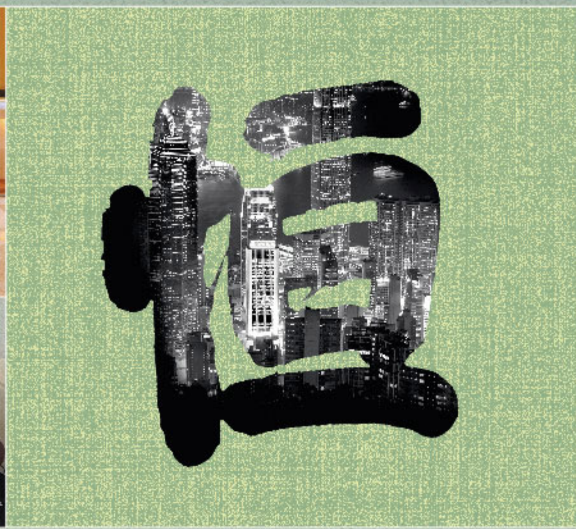
HANG SENG BANK



2013 Interim Report

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

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

RESULTS IN BRIEF

	30 June 2013	*30 June 2012 (restated)*
For the half-year ended	**HK$m**	HK$m
Operating profit excluding loan impairment charges	**9,132**	8,224
Operating profit	**8,934**	7,975
Profit before tax[1]	**18,773**	10,600
Profit attributable to shareholders[1]	**18,468**	9,253
	%	%
Return on average shareholders' funds[1]	**35.9**	22.8
Cost efficiency ratio	**32.2**	33.5
Average liquidity ratio	**35.8**	36.9
	HK$	HK$
Earnings per share[1]	**9.66**	4.84
Dividends per share	**2.20**	2.20

	At 30 June 2013	*At 31 December 2012*
At period-end	**HK$m**	HK$m
Shareholders' funds	**102,081**	92,323
Total assets	**1,106,657**	1,077,096
	%	%
Capital ratios under Basel III[2]		
- Common Equity Tier 1 ("CET1") Capital Ratio	**13.6**	–
- Tier 1 Capital Ratio	**13.6**	–
- Total Capital Ratio	**15.8**	–
Capital ratios under Basel II[2]		
- Core capital ratio	**–**	12.2
- Capital adequacy ratio	**–**	14.0

1 ***Industrial Bank Co., Ltd. ("Industrial Bank") reclassification***
Reported results for the first half of 2013 include a non-distributable accounting gain on reclassification of Industrial Bank from an associate to a financial investment of HK$8,454m before tax, HK$9,517m attributable profit. Reported results for the first half of 2012, when the investment in Industrial Bank was equity accounted for, include HK$2,364m before tax and HK$2,209m attributable profit respectively. Amounts quoted "excluding the Industrial Bank reclassification" adjust for the above items. Excluding the Industrial Bank reclassification, key financial results and performance metrics are set out below for comparison purpose:

	Half-year ended 30 June 2013	*Half-year ended 30 June 2012*
Profit before tax (HK$m)	***10,319***	*8,236*
Profit attributable to shareholders (HK$m)	***8,951***	*7,044*
Earnings per share (HK$)	***4.68***	*3.68*
Return on average shareholders' funds (%)	***19.0***	*17.4*

2 *On 1 January 2013, the Hong Kong Monetary Authority ("HKMA") implemented the first phase of the Basel III capital framework in Hong Kong. The capital disclosures for June 2013 under Basel III are, therefore, not directly comparable with the disclosure for December 2012 prepared under the Basel II basis.*

Comparative figures have been restated to reflect the adoption of the Hong Kong Accounting Standard 19 "Employee Benefits", details of which are set out in note 2 to the financial statements.

With global economic uncertainty creating ongoing challenges in the first half of 2013, Hang Seng Bank's focus on delivering service excellence helped us maintain good growth momentum to return solid first-half results.

Leveraging the trusted Hang Seng brand, we expanded our range of products and services, enhanced our extensive cross-border distribution network and took further steps to improve efficiency and manage risk.

Profit attributable to shareholders was HK$18,468m – double that at the same time last year. Earnings per share rose by 100% to HK$9.66. Excluding the Industrial Bank reclassification, profit attributable to shareholders was up 27% at HK$8,951m and earnings per share increased by 27% to HK$4.68.

Return on average shareholders' funds was 35.9%, compared with 22.8% in the first half of 2012. Excluding the Industrial Bank reclassification, return on average shareholders' funds was 19.0%, compared with 17.4% in the first half of last year.

The Directors have declared a second interim dividend of HK$1.10 per share, bringing the total distribution for the first half of 2013 to HK$2.20 per share, the same as in the first half of 2012.

Economic Environment

Investment sentiment improved during the early part of 2013 – as reflected in the movements of major stock indices and the stabilisation of European sovereign bond yields – but economic fundamentals remained mixed. The US economy expanded at a moderate pace due to further recovery in labour and housing markets, but the eurozone remained in recession as governments continued with austerity measures designed to restore fiscal discipline.

Rises in employment and wages in Hong Kong sustained robust consumer spending, underpinning the 2.8% expansion in the local economy in the first quarter of the year. However, weak external demand continued to put downward pressure on overall growth. Private consumption will remain the key economic driver and we expect real GDP to expand by 3.0% for the year – up 1.5 percentage points compared with 2012.

Subdued export activity will also continue to constrain the mainland China economy, which grew by 7.6% in the first half, down from 7.8% in 2012. Nevertheless, domestic consumption and investment have remained resilient and should support solid economic growth to generate a full-year GDP growth rate of 7.5%.

With the US set to roll back quantitative easing measures, the economic outlook for the rest of 2013 remains uncertain. Interest rates are likely to remain low until 2015. However, Hong Kong's ongoing development as a leading centre for offshore renminbi financial services and primary gateway for cross-border trade will generate new opportunities for business expansion.

We will enhance our market position in key areas of business by continuing with strategic initiatives in line with our competitive strengths as well as through more effective resource allocation and enhancing efficiency. We remain firmly committed to our core values of service excellence and generating increasing value for customers and shareholders.

Raymond K.F. Ch'ien

Raymond Ch'ien
Chairman
Hong Kong, 5 August 2013

Hang Seng Bank achieved encouraging results for the first half of 2013 – recording growth in income and profit across all business segments.

With the economic slowdown in mainland China, greater market volatility and keen competition, the operating environment remained challenging.

Profit attributable to shareholders was HK$18,468m – double that for the same period last year – and a return on average shareholders' funds of 35.9% was achieved.

Excluding the Industrial Bank reclassification, attributable profit was up 27% and return on average shareholders' funds rose by 1.6 percentage points to 19.0%.

Leveraging our brand and network, we continued to implement strategic initiatives that reinforce our position as the leading domestic bank in Hong Kong to drive sustainable growth in our core business.

Success in income diversification resulted in balanced growth of 8% in net interest income and 11% in non-funds income. Implementation of customer-focused initiatives drove wealth management income growth of 10%.

Hang Seng Bank (China) Limited enhanced its product suite and continued to invest in service delivery infrastructure and brand building. Our strong network in the Yangtze Delta Region and southern China placed us well to capture opportunities generated by increasing cross-border economic integration and renminbi internationalisation.

Our wholly owned subsidiary, Hang Seng Investment Management Limited, was the first non-Mainland financial institution in Hong Kong to be granted RMB Qualified Foreign Institutional Investor status, enabling us to invest in Mainland securities with renminbi raised in Hong Kong. We expect to launch an A-share exchange-traded fund in the second half of this year.

Profit before tax was up 77% at HK$18,773m. Excluding the Industrial Bank reclassification, profit before tax increased by 25% to HK$10,319m.

Operating profit excluding loan impairment charges rose by 11% to HK$9,132m. Operating profit grew by 12% to HK$8,934m. Compared with the second half of last year, operating profit excluding loan impairment charges and operating profit were both up 19%.

With the 9% growth in net operating income before loan impairment charges outpacing the 5% rise in operating expenses, our cost efficiency ratio improved to 32.2% – down 1.3 percentage points and 4.2 percentage points compared with the first and second halves of 2012 respectively.

Net interest income grew by HK$683m, or 8%, to HK$8,969m. Our in-depth knowledge of local markets and effective balance sheet management enabled us to expand lending by 8% while maintaining a high level of credit quality. Customer deposits increased by 2%.

Despite challenging conditions for the Treasury portfolio, we achieved a net interest margin of 1.84% – one basis point down and unchanged compared with the first and second halves of 2012 respectively.

Non-interest income was up by HK$434m at HK$4,508m.

Under the new Basel III rules, our total capital ratio at 30 June 2013 was 15.8% and our Common Equity Tier 1 and Tier 1 capital ratios were both 13.6%.

Corporate Responsibility

On March 3 1933, the first customers of Hang Seng – a small money-changing shop in Sheung Wan district – were greeted as honoured guests. As we celebrate our 80th anniversary this year, our continuing commitment to our founding principles and serving the community has seen us grow to become one of the 50 largest listed banks in the world. We aim to lead by example in supporting sustainable development as we strive for excellence in everything we do.

We are the only Hong Kong company included in the 2013 'Global 100 Most Sustainable Corporations in the World' list, compiled by Corporate Knights.

Reflecting our strong local ties, we maintain long-term relationships with organisations that share our commitment to social and environmental development, including The Community Chest of Hong Kong, which has been our close partner for 25 years. At our 80th anniversary celebratory cocktail reception, guests were asked to contribute to The Chest in lieu of sending congratulatory flowers. With generous donations from attendees and a top-up amount given by Hang Seng, the event raised HK$1m to help those in need.

Our anniversary also served to inspire other elements of our recent corporate responsibility initiatives. Our partnership with the Hong Kong Family Welfare Society is training primary school students to become 'Peer Mediators' – of which 80 will be selected as 'Outstanding Mediators'. We will build a further 800 biogas facilities this year under our award-winning Hang Seng Yunnan Biogas Project, which provides a free and renewable energy supply to rural areas of Yunnan province. Including this latest commitment, we have helped construct 3,000 such facilities since 2007.

In 2010, we became the first domestic bank in Hong Kong to implement the internationally recognised Global Reporting Initiative sustainability reporting guidelines in its Corporate Responsibility Report. For our 2012 Report, issued in May this year, we achieved the highest accreditation rating available (A+) for the second consecutive year. The Report can be found online at: http://www.hangseng.com/cms/ccd/csr/2012/eng/index.html.

A Strategy for Sustainable Growth

Our business is rooted in an economically dynamic region that offers exciting opportunities for growth. At the same time, a rapidly changing regulatory environment and volatile market conditions prevail. We must remain proactive in building for long-term success, reinforce our status as Hong Kong's leading domestic bank and further enhance our strong cross-border capabilities to benefit from increasing economic integration.

We will continue to drive a customer-need-focused strategy, further enhance efficiency and strategically deploy capital and other resources to develop our core business and maintain balanced growth. Our commitment to the personal and professional development of our staff saw us recognised as Hong Kong's most attractive employer in the banking and financial services sector in the 2013 Randstad Award.

We will maintain high standards of risk management and corporate governance. We remain committed to fulfilling our corporate social responsibility to promote the well-being of the communities to which we owe much of Hang Seng's success.

I would like to take this opportunity to thank our staff for their loyalty and dedication and our customers and shareholders for their unwavering support.

Rose Lee
Vice-Chairman and Chief Executive
Hong Kong, 5 August 2013

FINANCIAL PERFORMANCE

Income Statement

Summary of financial performance

Figures in HK$m	***Half-year ended 30 June 2013***	*Half-year ended 30 June 2012 (restated)*	*Half-year ended 31 December 2012 (restated)*
Total operating income	**19,897**	19,365	17,251
Operating expenses	**4,345**	4,136	4,372
Operating profit after loan impairment charges	**8,934**	7,975	7,512
Profit before tax	**18,773**	10,600	11,394
Profit attributable to shareholders	**18,468**	9,253	10,074
Earnings per share (in HK$)	**9.66**	4.84	5.27

Hang Seng Bank Limited ("the Bank") and its subsidiaries ("the Group") reported an unaudited profit attributable to shareholders of HK$18,468m for the first half of 2013, up 99.6% compared with the first half of 2012. Earnings per share were up 99.6% at HK$9.66. The profit for the first half of 2013 included the HK$9,517m non-distributable accounting gain on the reclassification of Industrial Bank Co., Ltd. ("Industrial Bank").

Operating profit excluding loan impairment charges grew by HK$908m, or 11.0%, to HK$9,132m.

The increase was driven by the growth in both net interest income and non-interest income. The Bank's investment in its core business continued to generate good growth momentum to generate solid first-half results in an increasingly challenging market environment.

Net interest income rose by HK$683m, or 8.2%, to HK$8,969m, driven in part by the 9.2% increase in average interest-earning assets. The insurance business also contributed to the rise in net interest income, with the Group recording solid growth in its life insurance investment portfolio.

Figures in HK$m	***Half-year ended 30 June 2013***	*Half-year ended 30 June 2012*	*Half-year ended 31 December 2012*
Net interest income/(expense) arising from:			
- financial assets and liabilities that are not at fair value through profit and loss	**9,705**	8,918	9,244
- trading assets and liabilities	**(770)**	(656)	(612)
- financial instruments designated at fair value	**34**	24	28
	8,969	8,286	8,660
Average interest-earning assets	**981,814**	898,862	935,411
Net interest spread	**1.73%**	1.74%	1.73%
Net interest margin	**1.84%**	1.85%	1.84%

Net interest margin and net interest spread both fell slightly by one basis point to 1.84% and 1.73% respectively compared with the same period last year. Income from the Treasury Balance Sheet Management portfolio declined, as yield curves continued to flatten and maturing available-for-sale debt securities were re-invested at prevailing lower interest rates. In mainland China, interbank market volatility and increasing competition for deposits placed significant downward pressure on spreads. These adverse factors were largely offset by the improved lending margins and the stable deposit spread in Hong Kong. The contribution from net free funds remained the same at 0.11%.

Compared with the second half of 2012, net interest income grew by HK$309m, or 3.6%, supported by higher average interest-earning assets, despite fewer days in the period. Net interest margin compared with the second half of 2012 was unchanged at 1.84%.

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 2013***	*Half-year ended 30 June 2012*	*Half-year ended 31 December 2012*
- Net interest income and expense reported as "Net interest income"			
- Interest income	**11,334**	10,602	10,935
- Interest expense	**(1,629)**	(1,684)	(1,691)
- Net interest income	**9,705**	8,918	9,244
- Net interest income and expense reported as "Net trading income"	**(770)**	(656)	(612)
- Net interest income and expense reported as "Net income from financial instruments designated at fair value"	**34**	24	28
Average interest-earning assets	**944,273**	835,783	895,641
Net interest spread	**1.98%**	2.06%	1.96%
Net interest margin	**2.07%**	2.15%	2.05%

Net fee income increased by HK$528m, or 21.9%, to HK$2,936m compared with the first half of 2012.

With the improved investor sentiment in the early part of the year, the Bank used its strong wealth management platform to capture new business opportunities, driving a 70.7% increase in retail investment funds income. Stockbroking and related services income increased by 15.3%, due to higher transaction volumes in the more favourable market conditions.

Insurance-related fee income rose by 65.2%, benefitting from the increase in non-life insurance products distribution commission since the second half of last year as a result of the disposal of the Bank's general insurance manufacturing business in the second half of 2012. This increase was offset by a corresponding fall in non-life insurance underwriting profit.

Supported by effective marketing campaigns, the credit card business sustained its growth momentum in the first half of 2013 in terms of card income and average card balances. Credit card income increased by 13.6%, underpinned by the 11.4% rise in cardholder spending and the 2.6% increase in the number of cards in circulation.

Fees from remittances and trade-related service income rose by 9.7% and 15.9% respectively, reflecting an increase in trade activity and the expansion of renminbi cross-border trade settlement volumes.

Compared with the second half of 2012, net fee income increased by 9.6%, mainly reflecting higher income from retail investment funds and stockbroking and related services.

Trading income grew by HK$34m, or 2.9%, to HK$1,204m compared with the first half of 2012.

Foreign exchange income remained broadly unchanged when compared with the first half of 2012. Increased customer-driven business and higher customer demand for foreign exchange option-linked structured products, notably in renminbi, has resulted in an improvement in foreign exchange revenues. However, these favourable factors were offset by lower net interest income from funding swaps* activities.

Income from securities, derivatives and other trading activities recorded a net gain of HK$14m, compared with a net loss of HK$23m for the same period last year, reflecting higher income on interest rate derivatives and linked structured products, caused by market interest rate movement, partly offset by the revaluation loss on equity options backing a life endowment product.

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

Net income from financial instruments designated at fair value recorded a net loss of HK$111m compared with a net income of HK$102m for the first half of 2012, mainly due to unfavourable equity movements during the first half of 2013. To the extent that the investment return is attributable to policyholders, there is an offsetting movement reported under "net insurance claims incurred and movement in policyholders' liabilities" or "movement in present value of in-force long-term insurance business ("PVIF")".

Net earned insurance premiums decreased by HK$811m, or 12.3% while net insurance claims incurred and movement in policyholders' liabilities decreased by HK$585m, or 8.4%.

Analysis of income from wealth management business

Figures in HK$m	***Half-year ended 30 June 2013***	*Half-year ended 30 June 2012 (restated)*	*Half-year ended 31 December 2012 (restated)*
Investment income:			
- retail investment funds	**845**	495	635
- structured investment products*	**667**	653	299
- private banking service fee**	**65**	72	51
- stockbroking and related services	**535**	464	477
- margin trading and others	**68**	71	71
	2,180	1,755	1,533
Insurance income:			
- life insurance	**1,722**	1,697	1,319
- general insurance and others	**105**	178	132
	1,827	1,875	1,451
Total	**4,007**	3,630	2,984

* *Income from structured investment products includes income reported under net fee income on the sales of structured investment products issued by other providers. 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 business income recorded growth of 10.4% compared with the first half of 2012. Investment income increased by 24.2%, driven by strong retail investment fund sales and a higher level of stock market trading activity. Insurance business income decreased slightly by 2.6%, mainly due to the fall in non-life insurance income.

Analysis of insurance business income

Figures in HK$m	***Half-year ended 30 June 2013***	*Half-year ended 30 June 2012*	*Half-year ended 31 December 2012*
Life insurance:			
- net interest income and fee income	**1,509**	1,381	1,464
- investment returns on life insurance funds/share of associate's profit/surplus on property revaluation backing insurance contract	**211**	210	551
- net earned insurance premiums	**5,800**	6,446	4,328
- net insurance claims incurred and movement in policyholders' liabilities	**(6,420)**	(6,954)	(5,225)
- movement in present value of in-force long-term insurance business	**622**	614	201
	1,722	1,697	1,319
General insurance and others	**105**	178	132
Total	**1,827**	1,875	1,451

Life insurance income rose by HK$25m, or 1.5%, to HK$1,722m. Supported by our comprehensive range of life insurance products, the Bank achieved an 8.5% increase in new annualised life insurance premiums when compared with the first half of 2012. The Bank continued to enhance its strong position in providing retirement savings and protection products to its customers. In response to the low interest rate environment and to achieve stable growth in life insurance business income, part of the life insurance funds investment portfolio has been invested in commercial property, which recorded a revaluation gain during the first half of 2013.

Net interest income and fee income from the life insurance investment portfolio grew by 9.3%, as a result of the growth in the size of the portfolio. Investment returns on life insurance funds remained broadly unchanged. This reflected the net effect of the unfavourable movement in equity markets partly offset by the property revaluation gains on the assets portfolio supporting insurance contracts and reported under "trading income", "net income/(loss) from financial instruments designated at fair value" and "other operating income". To the extent that the investment return is attributable to policyholders, there is an offsetting movement reported under "net insurance claims incurred and movement in policyholders' liabilities" or "movement in present value of in-force long-term insurance business ("PVIF")". The movement in PVIF was broadly the same as last year.

General insurance income decreased by 41.0% to HK$105m, mainly due to the disposal of the Bank's general insurance subsidiary in the second half of 2012. The decrease in non-life insurance underwriting profit was offset by a corresponding increase in non-life insurance products distribution commission reported under "Net fee income".

Operating expenses rose by HK$209m, or 5.1%, compared with the first half of 2012, reflecting the Bank's continued investment in new business platforms and Mainland operations to support long-term business growth while continuing carefully to manage costs. Compared with the second half of 2012, operating expenses were broadly unchanged.

Compared with the first half of 2012, employee compensation and benefits increased by HK$72m, or 3.4%. Salaries and other costs rose by 4.4%, reflecting the annual salary increment and increased staff numbers. General and administrative expenses were up 9.1%, due to the increase in marketing expenditure as more branding and promotional activities were conducted to support business growth. Rental expenses rose due to higher rents for branches in Hong Kong. Other premises and equipment expenses also increased as a result of continued investment in information technology infrastructure.

Full-time equivalent staff numbers by region	***At 30 June 2013***	*At 30 June 2012*	*At 31 December 2012*
Hong Kong and others	**8,014**	7,863	7,797
Mainland	**1,820**	1,785	1,883
Total	**9,834**	9,648	9,680

At 30 June 2013, the Group's number of full-time equivalent staff rose by 154 compared with the 2012 year-end.

With the increase in net operating income before loan impairment charges outpacing the growth in operating expenses, the cost efficiency ratio for the first half of 2013 reduced by 1.3 percentage points to 32.2%, compared with 33.5% for the first half of 2012. Compared with the second half of 2012, the cost efficiency ratio fell by 4.2 percentage points.

Operating profit grew by HK$959m, or 12.0%, to HK$8,934m, due to the reduction of HK$51m in **loan impairment charges.**

Loan impairment charges fell by HK$51m, or 20.5%, year-on-year to HK$198m. Overall credit quality was relatively stable with loan impairment ratios remaining at a low level. We remain cautious on our credit outlook.

Figures in HK$m	***Half-year ended 30 June 2013***	*Half-year ended 30 June 2012*	*Half-year ended 31 December 2012*
Net charge for impairment of loans and advances to customers:			
Individually assessed impairment allowances:			
- new allowances	**(61)**	(213)	(81)
- releases	**57**	81	143
- recoveries	**7**	4	9
	3	(128)	71
Net charge for collectively assessed impairment allowances	**(201)**	(121)	(208)
Net charge for loan impairment	**(198)**	(249)	(137)

Individually assessed impairment charges recorded a net release of HK$3m compared with a net charge of HK$128m for the first half of 2012 due to lower impairment charges on corporate and commercial banking customers during the first half of 2013.

Collectively assessed charges increased by HK$80m, largely due to the increase in impairment charges for credit card and personal loan portfolios, reflecting a revision to collective impairment models. Impairment allowances for loans not individually identified as impaired recorded a higher release compared with the first half of 2012 as a result of improved average historical loss rate.

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

	At 30 June 2013	*At 30 June 2012*	*At 31 December 2012*
	%	*%*	*%*
Loan impairment allowances:			
- individually assessed	**0.11**	0.19	0.13
- collectively assessed	**0.12**	0.14	0.13
Total loan impairment allowances	**0.23**	0.33	0.26

Profit before tax increased by 77.1% to HK$18,773m after taking into account an **accounting gain on reclassification of Industrial Bank** of HK$8,454m arising from the reclassification of Industrial Bank as a financial investment on 7 January 2013; an increase of HK$761m (or 319.7%) in **net surplus on property revaluation,** reflecting mainly the improved commercial property market in the first half of 2013; an increase of HK$173m in **net gains from financial investments and fixed assets**, due mainly to property disposals; and a decrease of HK$2,174m (or 91.1%) in **share of profits from associates**, mainly reflecting the reclassification of Industrial Bank as a financial investment.

Net surplus on property revaluation amounted to HK$999m, an increase of 319.7% compared with the first half of 2012.

Figures in HK$m	***Half-year ended 30 June 2013***	*Half-year ended 30 June 2012*	*Half-year ended 31 December 2012*
Surplus/(deficit) of revaluation on investment properties	**866**	238	504
Surplus/(deficit) of revaluation on assets held for sale	**136**	–	34
(Revaluation deficit)/reversal of revaluation deficit on premises	**(3)**	–	–
	999	238	538

The Group's premises and investment properties were revalued at 30 June 2013 by DTZ Debenham Tie Leung Limited. The valuation was carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of the valuation of property was market value which is consistent with the definition of fair value under HKFRS 13 "Fair Value Measurement" and taken into account the highest and best use of the property from the perspective of market participants. The highest and best use takes into account the use of the property that is physically possible, legally permissible and financially feasible as described in HKFRS 13. The net revaluation surplus for Group premises amounted to HK$1,523m, of which HK$1,526m was credited to the premises revaluation reserve and HK$3m was debited to the income statement. Revaluation gains of HK$1,147m on investment properties were recognised through the income statement. The related deferred tax provisions for Group premises was HK$253m.

The revaluation exercise also covered business premises and investment properties reclassified as properties held for sale. The revaluation gain of HK$136m was recognised through the income statement.

Segmental Analysis

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

Figures in HK$m	*Hong Kong & other businesses*						
	Retail Banking and Wealth Management	***Corporate and Commercial Banking***	***Treasury***	***Other***	***Total***	***Mainland China business***	***Total***
Half-year ended 30 June 2013							
Profit before tax	**4,455**	**3,140**	**1,320**	**1,225**	**10,140**	**8,633**	**18,773**
Share of profit before tax	**23.8%**	**16.7%**	**7.0%**	**6.5%**	**54.0%**	**46.0%**	**100.0%**
Share of profit before tax as a % of Hong Kong & other businesses	**43.9%**	**31.0%**	**13.0%**	**12.1%**	**100.0%**		
Half-year ended 30 June 2012 (restated)							
Profit before tax	3,896	2,761	1,311	167	8,135	2,465	10,600
Share of profit before tax	36.7%	26.0%	12.4%	1.6%	76.7%	23.3%	100.0%
Share of profit before tax as a % of Hong Kong & other businesses	47.9%	33.9%	16.1%	2.1%	100.0%		
Half-year ended 31 December 2012 (restated)							
Profit before tax	3,955	3,089	1,050	342	8,436	2,958	11,394
Share of profit before tax	34.7%	27.1%	9.2%	3.0%	74.0%	26.0%	100.0%
Share of profit before tax as a % of Hong Kong & other businesses	46.9%	36.6%	12.4%	4.1%	100.0%		

Retail Banking and Wealth Management ("RBWM") in Hong Kong reported profit before tax of HK$4,455m in the first half of 2013, representing a 14.3% year-on-year increase. Operating profit excluding loan impairment charges grew by 15.3% to HK$4,574m.

We achieved good results by leveraging the trusted Hang Seng brand and employing a competitive pricing strategy. We continued to expand the affluent customer base in attracting new sources of funds to sustain our business growth. Along with solid growth in unsecured lending businesses, this helped support a 16.2% increase in net interest income to HK$4,917m.

Non-interest income rose by 7.8% year-on-year to HK$2,272m. With our continued focus on wealth management, net fee income increased by 26.5% to HK$1,955m. Overall wealth management income grew by 12.6% to HK$3,169m.

Mortgage business remained an important source of income growth. We expanded our range of products with the launch of an enhanced fixed-rate mortgage plan in April that is designed to help customers guard against fluctuations in market interest rates. Despite keen competition, we sustained good business momentum with a market share of 15.6% in terms of new mortgage registrations in the first half of 2013. The mortgage loans portfolio grew by 3.0% compared to 31 December 2012 with an improvement in yield.

Supported by effective marketing campaigns and our quality credit card customer base, card spending achieved double digit growth of 11.3% compared with same period last year. Total cards in circulation rose by 5.8% to 2.4 million year-on-year and we were the third-largest card issuer of VISA and MasterCard in Hong Kong. The personal loan portfolio grew by 8.5% compared to 31 December 2012, with a total loan balance of HK$6,373m.

With improved investor sentiment in the early months of the year, total operating income from investment service business increased by 37.2% year-on-year, with sales of retail investment funds as the major growth driver. Retail investment funds turnover and income increased by 102.9% and 69.1% respectively. Securities turnover rose by 22.6% and related income grew by 13.4%. We broadened our product suite to capture market trends by launching the Hang Seng China A-Share FlexiPower Fund and the Hang Seng "God of Wealth" gold bar.

Total operating income from insurance business decreased by 3.2% year-on-year. Leveraging our extensive distribution network and timely promotion offers, annualised new life insurance premiums grew by 8.5% year-on-year and total life insurance policies in-force rose by 8.1% compared with the same period last year. The good sales results were, however, offset by the lower returns on our investment portfolio as the investment climate changed towards the end of the second quarter.

We took additional steps to acquire new quality customers with wealth management needs to successfully increase the number of Prestige and Preferred Banking customers compared with the same time last year. We invested in the development of our Prestige and Preferred Banking Centres to enhance the customer experience. As at the end of June, we had nine such centres in strategic locations, with plans to open more in the pipeline. We expanded our team of relationship managers and put additional resources into their professional development so as to better serve our customers.

We invested in new technology to improve and upgrade our online and mobile wealth management channels to provide customers with fast, convenient and secure access to financial services. Our new online "iPower" platform, launched in April, allows customers to manage their investment funds portfolio online and offers the option of a lower minimum subscription amount than traditional funds account services. With the introduction of our contactless mobile payment service in June 2013, customers who hold Hang Seng MasterCard credit cards can now link their compatible smartphone SIM to their credit card account to enjoy the convenience of using their mobile phones to make payments in a growing network of retail outlets in Hong Kong.

Corporate and Commercial Banking ("CNC") in Hong Kong achieved a 13.7% increase in profit before tax to HK$3,140m.

We have achieved a balanced growth in both customer advances and deposits, which increased by 10.6% and 8.4% respectively during the first half of 2013. Net interest income grew by 9.8% to HK$2,722m compared with the prior year.

We have stepped up portfolio management and increased the return on risk-weighted assets with more proactive cross-selling of non-interest income products and tailor-made propositions. Non-interest income was up 11.9% at HK$1,237m, underpinned by satisfactory growth on sales of investment funds, FX structured products and securities trading. Renminbi investment and hedging products were well-received by our corporate and commercial customers.

The credit portfolio remained healthy with HK$65m of net loan impairment released in the first half of 2013.

We have continued to attract and retain quality SME customers through our expanded network, enhanced mobile banking platform and new product offering. Two new Business Banking Centres were opened in Sheung Shui and Kwun Tong to enhance accessibility and services. Our Business Mobile Banking platform was upgraded in April 2013 with payment authorisation and fund transfer capability to registered third parties. We launched the "UpBiz Integrated Account" supporting high-value customers with designated relationship managers and Trade Advisory Team. We continued to be one of the major market participants in the Hong Kong Mortgage Corporation's SME Financing Guarantee Scheme ("SFGS") and approved over HK$4.5bn of loan facilities since June 2012 when SFGS was enhanced with an 80% guarantee. We won the "SME's Best Partner Award" from the Hong Kong General Chamber of Small and Medium Business for the eighth consecutive year in May 2013.

We have introduced innovative supply chain solutions to customers in the first half of 2013, including pre-delivery receivable financing under the vendor-managed inventory model. We were awarded "Trade Finance Domestic Bank – Hong Kong" by the Asian Banking & Finance Magazine for the second consecutive year in June 2013. We shall continue to strengthen transaction banking (trade and cash management) core product capabilities and infrastructure to meet customers' needs in the fast-changing international trade landscape.

Treasury ("TRY") in Hong Kong recorded a 0.7% increase in profit before tax to HK$1,320m.

Net interest income declined by 6.8% to HK$794m, reflecting the reduction in the commercial surplus available for deployment, as well as the low interest rate environment and flattened yield curves – which limited opportunities for yield enhancement. The prevailing low interest rates also had an unfavourable impact on the reinvestment of funds arising from the maturing of debt securities in the balance sheet management portfolio.

Total trading income increased by HK$81m, or 13.3%, to HK$690m. Option income from foreign exchange structured products registered encouraging growth, boosted in part by rising demand for renminbi-denominated products following the further development of renminbi business in Hong Kong. An increase in trading activity, particularly during the second quarter of the year, helped drive a 77.1% year-on-year rise in foreign exchange trading income.

Front-line channels (including e-Banking) and trading systems were enhanced to facilitate straight-through processing, enabling better position management.

To enhance our strong position as a provider of physical gold and gold-related investment products, we collaborated with Retail Banking and Wealth Management to launch the Hang Seng "God of Wealth" gold bar and a structured investment deposit linked to gold during the first half of the year.

To further diversify our revenue base, we increased the provision of treasury products to RBWM and CNC customers through closer collaboration and a segmentation study to identify potential new opportunities for fulfilling customer needs.

Mainland China business

Mainland China's economic growth momentum slowed during the first half of 2013, reflecting the effects of structural reforms introduced under the "12th Five-Year Plan" in 2011, the slowing of domestic investment and consumption and subdued external demand. Keen competition for deposits and volatility in the interbank market continued to put pressure on interest margins.

Hang Seng China continued with the development of its distribution and service platforms, including the commencement of operations at the Qianhai sub-branch in Shenzhen, to capture new cross-border business opportunities arising from the establishment of the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone. Shantou sub-branch is scheduled to open in the second half of 2013 to further strengthen Hang Seng China's foothold in the Closer Economic Partnership Arrangement ("CEPA") catchment area.

To further diversify the income base and in preparation for further liberalisation in the financial sector, Hang Seng China made additional investments in its people, e-banking platform, and product and service propositions. Close cooperation between the Bank and its Mainland subsidiary is enabling us to further leverage our unique strengths in serving customers who require seamless and sophisticated cross-border financial solutions and enhance awareness of the Hang Seng brand – particularly in the southern region of the Mainland.

Driven by an expansion in the customer base, overall advances to customers rose by 16.8%. Customer deposits were up 11.6%, compared with last year-end.

Total operating income was 15.3% lower than the first half of 2012, affected by a 21.6% decrease in net interest income. Operating profit fell by 35.2% compared with the same period last year, taking into account the 5.6% increase in operating expenses relating to further investment in future business development and a net release in loan impairment charges, compared with a net charge in the first half of 2012.

	As reported	***Constant currency****
Half-year ended 30 June 2013 compared with 30 June 2012		
Total operating income	**-15.3%**	**-15.9%**
Operating profit	**-35.2%**	**-36.7%**
At 30 June 2013 compared with 31 December 2012		
Gross advances to customers	**16.8%**	**14.7%**
Customer deposits	**11.6%**	**9.6%**

The Group has continued to cooperate closely with Industrial Bank as a strategic business partner in various business areas, including trade finance and retail banking business. Business collaboration between Hang Seng China and Industrial Bank has also been stepped up.

* *Constant currency comparatives for 2012 referred to in the tables above are computed by translating into Hong Kong dollars the functional currency (renminbi) of Hang Seng's mainland China business:*

- *the income statement for the half year to 30 June 2012 at the average rates of exchange for the half year to 30 June 2013; and*
- *the balance sheet at 31 December 2012 at the prevailing rates of exchange on 30 June 2013.*

Balance Sheet

Total assets rose by HK$29.6bn, or 2.7%, compared with last year-end to HK$1,106.7bn. The Group continued to pursue a balanced growth strategy in managing its assets and liabilities and achieved solid increases in both loans and deposits. Customer loans and advances grew by HK$43.5bn, or 8.1%, to HK$579.7bn, driven by growth in lending to corporate and commercial and mainland China customers. Residential mortgage lending also increased, helped by the Bank's diverse range of mortgage products, including an enhanced fixed-rate mortgage plan launched in April 2013. The increase in cross-border trade between Hong Kong and the Mainland supported a solid recovery in trade finance lending. Hang Seng China lending portfolios also increased, underpinned by the expansion of renminbi lending to corporate customers. Customer deposits, including certificates of deposit and other debt securities in issue, rose by HK$13.4bn, or 1.6%, to HK$832.2bn. At 30 June 2013, the advances-to-deposits ratio was 69.7%, compared with 65.5% at 31 December 2012.

Loans and advances to customers

Gross loans and advances to customers grew by HK$43.5bn, or 8.1%, to HK$581.1bn compared with the end of 2012.

Loans and advances for use in Hong Kong increased by HK$12.9bn, or 3.4%. Lending to the industrial, commercial and financial sectors grew by 4.0%. Lending to property development and property investment declined by 4.1% and 3.8% respectively, due mainly to repayments of certain existing loans. Lending to financial concerns remained active and grew by 27.0%. The Bank remained major market participant in the Hong Kong Government-organised schemes to support SMEs, and recorded growth of 20.7% in the wholesale and retail trade sector and 13.4% in the manufacturing sector. Growth in lending to "Other" was mainly due to certain new working capital financing facilities for large corporate customers.

Lending to individuals increased by 2.8% compared with the last year-end. The property market remained fairly active early this year but began to slow after the government implemented new prudential measures. The Bank was able to sustain a leading position for the mortgage business based on diversified mortgage products, a competitive pricing strategy and premium service. Residential mortgage lending to individuals rose by 3.6% compared with the end of 2012. Credit card advances were broadly the same level as last year-end. Other loans to individuals grew by 6.1%, reflecting the success of the Group in expanding its consumer finance business.

Trade finance regained momentum and recorded strong growth against last year, reflecting Corporate and Commercial Banking's achievement in expanding trade finance business by maintaining close relationship with its business partners to support cross-border renminbi trade business on the Mainland.

Loans and advances for use outside Hong Kong rose by 13.4%, compared with the end of 2012, driven largely by lending on the Mainland. The Mainland loan portfolio increased by 16.8% to HK$60.2bn, underpinned by the expansion of renminbi lending to corporate and commercial customers. The Group employed a cautious approach to lending on the Mainland and will continue to strengthen its prudent credit policies in light of the more difficult operating conditions for Mainland businesses.

Customer deposits

Customer deposits, including current, savings and other deposits accounts, certificates of deposit and other debt securities in issue stood at HK$832.2bn at 30 June 2013 – a rise of 1.6% from the end of 2012. Structured deposits, certificates of deposit and other debt securities in issue increased as instruments with yield enhancement features gained popularity. Deposits with Hang Seng China also rose by 11.6%, driven mainly by renminbi deposits.

At 30 June 2013, the advances-to-deposits ratio was 69.7%, compared with 65.5% at 31 December 2012.

CONSOLIDATED INCOME STATEMENT

unaudited

(Expressed in millions of Hong Kong dollars)	*note*	***Half-year ended 30 June 2013***	*Half-year ended 30 June 2012 (restated)*	*Half-year ended 31 December 2012 (restated)*
Interest income	4	**11,459**	10,780	11,081
Interest expense	5	**(2,490)**	(2,494)	(2,421)
Net interest income		**8,969**	8,286	8,660
Fee income		**3,637**	2,977	3,321
Fee expense		**(701)**	(569)	(643)
Net fee income	6	**2,936**	2,408	2,678
Trading income	7	**1,204**	1,170	893
Net income/(loss) from financial instruments designated at fair value	8	**(111)**	102	274
Dividend income	9	**4**	4	13
Net earned insurance premiums		**5,800**	6,611	4,336
Other operating income	10	**1,095**	784	397
Total operating income		**19,897**	19,365	17,251
Net insurance claims incurred and movement in policyholders' liabilities		**(6,420)**	(7,005)	(5,230)
Net operating income before loan impairment charges		**13,477**	12,360	12,021
Loan impairment charges	11	**(198)**	(249)	(137)
Net operating income		**13,279**	12,111	11,884
Employee compensation and benefits		**(2,170)**	(2,098)	(2,158)
General and administrative expenses		**(1,742)**	(1,596)	(1,779)
Depreciation of premises, plant and equipment		**(376)**	(381)	(381)
Amortisation of intangible assets		**(57)**	(61)	(54)
Operating expenses	12	**(4,345)**	(4,136)	(4,372)
Operating profit		**8,934**	7,975	7,512
Gains less losses from financial investments and fixed assets	13	**173**	–	(5)
Gain on reclassification of Industrial Bank		**8,454**	–	–
Gain on disposal of a subsidiary		**–**	–	355
Net surplus on property revaluation		**999**	238	538
Share of profits from associates		**213**	2,387	2,994
Profit before tax		**18,773**	10,600	11,394
Tax expense	14	**(305)**	(1,347)	(1,320)
Profit for the period		**18,468**	9,253	10,074
Profit attributable to shareholders		**18,468**	9,253	10,074
(Figures in HK$)				
Earnings per share	15	**9.66**	4.84	5.27

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 21 to 77 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 2013**	Half-year ended 30 June 2012 (restated)	Half-year ended 31 December 2012 (restated)
Profit for the period	**18,468**	9,253	10,074
Other comprehensive income			
Items that will be reclassified subsequently to the income statement when specific conditions are met:			
Available-for-sale investment reserve:			
- fair value changes taken to equity:			
- on debt securities	**(685)**	326	54
- on equity shares	**(3,458)**	54	36
- fair value changes transferred to income statement:			
- on hedged items	**461**	(62)	84
- on disposal	**–**	(1)	–
- share of changes in equity of associates:			
- fair value changes	**4**	471	(12)
- fair value changes transferred to income statement on reclassification of Industrial Bank	**94**	–	–
- deferred taxes	**42**	(156)	(1)
- exchange difference	**431**	–	(1)
Cash flow hedging reserve:			
- fair value changes taken to equity	**498**	33	308
- fair value changes transferred to income statement	**(516)**	(30)	(298)
- deferred taxes	**3**	–	(2)
Exchange differences on translation of:			
- financial statements of overseas branches, subsidiaries and associates	**338**	(136)	164
- cumulative foreign exchange reserve transferred to income statement on reclassification of Industrial Bank	**(2,039)**	–	–
- retained profits	**(3)**	1	(1)
Share-based payments	**(1)**	(7)	–
Others	**30**	(25)	(10)
Items that will not be reclassified subsequently to the income statement:			
Premises:			
- unrealised surplus on revaluation of premises	**1,526**	839	1,383
- deferred taxes	**(241)**	(128)	(230)
- exchange difference	**2**	(1)	1
Defined benefit plans:			
- actuarial gains/(losses) on defined benefit plans	**855**	(137)	861
- deferred taxes	**(141)**	22	(142)
Other comprehensive income for the period, net of tax	**(2,800)**	1,063	2,194
Total comprehensive income for the period	**15,668**	10,316	12,268
Total comprehensive income for the period attributable to shareholders	**15,668**	10,316	12,268

CONSOLIDATED BALANCE SHEET

unaudited

(Expressed in millions of Hong Kong dollars)	*note*	***At 30 June 2013***	*At 30 June 2012*	*At 31 December 2012*
ASSETS				
Cash and balances with banks	19	**19,190**	18,272	27,082
Placings with and advances to banks	20	**135,999**	137,948	140,382
Trading assets	21	**34,509**	41,037	34,399
Financial assets designated at fair value	22	**10,150**	7,708	8,343
Derivative financial instruments	23	**4,752**	4,063	5,179
Loans and advances to customers	24	**579,705**	504,902	536,162
Financial investments	25	**263,369**	224,385	253,408
Interest in associates	26	**2,753**	21,597	24,655
Investment properties	27	**10,547**	4,583	4,860
Premises, plant and equipment	28	**20,690**	18,250	19,262
Intangible assets	29	**7,403**	6,603	6,783
Other assets	30	**17,590**	16,520	16,581
Total assets		**1,106,657**	1,005,868	1,077,096
LIABILITIES AND EQUITY				
Liabilities				
Current, savings and other deposit accounts	31	**779,884**	720,397	769,147
Deposits from banks		**15,790**	11,284	19,845
Trading liabilities	32	**67,749**	57,364	59,853
Financial liabilities designated at fair value		**466**	443	464
Derivative financial instruments	23	**4,817**	4,759	4,118
Certificates of deposit and other debt securities in issue	33	**11,022**	12,662	11,291
Other liabilities	34	**20,874**	20,469	21,653
Liabilities to customers under insurance contracts		**86,584**	77,347	81,670
Current tax liabilities		**1,928**	1,420	588
Deferred tax liabilities		**3,633**	3,651	4,323
Subordinated liabilities	35	**11,829**	11,827	11,821
Total liabilities		**1,004,576**	921,623	984,773
Equity				
Share capital		**9,559**	9,559	9,559
Retained profits		**76,633**	54,623	59,683
Other reserves		**13,786**	17,960	19,257
Proposed dividends		**2,103**	2,103	3,824
Shareholders' funds	36	**102,081**	84,245	92,323
Total equity and liabilities		**1,106,657**	1,005,868	1,077,096

The notes on pages 21 to 77 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 2013**	Half-year ended 30 June 2012	Half-year ended 31 December 2012
Share capital			
At beginning and end of period	**9,559**	9,559	9,559
Retained profits (including proposed dividends)			
At beginning of period	**63,507**	53,152	56,726
Dividends to shareholders			
- dividends approved in respect of the previous year	**(3,824)**	(3,633)	–
- dividends declared in respect of the current period	**(2,103)**	(2,103)	(4,206)
Transfer	**1,978**	178	195
Total comprehensive income for the period	**19,178**	9,132	10,792
	78,736	56,726	63,507
Other reserves			
Premises revaluation reserve			
At beginning of period	**13,790**	12,280	12,811
Transfer	**(449)**	(179)	(175)
Total comprehensive income for the period	**1,287**	710	1,154
	14,628	12,811	13,790
Available-for-sale investment reserve			
At beginning of period	**227**	(561)	71
Transfer	**–**	–	(4)
Total comprehensive income for the period	**(3,111)**	632	160
	(2,884)	71	227
Cash flow hedging reserve			
At beginning of period	**17**	6	9
Total comprehensive income for the period	**(15)**	3	8
	2	9	17
Foreign exchange reserve			
At beginning of period	**3,071**	3,043	2,907
Transfer	**(64)**	–	–
Total comprehensive income for the period	**(1,701)**	(136)	164
	1,306	2,907	3,071
Other reserves			
At beginning of period	**2,152**	2,155	2,162
Cost of share-based payment arrangements	**17**	31	16
Transfer	**(1,465)**	1	(16)
Total comprehensive income for the period	**30**	(25)	(10)
	734	2,162	2,152
Total equity			
At beginning of period	**92,323**	79,634	84,245
Dividends to shareholders	**(5,927)**	(5,736)	(4,206)
Cost of share-based payment arrangements	**17**	31	16
Total comprehensive income for the period	**15,668**	10,316	12,268
	102,081	84,245	92,323

CONSOLIDATED CASH FLOW STATEMENT

unaudited

(Expressed in millions of Hong Kong dollars)	*note*	***Half-year ended 30 June 2013***	*Half-year ended 30 June 2012*
Net cash inflow from operating activities	37(a)	**1,393**	3,078
Cash flows from investing activities			
Dividends received from associates		**–**	660
Purchase of an interest in an associate		**–**	(18)
Purchase of available-for-sale investments		**(23,729)**	(20,545)
Purchase of held-to-maturity debt securities		**(953)**	(502)
Proceeds from sale or redemption of available-for-sale investments		**16,177**	40,153
Proceeds from redemption of held-to-maturity debt securities		**55**	305
Purchase of fixed assets and intangible assets		**(3,229)**	(178)
Proceeds from sale of fixed assets and assets held for sale		**910**	26
Interest received from available-for-sale investments		**826**	1,272
Dividends received from available-for-sale investments		**5**	4
Net cash (outflow)/inflow from investing activities		**(9,938)**	21,177
Cash flows from financing activities			
Dividends paid		**(5,927)**	(5,736)
Interest paid for subordinated liabilities		**(155)**	(126)
Net cash outflow from financing activities		**(6,082)**	(5,862)
(Decrease)/increase in cash and cash equivalents		**(14,627)**	18,393
Cash and cash equivalents at 1 January		**125,034**	120,469
Effect of foreign exchange rate changes		**(2,557)**	(784)
Cash and cash equivalents at 30 June	37(b)	**107,850**	138,078

The notes on pages 21 to 77 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 made under section 60A of the Banking Ordinance. The interim financial report was authorised for issue on 5 August 2013.

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 78.

2 Accounting policies

Except as described below, the accounting policies applied in preparing this interim financial report are the same as those applied in preparing the financial statements for the year ended 31 December 2012, as disclosed in the Annual Report and Financial Statements for 2012.

The Group has adopted the following new standards and amendments to standards which had insignificant or no effect on the consolidated financial statements:

- HKAS 27 (2011) "Separate Financial Statements"
- HKAS 28 (2011) "Investments in Associates and Joint Ventures"
- Hong Kong Financial Reporting Standards ("HKFRS") 10 "Consolidated Financial Statements"
- HKFRS 11 "Joint Arrangements"
- HKFRS 12 "Disclosure of Interests in Other Entities"
- Amendments to HKFRS 7 "Disclosures - Offsetting Financial Assets and Financial Liabilities"
- Annual Improvements to HKFRSs 2009-2011 Cycle

During the period, the Group also adopted the following new standard and amendments to standards which had the following impacts:

- Amendments to HKAS 1 "Presentation of financial statements" require grouping of items presented in other comprehensive income on the basis of whether they are potentially reclassifiable to profit or loss subsequently. The Group's presentation of other comprehensive income in the consolidated financial statements has been modified accordingly with comparative information re-presented.

2 Accounting policies *(continued)*

- Following the adoption of the amendments to HKAS 19 "Employee Benefits", the Group has replaced the interest cost and expected return on plan assets by a finance cost component comprising the net interest on the net defined benefit liability or asset. This finance cost component is determined by applying the same discount rate used to measure the defined benefit obligation to the net defined benefit liability or asset. The difference between the actual return on plan assets and the return included in the finance cost component in the income statement will be presented in other comprehensive income. The amendments have been applied retrospectively with comparative figures 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 2012			
Consolidated income statement:			
Employee compensation and benefits	(2,039)	(59)	(2,098)
Profit before tax	10,659	(59)	10,600
Tax expense	(1,357)	10	(1,347)
Profit attributable to shareholders	9,302	(49)	9,253
Earning per share (HK$)	4.87	(0.03)	4.84
Consolidated statement of comprehensive income:			
Defined benefit plans:			
- actuarial losses on defined benefit plans	(196)	59	(137)
- deferred taxes	32	(10)	22
Other comprehensive income for the period, net of tax	1,014	49	1,063
Return on average shareholders' funds (%)	22.9	(0.1)	22.8

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

- HKFRS 13 "Fair Value Measurement" establishes a single source of guidance for all fair value measurements required or permitted by HKFRSs and with prospective application. It clarifies the definition of fair value as an exit price - a price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions.

- The Group has applied the new fair value measurement guidance prospectively. In particular, the Group's premises and investment properties were revalued at market value which is consistent with the definition of fair value under HKFRS 13 and taken into account the highest and best use of the property from the perspective of market participants. The highest and best use takes into account the use of the property that is physically possible, legally permissible and financially feasible as described in HKFRS 13.

- HKFRS 13 also contains extensive disclosure requirements about fair value measurements. Some of the disclosures are specifically required for financial instruments in the interim financial reports. The Group has provided those disclosures in note 39. Comparative disclosures are not required in the first period of adoption of the standard.

3 Basis of consolidation

This interim financial report covers the consolidated positions of Hang Seng Bank Limited ("the Bank") and all its subsidiaries ("the Group"), unless otherwise stated, and includes the attributable share of the results and reserves of its associates. For regulatory reporting, the basis of consolidation is different from the basis of consolidation for accounting purposes. They are set out in supplementary note 1 to the financial statements.

4 Interest income

	Half-year ended 30 June 2013	*Half-year ended 30 June 2012*	*Half-year ended 31 December 2012*
Interest income arising from:			
- financial assets that are not at fair value through profit and loss	**11,334**	10,602	10,935
- trading assets	**91**	154	118
- financial assets designated at fair value	**34**	24	28
	11,459	10,780	11,081
of which:			
- interest income from listed investments	**698**	710	716
- interest income from unlisted investments	**1,697**	1,766	1,715
- interest income from impaired financial assets	**8**	7	4

5 Interest expense

	Half-year ended 30 June 2013	*Half-year ended 30 June 2012*	*Half-year ended 31 December 2012*
Interest expense arising from:			
- financial liabilities that are not at fair value through profit and loss	**1,629**	1,684	1,691
- trading liabilities	**861**	810	730
- financial liabilities designated at fair value	**–**	–	–
	2,490	2,494	2,421
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	**155**	126	163

6 Net fee income

	Half-year ended 30 June 2013	*Half-year ended 30 June 2012*	*Half-year ended 31 December 2012*
- stockbroking and related services	**535**	464	477
- retail investment funds	**845**	495	635
- insurance agency	**223**	135	232
- account services	**179**	177	176
- private banking service fee	**53**	54	39
- remittances	**158**	144	157
- cards	**1,016**	894	971
- credit facilities	**163**	194	162
- trade services	**284**	245	299
- other	**181**	175	173
Fee income	**3,637**	2,977	3,321
Fee expense	**(701)**	(569)	(643)
	2,936	2,408	2,678
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	**1,083**	1,061	1,111
- fee income	**1,640**	1,510	1,606
- fee expense	**(557)**	(449)	(495)
Net fee income on trust and other fiduciary activities where the Group holds or invests on behalf of its customers	**335**	303	315
- fee income	**416**	376	391
- fee expense	**(81)**	(73)	(76)

7 Trading income

	Half-year ended 30 June 2013	*Half-year ended 30 June 2012*	*Half-year ended 31 December 2012*
Foreign exchange	**1,190**	1,193	793
Gains/(losses) from hedging activities:			
- fair value hedge			
- on hedging instruments	**453**	(95)	58
- on the hedged items attributable to the hedged risk	**(461)**	62	(84)
- cash flow hedge			
- net hedging income	**(3)**	–	–
Securities, derivatives and other trading activities	**25**	10	126
	1,204	1,170	893

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

	Half-year ended 30 June 2013	*Half-year ended 30 June 2012*	*Half-year ended 31 December 2012*
Net income/(loss) on assets designated at fair value which back insurance and investment contracts	**(111)**	102	274
of which dividend income from:			
- listed investments	**47**	30	19
- unlisted investments	**–**	–	1
	47	30	20

9 Dividend income

	Half-year ended 30 June 2013	*Half-year ended 30 June 2012*	*Half-year ended 31 December 2012*
Dividend income:			
- listed investments	**–**	–	3
- unlisted investments	**4**	4	10
	4	4	13

10 Other operating income

	Half-year ended 30 June 2013	*Half-year ended 30 June 2012*	*Half-year ended 31 December 2012*
Rental income from investment properties	**106**	94	103
Movement in present value of in-force long-term insurance business	**622**	614	201
Other	**367**	76	93
	1,095	784	397

11 Loan impairment charges

	Half-year ended 30 June 2013	Half-year ended 30 June 2012	Half-year ended 31 December 2012
Net charge for impairment of loans and advances to customers (note 24(b)):			
Individually assessed impairment allowances:			
- new allowances	**(61)**	(213)	(81)
- releases	**57**	81	143
- recoveries	**7**	4	9
	3	(128)	71
Net charge for collectively assessed impairment allowances	**(201)**	(121)	(208)
Net charge for loan impairment	**(198)**	(249)	(137)

There was no impairment charge (nil for the first and second halves of 2012) provided for available-for-sale debt securities by the Group. There was also no impairment loss made in relation to held-to-maturity debt securities for the periods indicated.

12 Operating expenses

	Half-year ended 30 June 2013	Half-year ended 30 June 2012 (restated)	Half-year ended 31 December 2012 (restated)
Employee compensation and benefits:			
- salaries and other costs	**1,953**	1,871	1,929
- retirement benefit costs			
- defined benefit scheme	**154**	179	180
- defined contribution scheme	**63**	48	49
	2,170	2,098	2,158
General and administrative expenses:			
- rental expenses	**315**	275	284
- other premises and equipment	**519**	449	515
- marketing and advertising expenses	**322**	272	345
- other operating expenses	**586**	600	635
	1,742	1,596	1,779
Depreciation of premises, plant and equipment (note 28)	**376**	381	381
Amortisation of intangible assets	**57**	61	54
	4,345	4,136	4,372

13 Gains less losses from financial investments and fixed assets

	Half-year ended 30 June 2013	Half-year ended 30 June 2012	Half-year ended 31 December 2012
Net gains from disposal of available-for-sale equity securities	–	1	–
Net gains from disposal of available-for-sale debt securities	–	–	–
Impairment of available-for-sale equity securities	–	–	–
Gains less losses on disposal of assets held for sale	175	–	–
Gains less losses on disposal of loans and advances	1	–	(4)
Losses on disposal of fixed assets	(3)	(1)	(1)
	173	–	(5)

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 2013	Half-year ended 30 June 2012 (restated)	Half-year ended 31 December 2012 (restated)
Current tax - provision for Hong Kong profits tax			
Tax for the period	1,298	1,104	1,121
Adjustment in respect of prior periods	–	18	(93)
	1,298	1,122	1,028
Current tax - taxation outside Hong Kong			
Tax for the period	52	92	–
Adjustment in respect of prior periods	7	–	(2)
	59	92	(2)
Deferred tax			
Origination and reversal of temporary differences	(1,052)	133	294
Total tax expense	305	1,347	1,320

The current tax provision is based on the estimated assessable profit for the first half of 2013, 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 (2012: 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 2013 is based on earnings of HK$18,468m (HK$9,253m and HK$10,074m for the first and second halves of 2012 respectively *(restated)*) 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 2012).

16 Dividends per share

	Half-year ended 30 June 2013		*Half-year ended 30 June 2012*		*Half-year ended 31 December 2012*	
	HK$ per share	***HK$m***	*HK$ per share*	*HK$m*	*HK$ per share*	*HK$m*
First interim	**1.10**	**2,103**	1.10	2,103	–	–
Second interim	**1.10**	**2,103**	1.10	2,103	–	–
Third interim	**–**	**–**	–	–	1.10	2,103
Fourth interim	**–**	**–**	–	–	2.00	3,824
	2.20	**4,206**	2.20	4,206	3.10	5,927

17 Segmental analysis

HKFRS 8 requires segmental disclosure to be based on the way that the Group's chief operating decision maker regards and manages the Group, with the amounts reported for each reportable segment being the measures reported to the Group's chief operating decision maker for the purpose of assessing segmental performance and making decisions about operating matters. To align with the information reported internally to the Group's most senior executive management for the purposes of resources allocation and performance assessment, the Group has presented the following five reportable segments. Consolidation adjustments made in preparing the Group's financial statements and inter-segment elimination of income or expenses upon consolidation are included in the "Inter-segment elimination".

Hong Kong and other businesses segment

Retail Banking and Wealth Management activities offer a broad range of products and services to meet the personal banking, consumer lending and wealth management needs of individual customers. Personal banking products typically include current and savings accounts, mortgages and personal loans, credit cards, insurance and wealth management. **Corporate and Commercial Banking** activities include the provision of financial services, payments and cash management, international trade finance, insurance, wealth management and tailored financial solutions to corporate and commercial customers. **Treasury** activities are mainly the provision of treasury operation services in credit, interest rates, foreign exchange, money markets and securities services. 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, equity shares and subordinated debt funding.

Mainland China business segment

Mainland China business segment comprises the business of Hang Seng Bank (China) Limited and our share of profits from Mainland associates.

(a) Segmental result

For the purpose of segmental analysis, the allocation of revenue reflects the benefits of capital and other funding resources allocated to the business segments by way of internal capital allocation and fund transfer-pricing mechanisms. Cost allocation is based on the direct costs incurred by the respective business segments and apportionment of management overheads. Bank-owned premises are reported under Other segment. When these premises are utilised by Global Businesses, notional rent will be charged to respective business segments based on the market rate.

17 Segmental analysis *(continued)*

(a) Segmental result *(continued)*

	Hong Kong & other businesses							
	Retail Banking and Wealth Management	*Corporate and Commercial Banking*	*Treasury*	*Other*	*Total*	*Mainland China business*	*Inter-segment elimination*	*Total*
Half-year ended 30 June 2013								
Net interest income/(expense)	4,917	2,722	794	(113)	8,320	649	–	8,969
Net fee income/(expense)	1,955	889	(13)	66	2,897	39	–	2,936
Trading income/(loss)	89	326	690	(9)	1,096	108	–	1,204
Net income/(loss) from financial instruments designated at fair value	(108)	(3)	–	–	(111)	–	–	(111)
Dividend income	–	–	–	4	4	–	–	4
Net earned insurance premiums	5,761	39	–	–	5,800	–	–	5,800
Other operating income	956	25	–	140	1,121	–	(26)	1,095
Total operating income	13,570	3,998	1,471	88	19,127	796	(26)	19,897
Net insurance claims incurred and movement in policyholders' liabilities	(6,381)	(39)	–	–	(6,420)	–	–	(6,420)
Net operating income before loan impairment charges	7,189	3,959	1,471	88	12,707	796	(26)	13,477
Loan impairment (charges)/releases	(280)	65	–	–	(215)	17	–	(198)
Net operating income	6,909	4,024	1,471	88	12,492	813	(26)	13,279
Operating expenses *	(2,615)	(886)	(151)	(35)	(3,687)	(684)	26	(4,345)
Operating profit	4,294	3,138	1,320	53	8,805	129	–	8,934
Gains less losses from financial investments and fixed assets	(1)	1	–	173	173	–	–	173
Gain on reclassification of Industrial Bank	–	–	–	–	–	8,454	–	8,454
Net surplus on property revaluation	–	–	–	999	999	–	–	999
Share of profits from associates	162	1	–	–	163	50	–	213
Profit before tax	4,455	3,140	1,320	1,225	10,140	8,633	–	18,773
Share of profit before tax	23.8%	16.7%	7.0%	6.5%	54.0%	46.0%	–	100.0%
Share of profit before tax as a percentage of Hong Kong & other businesses	43.9%	31.0%	13.0%	12.1%	100.0%			
Operating profit excluding loan impairment charges	4,574	3,073	1,320	53	9,020	112	–	9,132
** Depreciation/amortisation included in operating expenses*	(24)	(13)	(1)	(345)	(383)	(50)	–	(433)
At 30 June 2013								
Total assets	307,081	324,547	283,618	98,429	1,013,675	118,176	(25,194)	1,106,657
Total liabilities	621,704	213,303	33,203	46,569	914,779	109,913	(20,116)	1,004,576
Interest in associates	1,769	9	–	–	1,778	975	–	2,753

17 Segmental analysis *(continued)*

(a) Segmental result *(continued)*

	Hong Kong & other businesses							
	Retail Banking and Wealth Management	*Corporate and Commercial Banking*	*Treasury*	*Other*	*Total*	*Mainland China business*	*Inter-segment elimination*	*Total*
Half-year ended 30 June 2012 (restated)								
Net interest income/(expense)	4,232	2,479	852	(105)	7,458	828	–	8,286
Net fee income/(expense)	1,545	770	(15)	59	2,359	49	–	2,408
Trading income	216	278	609	4	1,107	63	–	1,170
Net income/(loss) from financial instruments designated at fair value	106	(4)	–	–	102	–	–	102
Dividend income	–	–	–	4	4	–	–	4
Net earned insurance premiums	6,488	123	–	–	6,611	–	–	6,611
Other operating income	683	12	–	113	808	–	(24)	784
Total operating income	13,270	3,658	1,446	75	18,449	940	(24)	19,365
Net insurance claims incurred and movement in policyholders' liabilities	(6,931)	(74)	–	–	(7,005)	–	–	(7,005)
Net operating income before loan impairment charges	6,339	3,584	1,446	75	11,444	940	(24)	12,360
Loan impairment (charges)/releases	(189)	33	–	–	(156)	(93)	–	(249)
Net operating income	6,150	3,617	1,446	75	11,288	847	(24)	12,111
Operating expenses *	(2,373)	(857)	(135)	(147)	(3,512)	(648)	24	(4,136)
Operating profit	3,777	2,760	1,311	(72)	7,776	199	–	7,975
Gains less losses from financial investments and fixed assets	–	–	–	1	1	(1)	–	–
Gain on disposal of a subsidiary	–	–	–	–	–	–	–	–
Net surplus on property revaluation	–	–	–	238	238	–	–	238
Share of profits from associates	119	1	–	–	120	2,267	–	2,387
Profit before tax	3,896	2,761	1,311	167	8,135	2,465	–	10,600
Share of profit before tax	36.7%	26.0%	12.4%	1.6%	76.7%	23.3%	–	100.0%
Share of profit before tax as a percentage of Hong Kong & other businesses	47.9%	33.9%	16.1%	2.1%	100.0%			
Operating profit excluding loan impairment charges	3,966	2,727	1,311	(72)	7,932	292	–	8,224
** Depreciation/amortisation included in operating expenses*	(24)	(13)	(2)	(347)	(386)	(56)	–	(442)
At 30 June 2012								
Total assets	275,221	286,112	286,974	63,050	911,357	116,278	(21,767)	1,005,868
Total liabilities	579,005	194,085	41,060	35,053	849,203	89,178	(16,758)	921,623
Interest in associates	1,499	7	–	–	1,506	20,091	–	21,597

17 Segmental analysis *(continued)*

(a) Segmental result *(continued)*

	Hong Kong & other businesses: Retail Banking and Wealth Management	Corporate and Commercial Banking	Treasury	Other	Total	Mainland China business	Inter-segment elimination	Total
Half-year ended 31 December 2012 (restated)								
Net interest income/(expense)	4,529	2,810	824	(223)	7,940	720	–	8,660
Net fee income/(expense)	1,765	796	(13)	82	2,630	48	–	2,678
Trading income/(loss)	311	168	379	(16)	842	51	–	893
Net income/(loss) from financial instruments designated at fair value	275	(1)	–	–	274	–	–	274
Dividend income	–	7	–	6	13	–	–	13
Net earned insurance premiums	4,288	48	–	–	4,336	–	–	4,336
Other operating income	265	19	–	126	410	15	(28)	397
Total operating income	11,433	3,847	1,190	(25)	16,445	834	(28)	17,251
Net insurance claims incurred and movement in policyholders' liabilities	(5,189)	(41)	–	–	(5,230)	–	–	(5,230)
Net operating income before loan impairment charges	6,244	3,806	1,190	(25)	11,215	834	(28)	12,021
Loan impairment (charges)/releases	(186)	18	1	–	(167)	30	–	(137)
Net operating income	6,058	3,824	1,191	(25)	11,048	864	(28)	11,884
Operating expenses*	(2,462)	(901)	(141)	(169)	(3,673)	(727)	28	(4,372)
Operating profit	3,596	2,923	1,050	(194)	7,375	137	–	7,512
Gains less losses from financial investments and fixed assets	–	(3)	–	(2)	(5)	–	–	(5)
Gain on disposal of a subsidiary	187	168	–	–	355	–	–	355
Net surplus on property revaluation	–	–	–	538	538	–	–	538
Share of profits from associates	172	1	–	–	173	2,821	–	2,994
Profit before tax	3,955	3,089	1,050	342	8,436	2,958	–	11,394
Share of profit before tax	34.7%	27.1%	9.2%	3.0%	74.0%	26.0%	–	100.0%
Share of profit before tax as a percentage of Hong Kong & other businesses	46.9%	36.6%	12.4%	4.1%	100.0%			
Operating profit excluding loan impairment charges	3,782	2,905	1,049	(194)	7,542	107	–	7,649
** Depreciation/amortisation included in total operating expenses*	(21)	(13)	(2)	(344)	(380)	(55)	–	(435)
At 31 December 2012								
Total assets	292,217	289,667	326,257	63,480	971,621	125,232	(19,757)	1,077,096
Total liabilities	621,266	197,590	47,163	38,295	904,314	95,146	(14,687)	984,773
Interest in associates	1,644	8	–	–	1,652	23,003	–	24,655

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 2013	*Half-year ended 30 June 2012 (restated)*	*Half-year ended 31 December 2012 (restated)*
Total operating income			
Hong Kong	**18,640**	17,801	15,881
Mainland	**796**	940	834
Americas	**421**	595	502
Others	**81**	69	75
Inter-segment elimination	**(41)**	(40)	(41)
	19,897	19,365	17,251
Profit before tax			
Hong Kong	**9,683**	7,512	7,916
Mainland	**8,633**	2,465	2,958
Americas	**404**	579	468
Others	**53**	44	52
	18,773	10,600	11,394

17 Segmental analysis *(continued)*

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

	At 30 June 2013	At 30 June 2012 (restated)	At 31 December 2012
Total assets			
Hong Kong	**1,008,809**	905,808	967,288
Mainland	**118,176**	116,278	125,232
Americas	**57,583**	60,163	61,296
Others	**10,996**	11,393	11,768
Inter-segment elimination	**(88,907)**	(87,774)	(88,488)
	1,106,657	1,005,868	1,077,096
Total liabilities			
Hong Kong	**911,782**	844,866	901,369
Mainland	**109,913**	89,178	95,146
Americas	**56,008**	59,086	60,129
Others	**10,703**	11,182	11,523
Inter-segment elimination	**(83,830)**	(82,689)	(83,394)
	1,004,576	921,623	984,773
Interest in associates			
Hong Kong	**1,778**	1,506	1,652
Mainland	**975**	20,091	23,003
Americas	**–**	–	–
Others	**–**	–	–
	2,753	21,597	24,655
Non-current assets*			
Hong Kong	**37,556**	28,384	29,872
Mainland	**1,083**	1,051	1,032
Americas	**–**	–	–
Others	**1**	1	1
	38,640	29,436	30,905
Contingent liabilities and commitments			
Hong Kong	**272,675**	273,806	271,065
Mainland	**37,389**	45,834	36,587
Americas	**–**	–	–
Others	**4,112**	4,121	4,180
	314,176	323,761	311,832

* *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 contractual maturity at the balance sheet date, with the exception of the trading portfolio that may be sold before maturity and is accordingly recorded as "Trading".

	Repayable on demand	*One month or less but not on demand*	*Over one month but within three months*	*Over three months but within one year*	*Over one year but within five years*	*Over five years*	*Trading*	*No contractual maturity*	*Total*
Assets									
Cash and balances with banks	**19,190**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**19,190**
Placings with and advances to banks	**3,213**	**77,407**	**47,493**	**5,899**	**–**	**1,987**	**–**	**–**	**135,999**
Trading assets	**–**	**–**	**–**	**–**	**–**	**–**	**34,509**	**–**	**34,509**
Financial assets designated at fair value	**–**	**855**	**623**	**1,977**	**424**	**349**	**–**	**5,922**	**10,150**
Derivative financial instruments	**–**	**–**	**2**	**418**	**455**	**12**	**3,865**	**–**	**4,752**
Loans and advances to customers	**11,490**	**43,313**	**57,746**	**116,362**	**186,136**	**164,658**	**–**	**–**	**579,705**
Financial investments:									
- available-for-sale investments	**–**	**29,005**	**46,108**	**39,928**	**48,805**	**1,886**	**–**	**26,702**	**192,434**
- held-to-maturity debt securities	**–**	**672**	**1,338**	**6,804**	**22,735**	**39,386**	**–**	**–**	**70,935**
Interest in associates	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**2,753**	**2,753**
Investment properties	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**10,547**	**10,547**
Premises, plant and equipment	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**20,690**	**20,690**
Intangible assets	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**7,403**	**7,403**
Other assets	**5,516**	**5,014**	**3,753**	**1,956**	**764**	**160**	**–**	**427**	**17,590**
At 30 June 2013	**39,409**	**156,266**	**157,063**	**173,344**	**259,319**	**208,438**	**38,374**	**74,444**	**1,106,657**
At 30 June 2012	51,853	100,234	170,002	143,469	254,325	184,437	44,984	56,564	1,005,868
At 31 December 2012	47,381	138,732	167,686	167,421	256,976	198,038	39,239	61,623	1,077,096
Liabilities									
Current, savings and other deposit accounts	**553,405**	**121,898**	**67,067**	**34,698**	**2,816**	**–**	**–**	**–**	**779,884**
Deposits from banks	**2,006**	**13,626**	**155**	**3**	**–**	**–**	**–**	**–**	**15,790**
Trading liabilities	**–**	**–**	**–**	**–**	**–**	**–**	**67,749**	**–**	**67,749**
Financial liabilities designated at fair value	**3**	**–**	**–**	**–**	**–**	**463**	**–**	**–**	**466**
Derivative financial instruments	**–**	**5**	**5**	**70**	**764**	**150**	**3,823**	**–**	**4,817**
Certificates of deposit and other debt securities in issue:									
- certificates of deposit in issue	**–**	**–**	**–**	**6,368**	**4,654**	**–**	**–**	**–**	**11,022**
Other liabilities	**7,160**	**5,039**	**3,727**	**1,938**	**102**	**68**	**–**	**2,840**	**20,874**
Liabilities to customers under insurance contracts	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**86,584**	**86,584**
Current tax liabilities	**–**	**–**	**1**	**1,880**	**47**	**–**	**–**	**–**	**1,928**
Deferred tax liabilities	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**3,633**	**3,633**
Subordinated liabilities	**–**	**–**	**–**	**–**	**–**	**11,829**	**–**	**–**	**11,829**
At 30 June 2013	**562,574**	**140,568**	**70,955**	**44,957**	**8,383**	**12,510**	**71,572**	**93,057**	**1,004,576**
At 30 June 2012	553,061	101,163	67,375	35,745	8,083	10,208	60,672	85,316	921,623
At 31 December 2012	577,858	121,524	69,785	44,853	5,934	12,554	62,616	89,649	984,773

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	–	–	–	–	–	–	–	–	–
- available-for-sale investments	–	**120**	**1,282**	**3,986**	**666**	–	–	**25**	**6,079**
- held-to-maturity debt securities	–	**81**	**110**	**59**	**1,654**	**2,997**	–	–	**4,901**
At 30 June 2013	–	**201**	**1,392**	**4,045**	**2,320**	**2,997**	–	**25**	**10,980**
At 30 June 2012	–	270	2,081	5,394	1,640	3,003	430	38	12,856
At 31 December 2012	–	383	2,758	3,597	1,458	2,996	400	36	11,628
Debt securities included in:									
- trading assets	–	–	–	–	–	–	**34,141**	–	**34,141**
- financial assets designated at fair value	–	**855**	**623**	**1,977**	**424**	**349**	–	–	**4,228**
- available-for-sale investments	–	**28,885**	**44,826**	**35,942**	**48,139**	**1,886**	–	**531**	**160,209**
- held-to-maturity debt securities	–	**591**	**1,228**	**6,745**	**21,081**	**36,389**	–	–	**66,034**
At 30 June 2013	–	**30,331**	**46,677**	**44,664**	**69,644**	**38,624**	**34,141**	**531**	**264,612**
At 30 June 2012	–	10,807	46,355	42,493	77,413	37,464	39,787	962	255,281
At 31 December 2012	–	20,269	63,604	47,097	76,133	37,755	32,914	1,035	278,807
Certificates of deposit in issue included in:									
- trading liabilities	–	–	–	–	–	–	–	–	–
- financial liabilities designated at fair value	–	–	–	–	–	–	–	–	–
- issued at amortised cost	–	–	–	**6,368**	**4,654**	–	–	–	**11,022**
At 30 June 2013	–	–	–	**6,368**	**4,654**	–	–	–	**11,022**
At 30 June 2012	–	–	459	5,939	6,264	–	–	–	12,662
At 31 December 2012	–	–	–	7,353	3,938	–	–	–	11,291

19 Cash and balances with banks

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Cash in hand	**10,161**	9,933	11,041
Balances with central banks	**4,016**	1,523	8,973
Balances with banks	**5,013**	6,816	7,068
	19,190	18,272	27,082

20 Placings with and advances to banks

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Placings with and advances to banks maturing within one month	**80,620**	63,727	77,367
Placings with and advances to banks maturing after one month but less than one year	**53,392**	72,558	61,316
Placings with and advances to banks maturing after one year	**1,987**	1,663	1,699
	135,999	137,948	140,382
of which:			
Placings with and advances to central banks	**13,971**	11,042	11,757

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

21 Trading assets

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Treasury bills	**28,206**	33,972	26,808
Certificates of deposit	**–**	430	400
Other debt securities	**5,935**	5,815	6,106
Debt securities	**34,141**	40,217	33,314
Investment funds	**25**	22	30
Total trading securities	**34,166**	40,239	33,344
Other*	**343**	798	1,055
Total trading assets	**34,509**	41,037	34,399
Debt securities:			
- listed in Hong Kong	**4,322**	3,330	3,046
- listed outside Hong Kong	**232**	262	238
	4,554	3,592	3,284
- unlisted	**29,587**	36,625	30,030
	34,141	40,217	33,314
Investment funds:			
- listed in Hong Kong	**25**	22	30
Total trading securities	**34,166**	40,239	33,344
Debt securities:			
Issued by public bodies:			
- central governments and central banks	**33,077**	38,016	31,105
- other public sector entities	**69**	81	80
	33,146	38,097	31,185
Issued by other bodies:			
- banks	**581**	909	934
- corporate entities	**414**	1,211	1,195
	995	2,120	2,129
	34,141	40,217	33,314
Investment funds:			
Issued by corporate entities	**25**	22	30
Total trading securities	**34,166**	40,239	33,344

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

22 Financial assets designated at fair value

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Certificates of deposit	**–**	1	–
Other debt securities	**4,228**	3,831	4,047
Debt securities	**4,228**	3,832	4,047
Equity shares	**2,990**	1,356	1,632
Investment funds	**2,932**	2,520	2,664
	10,150	7,708	8,343
Debt securities:			
- listed in Hong Kong	**87**	15	38
- listed outside Hong Kong	**465**	44	336
	552	59	374
- unlisted	**3,676**	3,773	3,673
	4,228	3,832	4,047
Equity shares:			
- listed in Hong Kong	**1,554**	1,356	1,632
- listed outside Hong Kong	**1,408**	–	–
	2,962	1,356	1,632
- unlisted	**28**	–	–
	2,990	1,356	1,632
Investment funds:			
- listed in Hong Kong	**27**	24	30
- listed outside Hong Kong	**741**	476	599
	768	500	629
- unlisted	**2,164**	2,020	2,035
	2,932	2,520	2,664
	10,150	7,708	8,343
Debt securities:			
Issued by public bodies:			
- central governments and central banks	**313**	–	181
- other public sector entities	**46**	4	1
	359	4	182
Issued by other bodies:			
- banks	**3,664**	3,745	3,687
- corporate entities	**205**	83	178
	3,869	3,828	3,865
	4,228	3,832	4,047
Equity shares:			
Issued by banks	**499**	265	370
Issued by public sector entities	**12**	–	13
Issued by corporate entities	**2,479**	1,091	1,249
	2,990	1,356	1,632
Investment funds:			
Issued by banks	**–**	341	400
Issued by corporate entities	**2,932**	2,179	2,264
	2,932	2,520	2,664
	10,150	7,708	8,343

23 Derivative financial instruments

Derivative financial instruments are held for trading, as financial instruments designated at fair value, or designated as either fair value hedges 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 by class of derivatives.

	At 30 June 2013			At 30 June 2012			At 31 December 2012		
	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	543,255	1,802	1,749	657,397	1,585	1,114	607,543	2,865	1,238
- currency swaps	3,095	6	16	3,461	43	41	3,819	21	22
- currency options purchased	170,110	697	–	129,404	466	–	104,562	138	–
- currency options written	171,862	–	686	136,658	–	490	110,249	–	158
- other exchange rate contracts	37	–	–	94	1	2	37	–	1
	888,359	2,505	2,451	927,014	2,095	1,647	826,210	3,024	1,419
Interest rate contracts:									
- interest rate swaps	215,351	1,256	1,060	211,899	1,688	1,525	192,293	1,438	1,292
- other interest rate contracts	582	1	1	–	–	–	128	–	–
	215,933	1,257	1,061	211,899	1,688	1,525	192,421	1,438	1,292
Equity and other contracts:									
- equity swaps	3,143	1	207	3,829	12	108	2,841	125	16
- equity options purchased	8,601	95	–	11,395	109	–	11,732	199	–
- equity options written	2,057	–	80	1,661	–	27	2,018	–	30
- spot and forward contracts and others	1,816	7	24	1,169	43	1	1,023	54	6
	15,617	103	311	18,054	164	136	17,614	378	52
Total derivatives held for trading	1,119,909	3,865	3,823	1,156,967	3,947	3,308	1,036,245	4,840	2,763
Derivatives managed in conjunction with financial assets designated at fair value									
Interest rate contracts:									
- interest rate swaps	–	–	–	–	–	–	–	–	–
Cash flow hedge derivatives									
Exchange rate contracts:									
- currency swaps	4,992	793	38	3,276	–	3	4,263	280	3
Interest rate contracts:									
- interest rate swaps	7,122	9	4	27,286	41	5	10,313	20	2
	12,114	802	42	30,562	41	8	14,576	300	5
Fair value hedge derivatives									
Interest rate contracts:									
- interest rate swaps	28,677	85	952	28,550	75	1,443	27,426	39	1,350
Total derivatives	1,160,700	4,752	4,817	1,216,079	4,063	4,759	1,078,247	5,179	4,118

The above derivative assets and liabilities, being the positive or negative marked-to-market value of the respective derivative contracts, represent gross replacement costs.

24 Loans and advances to customers

(a) Loans and advances to customers

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Gross loans and advances to customers	**581,080**	506,583	537,571
Less: loan impairment allowances			
- individually assessed	**(666)**	(966)	(681)
- collectively assessed	**(709)**	(715)	(728)
	579,705	504,902	536,162

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

	At 30 June 2013	At 30 June 2012	At 31 December 2012
	%	%	%
Loan impairment allowances:			
- individually assessed	**0.11**	0.19	0.13
- collectively assessed	**0.12**	0.14	0.13
Total loan impairment allowances	**0.23**	0.33	0.26

24 Loans and advances to customers *(continued)*

(b) Loan impairment allowances against loans and advances to customers

	Individually assessed	*Collectively assessed*	*Total*
At 1 January 2013	**681**	**728**	**1,409**
Amounts written off	**(18)**	**(246)**	**(264)**
Recoveries of loans and advances written off in previous years (note 11)	**7**	**24**	**31**
New impairment allowances charged to income statement (note 11)	**61**	**324**	**385**
Impairment allowances released to income statement (note 11)	**(64)**	**(123)**	**(187)**
Unwinding of discount of loan impairment allowances recognised as "interest income"	**(3)**	**(1)**	**(4)**
Exchange	**2**	**3**	**5**
At 30 June 2013	**666**	**709**	**1,375**
At 1 January 2012	896	771	1,667
Amounts written off	(58)	(199)	(257)
Recoveries of loans and advances written off in previous years (note 11)	4	25	29
New impairment allowances charged to income statement (note 11)	213	221	434
Impairment allowances released to income statement (note 11)	(85)	(100)	(185)
Unwinding of discount of loan impairment allowances recognised as "interest income"	(3)	(2)	(5)
Exchange	(1)	(1)	(2)
At 30 June 2012	966	715	1,681
At 1 July 2012	966	715	1,681
Amounts written off	(219)	(217)	(436)
Recoveries of loans and advances written off in previous years (note 11)	9	22	31
New impairment allowances charged to income statement (note 11)	81	230	311
Impairment allowances released to income statement (note 11)	(152)	(22)	(174)
Unwinding of discount of loan impairment allowances recognised as "interest income"	(4)	(1)	(5)
Exchange	–	1	1
At 31 December 2012	681	728	1,409

24 Loans and advances to customers *(continued)*

(c) Impaired loans and advances to customers and allowances

	At 30 June 2013	*At 30 June 2012*	*At 31 December 2012*
Gross impaired loans and advances	**1,289**	1,691	1,340
Individually assessed allowances	**(666)**	(966)	(681)
Net impaired loans and advances	**623**	725	659
Individually assessed allowances as a percentage of gross impaired loans and advances	**51.7%**	57.1%	50.8%
Gross impaired loans and advances as a percentage of gross loans and advances to customers	**0.22%**	0.33%	0.25%

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

	At 30 June 2013	*At 30 June 2012*	*At 31 December 2012*
Gross individually assessed impaired loans and advances	**1,131**	1,568	1,190
Individually assessed allowances	**(666)**	(966)	(681)
	465	602	509
Gross individually assessed impaired loans and advances as a percentage of gross loans and advances to customers	**0.19%**	0.31%	0.22%
Amount of collateral which has been taken into account in respect of individually assessed impaired loans and advances to customers	**407**	569	498

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

24 Loans and advances to customers *(continued)*

(d) Overdue loans and advances to customers

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

	At 30 June 2013		At 30 June 2012		At 31 December 2012	
		%		%		%
Gross loans and advances which have been overdue with respect to either principal or interest for periods of:						
- more than three months but not more than six months	**140**	**–**	200	–	114	–
- more than six months but not more than one year	**50**	**–**	252	0.1	143	–
- more than one year	**681**	**0.1**	700	0.1	662	0.2
	871	**0.1**	1,152	0.2	919	0.2
of which:						
- individually impaired allowances	**(564)**		(845)		(515)	
- covered portion of overdue loans and advances	**293**		296		241	
- uncovered portion of overdue loans and advances	**578**		856		678	
- current market value held against the covered portion of overdue loans and advances	**850**		456		373	

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

24 Loans and advances to customers *(continued)*

(e) Rescheduled loans and advances to customers

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

	At 30 June 2013		At 30 June 2012		At 31 December 2012	
		%		%		%
Rescheduled loans and advances to customers	**167**	**–**	161	–	196	–

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

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

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

Loans and advances to customers by geographical area are classified according to the location of the counterparties after taking into account the transfer of risk. In general, risk transfer applies when a loan is guaranteed by a party located in an area that is different from that of the counterparty.

	Gross loans and advances	Individually impaired loans and advances	Overdue loans and advances	Individually assessed allowances	Collectively assessed allowances
At 30 June 2013					
Hong Kong	**467,327**	**886**	**715**	**498**	**545**
Rest of Asia-Pacific	**106,461**	**212**	**150**	**163**	**153**
Others	**7,292**	**33**	**6**	**5**	**11**
	581,080	**1,131**	**871**	**666**	**709**
At 30 June 2012 (restated)					
Hong Kong	428,752	1,292	973	752	560
Rest of Asia-Pacific	72,304	252	133	211	144
Others	5,527	24	46	3	11
	506,583	1,568	1,152	966	715
At 31 December 2012					
Hong Kong	447,310	948	718	503	561
Rest of Asia-Pacific	84,428	218	201	177	156
Others	5,833	24	–	1	11
	537,571	1,190	919	681	728

24 Loans and advances to customers *(continued)*

(g) Gross loans and advances to customers by industry sector

The analysis of gross loans and advances to customers by industry sector based on categories and definitions used by the HKMA is as follows:

	At 30 June 2013	% of gross advances covered by collateral	At 30 June 2012	% of gross advances covered by collateral	At 31 December 2012	% of gross advances covered by collateral
Gross loans and advances to customers for use in Hong Kong						
Industrial, commercial and financial sectors						
- property development	**28,551**	**47.2**	27,927	49.3	29,771	41.5
- property investment	**99,722**	**90.0**	103,178	88.2	103,675	88.8
- financial concerns	**4,566**	**39.5**	3,944	30.5	3,595	32.7
- stockbrokers	**402**	**33.9**	227	22.7	325	44.0
- wholesale and retail trade	**19,850**	**48.4**	15,952	34.9	16,445	37.4
- manufacturing	**17,252**	**36.6**	13,792	34.1	15,212	38.1
- transport and transport equipment	**6,072**	**67.6**	6,082	63.9	5,774	66.0
- recreational activities	**224**	**35.3**	233	35.7	244	45.6
- information technology	**1,968**	**39.7**	1,680	2.0	1,430	45.6
- other	**32,751**	**52.6**	23,102	52.5	26,766	52.7
	211,358	**67.8**	196,117	67.5	203,237	67.1
Individuals						
- loans and advances for the purchase of flats under the Government Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	**13,619**	**100.0**	13,962	100.0	13,886	100.0
- loans and advances for the purchase of other residential properties	**129,733**	**100.0**	115,731	100.0	125,176	100.0
- credit card advances	**20,081**	**–**	18,392	–	20,389	–
- other	**14,333**	**24.9**	13,814	27.3	13,514	25.1
	177,766	**82.6**	161,899	82.4	172,965	82.2
Total gross loans and advances for use in Hong Kong	**389,124**	**74.6**	358,016	74.3	376,202	74.0
Trade finance	**62,892**	**15.3**	42,917	23.1	47,555	18.7
Gross loans and advances for use outside Hong Kong	**129,064**	**31.8**	105,650	27.5	113,814	25.8
Gross loans and advances to customers	**581,080**	**58.7**	506,583	60.2	537,571	58.9

25 Financial investments

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Financial investments:			
- which may be repledged or resold by counterparties	**230**	164	88
- which may not be repledged or resold or are not subject to repledge or resale by counterparties	**263,139**	224,221	253,320
	263,369	224,385	253,408
Held-to-maturity debt securities at amortised cost	**70,935**	64,857	67,631
Available-for-sale at fair value:			
- debt securities	**166,288**	159,231	185,443
- equity shares	**26,103**	255	295
- investment funds	**43**	42	39
	263,369	224,385	253,408
Treasury bills	**75,014**	72,101	98,262
Certificates of deposit	**10,980**	12,425	11,228
Other debt securities	**151,229**	139,562	143,584
Debt securities	**237,223**	224,088	253,074
Equity shares	**26,103**	255	295
Investment funds	**43**	42	39
	263,369	224,385	253,408

There were no overdue debt securities at 30 June 2013 and the comparative periods for the Group. The Group did not hold any asset-backed securities, mortgage-backed securities and collateralised debt obligations.

25 Financial investments *(continued)*

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

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Listed in Hong Kong	**1,431**	1,367	1,616
Listed outside Hong Kong	**13,964**	12,004	13,578
	15,395	13,371	15,194
Unlisted	**55,540**	51,486	52,437
	70,935	64,857	67,631
Issued by public bodies:			
- central governments and central banks	**1,164**	500	808
- other public sector entities	**11,184**	8,529	8,345
	12,348	9,029	9,153
Issued by other bodies:			
- banks	**33,811**	37,401	38,225
- corporate entities	**24,776**	18,427	20,253
	58,587	55,828	58,478
	70,935	64,857	67,631
Fair value of held-to-maturity debt securities:			
- listed	**15,706**	14,426	16,602
- unlisted	**56,680**	54,505	56,114
	72,386	68,931	72,716

There were no held-to-maturity debt securities determined to be impaired at 30 June 2013 and the comparative periods for the Group.

25 Financial investments *(continued)*

(b) Available-for-sale debt securities

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Listed in Hong Kong	**11,245**	17,760	15,009
Listed outside Hong Kong	**32,466**	25,862	34,588
	43,711	43,622	49,597
Unlisted	**122,577**	115,609	135,846
	166,288	159,231	185,443
Issued by public bodies:			
- central governments and central banks	**108,930**	102,007	127,779
- other public sector entities	**16,471**	13,628	15,293
	125,401	115,635	143,072
Issued by other bodies:			
- banks	**37,049**	40,032	38,629
- corporate entities	**3,838**	3,564	3,742
	40,887	43,596	42,371
	166,288	159,231	185,443

For the periods indicated, there were 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 2013	At 30 June 2012	At 31 December 2012
Listed in Hong Kong	**65**	52	65
Listed outside Hong Kong	**25,753**	5	6
	25,818	57	71
Unlisted	**285**	198	224
	26,103	255	295
Issued by banks	**25,753**	5	6
Issued by corporate entities	**350**	250	289
	26,103	255	295

For the periods indicated, there were no available-for-sale equity securities individually determined to be impaired for the Group.

25 Financial investments *(continued)*

(d) Available-for-sale investment funds

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Unlisted	**43**	42	39
Issued by corporate entities	**43**	42	39

For the periods indicated, there were no available-for-sale investment funds individually determined to be impaired for the Group.

(e) The following table presents an analysis of debt securities by rating agency designation at the balance sheet dates, 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 2013	At 30 June 2012	At 31 December 2012
AA- to AAA	**184,183**	170,992	183,420
A- to A+	**43,799**	43,052	61,001
B+ to BBB+	**6,872**	7,571	6,161
Unrated	**2,369**	2,473	2,492
	237,223	224,088	253,074

26 Interest in associates

	At 30 June 2013	*At 30 June 2012*	*At 31 December 2012*
Share of net assets	**2,597**	21,082	24,151
Intangible assets	**15**	43	29
Goodwill	**141**	472	475
	2,753	21,597	24,655

Interest in Industrial Bank Co., Ltd. ("Industrial Bank") was reclassified from "Interest in associates" to "Financial investment" following the completion of Industrial Bank's private placement of additional share capital to third parties on 7 January 2013.

27 Investment properties

	Half-year ended 30 June 2013	*Half-year ended 30 June 2012*	*Half-year ended 31 December 2012*
Beginning of the period	**4,860**	4,314	4,583
Additions	**4,683**	–	–
Disposals	**–**	–	–
Surplus on revaluation credited to income statement	**1,147**	238	504
Transfer to assets held for sale	**–**	–	(228)
Transfer (to)/from premises (note 28)	**(143)**	31	1
End of the period	**10,547**	4,583	4,860
Representing:			
- measure at valuation	**10,547**	4,583	4,860

28 Premises, plant and equipment

Movement of premises, plant and equipment

	Premises	*Plant and equipment*	*Total*
Cost or valuation:			
At 1 January 2013	**18,748**	**3,751**	**22,499**
Exchange adjustments	**15**	**12**	**27**
Additions	**36**	**94**	**130**
Disposals	**(3)**	**(71)**	**(74)**
Elimination of accumulated depreciation on revalued premises	**(266)**	**–**	**(266)**
Surplus on revaluation:			
- credited to premises revaluation reserve	**1,526**	**–**	**1,526**
- debited to income statement	**(3)**	**–**	**(3)**
Transfer from investment properties (note 27)	**143**	**–**	**143**
At 30 June 2013	**20,196**	**3,786**	**23,982**
Accumulated depreciation:			
At 1 January 2013	**–**	**(3,237)**	**(3,237)**
Exchange adjustments	**–**	**(8)**	**(8)**
Charge for the period (note 12)	**(266)**	**(110)**	**(376)**
Written off on disposal	**–**	**63**	**63**
Elimination of accumulated depreciation on revalued premises	**266**	**–**	**266**
At 30 June 2013	**–**	**(3,292)**	**(3,292)**
Net book value at 30 June 2013	**20,196**	**494**	**20,690**
Representing:			
- measure at cost	**–**	**494**	**494**
- measure at valuation	**20,196**	**–**	**20,196**
	20,196	**494**	**20,690**

28 Premises, plant and equipment *(continued)*

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

	Premises	*Plant and equipment*	*Total*
Cost or valuation:			
At 1 January 2012	17,377	3,686	21,063
Exchange adjustments	(5)	(2)	(7)
Additions	–	100	100
Disposals	–	(53)	(53)
Elimination of accumulated depreciation on revalued premises	(237)	–	(237)
Surplus on revaluation:			
- credited to premises revaluation reserve	839	–	839
Transfer to assets held for sale	(241)	–	(241)
Transfer to investment properties (note 27)	(31)	–	(31)
Other	–	(17)	(17)
At 30 June 2012	17,702	3,714	21,416
Accumulated depreciation:			
At 1 January 2012	(7)	(3,073)	(3,080)
Exchange adjustments	–	1	1
Charge for the period (note 12)	(242)	(139)	(381)
Written off on disposal	–	49	49
Transfer to assets held for sale	2	–	2
Elimination of accumulated depreciation on revalued premises	237	–	237
Other	–	6	6
At 30 June 2012	(10)	(3,156)	(3,166)
Net book value at 30 June 2012	17,692	558	18,250
Representing:			
- measure at cost	–	558	558
- measure at valuation	17,692	–	17,692
	17,692	558	18,250

28 Premises, plant and equipment *(continued)*

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

	Premises	*Plant and equipment*	*Total*
Cost or valuation:			
At 1 July 2012	17,702	3,714	21,416
Exchange adjustments	5	2	7
Additions	–	114	114
Disposals	–	(54)	(54)
Elimination of accumulated depreciation on revalued premises	(260)	–	(260)
Surplus on revaluation:			
- credited to premises revaluation reserve	1,383	–	1,383
Transfer to assets held for sale	(81)	–	(81)
Transfer to investment properties (note 27)	(1)	–	(1)
Other	–	(25)	(25)
At 31 December 2012	18,748	3,751	22,499
Accumulated depreciation:			
At 1 July 2012	(10)	(3,156)	(3,166)
Exchange adjustments	–	(1)	(1)
Charge for the period (note 12)	(250)	(131)	(381)
Written off on disposal	–	51	51
Elimination of accumulated depreciation on revalued premises	260	–	260
At 31 December 2012	–	(3,237)	(3,237)
Net book value at 31 December 2012	18,748	514	19,262
Representing:			
- measure at cost	–	514	514
- measure at valuation	18,748	–	18,748
	18,748	514	19,262

29 Intangible assets

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Present value of in-force long-term insurance business	**6,625**	5,802	6,003
Internally developed software	**390**	426	400
Acquired software	**59**	46	51
Goodwill	**329**	329	329
	7,403	6,603	6,783

30 Other assets

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Items in the course of collection from other banks	**5,540**	5,333	5,642
Prepayments and accrued income	**3,245**	2,975	2,999
Assets held for sale			
- repossessed assets	**4**	23	16
- assets of disposal groups held for sale	**–**	686	–
- other assets held for sale	**–**	250	593
Acceptances and endorsements	**6,057**	5,076	5,264
Retirement benefit assets	**42**	30	31
Other accounts	**2,702**	2,147	2,036
	17,590	16,520	16,581

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

31 Current, savings and other deposit accounts

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Current, savings and other deposit accounts:			
- as stated in consolidated balance sheet	**779,884**	720,397	769,147
- structured deposits reported as trading liabilities (note 32)	**39,990**	37,764	38,113
	819,874	758,161	807,260
By type:			
- demand and current accounts	**68,142**	59,187	68,071
- savings accounts	**483,341**	453,716	495,880
- time and other deposits	**268,391**	245,258	243,309
	819,874	758,161	807,260

32 Trading liabilities

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Structured certificates of deposit in issue (note 33)	**–**	–	–
Other debt securities in issue (note 33)	**1,312**	1,009	248
Structured deposits (note 31)	**39,990**	37,764	38,113
Short positions in securities and others	**26,447**	18,591	21,492
	67,749	57,364	59,853

33 Certificates of deposit and other debt securities in issue

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Certificates of deposit and other debt securities in issue:			
- as stated in consolidated balance sheet	**11,022**	12,662	11,291
- structured certificates of deposit in issue reported as trading liabilities (note 32)	**–**	–	–
- other structured debt securities in issue reported as trading liabilities (note 32)	**1,312**	1,009	248
	12,334	13,671	11,539
By type:			
- certificates of deposit in issue	**11,022**	12,662	11,291
- other debt securities in issue	**1,312**	1,009	248
	12,334	13,671	11,539

34 Other liabilities

	At 30 June 2013	At 30 June 2012	At 31 December 2012
Items in the course of transmission to other banks	**8,034**	6,538	8,153
Accruals	**3,052**	2,404	3,248
Acceptances and endorsements	**6,057**	5,076	5,264
Retirement benefit liabilities	**1,682**	3,494	2,449
Liabilities of disposal groups held for sale	**–**	646	–
Other	**2,049**	2,311	2,539
	20,874	20,469	21,653

35 Subordinated liabilities

Nominal value	Description	**At 30 June 2013**	At 30 June 2012	At 31 December 2012
Amount owed to third parties				
US$300m	Callable floating rate subordinated notes due July 2017[1]	**–**	2,326	–
Amount owed to HSBC Group undertakings				
US$775m	Floating rate subordinated loan debt due December 2020[2]	**6,011**	6,011	6,007
US$450m	Floating rate subordinated loan debt due July 2021[3]	**3,491**	3,490	3,488
US$300m	Floating rate subordinated loan debt due July 2022[1&4]	**2,327**	–	2,326
		11,829	11,827	11,821
Representing:				
- measured at amortised cost		**11,829**	11,827	11,821

[1] *The Bank exercised its option to redeem these subordinated notes at par of US$300m and replenished them with a new issue of US$300m subordinated loan debt in July 2012.*

[2] *Interest rate at three-month US dollar LIBOR plus 1.79 per cent, payable quarterly, to the maturity date.*

[3] *Interest rate at three-month US dollar LIBOR plus 2.05 per cent, payable quarterly, to the maturity date.*

[4] *Interest rate at three-month US dollar LIBOR plus 4.06 per cent, payable quarterly, to the maturity date.*

The outstanding subordinated loan debts, which qualify as supplementary capital, serve to help the Bank maintain a balanced capital structure and support business growth.

36 Shareholders' funds

	At 30 June 2013	*At 30 June 2012*	*At 31 December 2012*
Share capital	**9,559**	9,559	9,559
Retained profits	**76,633**	54,623	59,683
Premises revaluation reserve	**14,628**	12,811	13,790
Cash flow hedging reserve	**2**	9	17
Available-for-sale investment reserve			
- on debt securities	**(141)**	(176)	(57)
- on equity securities	**(2,743)**	247	284
Capital redemption reserve	**99**	99	99
Other reserves	**1,941**	4,970	5,124
Total reserves	**90,419**	72,583	78,940
	99,978	82,142	88,499
Proposed dividends	**2,103**	2,103	3,824
Shareholders' funds	**102,081**	84,245	92,323
Return on average shareholders' funds	**35.9%**	22.8%	22.9%

The available-for-sale investment reserve for equity securities recorded a deficit of HK$2,743m compared with a surplus of HK$284m at the year-end of 2012, mainly caused by the share price of Industrial Bank being lower at 30 June 2013 than on reclassification as a financial investment (note 25) on 7 January 2013. Changes in the fair value of the Bank's investment in Industrial Bank are recognised in the available-for-sale investment reserve unless the investment becomes impaired. If the investment becomes impaired, the cumulative revaluation deficit would be reclassified from the available-for-sale investment reserve to the income statement. The Group will continue to perform an impairment review of its investment in Industrial Bank at each balance sheet date in accordance with the Group's accounting policy on impairment of available-for-sale financial assets.

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 2013, the effect of this requirement is to restrict the amount of reserves which can be distributed by the Group to shareholders by HK$5,213m (HK$4,639m and HK$4,866m at 30 June 2012 and 31 December 2012 respectively).

37 Reconciliation of cash flow statement

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

	Half-year ended 30 June 2013	Half-year ended 30 June 2012 (restated)
Operating profit	**8,934**	7,975
Net interest income	**(8,969)**	(8,286)
Dividend income	**(4)**	(4)
Loan impairment charges	**198**	249
Depreciation	**376**	381
Amortisation of intangible assets	**57**	61
Amortisation of available-for-sale investments	**49**	(23)
Loans and advances written off net of recoveries	**(233)**	(228)
Movement in present value of in-force long-term insurance business	**(622)**	(614)
Interest received	**10,794**	9,553
Interest paid	**(2,306)**	(2,128)
Operating profit before changes in working capital	**8,274**	6,936
Change in treasury bills and certificates of deposit with original maturity more than three months	**7,728**	8,317
Change in placings with and advances to banks maturing after one month	**7,923**	(23,232)
Change in trading assets	**2,537**	15,510
Change in financial assets designated at fair value	**–**	140
Change in derivative financial instruments	**1,126**	558
Change in loans and advances to customers	**(43,428)**	(24,345)
Change in other assets	**(6,020)**	(5,583)
Change in current, savings and other deposit accounts	**10,737**	20,540
Change in deposits from banks	**(4,101)**	(3,123)
Change in trading liabilities	**7,896**	(2,348)
Change in certificates of deposit and other debt securities in issue	**(269)**	3,378
Change in other liabilities	**3,541**	5,109
Elimination of exchange differences and other non-cash items	**5,444**	1,294
Cash generated from operating activities	**1,388**	3,151
Taxation recovered/(paid)	**5**	(73)
Net cash inflow from operating activities	**1,393**	3,078

37 Reconciliation of cash flow statement *(continued)*

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

	At 30 June 2013	At 30 June 2012
Cash and balances with banks	**19,190**	18,272
Placings with and advances to banks maturing within one month	**78,729**	61,347
Treasury bills	**9,931**	57,494
Certificates of deposit	**–**	965
	107,850	138,078

The balances of cash and cash equivalents included cash balances with central banks and placings with banks maturing within one month that are subject to exchange control and regulatory restrictions, amounting to HK$21,972m at 30 June 2013 (HK$18,705m at 30 June 2012).

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 HKMA by the Group. The return is prepared on a consolidated basis as specified by the HKMA 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 balance sheet 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$6,057m (HK$5,076m and HK$5,264m at 30 June 2012 and 31 December 2012 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 balance sheet date; 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 mark-to-market assets with any negative mark-to-market liabilities with the same customer. These offsets are recognised by the HKMA in the calculation of risk-weighted assets for the capital adequacy ratio.

The risk-weighted assets were calculated based on the "advanced internal ratings-based approach".

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

	Contract amounts	Credit equivalent amounts	Risk-weighted amounts
At 30 June 2013			
Direct credit substitutes	**6,973**	**6,747**	**3,253**
Transaction-related contingencies	**1,546**	**156**	**58**
Trade-related contingencies	**14,443**	**1,514**	**796**
Forward asset purchases	**32**	**32**	**32**
Undrawn formal standby facilities, credit lines and other commitments to lend:			
- not unconditionally cancellable*	**34,121**	**15,346**	**6,489**
- unconditionally cancellable	**247,537**	**81,705**	**22,708**
	304,652	**105,500**	**33,336**
Exchange rate contracts:			
- spot and forward foreign exchange	**449,358**	**2,740**	**777**
- currency swaps	**7,336**	**672**	**98**
- currency options purchased	**170,110**	**6,045**	**5,556**
- other exchange rate contracts	**37**	**1**	**–**
	626,841	**9,458**	**6,431**
Interest rate contracts:			
- interest rate swaps	**251,150**	**1,802**	**555**
- interest rate options purchased	**–**	**–**	**–**
- other interest rate contracts	**194**	**–**	**–**
	251,344	**1,802**	**555**
Equity and other contracts:			
- equity swaps	**3,143**	**192**	**25**
- equity options purchased	**2,055**	**199**	**157**
- others	**–**	**–**	**–**
	5,198	**391**	**182**

* *The contract amounts for undrawn formal standby facilities, credit lines and other commitments to lend with original maturity of "up to one year" and "over one year" as at 30 June 2013 were HK$6,652m and HK$27,469m respectively (30 June 2012: HK$12,957m and HK$23,695m, 31 December 2012: HK$8,336m and HK$24,925m).*

The total fair value of the derivatives at 30 June 2013 was HK$2,439m (30 June 2012: HK$2,008m, 31 December 2012: HK$2,965m) after taking into account the effect of valid bilateral netting agreement amounting to HK$1,780m (30 June 2012: HK$1,650m, 31 December 2012: HK$1,641m).

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

	Contract amounts	*Credit equivalent amounts*	*Risk-weighted amounts*
At 30 June 2012			
Direct credit substitutes	6,548	6,390	3,858
Transaction-related contingencies	1,402	140	57
Trade-related contingencies	11,339	1,136	677
Forward asset purchases	27	27	27
Undrawn formal standby facilities, credit lines and other commitments to lend:			
- not unconditionally cancellable*	36,652	16,448	7,233
- unconditionally cancellable	251,487	81,094	25,160
	307,455	105,235	37,012
Exchange rate contracts:			
- spot and forward foreign exchange	565,496	2,376	651
- currency swaps	6,738	299	51
- currency options purchased	129,388	3,001	2,525
- other exchange rate contracts	94	3	–
	701,716	5,679	3,227
Interest rate contracts:			
- interest rate swaps	267,734	2,378	529
- interest rate options purchased	–	–	–
	267,734	2,378	529
Equity and other contracts:			
- equity swaps	3,829	248	34
- equity options purchased	1,659	127	87
- others	–	–	–
	5,488	375	121

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

	Contract amounts	*Credit equivalent amounts*	*Risk-weighted amounts*
At 31 December 2012			
Direct credit substitutes	7,259	7,041	3,805
Transaction-related contingencies	1,250	128	54
Trade-related contingencies	11,548	1,181	696
Forward asset purchases	51	51	51
Undrawn formal standby facilities, credit lines and other commitments to lend:			
- not unconditionally cancellable*	33,261	15,258	6,189
- unconditionally cancellable	247,891	82,049	24,909
	301,260	105,708	35,704
Exchange rate contracts:			
- spot and forward foreign exchange	544,790	4,197	728
- currency swaps	7,330	481	58
- currency options purchased	104,578	1,874	1,487
- other exchange rate contracts	37	–	–
	656,735	6,552	2,273
Interest rate contracts:			
- interest rate swaps	230,032	2,121	472
- interest rate options purchased	–	–	–
	230,032	2,121	472
Equity and other contracts:			
- equity swaps	2,841	300	42
- equity options purchased	2,015	152	101
- others	–	–	–
	4,856	452	143

39 Fair value of financial instruments

(a) Determination of fair value

		Valuation techniques				
	Quoted market price Level 1	*Using observable inputs Level 2*	*With significant non-observable inputs Level 3*	*Third party total*	*Amounts with HSBC entities**	*Total*
At 30 June 2013						
Assets						
Trading assets	**32,894**	**1,615**	**–**	**34,509**	**–**	**34,509**
Financial assets designated at fair value	**4,195**	**1,982**	**524**	**6,701**	**3,449**	**10,150**
Derivative financial instruments	**421**	**3,952**	**2**	**4,375**	**377**	**4,752**
Available-for-sale financial investments	**110,738**	**81,411**	**285**	**192,434**	**–**	**192,434**
Liabilities						
Trading liabilities	**26,448**	**40,939**	**362**	**67,749**	**–**	**67,749**
Financial liabilities designated at fair value	**–**	**466**	**–**	**466**	**–**	**466**
Derivative financial instruments	**59**	**3,451**	**–**	**3,510**	**1,307**	**4,817**
At 30 June 2012						
Assets						
Trading assets	38,113	2,924	–	41,037	–	41,037
Financial assets designated at fair value	1,968	1,652	497	4,117	3,591	7,708
Derivative financial instruments	500	3,182	67	3,749	314	4,063
Available-for-sale financial investments	88,043	71,287	198	159,528	–	159,528
Liabilities						
Trading liabilities	18,591	38,480	293	57,364	–	57,364
Financial liabilities designated at fair value	–	443	–	443	–	443
Derivative financial instruments	42	3,804	–	3,846	913	4,759

39 Fair value of financial instruments *(continued)*

(a) Determination of fair value (continued)

	Valuation techniques					
	Quoted market price Level 1	*Using observable inputs Level 2*	*With significant non-observable inputs Level 3*	*Third party total*	*Amounts with HSBC entities**	*Total*
At 31 December 2012						
Assets						
Trading assets	30,930	3,469	–	34,399	–	34,399
Financial assets designated at fair value	2,545	1,874	478	4,897	3,446	8,343
Derivative financial instruments	325	4,278	161	4,764	415	5,179
Available-for-sale financial investments	112,245	73,308	224	185,777	–	185,777
Liabilities						
Trading liabilities	21,492	38,226	135	59,853	–	59,853
Financial liabilities designated at fair value	–	464	–	464	–	464
Derivative financial instruments	63	3,398	–	3,461	657	4,118

* *Included structured instruments and derivative contracts transacted with HSBC entities which were mainly classified within level 2 of the valuation hierarchy.*

During the six months ended 30 June 2013, there were no material movements between Level 1 and Level 2.

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk-taker. To this end, ultimate responsibility for the determination of fair values lies with Finance. Finance establishes the accounting policies and procedures governing valuation, and is responsible for ensuring that these comply with all relevant accounting standards.

For fair values determined using a valuation model, the control framework may include, as applicable, independent development or validation of valuation models, independent determination or validation of valuation model inputs and any adjustments required outside of the valuation model, and, where possible, independent validation of model outputs. For fair values determined without a valuation mode, there is independent price determination or validation.

39 Fair value of financial instruments *(continued)*

(a) Determination of fair value (continued)

Determination of fair value of financial instruments carried at fair value

Fair values are determined according to the following hierarchy:

(i) Level 1: Quoted market price
Financial instruments with quoted prices for identical instruments in active markets that the Group can assess at the measurement date.

(ii) Level 2: Valuation technique using observable inputs
Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

(iii) Level 3: Valuation technique with significant unobservable inputs
Financial instruments valued using models where one or more significant inputs are unobservable.

The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The majority of valuation techniques employ only observable market data. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are not observable. For these instruments, the fair value derived is more judgemental. "Not observable" in this context means that there is little or no current market data available from which to determine the level at which an arm's length transaction would likely occur, but it generally does not mean that there is absolutely no market data available upon which to base a determination of fair value (historical data may, for example, be used).

- *Debt securities, Treasury and eligible bills, and Equities*

These instruments are valued based on quoted market prices from an exchange, dealer, broker, industry group or pricing service, where available. Where unavailable, fair value is determined by reference to quoted market prices for similar instruments, or in the case of certain unquoted equities, valuation techniques using inputs derived from observable and unobservable market data.

- *Structured notes*

The fair value of structured notes valued using a valuation technique is derived from the fair value of the underlying debt security, and the fair value of the embedded derivative is determined as described in the paragraph below on derivatives.

Trading liabilities valued using a valuation technique with significant unobservable inputs principally comprised equity-linked structured notes, which are issued by the Group and provide the counterparty with a return that is linked to the performance of certain equity securities, and other portfolios. The notes are classified as level 3 due to the unobservability of parameters such as foreign exchange volatilities, long-dated equity volatilities and correlations between equity prices, between equity prices and interest rates and between interest rates and foreign exchange rates.

39 Fair value of financial instruments *(continued)*

(a) Determination of fair value (continued)

Determination of fair value of financial instruments carried at fair value (continued)

- Derivatives

OTC (i.e. non-exchange traded) derivatives are valued using valuation models. Valuation models calculate the present value of expected future cash flows, based upon "no-arbitrage" principles. For many vanilla derivative products, such as interest rate swaps and European options, the modelling approaches used are standard across the industry. For more complex derivative products, there may be some discrepancies in practice. Inputs to valuation models are determined from observable market data wherever possible, including prices available from exchanges, dealers, brokers or providers of consensus pricing. Certain inputs may not be observable in the market directly, but can be determined from observable prices via model calibration procedures. Finally, some inputs are not observable, but can generally be estimated from historical data or other sources.

Examples of inputs that are generally observable include foreign exchange spot and forward rates, benchmark interest rate curves and volatility surfaces for commonly traded option products. Examples of inputs that may be unobservable include volatility surfaces, in whole or in part, for less commonly traded option products, and correlations between market factors, such as foreign exchange rates, interest rates and equity prices.

Financial instruments measured at fair value using a valuation technique with significant unobservable inputs - Level 3

	Assets				*Liabilities*		
	Available-for-sale	*Held for trading*	*Designated at fair value through profit or loss*	*Derivatives*	*Held for trading*	*Designated at fair value through profit or loss*	*Derivatives*
At 30 June 2013							
Private equity	**285**	**–**	**520**	**–**	**–**	**–**	**–**
Structured notes	**–**	**–**	**–**	**–**	**362**	**–**	**–**
Other portfolios (bonds)	**–**	**–**	**4**	**–**	**–**	**–**	**–**
Derivatives	**–**	**–**	**–**	**2**	**–**	**–**	**–**
	285	**–**	**524**	**2**	**362**	**–**	**–**
At 30 June 2012							
Private equity	198	–	492	–	–	–	–
Structured notes	–	–	–	–	293	–	–
Other portfolios (bonds)	–	–	5	–	–	–	–
Derivatives	–	–	–	67	–	–	–
	198	–	497	67	293	–	–
At 31 December 2012							
Private equity	224	–	478	–	–	–	–
Structured notes	–	–	–	–	135	–	–
Other portfolios (bonds)	–	–	–	–	–	–	–
Derivatives	–	–	–	161	–	–	–
	224	–	478	161	135	–	–

39 Fair value of financial instruments *(continued)*

(a) Determination of fair value (continued)

Quantitative information about significant unobservable inputs in level 3 valuations

	Fair value at 30 June 2013	*Valuation technique(s)*	*Unobservable input(s)*	*Range (weighted average)*
Assets				
Private equity	805	Net asset value*	N/A	N/A
		Market-comparable companies	Earnings Multiple	17 - 25 (21)
Other portfolios (bonds)	4	Broker pricing	Bid Quotes	HK$4m - HK$5m (HK$4.5m)
Derivatives	2	Option model	Equity Volatility	5.42% - 120.18%
			FX Volatility	10.92% - 15.21%
Liabilities				
Structured notes	362	Option model	FX Volatility	8.80% - 17.49%
			Equity and Equity Index Correlation	0.523 - 0.607

* *The Group has determined that the reported net asset value represents fair value at the end of the reporting period.*

39 Fair value of financial instruments *(continued)*

(a) Determination of fair value (continued)

Movement in Level 3 financial instruments

	Assets				Liabilities		
	Available-for-sale	*Held for trading*	*Designated at fair value through profit or loss*	*Derivatives*	*Held for trading*	*Designated at fair value through profit or loss*	*Derivatives*
At 1 January 2013	224	–	478	161	135	–	–
Total gains or losses recognised in profit and loss							
- net interest income	–	–	–	–	–	–	–
- trading income	–	–	–	(82)	–	–	–
- net income from other financial instruments designated at fair value	–	–	36	–	–	–	–
- dividend income	–	–	–	–	–	–	–
- gains less losses from financial investments	–	–	–	–	–	–	–
Total gains or losses recognised in other comprehensive income							
- fair value gains/(losses)	61	–	–	–	–	–	–
- exchange differences	–	–	–	–	–	–	–
Purchases	–	–	40	–	–	–	–
Issues/deposit taking	–	–	–	–	–	–	–
Sales	–	–	(7)	–	–	–	–
Settlements	–	–	(9)	(60)	227	–	–
Transfers out	–	–	(18)	(17)	–	–	–
Transfers in	–	–	4	–	–	–	–
At 30 June 2013	285	–	524	2	362	–	–
Unrealised gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of the reporting period	4	–	35	2	(1)	–	–

39 Fair value of financial instruments *(continued)*

(a) Determination of fair value (continued)

Movement in Level 3 financial instruments (continued)

	Assets				*Liabilities*		
	Available-for-sale	*Held for trading*	*Designated at fair value through profit or loss*	*Derivatives*	*Held for trading*	*Designated at fair value through profit or loss*	*Derivatives*
At 1 January 2012	150	–	634	71	523	–	–
Total gains or losses recognised in profit and loss	–	–	39	(4)	2	–	–
Total gains or losses recognised in other comprehensive income	48	–	–	–	–	–	–
Purchases	–	–	69	–	–	–	–
Issues/deposit taking	–	–	–	–	298	–	–
Sales	–	–	(199)	–	–	–	–
Settlements	–	–	(5)	–	(432)	–	–
Transfers out	–	–	(41)	–	(98)	–	–
Transfers in	–	–	–	–	–	–	–
Exchange adjustments	–	–	–	–	–	–	–
At 30 June 2012	198	–	497	67	293	–	–
Total gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of the reporting period	4	–	36	(4)	–	–	–

39 Fair value of financial instruments *(continued)*

(a) ***Determination of fair value*** *(continued)*

Movement in Level 3 financial instruments (continued)

	Assets				Liabilities		
	Available-for-sale	*Held for trading*	*Designated at fair value through profit or loss*	*Derivatives*	*Held for trading*	*Designated at fair value through profit or loss*	*Derivatives*
At 1 July 2012	198	–	497	67	293	–	–
Total gains or losses recognised in profit and loss	–	–	(17)	94	4	–	–
Total gains or losses recognised in other comprehensive income	26	–	–	–	–	–	–
Purchases	–	–	89	–	–	–	–
Issues/deposit taking	–	–	–	–	117	–	–
Sales	–	–	(6)	–	–	–	–
Settlements	–	–	(81)	–	(221)	–	–
Transfers out	–	–	(4)	–	(58)	–	–
Transfers in	–	–	–	–	–	–	–
Exchange adjustments	–	–	–	–	–	–	–
At 31 December 2012	224	–	478	161	135	–	–
Total gains or losses recognised in profit or loss relating to those assets and liabilities held at the end of the reporting period	10	–	(16)	94	–	–	–

Transfers between levels of the fair value hierarchy are deemed to occur at the end of the reporting period.

Transfer out of Level 3 in respect of derivatives assets reflects change in observability of equity volatilities during the period. In respect of financial assets designated at fair value, transfer into Level 3 was due to change in valuation observability of certain debt securities, while the transfer out of Level 3 was due to change in portfolio mix of private equity investments.

39 Fair value of financial instruments *(continued)*

(a) Determination of fair value *(continued)*

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

The fair value of investment funds is determined using net asset value where the fair value measurement is positively correlated to the net asset value of the funds. As at 30 June 2013, with other variables held constant, it is estimated that an increase/decrease in the net asset value of the investment funds by 10% would have increased/decreased the Group's profit by HK$52m.

The fair values of unlisted available-for-sale equity shares are determined with reference to multiples of comparable listed companies, such as average of the price/earning ratios of comparables, or net asset value if comparables are not available. The fair value measurement is positively correlated to the price/earning ratios or net asset values. Had the highest price/earning ratio among the comparables been used as at 30 June 2013, the Group's other comprehensive income would have increased by HK$19m.

The fair value of bonds held in other portfolios has immaterial effects on the Group's profit due to its insignificant balance as at 30 June 2013. All derivatives and structured notes with embedded options are fully hedged. A change in the inputs of the valuation methodologies would thus have no effect to the Group's profit.

As discussed above, the fair value of financial instruments are, in certain circumstances, measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data. The following table shows the sensitivity of these fair values to reasonably possible alternative assumptions:

39 Fair value of financial instruments *(continued)*

(a) ***Determination of fair value*** *(continued)*

Sensitivity of fair values to reasonably possible alternative assumptions

	Reflected in profit or loss		*Reflected in other comprehensive income*	
	Favourable changes	*Unfavourable changes*	*Favourable changes*	*Unfavourable changes*
At 30 June 2013				
Private equity	**52**	**(52)**	**19**	**(19)**
Structured notes	**–**	**–**	**–**	**–**
Other portfolios (bonds)	**–**	**–**	**–**	**–**
Derivatives	**–**	**–**	**–**	**–**
	52	**(52)**	**19**	**(19)**
At 30 June 2012				
Private equity	49	(49)	20	(20)
Structured notes	–	–	–	–
Other portfolios (bonds)	–	–	–	–
Derivatives	4	(4)	–	–
	53	(53)	20	(20)
At 31 December 2012				
Private equity	48	(48)	22	(22)
Structured notes	–	–	–	–
Other portfolios (bonds)	–	–	–	–
Derivatives	3	(3)	–	–
	51	(51)	22	(22)

When the fair value of a financial instrument is affected by more than one unobservable assumption, the above table reflects the most favourable or the most unfavourable change from varying the assumptions individually.

39 Fair value of financial instruments *(continued)*

(a) ***Determination of fair value*** *(continued)*

Fair value of financial instruments not carried at fair value

The accounting policies which determine the classification of financial instruments and the use of assumptions and estimation in valuing them are described in note 4, of the Annual Report and Financial Statements for 2012.

The calculation of fair value incorporates the Group's estimate of the amount at which financial assets could be exchanged, or financial liabilities settled, between knowledgeable, willing parties in an arm's length transaction. It does not reflect the economic benefits and costs that the Group expects to flow from the instruments' cash flows over their expected future lives. Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available, so comparisons of fair values between entities may not be meaningful and users are advised to exercise caution when using this data.

The basis for measuring the fair values of loans and advances to customers, financial investments, deposits and customer accounts and debt securities in issue and subordinated liabilities are explained in the note 63(a) of the Annual Report and Financial Statements for 2012.

The following table lists financial instruments whose carrying amount is a reasonable approximation of fair value because, for example, they are short-term in nature or reprice to current market rates frequently:

Assets

Cash and balances at central banks
Items in the course of collection from other banks
Endorsements and acceptances
Short-term receivables within "Other assets"
Accrued income

Liabilities

Items in the course of transmission to other banks
Endorsements and acceptances
Short-term payables within "Other liabilities"
Accruals

39 Fair value of financial instruments *(continued)*

(b) Fair value

The following table provides an analysis of the fair value of financial instruments not measured at fair value in the balance sheet. For all other instruments, the fair value is equal to the carrying value:

	At 30 June 2013		*At 30 June 2012*		*At 31 December 2012*	
	Carrying amount	***Fair value***	*Carrying amount*	*Fair value*	*Carrying amount*	*Fair value*
Financial Assets						
Placings with and advances to banks	**135,999**	**135,955**	137,948	137,918	140,382	140,535
Loans and advances to customers	**579,705**	**575,953**	504,902	499,138	536,162	532,884
Held-to-maturity debt securities	**70,935**	**72,386**	64,857	68,931	67,631	72,716
Financial Liabilities						
Current, savings and other deposit accounts	**779,884**	**779,982**	720,397	720,432	769,147	769,223
Deposits from banks	**15,790**	**15,790**	11,284	11,284	19,845	19,845
Certificates of deposit and other debt securities in issue	**11,022**	**11,043**	12,662	12,667	11,291	11,317
Subordinated liabilities	**11,829**	**13,939**	11,827	13,328	11,821	14,107

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 2012, 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 4 March 2013. The Annual Report and Financial Statements for the year ended 31 December 2012, 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 19 "Employee Benefits", 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 2013.

42 Change in accounting treatment for Industrial Bank Co., Ltd. ("Industrial Bank")

On 7 January 2013, Industrial Bank completed a private placement of additional share capital to a number of third parties, thereby diluting the Group's equity holding from 12.8% to 10.9%. As a result of this and other factors, the Group considered it was no longer in a position to exercise significant influence over Industrial Bank and ceased to account for the investment as an associate (note 26) from that date, giving rise to an accounting gain on reclassification of Industrial Bank of HK$9,517m for the first half of 2013. The accounting gain included the deemed disposal profit on reclassification of Industrial Bank of HK$8,454m and the release of deferred tax amounted to HK$1,063m.

Thereafter, the holding in Industrial Bank is being recognised as a financial investment (note 25) in the balance sheet of the Group with any subsequent movement in its fair value reflected in accordance with current applicable HKFRS. At 30 June 2013, there was a revaluation deficit on the investment in Industrial Bank recorded in the "available-for-sale investment reserve", reflecting the decline in its fair value below the deemed cost upon reclassification based on the share price on 4 January 2013. The change in fair value of the Bank's investment in Industrial Bank is recognised in the available-for-sale investment reserve unless the investment becomes impaired. If the investment becomes impaired, the cumulative revaluation deficit would be reclassified from the available-for-sale investment reserve to the income statement.

The Group will continue to perform an impairment review of its investment in Industrial Bank at each balance sheet date in accordance with the Group's accounting policy on impairment of available-for-sale financial assets. Dividends from Industrial Bank are recognised in the Group's consolidated income statement. This change has been incorporated and reflected in the Group's 2013 interim results.

Financial implication of change in accounting treatment on Industrial Bank:

From 2013 onwards, the reclassification of Industrial Bank and the change in accounting treatment will result in an increase in the Group's dividend income, subject to the amount of dividend to be declared by Industrial Bank and a decrease in the share of profit from associates. The share of profit from Industrial Bank was HK$2,364m in the first half of 2012.

Since there are significant financial implications as a result of the change in accounting treatment for Industrial Bank, the key financial results and performance metrics are not directly comparable when comparing the first half of 2013 with 2012. For the sake of comparison, we have prepared the following key financial results and performance metrics by excluding the non-distributable accounting gain in the first half of 2013 and the share of Industrial Bank's profit in the first half of 2012.

42 Change in accounting treatment for Industrial Bank Co., Ltd. ("Industrial Bank") *(continued)*

	As Reported			Excluding Industrial Bank reclassification		
	Half-year ended 30 June 2013	*Half-year ended 30 June 2012*	*Change**	**Half-year ended 30 June 2013**	*Half-year ended 30 June 2012*	*Change**
Attributable profit	**18,468**	9,253	99.6%	**8,951**	7,044	27.1%
Profit before tax	**18,773**	10,600	77.1%	**10,319**	8,236	25.3%
Return on average shareholders' funds (%)	**35.9**	22.8	13.1pp	**19.0**	17.4	1.6pp
Return on average total assets (%)	**3.4**	1.9	1.5pp	**1.7**	1.4	0.3pp
Earnings per share (HK$)	**9.66**	4.84	99.6%	**4.68**	3.68	27.2%

* *Change in "pp" represents change in percentage points.*

43 Property revaluation

The Group's premises and investment properties were revalued at 30 June 2013 by DTZ Debenham Tie Leung Limited. The valuation was carried out by qualified persons who are members of the Hong Kong Institute of Surveyors. The basis of the valuation of property was market value which is consistent with the definition of fair value under HKFRS 13 Fair Value Measurement and taken into account the highest and best use of the property from the perspective of market participants. The highest and best use takes into account the use of the property that is physically possible, legally permissible and financially feasible as described in HKFRS 13. The net revaluation surplus for Group premises amounted to HK$1,523m, of which HK$1,526m was credited to the premises revaluation reserve and HK$3m was debited to the income statement. Revaluation gains of HK$1,147m on investment properties were recognised through the income statement. The related deferred tax provisions for Group premises was HK$253m.

The revaluation exercise also covered business premises and investment properties reclassified as properties held for sale. The revaluation gain of HK$136m was recognised through the income statement.

44 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.

To the Board of Directors of Hang Seng Bank Limited
(Incorporated in Hong Kong with limited liability)

Introduction

We have reviewed the interim financial report set out on pages 16 to 77 which comprises the consolidated balance sheet of Hang Seng Bank Limited ("the Bank") as of 30 June 2013 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 2013 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

5 August 2013

These notes set out on pages 79 to 102 are supplementary to and should be read in conjunction with the consolidated financial statements set out on pages 16 to 77. The consolidated financial statements and these supplementary notes taken together comply with the Banking (Disclosure) Rules ("Disclosure Rules") made under section 60A of the Banking Ordinance, as amended by the Banking (Disclosure) (Amendment) Rules 2013 which came into operation on 30 June 2013.

1 Basis of preparation

(a) Except where indicated otherwise, the financial information contained in these supplementary notes has been prepared on a consolidated basis in accordance with Hong Kong Financial Reporting Standards. Some parts of these supplementary notes, however, are required by the Disclosure Rules to be prepared on a different basis. In such cases, the Disclosure Rules require that certain information is prepared on a basis which 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 2013 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 exposures continually by means of reliable and up-to-date management information systems. The Group's risk management policies and major risk appetite or risk control limits are approved by the Board of Directors and they are monitored and reviewed regularly by various Board or management committees, including the Executive Committee, Risk Committee, Asset and Liability Management Committee ("ALCO") and Risk Management Committee ("RMC").

Risk appetite limit is a key component of our management of risk. The Bank's Risk Appetite Statement for 2013 was approved by the Board as advised by the Risk Committee ("RC"), which describes the types and amount of risk that the Bank is prepared to accept taking into consideration of our financial capacity and business strategy.

Our risk appetite framework is underpinned by the following core principles:

- Strong balance sheet and brand
- Healthy capital position
- Accountable use of shareholders' funds
- Conservative liquidity management
- Risk must be commensurate with returns
- Sustainable long term growth

2 Financial Risk Management *(continued)*

These core principles are applied to define the risk appetite limits on a Bank-wide and individual risk and business level, which cover key risk types and exposures that are faced by the Bank's business activities. The Bank's Risk Management Committee undertook regular reviews and monitors the Bank's risk profile against the limits set out in the Risk Appetite Statement and determine appropriate management action if material deviation from approved limits. Reports are submitted to the Risk Committee and Board from Chief Risk Officer on the actual profile of the Risk Appetite Statement including material deviation and management action where required.

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

(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, and treasury businesses. The Group has dedicated standards, policies and procedures in place to control and monitor risk from all such activities.

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

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

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 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.

2 Financial Risk Management *(continued)*

(a) Credit risk *(continued)*

Risk rating framework

A 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 approach will allow a more granular analysis of risk and trends. The information generated from the risk rating framework is mainly, but not exclusively 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 properties, securities, investment funds and deposits;
- in the commercial and industrial sector, charges over business assets such as properties, stock, debtors, investment funds, deposits and machinery; and
- in the commercial real estate sector, charges over the properties being financed.

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

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

Settlement risk

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

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

2 Financial Risk Management *(continued)*

(a) Credit risk *(continued)*

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 instruments 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

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

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 and funding 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 on a regular basis. This process includes:

- maintaining within relevant regulatory requirements of the reporting entity;
- projecting cash flows under various stress scenarios and considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet liquidity and advances to core funding ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- managing the concentration and profile of debt maturities;
- managing contingent liquidity commitment exposures within pre-determined limits;
- managing debt financing plans;
- monitoring of depositor concentration in order to avoid undue reliance on large individual depositors and ensuring a satisfactory overall funding mix; and
- maintaining liquidity and funding 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)*

Primary sources of funding

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 management of funding and liquidity risk

Inherent liquidity risk categorisation

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

Core deposits

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

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

- price: any deposit priced significantly above market or benchmark rates is generally treated as entirely non-core;
- size: depositors with total balances above certain monetary thresholds, the excess balances are classified as non-core. Thresholds are established by considering the business line and inherent liquidity risk categorisation; and
- line of business: the element of any deposit remaining after the application of the price and size filter is assessed on the basis of the line of business to which the deposit is associated. The proportion of any customer deposit that can be considered as core under this filter is between 35% and 90%.

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

Advances to core funding ratio

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

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

2 Financial Risk Management *(continued)*

(b) Liquidity risk (continued)

The management of funding and liquidity risk *(continued)*

Stressed coverage ratio

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

The stressed cash inflows include:

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

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

A stressed coverage ratio of 100% or higher reflects a positive cumulative cash flow up to three months being monitored by the Group under the combined market-wide and institution-specific stress scenario.

Compliance with liquidity and funding requirements is monitored by ALCO on a regular basis.

Liquidity behaviouralisation

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

Contingent liquidity risk

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

Contingency funding plan

A contingency funding plan ("LCP") is reviewed and approved by ALCO and the Board at least annually with an objective to ensure the Group can cope with a crisis by having practical and operational plan in place. The LCP states the options available to the Group for garnering liquidity and funding and an agreed course of action should there be an unexpected crisis. It is a real practical tool that can be used to manage liquidity during a crisis event. The LCP includes detailed action steps and properly assigned responsibilities. To serve as a guideline for the Crisis Management Team and its support team to evaluate the liquidity crisis situation and execute action steps during the crisis, the LCP consists of a sound Balance Sheet maturity analysis and spells out all potential funding sources with due consideration of their reliability, priority and the lead time during crisis. It also estimates liquidity shortfalls and liquid assets inflow from stress tests performed by the Bank under institution-specific, market-wide and combined stress scenarios.

2 Financial Risk Management *(continued)*

(b) Liquidity risk (continued)

The management of funding and liquidity risk *(continued)*

Liquidity ratio under the Hong Kong Banking Ordinance

The Hong Kong Banking Ordinance also requires banks operating in Hong Kong to maintain a minimum liquidity ratio. 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 2013	*Half-year ended 30 June 2012*	*Half-year ended 31 December 2012*
The Bank and its subsidiaries designated by the Hong Kong Monetary Authority ("HKMA")	**35.8%**	36.9%	36.8%

(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, customer-related business, proprietary position-taking and strategic foreign exchange. 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 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.

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 1-year period. The actual number of excesses over this period can therefore be used to gauge how well the models are performing.

Apart from the standard 1-day VAR mentioned above, the Group has introduced stressed VAR since the start of 2012 according to the Basel 2.5 requirement. Stressed VAR is the measure of VAR using a specific, continuous one-year period of stress for the trading portfolio, assuming a 10-day holding period with a 99 per cent level of confidence.

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)*

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

The Group's VAR, both trading, non-trading and stressed VAR for trading. The total positions of all interest rate risk and foreign exchange risk positions and on individual risk portfolios during the first halves of 2013 and 2012 are shown in the table below:

Value at risk

	At 30 June 2013	***Minimum during the period***	***Maximum during the period***	***Average for the period***
Total VAR	**34**	**22**	**60**	**36**
Total trading VAR	**12**	**4**	**14**	**7**
VAR for foreign exchange risk (trading)	**11**	**3**	**15**	**6**
VAR for interest rate risk:				
- trading	**4**	**3**	**9**	**5**
- non-trading	**28**	**24**	**37**	**28**
Stressed VAR				
Total trading VAR	**60**	**14**	**63**	**34**
VAR for foreign exchange risk (trading)	**26**	**7**	**35**	**16**
VAR for interest rate risk:				
- trading	**44**	**16**	**64**	**37**

	At 30 June 2012	*Minimum during the period*	*Maximum during the period*	*Average for the period*
Total VAR	55	40	92	56
Total trading VAR	23	5	23	11
VAR for foreign exchange risk (trading)	4	2	8	5
VAR for interest rate risk:				
- trading	23	4	23	10
- non-trading	23	19	29	24
Stressed VAR				
Total trading VAR	104	20	104	53
VAR for foreign exchange risk (trading)	10	5	34	17
VAR for interest rate risk:				
- trading	103	14	106	49

The average daily revenue earned from market risk-related treasury activities for the first half of 2013, including non-trading book net interest income and funding related to trading positions, was HK$15m (HK$16m for the first half of 2012). The standard deviation of these daily revenues was HK$8m (HK$10m for the first half of 2012).

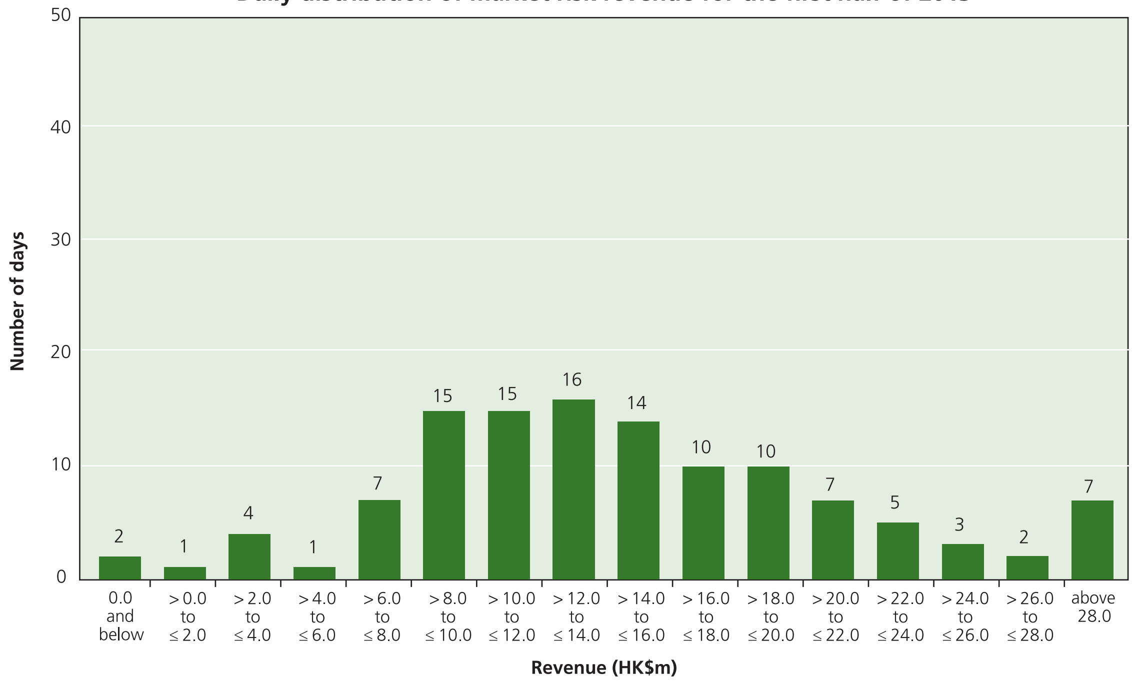
2 Financial Risk Management *(continued)*

(c) Market risk *(continued)*

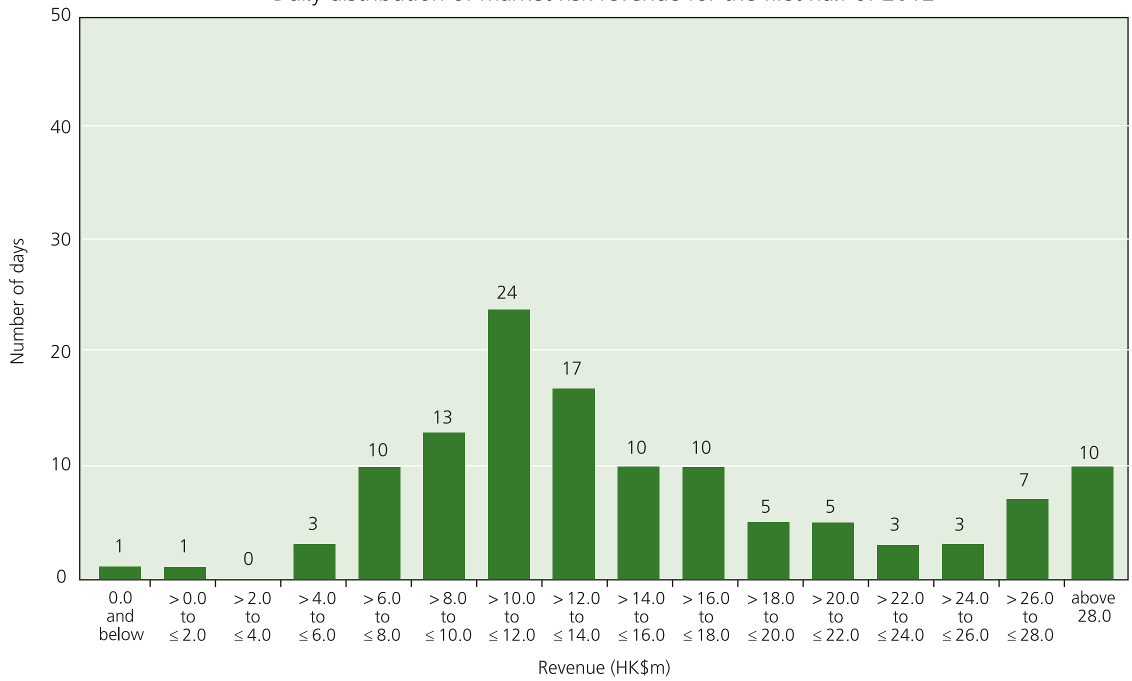
Value at risk ("VAR") *(continued)*

An analysis of the frequency distribution of daily revenue shows that out of 119 trading days for the first half of 2013 (122 trading days for the first half of 2012), losses were recorded on 2 days (1 day for the first half of 2012), and maximun daily loss was HK$10m (daily loss of HK$3m was recorded for the first half of 2012). The most frequent result was a daily revenue of between HK$6m and HK$20m, with 87 occurrences (89 occurrences for the first half of 2012). The highest daily revenue was HK$49m (HK$69m for the first half of 2012).

Daily distribution of market risk revenue for the first half of 2013



Daily distribution of market risk revenue for the first half of 2012



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 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 arises from the different 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 the ALCO is usually achieved by a series of internal deals between the business units and these books. When the behavioural characteristics of a product differ from its contractual characteristics, the behavioural characteristics are assessed to determine the true underlying interest rate risk. ALCO regularly monitors all such behavioural assumptions and interest rate risk positions, to ensure they comply with interest rate risk limits established by 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. The net options position is calculated on the basis of delta-weighted positions of all foreign exchange options contracts. Structural foreign exchange positions arising from capital investment in associates, subsidiaries, branches and the fair value of the Group's long-term foreign currency equity investment, mainly in US dollar and Chinese renminbi as set out below, are managed by the ALCO.

At 30 June 2013, the US dollar ("US$"), Chinese renminbi ("RMB"), Australian dollar ("AUD") and Japanese Yen ("JPY") 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.

2 Financial Risk Management *(continued)*

(c) Market risk (continued)

Foreign exchange exposure *(continued)*

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

	US$	*RMB*	*AUD*	*JPY*	*Other foreign currencies*	*Total foreign currencies*
At 30 June 2013						
Non-structural position						
Spot assets	**173,526**	**147,750**	**44,328**	**6,417**	**51,559**	**423,580**
Spot liabilities	**(154,308)**	**(128,555)**	**(49,486)**	**(3,194)**	**(55,661)**	**(391,204)**
Forward purchases	**271,887**	**113,794**	**10,107**	**11,096**	**20,646**	**427,530**
Forward sales	**(292,423)**	**(129,830)**	**(5,115)**	**(13,937)**	**(16,482)**	**(457,787)**
Net options position	**753**	**(156)**	**(209)**	**(48)**	**(375)**	**(35)**
Net long/(short) non-structural position	**(565)**	**3,003**	**(375)**	**334**	**(313)**	**2,084**
Structural position	**205**	**34,011**	**–**	**–**	**478**	**34,694**
At 30 June 2012						
Non-structural position						
Spot assets	169,003	102,668	47,817	40,998	56,680	417,166
Spot liabilities	(136,120)	(104,599)	(51,536)	(5,404)	(58,663)	(356,322)
Forward purchases	319,178	87,915	10,458	15,039	21,044	453,634
Forward sales	(351,333)	(84,961)	(6,601)	(50,658)	(19,078)	(512,631)
Net options position	142	(114)	(24)	–	(7)	(3)
Net long/(short) non-structural position	870	909	114	(25)	(24)	1,844
Structural position	205	26,935	–	–	387	27,527
At 31 December 2012						
Non-structural position						
Spot assets	160,217	119,957	50,739	23,957	69,491	424,361
Spot liabilities	(144,015)	(112,827)	(50,157)	(2,141)	(56,493)	(365,633)
Forward purchases	301,222	83,737	8,503	11,182	14,889	419,533
Forward sales	(313,787)	(90,096)	(9,028)	(33,069)	(27,827)	(473,807)
Net options position	160	(142)	82	(19)	(55)	26
Net long/(short) non-structural position	3,797	629	139	(90)	5	4,480
Structural position	205	30,375	–	–	434	31,014

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 of different level of equity capital on shareholder returns and seeks to maintain a prudent balance between advantages and flexibility provided by a strong capital position and higher returns on equity through greater leverage.

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

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

The principal forms of capital are included in the following balances on the consolidated balance sheet: called up share capital, retained profits, other reserves and subordinated liabilities. Capital also includes the collectively assessed impairment allowances held in respect of loans and advances and the regulatory reserve as allowed under Banking (Capital) Rules.

Externally imposed capital requirements:

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

Basel II enhancements (commonly known as Basel 2.5) took effect from 1 January 2012. The main changes include raising banks' capital requirements for trading and securitisation exposures, providing supplemental guidance on risk management principles and strengthening disclosure in corresponding areas. The resulting effect was an increase in risk-weighted assets for market risk.

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

In December 2010, the Basel Committee on Banking Supervision ("BCBS") issued two documents: A global regulatory framework for more resilient banks and banking systems and International framework for liquidity risk measurement, standards and monitoring, which together are commonly referred to as "Basel III". In June 2011, the BCBS issued a revision to the former document setting out the finalised capital treatment for counterparty credit risk in bilateral trades.

2 Financial Risk Management *(continued)*

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

The Basel III rules set out the minimum Common equity tier 1 ("CET1") requirement of 4.5% and additional capital conservation buffer requirement of 2.5%, to be phased in sequentially from 1 January 2013, becoming fully effective on 1 January 2019. Any additional countercyclical capital buffer requirements will also be phased in, starting in 2016 to a maximum level of 2.5% effective on 1 January 2019, although individual jurisdictions may choose to implement larger countercyclical capital buffers. In addition to the criteria detailed in the Basel III documents, the BCBS issued further minimum requirements in January 2011 to ensure that all classes of capital instruments are able to absorb losses at the point of non-viability before taxpayers are exposed to loss. Instruments issued on or after 1 January 2013 may only be included in regulatory capital if the new requirements are met. The capital treatment of instruments issued prior to this date will be phased out over a 10-year period commencing on 1 January 2013.

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

The Banking (Capital) (Amendment) Rules 2012, effective on 1 January 2013, signified the first phase of Basel III requirements in Hong Kong. The changes in minimum capital ratio requirements are phased in from 1 January 2013 to 1 January 2019, while the capital treatment for counterparty credit risk is effective from 1 January 2013. The definition of regulatory capital under Basel III is different from that under Basel II which was used at 31 December 2012. The capital disclosures for June 2013 are, therefore, not directly comparable with the disclosures for December 2012 prepared under Basel II basis. Certain comparative figures have not been provided where the current year is the first year of disclosure.

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

The Bank and its subsidiaries maintain a regulatory reserve to satisfy the provisions of the Banking Ordinance and local regulatory requirements for prudential supervision purposes. At 30 June 2013, the effect of this requirement is to restrict the amount of reserves which can be distributed to shareholders by HK$5,213m (31 December 2012: HK$4,866m).

There are no relevant capital shortfalls in any of the Group's subsidiaries as at 30 June 2013 (31 December 2012: nil) which are not included in the Group's consolidation for regulatory purposes.

2 Financial Risk Management *(continued)*

(d) Capital management (continued)

(i) Capital adequacy

a. Capital structure

	At 30 June 2013
Common Equity Tier 1 ("CET1") Capital	
Shareholders' equity	**93,464**
- Shareholders' equity per balance sheet	**102,081**
- Unconsolidated subsidiaries	**(8,617)**
Regulatory deductions to CET1 capital	**(40,027)**
- Cash flow hedging reserve	**(3)**
- Changes in own credit risk on fair valued liabilities	**(109)**
- Goodwill and intangible assets	**(565)**
- Regulatory reserve	**(5,213)**
- Reserves arising from revaluation of property[1]	**(20,019)**
- Valuation adjustments	**(219)**
- Excess AT1 deductions	**(13,899)**
Total CET1 Capital	**53,437**
Additional Tier 1 ("AT1") Capital	
Total AT1 capital before regulatory deductions	**–**
Regulatory deductions to AT1 capital	**–**
- Significant capital investments in unconsolidated financial sector entities	**(13,899)**
- Excess AT1 deductions	**13,899**
Total AT1 Capital	**–**
Total Tier 1 ("T1") Capital	**53,437**
Tier 2 ("T2") Capital	
Total T2 capital before regulatory deductions	**22,344**
- Term subordinated debt	**10,880**
- Property revaluation reserves[1]	**9,009**
- Impairment allowances and regulatory reserve eligible for inclusion in T2 capital	**2,455**
Regulatory deductions to T2 capital	**(13,899)**
- Significant capital investments in unconsolidated financial sector entities	**(13,899)**
Total T2 capital	**8,445**
Total Capital	**61,882**

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

2 Financial Risk Management *(continued)*

(d) Capital management *(continued)*

(i) Capital adequacy *(continued)*

b. Risk-weighted assets by risk type

	At 30 June 2013
Credit risk	**350,616**
Market risk	**2,534**
Operational risk	**39,361**
Total	**392,511**

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

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

	At 30 June 2013
CET1 capital ratio	**13.6%**
Tier 1 capital ratio	**13.6%**
Total capital ratio	**15.8%**

d. Capital instruments

The following is a summary of the Group's CET1 and Tier 2 capital instruments.

	At 30 June 2013
CET1 capital instruments issued by the Bank	
Ordinary shares:	
1,911,842,736 issued and fully paid ordinary shares of HK$5 each	**9,559**
Tier 2 capital instruments	
Issued by the Bank:	
Subordinated loan due 2020 (nominal value: US$775m)	**6,011**
Subordinated loan due 2021 (nominal value: US$450m)	**3,491**
Subordinated loan due 2022 (nominal value: US$300m)	**2,327**

e. Additional information

To comply with the Banking (Disclosure) Rules ("BDR"), the Group will establish a new section "Regulatory Disclosure" on its website to house all the information relating to the disclosure of regulatory capital instruments and the reconciliation to the Group's published financial statements.

The disclosure will be published before 30 September 2013 according to the BDR and will include the following information:

– A description of the main features and the full terms and conditions of the Group's capital instruments can be viewed on our website: www.hangseng.com.

– A detailed breakdown of the Group's CET1 capital, AT1 capital, T2 capital and regulatory deductions, using the standard template as specified by the HKMA, can be viewed on our website: www.hangseng.com.

– A full reconciliation between the Group's accounting and regulatory balance sheets, using the standard template as specified by the HKMA, can be viewed on our website: www.hangseng.com.

2 Financial Risk Management *(continued)*

(d) Capital management (continued)

(i) Capital adequacy *(continued)*

The capital base after deductions used in the calculation of capital adequacy ratios and reported to HKMA for 30 June 2012 and 31 December 2012 is analysed as follows:

	At 30 June 2012	*At 31 December 2012*
Core capital:		
Paid-up ordinary share capital	9,559	9,559
- Reserves per balance sheet	72,583	78,940
- Unconsolidated subsidiaries	(8,359)	(8,872)
- Cash flow hedging reserve	(9)	(17)
- Regulatory reserve	(4,639)	(4,866)
- Reserves arising from revaluation of property and unrealised gains on available-for-sale equities and debt securities	(17,347)	(18,936)
Total reserves included in core capital	42,229	46,249
- Goodwill and intangible assets	(987)	(965)
- 50% of unconsolidated investments	(12,395)	(13,683)
- 50% of securitisation positions and other deductions	(158)	(158)
Deductions	(13,540)	(14,806)
Total core capital	38,248	41,002
Supplementary capital:		
- Term subordinated debt	11,827	11,821
- Property revaluation reserves[1]	5,894	5,894
- Available-for-sale investments revaluation reserves[2]	155	183
- Regulatory reserve[3]	325	303
- Collective impairment allowances[3]	50	46
- Excess impairment allowances over expected losses[4]	1,651	1,727
Supplementary capital before deductions	19,902	19,974
- 50% of unconsolidated investments	(12,395)	(13,683)
- 50% of securitisation positions and other deductions	(158)	(158)
Deductions	(12,553)	(13,841)
Total supplementary capital	7,349	6,133
Capital base	45,597	47,135

2 Financial Risk Management *(continued)*

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

(i) Capital adequacy *(continued)*

	At 30 June 2012	*At 31 December 2012*
Risk-weighted assets		
- credit risk	286,786	295,743
- market risk	4,003	2,447
- operational risk	36,502	37,827
	327,291	336,017
- Capital adequacy ratio	13.9%	14.0%
- Core capital ratio	11.7%	12.2%
Reserves and deductible items		
Published reserves	38,275	39,152
Profit and loss account	3,954	7,097
Total reserves included in core capital	42,229	46,249
Total of items deductible 50% from core capital and 50% from supplementary capital	25,106	27,682

[1] *Includes the revaluation surplus on investment properties which is reported as part of retained profits and adjustments made in accordance with the Capital Rules.*

[2] *Includes adjustments made in accordance with the Capital Rules.*

[3] *Total regulatory reserve and collective impairment allowances are apportioned between the standardised approach and internal ratings-based approach in accordance with the Capital Rules. Those apportioned to the standardised approach are included in supplementary capital. Those apportioned to the internal ratings-based approach are excluded from supplementary capital.*

[4] *Excess impairment allowances over expected losses are applicable to non-securitisation exposures calculated by using the internal ratings-based approach.*

2 Financial Risk Management *(continued)*

(d) Capital management *(continued)*

(ii) Principal subsidiaries and basis of consolidation

Scope of regulatory consolidation

The basis of consolidation for financial accounting purposes is in accordance with Hong Kong Financial Reporting Standards ("HKFRS"), as described in Note 3 on the notes to the financial statements.

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

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

A list of these subsidiaries is shown below:

		At 30 June 2013	
in HKD thousands	*Principal activities*	*Total assets*	*Total equity*
Hang Seng (Nominee) Ltd	Nominee service	98	87
Hang Seng Bank (Trustee) Ltd	Trustee service	5,499	3,000
Hang Seng Futures Ltd	Futures brokerages	102,669	101,696
Hang Seng Investment Management Ltd	Fund management	597,889	556,270
Hang Seng Investment Services Ltd	Provision of investment commentaries	8,682	8,682
Hang Seng Securities Ltd	Stockbroking	3,051,147	1,527,627
Hang Seng Insurance Co. Ltd	Retirement benefits and life assurance	95,522,010	7,509,136
Hang Seng Insurance (Bahamas) Ltd	Insurance business	49,275	49,256
Hang Seng Bank Trustee International Ltd	Trust business	16,533	11,339

As at 30 June 2013, there are no subsidiaries which are included within both the accounting scope of consolidation and the regulatory scope of consolidation but the method of consolidation differs.

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

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

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 loans and 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 2013				
Residential mortgages	**156,616**	**120**	**(5)**	**(3)**
Commercial, industrial and international trade	**165,426**	**910**	**(643)**	**(485)**
Commercial real estate	**77,678**	**–**	**–**	**(4)**
Other property-related lending	**84,203**	**42**	**(2)**	**(13)**
At 30 June 2012				
Residential mortgages	139,017	120	(1)	(23)
Commercial, industrial and international trade	123,317	1,309	(942)	(538)
Commercial real estate	60,840	11	–	(4)
Other property-related lending	92,851	66	(6)	(18)
At 31 December 2012				
Residential mortgages	150,812	137	(2)	(16)
Commercial, industrial and international trade	137,259	939	(662)	(558)
Commercial real estate	72,379	8	–	(5)
Other property-related lending	85,821	54	(3)	(17)

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 Disclosure Rules with reference to the HKMA return for non-bank Mainland exposures, which include 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 2013				
Mainland entities	**39,265**	**9,105**	**48,370**	**–**
Companies and individuals outside Mainland where the credit is granted for use in Mainland	**25,608**	**2,673**	**28,281**	**45**
Other counterparties where the exposure is considered by the Bank to be non-bank Mainland exposure	**155**	**–**	**155**	**–**
	65,028	**11,778**	**76,806**	**45**
Exposures incurred by the Bank's mainland subsidiary	**55,619**	**10,987**	**66,606**	**171**
	120,647	**22,765**	**143,412**	**216**
At 30 June 2012				
Mainland entities	39,909	4,273	44,182	–
Companies and individuals outside Mainland where the credit is granted for use in Mainland	21,800	4,424	26,224	312
Other counterparties where the exposure is considered by the Bank to be non-bank Mainland exposure	137	–	137	–
	61,846	8,697	70,543	312
Exposures incurred by the Bank's mainland subsidiary	48,501	6,492	54,993	200
	110,347	15,189	125,536	512
At 31 December 2012				
Mainland entities	40,979	8,320	49,299	–
Companies and individuals outside Mainland where the credit is granted for use in Mainland	22,458	3,580	26,038	132
Other counterparties where the exposure is considered by the Bank to be non-bank Mainland exposure	130	–	130	–
	63,567	11,900	75,467	132
Exposures incurred by the Bank's mainland subsidiary	52,730	7,950	60,680	176
	116,297	19,850	136,147	308

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, 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 2013				
Asia-Pacific excluding Hong Kong:				
- China	**86,390**	**–**	**50,871**	**137,261**
- Japan	**12,873**	**–**	**8,402**	**21,275**
- Other	**42,924**	**2,701**	**17,150**	**62,775**
	142,187	**2,701**	**76,423**	**221,311**
The Americas:				
- United States	**3,482**	**–**	**5,771**	**9,253**
- Other	**5,672**	**1,511**	**15,568**	**22,751**
	9,154	**1,511**	**21,339**	**32,004**
Europe:				
- United Kingdom	**7,987**	**–**	**2,853**	**10,840**
- Other	**19,216**	**6,928**	**8,932**	**35,076**
	27,203	**6,928**	**11,785**	**45,916**
At 30 June 2012				
Asia-Pacific excluding Hong Kong:				
- China	81,362	–	41,592	122,954
- Japan	14,210	–	38,170	52,380
- Other	44,250	2,061	13,897	60,208
	139,822	2,061	93,659	235,542
The Americas:				
- United States	5,240	–	4,263	9,503
- Other	8,634	1,652	13,329	23,615
	13,874	1,652	17,592	33,118
Europe:				
- United Kingdom	10,849	–	1,933	12,782
- Other	17,772	3,552	7,963	29,287
	28,621	3,552	9,896	42,069

6 Cross-border claims *(continued)*

	Banks & other financial institutions	*Public sector entities*	*Sovereign & other*	*Total*
At 31 December 2012				
Asia-Pacific excluding Hong Kong:				
- China	78,682	–	37,256	115,938
- Japan	14,763	–	26,004	40,767
- Other	46,810	1,356	16,125	64,291
	140,255	1,356	79,385	220,996
The Americas:				
- United States	3,997	–	4,615	8,612
- Other	9,317	1,680	18,139	29,136
	13,314	1,680	22,754	37,748
Europe:				
- United Kingdom	11,091	–	5,928	17,019
- Other	20,296	5,408	13,725	39,429
	31,387	5,408	19,653	56,448

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 (including the one who has ceased to be a Director during the first six months of 2013) who have confirmed that they have complied with the Bank's Code for Securities Transactions by Directors throughout the six months ended 30 June 2013.

Changes in Directors' Biographical Details

Changes in Directors' biographical details since the date of the Annual Report 2012 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

Cessation of appointments
- China.com Inc(1) (Chairman)
- Hong Kong Mercantile Exchange Limited (Independent Non-executive Director)

Ms Rose LEE Wai Mun

New appointments
- Guangdong's Association for Promotion of Cooperation between Guangdong, Hongkong & Macao (Vice-Chairman of the Finance Professional Committee)
- Hong Kong Trade Development Council (Member of the Financial Services Advisory Committee)
- The Community Chest of Hong Kong (Board Member and Co-chairman of the Campaign Committee)

Cessation of appointment
- Hong Kong General Chamber of Commerce (Vice-Chairman of the China Committee)

Dr John CHAN Cho Chak GBS, JP

Cessation of appointment
- Sir Edward Youde Memorial Fund (Chairman of the Council)

Ms CHIANG Lai Yuen JP

New appointment
- Hang Seng Bank Limited(1) (Member of Remuneration Committee)

Mr Andrew FUNG Hau Chung JP

New appointment
- Independent Commission on Remuneration for Members of the Executive Council and the Legislature, and Officials under the Political Appointment System of HKSAR Government (Member)

Cessation of appointment
- The Federation of Hong Kong Industries (Member of General Committee)

Ms Anita FUNG Yuen Mei BBS

Cessation of appointment

- Hong Kong Trade Development Council (Member of the Financial Services Advisory Committee)

Dr Eric LI Ka Cheung GBS, OBE, JP

Cessation of appointments

- Bank of Communications Co., Ltd.[(1)] (Independent Non-executive Director and Chairman of Audit Committee)
- HKSAR Commission on Strategic Development (Member)
- The Financial Reporting Council (Convenor of Financial Reporting Review Committee)

Mr Richard TANG Yat Sun BBS, JP

New appointment

- Customs and Excise Service Children's Education Trust Fund Investment Advisory Board (Chairman)

Cessation of appointment

- Customs and Excise Service Children's Education Trust Fund Committee (Chairman)

Mr Peter WONG Tung Shun JP

New appointment

- The Hongkong and Shanghai Banking Corporation Limited (Deputy Chairman)

Cessation of appointment

- Greater Pearl River Delta Business Council (Member)

Mr Michael WU Wei Kuo

New appointments

- Hang Seng Bank Limited[(1)] (Member of Nomination Committee)
- Hongkong Land Holdings Limited[(1)] (Director)

Notes:

(1) The securities of these companies are listed on a securities market in Kong Kong or overseas.

(2) 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

As at 30 June 2013, the interests of the Directors and Alternate Chief Executives in the shares, underlying shares of equity derivatives and debentures of the Bank and its associated corporations (all within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) disclosed in accordance with the Listing Rules were detailed below.

Interests in shares

	Personal Interests (held as beneficial owner)	Family Interests (interests of spouse or child under 18)	Corporate Interests (interests of controlled corporation)	Other Interests	Total Interests	Total Interests as % of the relevant issued share capital
Number of ordinary shares of HK$5 each in the Bank						
Director:						
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	57,814	–	–	–	57,814	0.00
Ms Rose W M Lee	157,548	1,420	–	34,116[(5)]	193,084	0.00
Dr John C C Chan	24,605[(1)]	–	–	–	24,605	0.00
Mr Andrew H C Fung	59,888	–	–	33,064[(5)]	92,952	0.00
Ms Anita Y M Fung	390,873	–	–	310,906[(5)]	701,779	0.00
Ms Sarah C Legg	85,494	2,008	–	74,613[(5)]	162,115	0.00
Dr Eric K C Li	–	44,198	–	–	44,198	0.00
Mrs Dorothy K Y P Sit	80,853[(2)]	1,031	–	29,098[(5)]	110,982	0.00
Mr Peter T S Wong	858,922	18,724	–	744,987[(5)]	1,622,633	0.00
Alternate Chief Executives:						
Mr Nixon L S Chan	42,882	–	–	21,682[(5)]	64,564	0.00
Mr Christopher H N Ho	98,045	47,731	–	7,250[(5)]	153,026	0.00
Mr Donald Y S Lam	33,619	–	–	19,458[(5)]	53,077	0.00
Mr Andrew W L Leung	6,697	–	–	3,450[(5)]	10,147	0.00
Number of perpetual non-cumulative preference shares of US$0.01 each in HSBC Holdings plc						
Director:						
Ms Rose W M Lee	–	–	–	306,075[(3)]	306,075	0.20

Interests in debentures of associated corporations of the Bank

Name of debenture	Name of Director	Personal Interests (held as beneficial owner)	Family Interests (interests of spouse or child under 18)	Corporate Interests (interests of controlled corporation)	Other Interests	Total Interests
8.00% perpetual subordinated capital securities, series 2 issued by HSBC Holdings plc	Ms Rose W M Lee	–	–	–	US$7,651,875[(3)]	US$7,651,875
4.75% senior notes, due on 15 July 2013 and issued by HSBC Finance Corporation	Ms Anita Y M Fung	US$1 million[(4)]	–	–	–	US$1 million
5% senior notes, due on 30 June 2015 and issued by HSBC Finance Corporation	Ms Anita Y M Fung	US$3 million	–	–	–	US$3 million

Notes:

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

(2) 8,046 shares were jointly held by Mrs Dorothy K Y P Sit and her husband.

(3) Ms Rose W M Lee was a beneficiary of a trust, which had interests in the total principal amount of US$7,651,875 of the 8.00% perpetual subordinated capital securities, series 2. These perpetual subordinated capital securities were exchangeable at the option of HSBC Holdings plc to 306,075 perpetual non-cumulative preference shares of US$0.01 each in HSBC Holdings plc. Ms Lee's interests set out in the table under "Interests in shares" and the table under "Interests in debentures of associated corporations of the Bank" represented the same interests.

(4) These senior notes were due on 15 July 2013, and Ms Anita Y M Fung ceased to have interests in such senior notes with effect from the same day.

(5) 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:			
Ms Rose W M Lee	–	34,116	34,116
Mr Andrew H C Fung	4,197	28,867	33,064
Ms Anita Y M Fung	4,197	306,709	310,906
Ms Sarah C Legg	10,267	64,346	74,613
Mrs Dorothy K Y P Sit	–	29,098	29,098
Mr Peter T S Wong	–	744,987	744,987
Alternate Chief Executives:			
Mr Nixon L S Chan	4,533	17,149	21,682
Mr Christopher H N Ho	3,443	3,807	7,250
Mr Donald Y S Lam	11,082	8,376	19,458
Mr Andrew W L Leung	–	3,450	3,450

Options

As at 30 June 2013, 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 2013	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:						
Mr Andrew H C Fung	4,197	–	HK$37.8797	29 Apr 2009	1 Aug 2014	31 Jan 2015
Ms Anita Y M Fung	4,197	–	HK$37.8797	29 Apr 2009	1 Aug 2014	31 Jan 2015
Ms Sarah C Legg	–	2,295[1]	£6.0216	2 May 2003	2 May 2006	2 May 2013
	5,738	–	£7.2181	30 Apr 2004	30 Apr 2009	30 Apr 2014
	4,529	–	£3.3116	29 Apr 2009	1 Aug 2014	31 Jan 2015
	10,267					
Alternate Chief Executives:						
Mr Nixon L S Chan	–	3,615[2]	£6.0216	2 May 2003	2 May 2006	1 May 2013
	4,533	–	£7.2181	30 Apr 2004	30 Apr 2009	29 Apr 2014
	4,533					
Mr Christopher H N Ho	3,443	–	£7.2181	30 Apr 2004	30 Apr 2009	29 Apr 2014
Mr Donald Y S Lam	6,885	–	£7.2181	30 Apr 2004	30 Apr 2009	30 Apr 2014
	4,197	–	HK$37.8797	29 Apr 2009	1 Aug 2014	31 Jan 2015
	11,082					

Notes:

(1) As at the date of exercise, 1 May 2013, the market value per share was £7.0750.

(2) As at the date of exercise, 26 April 2013, the market value per share was £6.9990.

Conditional Awards of Shares

As at 30 June 2013, 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 2013	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 2013
Directors:				
Ms Rose W M Lee	7,988	33,549	7,988	34,116(1)
Mr Andrew H C Fung	34,334	11,999	17,945	28,867(1)
Ms Anita Y M Fung	455,184	154,669	308,243	306,709(1)
Ms Sarah C Legg	55,439	30,194	22,354	64,346(1)
Mrs Dorothy K Y P Sit	32,568	12,324	16,277	29,098(1)
Mr Peter T S Wong	547,165	334,809	149,372	744,987(1)
Alternate Chief Executives:				
Mr Nixon L S Chan	13,691	9,729	6,555	17,149(1)
Mr Christopher H N Ho	4,627	1,676	2,559	3,807(1)
Mr Donald Y S Lam	7,028	4,324	3,115	8,376(1)
Mr Andrew W L Leung	2,993	1,729	1,328	3,450(1)

Note:

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

All the interests stated above represent long positions. As at 30 June 2013, 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 2013.

Substantial Interests in Share Capital

The register maintained by the Bank pursuant to the SFO recorded that, as at 30 June 2013, 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 wholly-owned subsidiary of HSBC Asia Holdings BV, which is a wholly-owned subsidiary of HSBC Asia Holdings (UK) Limited, which in turn is a wholly-owned subsidiary of HSBC Holdings BV. HSBC Holdings BV is a wholly-owned subsidiary of HSBC Finance (Netherlands), which in turn is a wholly-owned subsidiary of HSBC Holdings plc. Accordingly, The 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 2013, 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 Listed Securities

There was no purchase, sale or redemption by the Bank, or any of its subsidiaries, of the Bank's listed securities during the first half of 2013.

Remuneration and Staff Development

There have been no material changes to the information disclosed in the Annual Report 2012 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 with a view to safeguarding the interests of shareholders, customers, staff and other stakeholders. 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 Corporate Governance Code contained in Appendix 14 of the Listing Rules throughout the six months ended 30 June 2013.

The Audit Committee of the Bank has reviewed the results of the Bank for the six months ended 30 June 2013.

Register of Shareholders

The Register of Shareholders of the Bank will be closed on Wednesday, 21 August 2013, 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 Registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, for registration not later than 4:30 pm on Tuesday, 20 August 2013. The second interim dividend will be payable on Thursday, 5 September 2013 to shareholders on the Register of Shareholders of the Bank on Wednesday, 21 August 2013. Shares of the Bank will be traded ex-dividend as from Monday, 19 August 2013.

Proposed Timetables for the Remaining Quarterly Dividends for 2013

Third interim dividend for 2013

Announcement date	7 October 2013
Book close and record date	24 October 2013
Payment date	7 November 2013

Fourth interim dividend for 2013

Announcement date	24 February 2014
Book close and record date	12 March 2014
Payment date	27 March 2014

Board and Committees

Board

Independent Non-executive Chairman
Raymond CH'IEN Kuo Fung

Executive Directors
Rose LEE Wai Mun (Vice-Chairman and Chief Executive)
Andrew FUNG Hau Chung

Non-executive Directors
Anita FUNG Yuen Mei
Sarah Catherine LEGG
Vincent LO Hong Sui
Dorothy SIT KWAN Yin Ping
Peter WONG Tung Shun

Independent Non-executive Directors
John CHAN Cho Chak
Marvin CHEUNG Kin Tung
CHIANG Lai Yuen
HU Zuliu, Fred
Eric LI Ka Cheung
Richard TANG Yat Sun
Michael WU Wei Kuo

Committees

Executive Committee

Rose LEE Wai Mun (Chairman)
Andrew FUNG Hau Chung
Nixon CHAN Lik Sang
Christopher HO Hing Nin
Donald LAM Yin Shing
Andrew LEUNG Wing Lok
TANG Nai Pan
Louise LAM

Audit Committee

Eric LI Ka Cheung (Chairman)
Marvin CHEUNG Kin Tung
Richard TANG Yat Sun

Remuneration Committee

John CHAN Cho Chak (Chairman)
Raymond CH'IEN Kuo Fung
CHIANG Lai Yuen

Risk Committee

Marvin CHEUNG Kin Tung (Chairman)
HU Zuliu, Fred
Eric LI Ka Cheung

Nomination Committee

Raymond CH'IEN Kuo Fung (Chairman)
Rose LEE Wai Mun
John CHAN Cho Chak
Peter WONG Tung Shun
Michael WU Wei Kuo

Notes:

(1) Terms of Reference of the Bank's Audit Committee, Remuneration Committee, Risk Committee and Nomination Committee are available on the websites of the Bank and Hong Kong Exchanges and Clearing Limited ("HKEx").

(2) List of Directors identifying their role and function is available on the websites of the Bank and HKEx.

Registered Office

83 Des Voeux Road Central, Hong Kong
Website: www.hangseng.com
Email: hangseng@computershare.com.hk

Stock Code
The Stock Exchange of Hong Kong Limited: 11

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

Depositary*
The Bank of New York Mellon
PO Box 43006
Providence, RI 02940-3006, 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 2013
The Interim Report 2013 in both English and Chinese is now available in printed form and on the Bank's website (www.hangseng.com) and the website of HKEx (www.hkexnews.hk).

Shareholders who:

A) browse this Interim Report 2013 on the Bank's website and wish to receive a printed copy; or
B) receive this Interim Report 2013 in either English or Chinese and wish to receive a printed copy in the other language version,

may send a request form, which can be obtained from the Bank's Registrar or downloaded from the Bank's website (www.hangseng.com) or HKEx's website (www.hkexnews.hk), to the Bank's Registrar:

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

If shareholders who have chosen (or deemed to have chosen) to read this Interim Report 2013 on the Bank's website have difficulty in reading or gaining access to this Interim Report 2013 via the Bank's website for any reason, the Bank will promptly send this Interim Report 2013 in printed form free of charge upon the shareholders' request.

Shareholders may change their choice of means of receipt or language of the Bank's future corporate communications at any time, free of charge, by giving the Bank c/o the Bank's Registrar reasonable notice in writing or by email to hangseng@computershare.com.hk.

Photography: Josiah Leung

Hang Seng Bank Limited
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