 January 2010 | Awards made during the Director's/ Alternate Chief Executive's term of office in the first half of the year | Awards released during the Director's/Alternate Chief Executive's term of office in the first half of the year | Awards held as at 30 June 2010 |
|---|---|---|---|---|
| Directors: | | | | |
| Mrs Margaret Leung | 303,469 | 100,117 | 19,938 | 389,607[(1)] |
| Mr Alexander A Flockhart | 878,274 | 297,746 | 55,799 | 1,045,721[(1)&(2)] |
| Mr William W Leung | 31,192 | 1,074 | 9,678 | 23,108[(1)] |
| Mr Iain J Mackay | 233,624 | 57,700 | – | 295,721[(1)] |
| Mrs Dorothy K Y P Sit | 37,307 | 15,984 | 12,173 | 41,886[(1)] |
| Mr Peter T S Wong | 240,639 | 89,323 | 31,941 | 302,844[(1)] |
| Alternate Chief Executives: | | | | |
| Mr Nixon L S Chan | 18,976 | 3,225 | 5,232 | 17,312[(1)] |
| Mr Andrew H C Fung | 22,280 | 19,353 | 4,064 | 38,124[(1)] |
| Mr Christopher H N Ho | 4,682 | 3,225 | – | 8,015[(1)] |
| Mr Andrew W L Leung | – | 826 | – | 834[(1)] |
| Mr David W H Tam | 7,621 | 1,620 | 5,713 | 1,635[(1)&(2)] |

Notes:

(1) This includes additional shares arising from scrip dividends.

(2) This takes into account the forfeiture of shares under the relevant Share Plan(s).

All the interests stated above represent long positions. As at 30 June 2010, no short positions were recorded in the Register of Directors' and Alternate Chief Executives' Interests and Short Positions required to be kept under section 352 of the SFO.

Other than those disclosed above, no right to subscribe for equity or debt securities of the Bank has been granted by the Bank to, nor have any such rights been exercised by, any person during the six months ended 30 June 2010.

## Substantial Interests in Share Capital

The register maintained by the Bank pursuant to the SFO recorded that, as at 30 June 2010, the following corporations had interests or short positions in the shares or underlying shares (as defined in the SFO) in the Bank set opposite their respective names:

| Name of Corporation | Number of Ordinary Shares of HK$5 each in the Bank (Percentage of total) |
|---|---|
| The Hongkong and Shanghai Banking Corporation Limited | 1,188,057,371 (62.14%) |
| HSBC Asia Holdings BV | 1,188,057,371 (62.14%) |
| HSBC Asia Holdings (UK) Limited | 1,188,057,371 (62.14%) |
| HSBC Holdings BV | 1,188,057,371 (62.14%) |
| HSBC Finance (Netherlands) | 1,188,057,371 (62.14%) |
| HSBC Holdings plc | 1,188,057,371 (62.14%) |

The Hongkong and Shanghai Banking Corporation Limited is a subsidiary of HSBC Asia Holdings BV, which is a wholly-owned subsidiary of HSBC Asia Holdings (UK) Limited, which in turn is a wholly-owned subsidiary of HSBC Holdings BV. HSBC Holdings BV is a wholly-owned subsidiary of HSBC Finance (Netherlands), which in turn is a wholly-owned subsidiary of HSBC Holdings plc. Accordingly, The Hongkong and Shanghai Banking Corporation Limited's interests are recorded as the interests of HSBC Asia Holdings BV, HSBC Asia Holdings (UK) Limited, HSBC Holdings BV, HSBC Finance (Netherlands) and HSBC Holdings plc.

The Directors regard HSBC Holdings plc to be the beneficial owner of 1,188,057,371 ordinary shares in the Bank (62.14%).

All the interests stated above represent long positions. As at 30 June 2010, no short positions were recorded in the Register of Interests in Shares and Short Positions required to be kept under section 336 of the SFO.

## Purchase, Sale or Redemption of the Bank's Securities

Save for the redemption of all the (1) Series A HK$1,000 million 4.125 per cent. subordinated notes due 2015 and (2) Series B HK$1,500 million floating rate subordinated notes due 2015, both at par on 24 June 2010, there was no purchase, sale or redemption by the Bank, or any of its subsidiaries, of the Bank's securities during the first half of 2010.

## Remuneration and Staff Development

There have been no material changes to the information disclosed in the Annual Report 2009 in respect of the remuneration of employees, remuneration policies and staff development.

## Code on Corporate Governance Practices

The Bank is committed to high standards of corporate governance. The Bank has followed the module on 'Corporate Governance of Locally Incorporated Authorised Institutions' under the Supervisory Policy Manual issued by the Hong Kong Monetary Authority and has fully complied with all the code provisions and most of the recommended best practices as set out in the Code on Corporate Governance Practices contained in Appendix 14 of the Listing Rules throughout the six months ended 30 June 2010.

The Audit Committee of the Bank has reviewed the results of the Bank for the six months ended 30 June 2010.

## Register of Shareholders

The Register of Shareholders of the Bank will be closed on Tuesday, 17 August 2010, during which no transfer of shares can be registered. To qualify for the second interim dividend, all transfers, accompanied by the relevant share certificates, must be lodged with the Bank's Registrars, Computershare Hong Kong Investor Services Limited, Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, for registration not later than 4:30 pm on Monday, 16 August 2010. The second interim dividend will be payable on Wednesday, 1 September 2010 to shareholders on the Register of Shareholders of the Bank on Tuesday, 17 August 2010. Shares of the Bank will be traded ex-dividend as from Friday, 13 August 2010.

## Proposed Timetables for the Remaining Quarterly Dividends for 2010

*Third interim dividend for 2010*

| | |
|---|---|
| Announcement date | 1 November 2010 |
| Book close and record date | 16 November 2010 |
| Payment date | 1 December 2010 |

*Fourth interim dividend for 2010*

| | |
|---|---|
| Announcement date | 28 February 2011 |
| Book close and record date | 15 March 2011 |
| Payment date | 30 March 2011 |

## Board of Directors

As at 2 August 2010, the Board of Directors of the Bank comprises Dr Raymond K F Ch'ien* (Chairman), Mrs Margaret Leung (Vice-Chairman and Chief Executive), Dr John C C Chan*, Dr Marvin K T Cheung*, Mr Alexander A Flockhart#, Mr Jenkin Hui*, Mr William W Leung, Dr Eric K C Li*, Dr Vincent H S Lo#, Mr Iain J Mackay#, Mrs Dorothy K Y P Sit#, Mr Richard Y S Tang* and Mr Peter T S Wong#.

* *Independent Non-executive Directors*

\# *Non-executive Directors*

## Registered Office

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Facsimile: (852) 2868 4047
Telex: 73311 73323
SWIFT: HASE HK HH
Website: www.hangseng.com

## Stock Code

The Stock Exchange of Hong Kong Limited: 11

## Registrars

Computershare Hong Kong Investor Services Limited
Shops 1712-1716, 17th Floor, Hopewell Centre
183 Queen's Road East, Wanchai, Hong Kong

## Depositary*

The Bank of New York Mellon
BNY Mellon Shareowner Services
PO Box 358516
Pittsburgh, PA 15252-8516, USA
Telephone: 1-201-680-6825
Toll free (domestic): 1-888-BNY-ADRS
Website: www.bnymellon.com\shareowner
Email: shrrelations@bnymellon.com

* The Bank offers investors in the United States a Sponsored Level-1 American Depositary Receipts Programme through The Bank of New York Mellon.

## Interim Report 2010

The Interim Report 2010 in both English and Chinese is now available in printed form and on the Bank's website: www.hangseng.com.

Shareholders who:

A) receive this Interim Report 2010 by electronic means and wish to receive a printed copy; or
B) receive this Interim Report 2010 in either English or Chinese and wish to receive a printed copy of the other language version,

may send a notice in writing to the Bank's Registrars:

Computershare Hong Kong Investor Services Limited
17M Floor, Hopewell Centre
183 Queen's Road East
Wanchai, Hong Kong
Facsimile: (852) 2529 6087
Email: hangseng@computershare.com.hk

Shareholders who have chosen to receive this Interim Report 2010 by electronic means through the Bank's website and who, for any reason, have difficulty in receiving or gaining access to this Interim Report 2010, may submit a written request to the Bank's Registrars, Computershare Hong Kong Investor Services Limited, and will be sent this Interim Report 2010 in printed form free of charge.

Shareholders may change their choice of language or means of receipt of the Bank's future corporate communications at any time, free of charge, by completing and sending to the Bank's Registrars, Computershare Hong Kong Investor Services Limited, by post or by email (hangseng@computershare.com.hk), a change request form which can be obtained from the Bank's Registrars.

Photography: Ringo Tang

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